RECORD, Volume 24, No. 1*

Maui I Spring Meeting
June 15–17, 1998

Session 31IF
Insurance Compensation Trends and Outlook

Track: Product Development
Key words: Compensation

Moderator: JOEL I. WOLFE
Panelists: DEANNE L. OSGOOD
JEFFREY M. ROBINSON†
Recorder: JOEL I. WOLFE

Summary: This session focuses on recent compensation developments and trends in the financial services industry. Specifically, panelists address:

- *Changes in New York compensation laws—overview, opportunities, challenges, and trends starting to appear;*
- *Compensation patterns and trends emerging on insurance products sold through financial institutions other than insurance companies;*
- *Pressures on the current systems from direct marketers, the Internet, and otherwise.*

Mr. Joel I. Wolfe: I'm a second vice president and actuary at Mass Mutual Life Insurance. Joining me is Jeff Robinson, who's president of Life Insurance Financial Essentials/LIFE in Parsippany, NJ, a consulting firm providing actuarial management and systems implementation services to a variety of clients. Also with me is Deanne Osgood, who's a consulting actuary with Milliman & Robertson's Chicago office.

My responsibilities at Mass Mutual include the design and pricing of agent and general agent contracts, control and monitoring of all field expenses, and compliance with applicable statutory law affecting field compensation. I spent 18 years working in these areas. I'm also a member of the Core Modernization of New York Section 4228, LICONY Core Committee, which, for those who aren't familiar with it, is a technical advisory committee that was charged with constructing the new statute and basically helping interpret the statute. Between them, both my

*Copyright © 1999, Society of Actuaries

†Mr. Robinson, not a member of the sponsoring organizations, is President of Life Insurance Financial Essentials/LIFE in Parsippany, NJ.

panelists bring extensive experience in product development and nontraditional compensation, marketing strategies, and systems development.

Jeff has been an actuarial consultant for more than 29 years and has served as a company officer for more than 7 years. He's worked with more than 52 life insurance companies and 6 located in 7 different countries. Jeff's also the east coast representative of Poly Actuarial Software and Solutions, Inc., a national software firm providing PC base programs for pricing, modeling, and cash-flow testing for individual life, annuity, health, and credit insurance.

Deanne's a consulting actuary in the life insurance and annuity practice of M&R in Chicago. She has 13 years of life insurance industry experience, specializing in variable and fixed insurance and annuity product development and management. She's also worked with various financial institutions and third party marketing firms to develop marketing strategies and to provide product and sales training.

Today's financial services landscape changes more frequently than it stays the same. Witness recently proposed mergers between Citicorp and Travelers or the spate of recently announced demutalizations that include Prudential, MET and John Hancock, among others. Many industry pundits are claiming that the cost of traditional distribution is too high, and that companies are looking for cheaper and cheaper ways to distribute product. Banks, producer groups and other financial intermediaries are coming up with large bounties to attract the bigger producers in our companies. In fact, one of my company's largest producers was approached, and was offered $25 million for his in-force block. One of Guardian Life's producers was offered $5 million for his in-force block.

Now that Section 4228 has been modernized, many innovative ways to compensate agents that have heretofore been illegal are now legal. New York licensed companies can now employ the following ways to compensate their field forces: paying trailer commissions on life insurance to constructing true level commission structures instead of only levelized scales, paying compensation on settlement options, or reinvested annuity funds at the end of surrender charge periods, and paying cost of insurance base compensation, for that matter, any compensation structure that can be shown to be equivalent to value of premium base structures. So, we have great flexibility. It makes for interesting times and interesting product development. I'm not a product development actuary, although I do work closely with our product development actuaries in designing compensation and making sure that they're pricing appropriately.

At this point, what I'd like to do is start the session by asking Deanne to pose several questions for us.

Ms. Deanne L. Osgood: Has anyone decided to cash it all in and just come to Maui and be a dive master for a while? That's not the question Joel wanted me to work with. Unfortunately, we do have to get down to business here. What Joel said is really important. It's only going to work if we get participation from the audience.

We could stand up here with prepared speeches, but we were really asked to facilitate a forum as opposed to having a panel discussion. So we decided that one approach we could take would be to ask a few questions of the audience. These are questions to get the brain working, and get the conversation started.

An article published in early 1998 suggested that variable annuities are sold for the commission. In fact, a fee-only financial planner was quoted as follows: "The salesman has a new hammer and everybody starts looking like a nail." What magazine was this published in?

From the Floor: *Forbes.*

Ms. Osgood: You're right. The answer is *Forbes*. For my next question this same article mentioned that the variable annuity payout could be as high as 7% while the average commission for a low mutual fund is 4%. What steps, if any, have distributors taken to insure that sales representatives are selling a product that is suitable for a particular customer without regard to the commission that is paid?

Using trailers is one way that you could help determine that the right product is being sold, and that's with a less or a smaller up-front commission and more persistency based commissions. Agents are encouraged to sell the product that's appropriate because the product is going to stay on the books for a longer period of time, and they'll be compensated over that period of time as opposed to receiving the big chunk of cash up front, and then maybe doing something else a few years down the road.

From the Floor: One thing that we've done is we've made our commissions closer between our VA and our mutual funds. The reality is that it's going to be very difficult to insure that sales representatives are selling the products that are suitable without paying attention to the commissions because they are motivated by commissions. So it's pretty important to not put them in that situation where they have to make the choice between selling a suitable product or putting money in their family's checkbook.

