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Demographics in the Year 2000

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Summary: Who are our customers? What do they value? How do they buy? These are just a few of the questions that must always be considered. This panel discusses the answers to these and other questions as they exist today and as they will develop over the next five years.

Mr. Douglas Menkes: I'm a consulting actuary with Milliman & Robertson. We have three panelists with broad backgrounds in the insurance industry.

We were reminded that in order to be effective twenty-first-century actuaries, we have to do more than just gather and collect data—we have to use these data to build and share knowledge. We all know that our population is aging. The baby boomers are getting older, but what else is happening around us? How will we deal with it? Some people might even ask whether we really need to go through all of this. After all, if we spend a whole lot of time and money trying to figure out what's going to happen in the future and designing products and services that we won't need for three, four, or five years, we run the risk that some of these things we concoct won't be needed, and that we will have wasted some of our research money. Of course, the other side of that is that standing still doesn't work very well either, and although none of us would like to be associated with an Edsel, being last to come out with new and competitive products is a surefire way to lose distribution and customers.

Bob Stein is the national director of insurance services at Ernst & Young. He's a Fellow of the SOA and a CPA. He's currently a vice president of the SOA. Bob has written articles that deal with changes to our business environment, and he is going to share some of his views with us.

Mr. Robert W. Stein: As Doug said, I do want to begin with a brief review of some of the demographics around us. I think some of this is clearly going to summarize some conventional wisdom, but I think some of the statistics will surprise you. I believe they will lay a fairly good foundation for discussing what some of the impacts of the demographic changes will be on our industry. I'd like to discuss the savings market—asset accumulation market—and help us assess some of the environmental trends in the asset accumulation product area. At the end, I'd like to close with a very brief discussion of some of the threats and opportunities that are suggested by the changing structure of our consumer marketplace.

Just a few brief comments on some of the demographics. We're clearly, as Doug said, all familiar with the graying of America, but I wonder if we all really understand just how pervasive the aging of the population really is. By the year 2000, the over-age-65 market is going to be bigger than 40 million strong, with over $130 billion in buying power, obviously an extraordinarily huge market. A few years into the next century, fully 20% of the population is going to be over age 65, and the very old population, those individuals over 70, is going to soar. I think we'll see a very old population and a whole new market created that will number in the tens of millions.

The increasing life expectancy of the elderly, and particularly the growth of this segment, is going to put extreme pressures on entitlement programs. Obviously, we refer here mainly to Medicare and Social Security. If we examine the health care cost of the very old, which is about two-and-a-half to three times the already high cost of the elderly, and if we look at the number of workers that are available to support Social Security, you quickly conclude that these entitlement programs aren't going to survive in their present form. I think quite clearly this outlook offers major opportunities and challenges for insurers. We clearly will have a very large, growing market and a changing market as the very old population takes on greater and greater impact and some of the entitlement and governmental programs either cease to exist or are radically changed.

Let's just take a look at the next segment. The aging baby boomers, at 25–30% of the population, are going to have enormous economic and social consequences. It's quite clear most of us are beginning—at least we hope we're beginning—to think about preparing for retirement. There's talk that we're becoming compulsive savers, but I wouldn't be fooled by what I consider to be all the rhetoric. Many of the studies that I've seen suggest that the level of assets accumulated by the baby boomers is really not any different substantially, and certainly are no worse off than the assets accumulated by the prior generation at the same stage in life. Some of the notions, perhaps intuitive notions, that we're underfunding retirement may or may not be true. Also, when one looks at the baby boomers by different segments, if you will, one finds that a very large proportion of the baby boomer generation simply does not have any significant amount of discretionary financial assets, so to look for changes in savings behavior, which I'll touch on again in a moment, to further boost our opportunities in the savings and asset accumulation products, might be wishful thinking.