Mr. Jeffrey M. Robinson: What has your experience been? Are they selling more of one than the other? How long have you had both products out there?

From the Floor: We've had VAs for about four years now, and we have had mutual funds for about eight or nine years. We've seen them sell in about equal amounts. Our VAs have quickly moved up to about $1 billion in assets, and we have about $5 billion in mutual funds. So we're seeing good growth in both, we think we're selling the suitable product.

Mr. Wolfe: Do you offer choices in your product design of premium base compensation only, or premium based and a small trailer versus very low or no premium based compensation and a much larger trailer?

From the Floor: No. We have just one compensation for our mutual funds and our VAs.

Mr. Wolfe: Because a lot of companies do offer options to the agents.

Mr. Robinson: By the way, are you licensed in New York?

From the Floor: Yes we are. We had the longest time because of our organization style. We just got approved in New York for VAs.

Ms. Osgood: I'll talk about the bank distribution channel. I'm aware of a couple of programs that will compensate the individual representative on the same basis regardless of which product is sold, and that's also regardless of the actual compensation they're receiving from the product provider. So, for example, they might have a VA of 7% and a mutual fund at 4%. Maybe what actually goes into the grid of the individual representative level is 4% or 3%, or 2%, depending on the program. If I'm sitting in the bank deciding which product to sell, it doesn't matter to me. The same percentage is going into the grid; the same funds in theory are coming in. There are problems with that on the representative's side. They think the bank is just hoarding tons of money and, in some cases, maybe they are.

I was launching a product for a company and the first question that was asked was, “What commission are you paying to the bank?” That's a question that is not for a company to answer. That's really for the bank program manager to answer. The representatives were just hot that they couldn't get an answer to that from their own manager or the company because they just believed that there was so much money that was staying out of their pocket. It actually tied into a single premium life product. They thought the company was making a lot of money on that, but the commission paid on that product was actually the lowest of the three if you compare it with annuities and mutual funds. So there are some problems from the representative level that have to be worked through.

There are also some interesting things that happened with that. I'm aware of one program where the actual amount that went into the grid for the mutual fund was higher than the amount the bank received for selling the mutual funds. And so they were in a loss situation every time the representative sold a mutual fund. It's a really interesting management issue to work through, but I am aware of several programs that do that on the bank side.

From the Floor: I have one question for those companies that are, and most are paying trailer commissions, let's say, on VAs. Since I know in a lot of companies expense allowances are generated based on first-year commissions, what are companies doing? Are you coming up with first-year commissions if a trailer-based option is chosen instead of a premium base and generating an expense allowance based on a commission that's not really paid? Are you making your allowances functions of trailer commissions? In the early years, trailer commissions were really small, so your field representatives probably wouldn't like that idea very much.

Ms. Osgood: I guess I could stay on the VA and the annuity subject for a couple of more minutes. One of the questions that was asked earlier, are multiple commissions options being offered? One of the trends that we are seeing, particularly with annuity compensation, is that there are typically three compensation options that are offered, and the trend is moving toward being able to have the individual representative select which commission option he or she would like to have with each and every contract that is sold.

The typical options are having everything up front, having a smaller amount up front with some minimal trailer, or having it completely asset based. The up-front option tells us, stick with VA. To throw some numbers out here, commissions might be anywhere from 4.75% to 7%, with the average being 5.25–6.25%, or 6.5% as a total up-front commission. A second option would be to have maybe something like a 5.25% commission up front with a 20- or 25-basis point trailer. The third option would be all trailer.

What we've heard in talking to broker-dealers and wire houses is that the representative really is not interested in anything under 100 basis points of total trailers. That seems to be the number that's tossed around a lot. The bulk of the business or the bulk of the representatives are selecting that second option, which is a somewhat smaller up-front commission coupled with some kind of trailer. That's a pretty common relationship actually to have something like 5.25% and then 20–or 25-basis point trailer.

Now, the representatives are interested in building these assets under management. One of the interesting things that we have seen when companies start offering these commission options is there's a huge influx of 1035 exchange money because representatives are looking to bring business in and put it all with one carrier to build their assets under management and receive the trailer commission. I don't know if we'll see that change as if all companies offer some kind of asset-based trailer commission. Maybe some of that activity will subside. But it has been an interesting phenomenon. I'm not sure if that was anticipated, but that is something that we have seen and something that companies are looking for and monitoring to see what kind of 1035 exchange business they're experiencing.

I've seen some percents that are as high as 50–60% of new money and, obviously, that's a bit much. Companies are keeping their eye on that to make sure that comes down, and monitoring that business pretty closely. But that is something that can happen. I've seen some numbers tossed around where representatives are being coached to have $100 million in VA assets under management and to receive a trailer on that. It's dollars, and that's sort of how they're being coached right now. There is a lot of activity.

From the Floor: You mentioned that most representatives are selecting this middle option. Is there anything about the demographics of these agents?

Ms. Osgood: The question is if there is any demographical information about the people who are selecting the various options. Are they the older, more experienced agents selecting one option versus another? That's basically the gist of the question. I don't think there's any reported numbers on that. The general feel in the industry is that the more experienced agents, the ones who have been in business for longer periods of time, and an established book of business, are more comfortable going with the modest trailer or actually the full trailer options. They don't need the big up front commissions to pay the bills per se. They 're more established in the business.

But we are seeing a fair amount of new brokers; whether they're new to the industry or new to a particular company who are interested in at least a smaller trailer, and they're willing to forgo some of that up front even if they're not willing to forgo it all.

Mr. Robinson: Also, trailers, particularly in New York, is a rather new thing. I think the agents are experimenting. They still want the up-front money, but the trailer has been said to be good so that they're experimenting with it, but they're not putting all their chips in just a trailer commission. In New York, it looks like people are going very cautiously. They're staying with the up-front commission. The companies don't seem to be doing anything wild yet either, but I think this is going to take a while to see what the circumstances are. The agent will have to get used to it.

Mr. Wolfe: We have only had trailer commission capability on annuities in New York, I think, for about a year and a half or two years. And, of course, as of January 1, you can pay trailers on life insurance. So it is relatively new as Jeff says.

Mr. Robinson: Is anyone offering trailers where the persistency is better? In annuities, you saw the surrender charges to keep the people in. But is anybody offering trailers on life insurance?

Mr. Wolfe: Interesting.

From the Floor: Yes.

Mr. Wolfe: You are?

From the Floor: Yes. We have a small trailer on the variable interest. And the persistency on that product has been real good.

Mr. Robinson: Yes.

From the Floor: We can't say that it's because of a trailer commission. There are a number of other factors.

Mr. Robinson: Well, the companies are going to have to gain experience in this, too, and find out what percentage is the best to offer, or what, you know, how many basis points.

Ms. Osgood: But I do think it's still fairly new to know what the impact on persistency is. I did recently interview one of the large regional broker-dealers that I'm sure everybody in here has heard of. And their position is, we will only accept one commission option. They're thinking about maybe adding a couple sometime down the road, but they really are not interested in giving that option to their individual representatives. They were the one outlier, and I talked to 13 firms. This is a very large, very attractive broker-dealer that everybody is either in or after, and they want to know how they can get on the list. They really are taking a completely different position from the other firms that I've spoken with.

So there is a different school of thought out there, and it really comes down to knowing whom you're doing business with. You want to be flexible enough to accommodate their needs and fit in with their system as well. It's just something to mention that there are these multiple options being made available.

Mr. Robert Ozenbaugh: One of the challenges with up-front commission has always been putting charge backs in to try to make sure that the representative is selling the product in the right vein. It's a long-term investment, and that's always a hassle. That's always not perceived very well by distribution because we do more exceptions in that regard than we would like. But for the trailer part of that, I'm very much against letting it go down to the representative making the decision case by case; whether or not they're going to take a trailer or up-front commission because they're looking at this individual and they see that this one is walking through the front door of a nursing home, and they know that the average stay is less than eight months—

Mr. Robinson: So you're saying it's going to be selection.

From the Floor: You're going to get selected against. I think that the trailer commission is a wonderful thing. I think we should have gone to it a long time ago. I love the flat trailer. I'm not really excited about the no surrender charge products on the VAs, but I think levelized commission, such as the B&C shares is a good way to go for us. It helps my profitability flows immensely, but I'm not willing to let them make that choice for me, to put me in that spot where I'm going to lose-lose again.

Mr. Robinson: As an actuary you may like levelized commissions, but what do the agents think about them? We haven't seen groundswell of support in the U.S.

From the Floor: From agency distribution, though, if you go to your sales convention and talk to your top 100 or 200 agents, they've been screaming for trailers for years.

Mr. Robinson: As a trailer, but, yes. OK.

From the Floor: Give me the flat commission because, as Dan said, I have my book built. I want to build on it. Your problem is financing the new people coming through the door, and that's another problem we've had as an industry.

Mr. Wolfe: There's also an issue. We've had our top agents, and we have a fair amount of them, come to us and ask us to develop product with level commissions. Why? Because of all the fears they have on commission disclosure and all the market conduct problems. A lot of these agents would much prefer true level commissions so it doesn't appear as if they're pushing product just for the big 55% first year commissions.

From the Floor: So are you offering a levelized commission scale, Joel?

Mr. Wolfe: We will, on a product that will be very much walled off, have very high minimums. Being in New York, because of the antidiscrimination problems, you have to separate that product somehow when you're offering different commission scales on what would seem to be the same product.

Ms. Osgood: That's an interesting point, Bob. I haven't heard anybody else voice that concern. A couple of months ago, I actually spoke with 15 of the top VA writers, and if they weren't already offering multiple commission options, they were planning on it. And at the individual representative level, they didn't really have that concern.

It's pretty standard for there to be charge backs in the first year of the contracts. They weren't talking about going beyond that at all. Charge backs at death, have been a no-no for quite some time. I know some companies that are still doing that, but from the distribution perspective they really aren't interested in that. Those are things, I think, that companies watch and if there's a trend or, a certain representative has a pattern, then they're going to the broker-dealer and things like that. But that really hasn't been a big concern. I don't know if anyone else in this room has that concern. I'm not aware of it from my end. Anybody?

Ms. Osgood: Generally speaking, offering a level commission option in lieu of a heaped commission option for level term insurance policies lowers the annual premium by approximately what percent? Just throw a number out.

From the Floor: Twenty-five.

From the Floor: Thirty.

From the Floor: Ten.

Ms. Osgood: The answer that I have here, and maybe this will generate some interesting discussion, is about 5%. I recently worked with a company that really wanted to go down the levelized commission path on their term insurance business, and presented it to the field. The field was very excited about it. They asked to see the premium rates. The premium rates were about 5% less. They said, "Wait a minute. We aren't taking a cut in commission. We're not going to a levelized plan for a measly 5%. The applicant isn't even going to notice that. I mean if you could bring me a product paying me 20% or level commission, and bring me a product that is significantly more competitive than what's in the industry today at full up front, I'm all over that. But 5%, forget it."