Another item that's often referred to when one looks at baby boomers and the elderly working in concert, if you will, is the massive intergeneration of wealth transfer that's likely going to occur. During the next ten years, $3 trillion will transfer from one generation to the next. But I'd also point out that it's not as easy, perhaps, as one might think to get a share of those assets. It's going to be a very highly concentrated transfer. Seven percent of the households will account for 60% of the net worth of the transfer that will take place. If we are going to attack the high net worth market, one might be looking at a very small, highly specialized and clearly an extremely competitive marketplace.

Some comments about Generation X, which is the next generation, or our children. There are suggestions that the Generation Xers, if you will, are already saving at their early years in their 20s or 30s at a greater rate than the baby boomer generation did. What's perhaps more important is that this generation appears to be more self-reliant. I think both of these trends clearly bode well for the insurance products and insurance industry, but there are challenges as well.

Certainly, lifestyle and social patterns are much different than my generation or my parents' generation. Some indications are that they'll be marrying, buying homes, and raising families much later in their lives than prior generations, and it appears that they're delaying retirement planning and retirement savings. I think this delay of getting into the retirement planning area is due in part to the nature of their expectations with respect to their employment experiences. By that I mean, most Generation Xers believe that they will change jobs much more frequently and many expect to have periods of self-employment or entrepreneurial employment. I think they expect to work longer, although they anticipate that there may be significant breaks from active participation in the work force. Clearly the younger generation is approaching their lives much differently, and I think it will clearly impact the suitability of the industry's existing products to meet the needs of that generation and, perhaps more importantly, will dramatically impact the effectiveness of traditional methods of selling our existing products.

Let me move on to retirement savings trends. We all know, of course, that participation in benefit plans is shifting to defined-contribution plans. Participation on the defined-benefit side is declining rather significantly, while participation on the defined-contribution plan side is increasing radically. In fact, it appears that only the defined-contribution plans, in aggregate, are showing any asset growth. While this continues to offer good opportunities, I think, as with some of the other demographic trends, the superficial look might look fine, but I believe it's dangerous to take too much for granted when one looks at the changes in the retirement savings activities in this economy.

One might already conclude that we see company participation in defined-contribution plans reaching a saturation point. This might be the case, particularly at large employers. Two-thirds of companies with over 500 employees (considered a large employer) already sponsor a 401(k) program, for example, and at those companies that already have plans, 75% of employees participate. It doesn't say that one can attack that market, but it is already relatively saturated.

New plan growth is clearly at the small employer's side, those with under 500 lives and, in particular, those with under 100 lives. But that, too, will present its own challenges, for the small employer is increasingly demanding the same kind of products, the same kind of asset performance of those products, and the same kind of service level that the big employers demand from mutual fund companies, insurance companies, and other asset managers. Exploiting opportunities at the small end of the company scale, I think, is going to demand major investments both in technology and in new products and services. I think finding a profitable niche in that marketplace while sustaining those investments will, in fact, be quite a challenge.

Let's take another look at some of the other savings trends, highlighting some of the concentration of asset accumulation that has already taken place. I think, again, finding profitable niches won't be easy. As an overall industry, I think it's unclear whether we're particularly well positioned to increase our share of the management of the financial assets of this country in the next 10–15 years.

Ownership of discretionary financial assets is already highly concentrated. It does tend to follow the 20/80 rule. Twenty percent of households, when measured by net worth, control 75% of the discretionary financial assets of this economy. Ninety percent of the traditional investment securities are owned by the top 20% of households when measured by net worth. When you look at households measured by income, the top 20% control two-thirds of all assets of the country. The top 3% of households control fully one-half of the discretionary financial assets of the economy. Going after the upscale market will be tough. I think it is a relatively small, well-defined population somewhere in the 20–25 million household range, and the competition in that well-defined, clearly identifiable marketplace will be intense.

When we look at the broad market, it comprises about 100 million U.S. households. One other measure of the saturation of investment products and services in the economy is the ownership of mutual funds and 401(k) plan participation. About 30 million households already own mutual funds, and 25 million people already participate in 401(k) programs. While this 25–30 million isn't necessarily the same as the 20%, top 25–30 million, there is a substantial degree of overlap, and it seems relatively clear that almost every household with some level of discretionary financial assets already has a savings program in place. In fact, nearly all of those households already have at least one relationship with an existing financial advisor. The success in penetrating the savings markets is not going to come from generating more clients, by and large, but by capturing a greater share of the assets of those customers with whom one already may have relationships or with whom someone else has relationships.