I guess the follow-up question to this is how does the commission pattern impact the other pricing assumption? In this company's mind, when they revised their assumptions, particularly the persistency assumption, the pricing results of the product actually came down to the same overall profitability of 5% change in premium rates. I guess what I'd be curious to know is has anyone else experienced something this low. Has anyone done some pricing on this for their field or for the company?

From the Floor: We didn't get any savings.

Ms. Osgood: Did you look into it and see what the reasons for that might have been?

From the Floor: For the persistency level, there was a lot more compensation.

Ms. Osgood: Right. So it was primarily the persistency assumption when you figured that the business would stay on the books for a longer period of time, and you're paying out more compensation, and came up to 0%.

From the Floor: Well, for the most part, the longer the term is, the level term policies are essentially lapsed for it, so we're happy when those types of product people leave us early and start up with someone else.

Ms. Osgood: Which kind is counter to the levelized commission idea? Yes, that definitely is a cut in pay then.

Mr. Robinson: I've had experience with a low-load or a no-load company on an ordinary product, a whole-life-type product. They were paying out maybe 18%, and they thought their product would be significantly better and it was between years 5 and 15. But then the companies who had already amortized their expenses in the 20th year looked good. So they had a very small window, and this was something with a pretty fat average premium, maybe $5000 at 18%. It came about because of a mistake, which we inherited, but it wasn't enough to motivate the agents to do anything when you had a fat premium to cover. One thing is term insurance, but when you're selling a whole life policy, I'm not sure that you can transfer those lower commissions and better the product that much more and have it significantly show up better. Does anybody want to comment on that? Anybody done anything with whole-life-type policies and levelized commission or a low commission? Are there any Canadians in the room?

Mr. Wolfe: What proportion of the room are in New York licensed companies? I'm just curious. A fair amount, so that may be one reason why there's not much.

From the Floor: Would you care to comment on the Canadian experience?

Mr. Robinson: Well, what I've seen is that one company, in particular, has done pretty well with levelized commissions in a whole-life-type situation. I had not heard of it being successful in the U.S. I'm not exactly sure why, but it should be interesting to see why it is working in Canada and not working here in the U.S. What's the difference? There are a lot more actuaries running the sales department in Canadian companies. They're doing well, their business is persisting, and they, seem to be doing better than the industry in Canada utilizing a levelized commission situation.

Mr. Wolfe: That company, by the way, in order to provide inducement to their agents to accept the levelized commissions, started paying compensation on the agent's in-force block. I think it cost them about $25 million. It's not a small amount of money that company came up with out of surplus to ease the transition.

From the Floor: Have they been able to recruit new agents?

Mr. Wolfe: Yes. It's astonishing when I hear agent retention rates from some of the Canadian companies. That one, I believe, in particular. When I look at my poor dismal agent retention rates compared to 3-year survival rates in the 30s for some of these companies, it just blows my mind. It's great. A lay person to this industry would ask, “You mean to say that after three years only three out of ten agents survived in this business?” They would think it's poor, but, relatively speaking, it's great experience.

Mr. Robinson: In New York, I've heard that the average age of a general agent is over 50. How do you get new people? Is anybody doing anything that they consider novel, or want to tell us about, which is encouraging new agents or getting agents? Are people just leaving the general agency and career areas to do something else?

Mr. Wolfe: Every year, you can look at the Life Insurance Marketing and Research Association's statistics and see that the number of newly recruited agents to our business goes down. It's pretty disheartening especially when you're a career company trying to build your field force. When you put such pressure on your field managers to recruit agents, what do you get. Oftentimes, you the old vaudeville cane to just drag people in off the street. Here, you know, sign on the dotted line. What a great career this is. Salespeople are very optimistic when they show income illustrations to prospective agents. They're phenomenal illustrations. My company's no different from all the companies in the room. So you worry about, the retention getting even worse when you put such pressure on your field managers to keep hiring.

Ms. Osgood: I would just like to take this opportunity for a commercial, I guess. Moody's Investor Service has just come out with a report called "The Changing Distribution Paradigm For U.S. Life Insurers." I don't know if any of you have seen that, but you may want to keep your eyes open for it. It talks about some of the issues that Joel was just mentioning in lieu of the recruiting issues, and what's going on in the career agency distribution and the cost of that distribution channel.

Mr. Wolfe: This is a quote from Conning and Company. It says, "Over the past decade the distribution of individual life insurance products, life and annuities has been changing, and will change even more in the next five years. New entrants such as banks have triggered some of this shift, but the greatest fundamental factor driving change is the cost of distributing through traditional career and independent agents. Lower cost distribution systems are growing rapidly and will threaten those insurers that rely solely on a traditional distribution system. Also, flat life insurance sales and increasing competition in the annuity market will make it more difficult for the traditional agent to produce a level of business that generates a reasonable income."

During the period 1990–95, has the unit cost of career distribution increased at a rapid rate? Stayed approximately the same? Decreased at double digit rates? Or decreased slightly?

Mr. Wolfe: I'm in the middle of a big project at my company whereby we are reducing our field unit expenses fairly dramatically. There's a lot of pain on the part of agents and general agents because when you're talking about reducing people's incomes, people don't receive that message very readily. We're trying to do this with our executive committees and the agents association and general agents association. I firmly feel that, at the least, our product is too expensive, especially when they're trying to compete with the wire houses and, people who are used to getting lesser compensation for selling things.

I think it's a terrible problem our industry has, our levels of expenses. I know in our company, the first thing the general agents want to do is offer suggestions on how to reduce home office expenses. We try to tell them, "No, we're not asking for your help in that regard. That's not to say that we also can't reduce those expenses. But we want your help in reducing your expenses, not the home office expenses."

From the Floor: Another way to handle it is to provide soft dollars through different things such as PCs or new software to your agents to keep their expenses down. The agents have increasing expenses. Even though inflation hasn't really been going up, they still have increased costs. How are they dealing with this? Well, the agents probably are not staying in business. We have to provide some mechanism to keep them around, or else go to alternative distribution methods.

Mr. Wolfe: There's a question here about what trends in product development are taking place in New York-licensed companies now that a modernized, more flexible 4228 has been enacted? We covered this a little bit with companies moving, to level commissions. We said that nobody's really offering trailer commissions on life insurance yet. How are companies in the audience reacting to the greater flexibility in 4228?

From the Floor: What I found, is that the agents have become very knowledgeable about the new 4228 very quickly, and the first thing they want is 99%. Obviously, 99% comes with a lot of other things involved. But that's the first thing we've had to deal with ourselves, along with, of course, the competition, is producing products that have 99% compensation at this point.

Mr. Wolfe: For those what aren't aware, 99% is the new general agency limits for nonpersonal production in New York. One of the reasons why it's 99% and not something higher is the obvious perception that if it were 100% or more than a 100%, you're paying out in field and acquisition expenses more than the premium that you're receiving in the first year. So we on the core committee and Daniel McCarthy from M&R felt that 99% was probably the most that we can get.
Why did we go for an increase for general agent (GA) companies? Because companies have, in the past and currently, had to include a lot of expense dollars for, let's say, second-line management in their acquisition expense limits, which branch companies have not had to do. There was an uneven playing field.

Mr. Robinson: One of the objectives of the new 4228 is to try to level the playing field amongst all distribution systems. Are there any direct writers here? Can they talk about not the compensation, but what they have to pay for selling the product?

I had an interesting conversation with a pretty big company that was a direct writer. When we changed the 4228, I was chairman of the data group, and we solicited some information. The guy said, "I'm very happy that you're now including direct expenses because we have this big Schedule." We never had to fill it out. We thought it was a waste, but now they have to do that. That's all being recognized now within 4228. No matter how you sell your product, those costs are being included to levelize the playing field. Jack, are you now offering a scale with 99%?

From the Floor: It will be on our next release.

Mr. Robinson: And that doesn't come for free either. You have to file. Self-support will be an issue?

From the Floor: Yes.

Mr. Wolfe: The other issue that we have and we haven't figured out exactly how to deal with at this point is that the 99% comes on the agent level in total compensation, but the Personal Producing General Agents (PPGAs) who we did a great deal of business with were cut back to 91%, and I suspect some of these PPGAs aren't even aware of it or have to try to find some way to deal with that because a lot of them end up with lower compensation.

Mr. Robinson: Yes, that's true. A lot of the smaller New York companies, those that are left, sell a lot of PPGA business and they're going to get less money.

Mr. Wolfe: While we're on the subject of self-support, I attended one of the regulatory trend sessions, and, of course, everybody's talking about *XXX* and all the other stuff that's going on. But one of the things for New York companies that hasn't hit yet, but that will probably appear early next year is a new self-support regulation. The new 4228 has a much more expansive verbiage on product self-support. Under the new law, when you file a policy form under section 3201, you have to send in a statement of self-support with each of those product filings, and they have to be backed up in your home offices by demonstrations of self-support.

The initial shot at a self-support regulation by the New York Department was horrendous. It was much more onerous than we were willing to accept. You had this strange situation where their requirements were more onerous than the illustration actuary regulations. You had a situation where you could illustrate a product, but you couldn't offer it for sale, which makes no sense. We're still talking to them at the New York Department. We hope that reasonability will prevail, but one never knows with the New York Department.

From the Floor: Doesn't a best faith effort make it a little bit easier until the new regulation comes out. People have suggested to taking advantage of it because when a new regulation comes out, it's going to be much tougher.

Mr. Wolfe: Yes. We're not clamoring for a new regulation at this point because we have a transition circular letter in place, which does allow reasonable interpretation.

From the Floor: Good faith.

Mr. Wolfe: Good faith, self-support. So we can operate under this transition circular letter. When the actual regulation comes out, it remains to be seen.

By the way, the filing requirements under the new law are much, much more flexible and better than under the old law.

But doing that, you have to file statements of self-support. And I know I don't do those statements because I'm not a product development actuary. But it's created an enormous amount of work for the product development actuaries at my company because we just went through a whole series of expense allowance filings. It's a lot more work on top of all the illustration actuary stuff. It's really pretty onerous.

Mr. Robinson: From what I've heard from some people, maybe it's not so easy to get it filed. The New York Department is really hurting for people, and things are not going as well as you might perceive by the new flexibility. Has anybody filed under the new rules? I know one person has.

From the Floor: Yes.

Mr. Robinson: And what happened? I'm talking about policies.

Mr. Wolfe: Oh, policies. No. That's not in my domain. So I don't know what's happening in the policy side. I know what's happening on the compensation filing side.