Some look for a silver lining in improved savings rates. Will savings rates increase in the future and boost industry growth? Personally, I don't think that they will when you look at the broad economy. Worker productivity has been stagnant for at least the last 10–15 years, and real wage growth has been virtually nonexistent, being in the 0.05% to 1% range per year. I don't think we're going to see major increases in the savings rate. There will certainly be increases in aggregate savings. This, of course, will be driven by the sheer size of the aging population, as the baby boomers move through their peak savings years. But I don't believe that there will be a further boost to our ability to achieve growth on the asset accumulation management side by changes in the savings behavior of the baby boomers.

Where does this leave the life insurance industry? Let me talk about some of the threats and opportunities here and then review briefly some of the potential specifics that could be pursued within the three main categories of the market: the elderly, the baby boomers, and the coming generation.

The first threat that strikes me is that some of our products will not match customer needs. It isn't at all clear that we have the appropriate product portfolio for the old, let alone the growing population of the very old, that is, those over 70. I think for our generation, it seems we need a broader, more creative, more flexible savings program to be offered in the savings program, savings product, and service arena.

Certainly, new products seem to be necessary to meet some of the unique protection needs of the younger generation.

It also isn't clear that we have the right distribution system. It seems, in fact, that the distribution system we do have doesn't match the emerging buying habits and service preferences of the newer generation. I think that in the newer generation, or the coming generation where market growth will come in the early part of the next century, there will be much less reliance on personal service and much more flexibility when using alternative service providers and looking for other sources of products and services in these areas. Of course, wherever there are threats, there are substantial opportunities. I think there are many product opportunities that we will be able to exploit.

Let's talk about the small-employer market—the under-500-lives market. Clearly a tremendous amount of growth potential exists in the under-100-life market in the defined-contribution savings areas. We've referred to new products for the old and the very old, and I think there will be some very attractive opportunities there. I think also creating products to serve the relatively basic needs of the broad middle market, where discretionary financial capability is relatively limited at this time, is also likely to be lucrative, if we can crack some of the costs and affordability in distribution system issues.

Technology offers many opportunities in many of these and other product areas. I think, first of all, technology will help us to reduce the cost of the products and services that we offer and will make many of these products more affordable and more competitive in the marketplace. Technology also is likely going to be able to help us achieve the kinds of service levels that the market increasingly demands. One thinks about, at least in my generation, what we expect from service providers, and it's nothing compared to what my children expect on a routine basis.

Finally, I think, if used wisely, technology will enable us to actually reach the market segment, to develop new kinds of distribution, to reach marketplaces that the traditional agent does not have and, in the future, will not be effective at reaching.

Let me touch on some of the particular situations in each of the three broad segments of the population, and how we might be able to take advantage of some of the specific characteristics of the market. First, let's touch on the current aged. Most of them are currently supported by Social Security. They are over 65 and from the defined-benefit plans. Savings are considered supplemental by most of the aged at this point, but keep in mind the population over 65 in this country controls over one-third of the discretionary financial aspects of the economy. Because they tend to seek relatively financially sound stable institutions, it would seem that many insurance products, in fact, should be very attractive to some of this audience. Let's turn to the baby boomers. Many of us are just reaching our peak asset accumulation years. We're looking at rising life expectancies. We're all concerned about outliving our savings. There are articles about that in the general media every day of the week. As a result, I think, we, in the baby boomer generation, recognize that we may need higher returns to reach our savings goals, and we're increasingly willing to take on more risks to do that. I think these characteristics clearly make us good customers for a very broad range of financial products. The real question in my mind is whether the typical insurer, first of all, has the products we want, has the product performance that will make those products competitive with alternative providers, and has the sales methodologies and service capabilities that will meet our demands. While there are some great opportunities there, I think the insurance industry has a way to go to take advantage of that opportunity.