Mr. Wolfe: We're in the process of filing a term product on that basis. And sure enough, within 90 days, we get our response. Within 45 days should be about today, so I'm not really sure.

Mr. Robinson: So that's four and a half months, right?

Mr. Wolfe: Yes. Even under the new law they're talking about what probably will be at least a six month period, which is substantially better than it used to be.

From the Floor: There is an order to that.

Mr. Wolfe: It's actually better than the—

From the Floor: Is it a year shorter?

Mr. Wolfe: Maybe six months shorter.

Mr. Robinson: It's incredible. If you file in New York and in other states, it's—

Mr. Wolfe: Well, New Jersey is not great I understand.

Mr. Robinson: No. They've gotten a little better.

Ms. Osgood: We had, a way long time ago, a question or a comment from the back.

From the Floor: Yes. On the 99% that you pay, what's the renewal that you pay on that?

Mr. Wolfe: Is the implication that maybe some of the renewals were lowered to pay for the higher first year? Is that really the question?

From the Floor: It's really hard to say because the product that we recently submitted as a term product is a new one for us, so it is a relatively low renewal commission product. I believe it's in the 5% range. We also have a universal life product that we have redesigned with the 99%, and with that we haven't reduced the compensation. But then again, we designed the product. So we just incorporated wherever the compensation is into the product design.

Mr. Robinson: Also, now at the fourth year there are no restrictions on the commissions. Of course, you have the self-support issues that you have to get around, and the department didn't take an active role in the development of 4228. They said, "We'll get you on the self-support issues."

Mr. Wolfe: We basically know the statute much, much better than the regulators do because we're the ones who formulated it. They're playing catch-up.

Can we leave 4228 for a second, so I can put Deanne back on the spot? We have some nontraditional marketing and distribution questions about Internet sales and we did a little bank distribution, but—

Ms. Osgood: We actually have a teaser question on Internet sales. Is anyone here interested in talking about selling insurance on the Internet or compensation a few. This is actually an interesting question. Has anyone ever heard of wholesale life? I haven't.

Mr. Robinson: Is it any different from association life? Didn't that used to be called wholesale life?

Ms. Osgood: Well, this wholesale life provides consumers with an *x*% cash rebate if they buy through wholesale life Web site. What is that *x*%?

From the Floor: This is a company?

Ms. Osgood: This is a company selling term insurance over the Internet and they offer a 15% rebate to the customer if they buy.

From the Floor: How do they normally distribute their product?

Ms. Osgood: Through the Internet.

From the Floor: Is that all?

Ms. Osgood: That's it.

From the Floor: So they convince an agent that this a good thing?

Ms. Osgood: A good point.

From the Floor: So a 15% rebate. What other way can you buy?

Ms. Osgood: You can't.

From the Floor: So where's the 15%? Is that a finders fee?

Ms. Osgood: Well, next question. How is this rebate possible with existing antidiscrimination laws? This one is a little tougher.

From the Floor: The premium is higher.

Ms. Osgood: No.

From the Floor: Why shouldn't the premium just be 85% of the premium that they're charging?

Ms. Osgood: Well, I'll give you a hint. It's kind of like enticing you to use your Discover Card. You get a cash rebate. Where is the consumer focused? What are they thinking of? Getting something back. Getting cash back. Not having to pay less. We're going to give you 15% in cash. It's the same thing, but it's a rebate.

From the Floor: Can the policies survive?

Ms. Osgood: Not to my knowledge. It's a good question, but he asked if it was a participating policy. I don't think so. Are you ready for the answer? The rebate is not paid by wholesale life or the insurance company providing the product. It's paid for by the parent company, Southern Financial Network, which is a Web commerce marketing company. This is a change in ways of doing business, and an interesting way around maybe an existing regulation or a law that we have a mind set as to how business should be done. Are there are some people who are thinking outside of that box and working with the consumer perspective?

Mr. Robinson: When we three panelists got together for breakfast, I had all sorts of questions. Obviously, I'm from an old line career GA company, and I don't know a whole lot about Internet sales. I have all sorts of questions on what the licensing requirements would be in these scenarios.

I also told Deanne that I saw a statistic last week, that said that only about 6–8% of the consumers are even interested in buying insurance on the Internet. That's not 6–8% buying on the Internet. That's only 6–8% actually being interested in buying, which means the yield rate is going to be a lot lower than those numbers at this point.

From the Floor: Yes. But I would contend that those are the more sophisticated consumers. Wouldn't you agree?

Mr. Robinson: You would think that, they would be the only people who could understand the differences. I offered the opinion that it might be a good way because then you don't have an agent pressuring you. You can look at the things off-line and in the privacy of your home. But it will take a more sophisticated person. And again, are they going to go after anything other than term? Can you sell direct insurance for a heftier premium policy?

From the Floor: Do insurance departments accept this approach? Does any insurance department say, “You can't do that. That's a rebate?” I know in New

York, they get games played similar to this type of thing, but it's hard for me to believe that the departments would accept this without going after them.

Ms. Osgood: I don't have an answer to that other than what I read didn't imply that there were any problems with any states, but it didn't say which states they were selling in. It did talk itself around the discrimination and the rebate issues. My guess is that it has been accepted, but I don't have an answer for that.

I have had the opportunity to work with a couple of marketing companies who are pursuing very innovative and interesting strategies for marketing auto, homeowner's, life, and eventually health annuities on the Internet. They had some really innovative approaches that combined education and product, with price, and they were looking for companies that were interested sitting down and designing a product exclusively for the Internet customer.

Actually, there was a lot of "Intranet" marketing going on, and that's very different because that would be a targeted group connected by their own Internet system. They were taking a look at who that potential group or groups might be and designing a new product and different compensation. They were willing to take levelized commissions. I'll toss around a number; 75–100 basis points on an annuity. They didn't want to really go below that, but they were willing to go below 100 basis points. They just wanted companies to offer something on the term insurance side, and that's really where they're starting. It's more of a commodity type of product.

Companies weren't willing to do it. They weren't convinced that the marketing would work. They weren't convinced that the sales were going to happen. And they said, “You know, we'll give you a shelf product and if things work out, maybe we can talk about custom designing a product later.” The marketing company came back and said, “If you're going to give me the shelf product, I want the same commission that your retail distribution is getting.” There is an opportunity to do something groundbreaking, a new strategy hitting the market, but it just really hasn't happened yet. I think there's a lot of skepticism, but there are some people out there trying, and there's a lot of money backing some of these people up. Someone just might hit the jackpot.

I don't know if any of you have any experience that you would like to share.

There are some people who said that they were interested in Internet sales. What do you plan on doing with it? Does anyone want to volunteer that? Is it sales or is it just education?

Ms. Osgood: I have yet to see somebody actually go through the whole application and that type of process on the Internet. But there are an awful lot of 800 numbers being provided and applications being taken over the phone, and direct links to other Web sites through the Internet. There's a lot of pretty creative work going on. Is anyone involved in any of that? I understand it's difficult to give away any secrets, but I can appreciate that as well. I just wanted to throw a couple of ideas out there, I guess, and give you some food for thought for the plane ride home.

Mr. Robinson: There are a lot of these agencies offering various term rates or term policies without giving the name of the company. I hear it on the radio throughout the day. I don't know why they couldn't do the same screen through the Internet. Of course, the person behind this thing has to be licensed, I guess, as to what has to happen on the telephone poll. But there are significant regulatory issues involved in this, which are somewhat related to direct sales.

Mr. Wolfe: Turning gears back to a more traditional theme, can career companies continue to carry and support inefficient producers? And what's the view of the rating agencies toward possible inefficiencies in the career distribution system? I know that I've heard that the rating agencies are now not just interested in your surplus ratios and all that stuff, but they're actually interested in making sure companies have coherent and cogent strategies. They're really concerned about career distribution costs and the inefficiencies most career companies. Anybody care to say anything on that subject? Particularly, if you've had any experience with the rating agencies in your career forces for those career companies.

From the Floor: Under the new 4228, some of those costs are going to be more apparent. I don't know if they're going to be able to get at them because you have to disclose all selling expenses. People are going to see them. And I think New York used to file, and print Schedule Q results. I don't know if they still have the green books that do that.

Mr. Wolfe: It just kills me knowing the levels of fixed field expenses that we incur for some agents because we're a hybrid general agency company and we direct pay the rent. The GA doesn't pay the rent as in a pure GA system. You provide agent benefits and you try to keep increasing, the minimums to qualify for benefit subsidies, and it just seems like it's never enough. You have so many smaller producers. I'm sure we're no different from the rest of you. It's very frustrating when you have these high fixed expense ratios to the point where you think about going to maybe all cash-type contracts and basically turn a fixed expense, into a variable expense albeit at a much lower than current level.

You have statutory employee problems. They probably couldn't stay statutory employees if you did that.

From the Floor: I guess I've been involved with quite a few companies dealing with rating agency presentations already this year. A number of them were career distribution companies. The publications and the themes of their meetings make it clear. The themes now recall things such as the growth, distribution, and efficiency of the rating services. The questioning and the commentary is intense, and I think it's only going to get more so. You have to remember that they're stressing even other levels of this—differentiation of your system, why you have a protected market position, protected products, how your position is defensible, those kinds of issues. Frankly, they didn't really exist and weren't raised in this way five years ago, but it's extremely intense. Companies have been put through entire mornings that I'm familiar with of grilling on these topics.

I won't go on about this, but you need to remember that for every company that they talk to that's trying to prove to them or claim that their career distribution system is a good one, they've talked to a company the prior day that told them why they were getting out of it, getting rid of those agencies, and changing their system. They talk to peers all the time. They know a good story from a bad story. They do not have to be as expert as all of us are in this room on compensation, products and agent distribution and building. They hear lots of good and bad stories, so they can sort that out, and it's a difficult issue to deal with that.

Mr. Wolfe: Won't this issue get impacted by the whole demutalization situation? I would think that the larger mutual companies can't afford to keep paying their career agencies as much as was done in the past because they're going to have to compete on different levels in a public sector, and on a stock basis which would be just like the rating bureaus. The stock analysts are going to be analyzing that stuff as well.

Mr. Wolfe: Anybody in the audience actually have to prepare these rating agency presentations on the efficiencies or inefficiencies of your distribution system?

From the Floor: Well, we are a PPGA company, that is, theoretically, a variable cost operation. But the rating agencies still focus on the inefficiencies of the lowest producers within that market. There are certain fixed costs. Not as good as a career distribution for us, but everything that Jack said is true. Hours of grilling particularly on field-related costs.

Mr. Wolfe: Are you a stock or mutual company?

From the Floor: Stock company.