Let me close with a comment on the Generation Xers and another closing remark. As always, and, I'm sure every generation says this, the younger generation presents probably the most serious challenges. Generation Xers, and I certainly recognize this in my own children, have little faith in institutions of almost any type. I think they are particularly skeptical of insurance companies, and I don't believe they see us as being the leading-edge service providers in the financial product area. They tend to be very self-reliant, extremely analytical, and technology literate far beyond my meager capabilities.

Those characteristics, I think, make Generation Xers (where some of the growth of our industry is going to come from a number of decades from now) much less likely to respond to traditional sales and marketing techniques that the industry uses. They're certainly less likely to act on recommendations from insurance companies or insurance distribution systems without seriously analyzing and challenging that information themselves. They're much more likely to voluntarily and proactively seek information that they conclude they need in their own right. I think they will want to take control of the sales and service process. We see that more and more in much of the online and telephone processing, and, again, they are very likely, in my view, to go to alternative providers or to alternative sources for creative products.

Will insurers, in fact, be able to successfully crack the younger generation? It's actually unclear at this point, but I think a great deal has to be done in order to make a good run at that. In particular, we need better development of products, sales approaches, and service capabilities that this generation demands and that our industry has not had to really struggle with yet.

In closing, I'd just like to observe the obvious. We're part of unheard-of changes in the demographics of this country, and I think it comes at a unique time. That is, it comes in conjunction with an electronic revolution. I think the industry is going to have to dramatically change its views of many very basic behavioral, cultural, and social norms. If the industry currently looks at a situation, I think that it will see that it demands that in order to be successful in the future, we more carefully examine and challenge who it is we're doing business with, what products that they really need, and how we intend to not only reach them initially but service their expectations once the product is put in place. I think that kind of self-examination and more pointed evaluation of the marketplace of the next century will be crucial to finding a path to success during the next century.

Mr. Menkes: Our next speaker is Tim Ruark. Tim has worked with CIGNA Corporation for 13 years in a variety of areas. His specialty is life reinsurance. He's currently an assistant vice president and actuary for CIGNA Reinsurance, where his duties include pricing and product development. Tim has written articles for the AAA's *Contingencies* and has participated in past Society meetings. He's going to share with us his experience with his company's development of a specific product, which was designed in response to anticipated demographic changes in its customer base.

Mr. Timothy J. Ruark: What I want to talk about is a product called a reverse mortgage. First, let me give you some background on that product because some of you may not know about it. It's a product that has been talked about a lot as far as demographical trends, and it is a product that has a great deal of potential. I then want to talk about how my company, CIGNA Reinsurance, became involved or was approached on a concept like reverse mortgages. With mortgages, you think more of lenders and banks than you do insurance companies. Finally, I want to talk about how we weighed the choice of whether to get involved or not.

Who remembers what they were doing on November 9, 1995? I remember what I did because after my work day, I went home, I sat across the table from my wife, and I said, "How did it go today?" And she said, "Hey, I saw you on TV today." She said, "I was watching CNN and they had a press conference at Fannie Mae, and they were talking about a reverse mortgage. Haven't you been talking with that company and doing work on their behalf for the last two-and-a-half years?" And so I said, "That's right."

That was an important day, but that also gives you the punchline for my talk. My company did work hard with Fannie Mae for two-and-a-half years, and in November it was announced that they were going to go forward with their plan to buy or create a secondary market for reverse mortgages.

With that background, here are some demographics. Seniors are house-rich and cash-poor. Three million households with people age 70 or over who own homes have annual incomes of $30,000 and home equity above $60,000. This is only going to get worse as time goes on. There is about a trillion dollars of home equity for people above 65 just sitting there waiting to be tapped.

With regards towards senior attitudes, they want to travel, and they want to buy gifts. These are people who did the right thing. They didn't spend widely. They saved money. Yet many of them got killed in the early 1980s when inflation went crazy, so many of them felt like they paid their dues throughout their life to have a nice retirement and now they get there and they don't feel like they have the luxury to do some things that they'd like to do. Certainly they desire independence, and they also want to be in their own homes.

They are intrigued by the reverse mortgage concept. I believe the American Association of Retired Persons (AARP) lists reverse mortgages as either the first or the second most common question that they get asked by seniors that call into their 1-800 number. Seniors are really very interested in this concept.

I guess the reverse mortgage concept has been around for a while, but it really hasn't taken off. It may be because of some cultural changes in our society. It wasn't that long ago where it was not uncommon to see a situation like Aunt Bea living with Sheriff Taylor. Aunt Bea was someone who had a natural network of protection, comfort, safety, and support. It's going to be harder to find that type of situation, so this concept has really taken off, and there's a great deal of interest in it.

The concept is, the borrower, which would be the senior, would receive either monthly payments or a line of credit from the lender. A line of credit would be like a typical home equity loan, except the senior is not expected to pay it off every month or to make any payments. In exchange for monthly payments to the senior, the lender has a lien on the property so that some day he or she will get back, with interest, the monthly payments or the line of credit that accumulate from day one. The way that he can get most of his money back is by having a lien on the property. The payments will continue if the borrower chooses a monthly payment program until he or she dies, moves, or there's an extended nursing home stay.

We're starting to get a flavor here for some things that are not lender-driven, but are more insurance-driven. There's the value of the loan that's accumulating at interest and the equity value in the home; so the idea is this is pretty safe when you write this loan. If the person was to have to terminate the loan while the lender has a lien on the property, you just sell the place and pay off the loan, and the rest of the surplus money goes back to the beneficiaries or the owner, if they're still alive. But if you get out to where they cross, all of a sudden you might have a problem because the loan value may be increasing quite rapidly, and the value of the home may not be. You get to the crossover point where if the loan was to terminate, the lender would try to sell the home and the lender would be very unhappy with the amount of money that it could get on the home because it would not pay off the balance on the loan. That's a real issue.

Two-and-a-half years ago, Fannie Mae decided this was a market that it needed to be in, but it was aware of this insurance or longevity risk, and so it knew that it needed to team up with someone. Fannie Mae contacted us. We started thinking about this. One of the items that's very important here is that reverse mortgages have been around for several years, but Fannie Mae's presence in the market, and willingness to buy reverse mortgage loans from lenders to, in essence, create a secondary market, has never been out there. Most of you who have mortgages know that it's likely that at some point in time after you buy your house and get your mortgage, your mortgage will be sold to somebody. Often it is sold to Fannie Mae. That's why mortgages are so standard and that's why local banks can still function. They get their fees off of the closing costs, and then they just sell off the obligation.

Two-and-a-half years ago, Fannie Mae wanted to create that type of an environment for reverse mortgages. They came to us. We had to decide whether we should pursue this. The pros to our decision were that we understood senior mortality—we'd been in the reinsurance business for 75 years. We also have some understanding of morbidity because of the far-reaching tentacles of CIGNA Corporation. We have a great deal of access to some important information. We understand senior buying habits, or at least we think we do.

There were parallels to insurance products. As I'm describing the reserve mortgage, you might be thinking of immediate annuities. There may be some thoughts of long-term care. There are some parallels there, and we felt that this wouldn't be totally foreign to us. There's enormous potential. The demographics speak for themselves. If this product were to take off and we would have a major role in it, it would be very good for CIGNA Corporation, CIGNA Reinsurance, and me, too. This is something that we felt was definitely worth pursuing.

But there are also disadvantages, and this is familiar to many of you. We are not a company that actively pursues the real estate type of risk. We don't want to be on the hook for that type of thing. This sounds like it has some real estate risk in it. We're very unfamiliar with the world of banks and lenders. We know about them from being customers, but as far as business relationships, we didn't have too much experience with them.

At that time, CIGNA Reinsurance was in a transition phase of moving to being more market-driven and more innovative in its approach. This is a case where you worry that you might get what you wished for. Here is an enormous opportunity to innovate. But there's always a risk if you talk about being an innovator and you have your big chance, you won't be able to pull it off. So that's something that will often scare management. Then there's resources. This sounded like a really big undertaking, and it was, I assure you. But the pros outweighed the cons, and we decided to go after it. As I said earlier, the main reason we did so was demographics. It wasn't just that there are a large number of seniors, there are going to be more seniors. They're house-rich, cash-poor. It was also the demographics of one entity and that's Fannie Mae.

This is an unusual situation. I'm giving you a case study on how to use demographics to make decisions and how a company should capitalize on demographics. Obviously, I acknowledge that there are only so many of these deals that come by. You still want to look at the demographics not just of retail customers, but some of the entities that will offer products or ancillary products. For us, the thing that we had to deal with, or the thing that we liked about this, was that you did have a 600-pound gorilla, so to speak, a company that is a private corporation yet has a federal charter, which is short of them being able to actually print money. What it means is that Fannie Mae's credit is viewed by the marketplace as being as good as the U.S. government's. That's an enormous entity moving into a market. The ability to partner with them was pretty exciting.

It did not create any real estate risk for CIGNA Reinsurance. The retail product being sold to the customer still has that real estate risk in it. If the value of the home does not keep up, the lender or someone is going to lose out, but I'm proud to say it won't be us. It's not like we pulled the wool over Fannie Mae's eyes. I assure you, there is no wool to be pulled over their eyes. They are comfortable with real estate risk. They deal with it all the time. When they approached us on a deal to try to take over longevity risk, they didn't talk about real estate risk. They were as eager as us to figure out a way for us to put together a deal such that we have mortality and they have real estate. That was very important, and we ended up having that in the final deal.

Another item that is really important is the assessment of mortality. I do product development and pricing. If I tried to put the individual annuity table in here with future mortality improvements, and if I tried to put that into my product, that could be very problematic. What you have to concede here is that these are not the greatest mortality-risk people. It's true that their interest is buying into something for the long term, and they want to stay in the house forever, but a reverse mortgage is not a cheap undertaking. It's an expensive option. It should be an option of last resort. What that often means is that it is a last resort. People could have medical problems, and they could be under financial stress from a lifetime of rough living, so you have to have a very measured view of what mortality will be like.

There are many legal hurdles. I don't care to get into them too much right now. Suffice it to say that when it came to legal issues and putting together an actual deal, they (Fannie Mae) were like an 800-pound gorilla. It became much tougher when we got to that part.

Have we been successful yet? No. It's way too early to know. They announced it in November. They have a handful of loans right now. They automatically buy the loans from any lender. We automatically reinsure the loans. We've seen a few, but not enough to say whether this is successful. This is, in truth, one egg in one basket. We haven't been sitting as an entity, and this is an example, I think, for you. You don't find one great opportunity and just go after that and ignore everything else. We actually had several different initiatives going on in CIGNA Reinsurance. This was one of them.

Finally, there is an irony of demographics in that the demographics are great for this product and for it taking off; but not only as the product person but also as the pricing person, I happen to know that if the wrong type of people buy this product, I could get killed in it. Fannie Mae can't have a retail product that has differences by sex. You can't do that in their market. It's a situation where I had to make some assumptions on how many females and males would be covered and then develop a unisex price. Because it's a longevity type of program, the more males I get, the better for me. You live by the sword, you die by the sword. It could be demographics that end up haunting us here, but we're getting to a point where companies (if they want to win big) have to take some pretty big gambles. We viewed this as a big gamble, but so far it seems to be working out for us.

Mr. Menkes: Al Greenberg is the chairperson of Greenberg & Fickus, a merger and acquisition and reinsurance firm. He's also vice chairperson of Penn Corp Financial Group, a publicly traded insurance holding company. Al is going to share his experiences with us as they relate to his involvement in the acquisition of Penn Corp, how the changing demographics affected the type of insurance company his investor group was looking for, and how changes that are taking place now might impact their view of what a successful insurance company would look like in the year 2000.

Mr. Allan D. Greenberg: I want to first talk about Penn Corp and some of its history and background. I then want to talk about some of the economic environmental issues that I foresee over the next several years. Then I'll get into the demographic environment again that we at Penn Corp think is important to us and what it means.

Penn Corp Financial Group started in 1988–89 when Steve Fickus and I became partners with David Stone and formed a company called Penn Corp Financial Acquisition Company. It was formed specifically for the purpose of buying the Penn Corp, Pennsylvania Life and its affiliates, from Primerica. We did this in 1990. In 1991, we purchased Occidental Life of North Carolina and its affiliates. In 1992, we did an initial public offering and became Penn Corp Financial Group, Inc., a New York Stock Exchange company. Then in 1993, we purchased a company called Professional Insurance Corporation from the old Sammons Group and also did a secondary offering. In 1994, we purchased American Amicable from American General. Then in 1995, we purchased Integon during the course of the year.

Just before the end of the year, we, in association with a fund called Knightsbridge, bought Southwestern Life and its affiliates from the bankrupt ICH.

In 1990, the original companies we bought had revenues of less than $200 million and assets of approximately $500 million. At the end of 1996, I think we will show revenue between $750 million and $1 billion and assets of over $5 billion. We have been very fortunate, but I think we've also worked hard to be fairly smart in what we do.

We think that the most important economic trend in the insurance industry going forward is going to be the consolidation of insurance business. None of us among the people involved with Penn Corp Financial Group feels that anything less than one-half, and probably considerably more than one-half, of the independent insurance organizations in the U.S. are going to disappear within the next ten years through consolidation of one form or another. It is impossible, we feel, with all the tremendous pressures on the insurance industry from other financial institutions, and internally from new types of companies, to sustain the pressure on transaction costs without substantial consolidation.

We think there's a certain critical mass that is going to be needed. Companies with under $200 million of life insurance premium, unless they're very small, niche companies that don't rely on anything or are not in a competitive market, are going to have to disappear. Take a look around and notice what Eli Brode has been doing in the annuity business, what Provident has just done in the upscale disability income markets, and to a certain extent what Penn Corp Financial Group has done in the lower-middle to middle-income markets.

Finally, if any of these things don't show the trend, you still have and will have more of the CONSECO-type companies that are very, very effective in buying up companies and moving much of the operations to Carmel, Indiana, or wherever the next company is going to have its headquarters like CONSECO. I foresee that over the next ten years, there will be a tremendous consolidation within the insurance industry. I would think everyone in this room should be very thoughtful about where his or her career is going and take into consideration what I think—although they're predictions—are close to being facts.

With respect to our marketplace, which is the lower-middle-income marketplace, we see demographic trends both helpful and somewhat less than helpful. Because we operate in the lower- and middle-income markets, we're probably one of the few companies that still sell disability income policies of $500 a month and less. We sell life insurance policies of $20,000. It's a very limited market, and the market with those baby boomers in the lower-middle to middle-class market, who are entering the last 15 years of their active working lifetime, is going to expand somewhat. I think, however, in total, there are other things that are happening that will shrink the market, at least in our particular market.

The other thing that we see happening is a much longer term trend, and we don't know how much we're going to profit from it. It's too far in the future. But for those of you who have had kids in the school system, you may remember that in the early 1980s and mid-1980s, everyone was talking about closing down school buildings. Let's get rid of them. Let's save this money. Why have an extra school, and those places that did are now in real trouble because they have to build new schools because of the boomlet of the mid- to late-1980s. I think it was a confluence of people who put off having children for a very long time, combined with people getting married but much younger. Now we have this boomlet. We think, in our marketplace, those people, as they enter the work force and are starting out, will have a need for the kind of products that we sell.

We think that the tremendous decrease in demographic trends in rural populations and small suburban to large suburban related to urban areas will hurt the captive agency forces that we have with respect to door-to-door selling. With both adults working, it will be much harder to make appointments to see people. We think this will affect that part of our niche business. Although it will be tougher and tougher to compete in those markets, we may be a little bit better off because there will be fewer players in that marketplace.

We think that our payroll deduction marketplace, which is really for the small employers, will be very positive for us. By the year 2000 and beyond, we expect that to be one of our fastest growing insurance markets. We're not sure about the military and civilian government marketplaces, it's a pure gamble. We feel that things can happen in the world to increase civilian government personnel, but there's certainly much emotion in the country when Bill Clinton starts saying "big government is over." That's a sign, first, he wants to get reelected, but second, there could finally be a shrinking of the amount of people in government. While I think the trend of a decreasing military may have stopped already, it's not likely to have a significant increase going forward.

The conclusion I have is that the demographics, I think, as you would expect with so many factors coming into play, are not one-sided in any way. For those of us who think about it, what's going to happen is going to cause tremendous disruption, but there's also going to be tremendous opportunity.

Let me throw out one thing, and this is something that is for the person who is over 50. I've heard so many stories about how the problems with insurance are the high initial cost, the high marketing costs, and the high issue costs. There are all these schemes to reduce them, none of which has ever worked because nobody buys insurance unless they're very sick, even if they don't know it. They're very sick. If you feel tomorrow you want to buy insurance, you know you're sick, even though you haven't found any medical problem yet.

There is a feeling that one of the big demographic trends that can really have an impact, if not by the year 2000, perhaps by the year 2010, is that of substantial computer literacy in the population, and not just among 5% of the population. Perhaps in 15 years, many people will actually buy insurance because they will constantly see it on the Internet on all kinds of different sources. This can be an opportunity and also a catastrophe at the same time. The catastrophe is for those like myself, the dinosaurs that continue to have these sort of companies that have their niche businesses and have been very successful, and an opportunity for those of you who have an opportunity to work in organizations that can meet the needs of these particular people.

Mr. Menkes: I just had one thing I thought I'd throw out, maybe to Bob because he brought it up. This has to do with the increasing independence of the baby boomers. Maybe their distrust for the financial services industry is general and not just directed at insurance companies. In any case, we, as actuaries, have been asked to try to improve the way life insurance is sold, particularly when sold with illustrations. We have a model regulation and an actuarial standard of practice. It's not clear to me that while this will probably curb some of the abuses, it really will do a whole lot in the long run to change their thinking about how we conduct our business. I wonder if any of you would like to comment on that.

Mr. Stein: I'd be inclined to say it doesn't address the issue, at least with respect to the ability of the existing distribution system, which is, who will use or who will be constrained by those regulations? I think, as Al described, alternative sources of purchase and service of that generation are likely going to predominate. Although that might be a factor in how the distribution system handles itself, I think that generation will increasingly not even think about the personal-based selling that we rely on now. I think Al had referred to that, and I agree with that completely. With alternative sources, like telephone banks, electronic forms, and so forth, I think it will really be powerful in the market that Al is talking about—the lower-middle income marketplace seeking commodity products.

Mr. Greenberg: I think that one thing we should not forget is there have been attempts, and successful attempts, at marketing in other ways than an agent selling a policy. I was recently at the Canadian Life and Health Insurance Association annual meeting, and someone got up who was from whatever Ralph Nader equivalent they have there. I never heard people in that area of the Society speak so highly of insurance companies before, but Canada has a fairly well-run insurance industry in terms of compliance of standards and great claims handling. They said the real problem is the cost of marketing—too much. Agents are getting too high first-year commissions. There should be something else. A guy got up and said, "Terrific. If you can come up with a way to do it, we'll hire you and pay you the millions of dollars because we will save." Who knows what the cost will be of setting up the things to do it—the initial cost versus the amount of sales you have. I think there can be new things, just like direct marketing, but I don't think anyone who has been involved in direct marketing thinks it's a panacea as far as saving money on marketing.