Ms. Osgood: I'd like to ask a related question on channel conflict for companies that do have career agency distributions. Channel conflict can be a very, very big issue to deal with as you start pursuing alternative distribution for your products and a career agency will accept that if you can even go down that path. It is easier now than it may have been, say, five years ago in having your agents accept the company moving, or having the division of the company itself.

Let's talk about some of the internal operations of the company. Are you able to sell an alternative distribution to the people who are responsible for the career agency channel? Are there still quite a bit of inside battles? Or is that lessening?

Mr. Wolfe: Deanne, I can give you a personal experience because I developed a compensation package for a supplemental distribution channel at my company. And I have to tell you, first of all, the compensation to the supplemental channel is pure variable compensation. So that's great. It's lower unit cost of compensation than the career GA side, but the GAs have gone crazy. They've actually gone outside the bounds of their executive organization and, there are a bunch of them who are rabble rousers.

What we've had to do is to slightly increase the cost of the career GA distribution side to kind of pacify the GA. At the same time, we're going out with a lower cost supplemental distribution. Your unit cost might go up a little bit initially, but you'd like to think that you'd sell enough product on a lower cost basis so that the weighted average field distribution cost ultimately comes down. That's my hope anyway. But that's my experience. Anybody in the audience have a channel conflict? It's a terrible, terrible conflict.

From the Floor: I work for a company that actually has been acquired by another company. I used to work for CIGNA. Probably five years ago, CIGNA was entirely career. Today, Lincoln has purchased CIGNA in order to build a career even more, and Lincoln has purchased business from Aetna in order to build its brokerage side. Lincoln is going to end up with two distributions almost equally weighted; 50% of the business coming from career brokerage.

We found out that the conflicts came in two places. Compensation was not one of them. One of the things that we noticed was that the brokerage side had so many people who got paid on one piece of business from the Modified Guaranteed Annuity (MGA) all the way on down. It's hard to figure out who's got what. The career side is a little bit cleaner to figure out. The brokerage is actually just as expensive as career when you get down to the number of people who are involved.

Mr. Wolfe: But is the company paying for that? Doesn't the agent and the MGA take care of the distribution of the money?

From the Floor: The MGA has the volume risk. If production is at a high enough volume, the MGA wins the company is actually making its expected return. If it's very low volume, the MGA loses, but the company is still making its expected return. You've transferred the volume of business to that MGA. On the career side, obviously, the company is doing much better as you increase in volume.

Anyway, back to the other question. The channel conflicts have come mostly from the inside. We started out with two things. One, the compensation didn't seem to be a problem. It still isn't. The product isn't. It's the exact same product on both sides. Where you get some of the conflict is control. In rare situations, have two producers after the same policyholder. Whoever gets into underwriting first wins. We have some very set guidelines. It's rare, but it's always embarrassing when it happens. You try to do your best to recognize it ahead of the time and do what you can to stop it.

That is the biggest channel conflict that we face. Are we giving the right amount of attention to the side when one side wants to see this kind of improvement in the whole life product, and the other side wants to see this kind of improvement in the universal life product? There are limited resources. Systems resources are limited the administration capabilities. That's been our most significant concern of all.

But five years later, there's a begrudging respect on each side; both recognize that they have got something that they wouldn't be able to get had they stood by themselves. The broker side has a fairly significant financial planning infrastructure behind them, including a lot of software, that was originally developed for the career people. The career side now realizes that they have a product that is very competitive with all the companies in the brokerage market, which tends to be a more competitive market than where they would have been otherwise.

Mr. Wolfe: Right. Mike, that's exactly one of the strongest selling points we present to our GAs, that ultimately they get a better product if we are successful on the national brokerage side. We wouldn't have to cut their field expenses as deeply as I'm looking at cutting them now if we were successful on that channel.

In response to your other point about conflicts for the same consumer, we've come up with what we call Rules of Engagement. You have a conflict with a broker who might want to affiliate with your GA, or this national brokerage firm, if he or she has done business with a GA within the last two years, that broker is off limits to the national brokerage firm. You have to come up with all these rules just to get into the business.

From the Floor: We have a lot of that. One final comment regarding the rating agencies. I know that as Lincoln has done these two acquisitions within the last 12 months, obviously, they're putting a lot of time in front of the rating agencies. Generally, the ratings are reaffirmed and that could be a negative outlook. Let's look again in three months, six months, or whatever. But they're still holding up.

I will say that the board of directors loves the idea of channel conflict because they've thrown $2.5 billion into it recently. And the shareholders have liked it as well because the stock prices are going up. So Lincoln has gone from not having any solid production on either side to two major acquisitions; one that was career motivated and one that was brokerage.

Mr. Robinson: I have a question for you. What about the business in both sides? Have you noticed a difference in the quality? Is one better than the other? Or different in any particular way?

From the Floor: You certainly notice a difference in the underwriting for brokerage producers and companies—the fact that they can pick and choose any underwriting. They'll go here when they know it's going to work for them. Or they'll go there when they know it's going to work for them.

We pay more attention, obviously, to that on the brokerage. But what we also have is a very high face amount, very is solid underwriting, and some pretty experienced underwriters. We set some guidelines up front, and we don't really bend too much on them, and that has helped us. But underwriting is probably the biggest difference.

Mr. Robinson: Do you have different underwriters working on the business too?

From the Floor: We have underwriters who are in teams. So, yes, there's a brokerage team and a career team.

Mr. Wolfe: Jeff, we have specifically earmarked underwriters for this new channel.

From the Floor: Same chief underwriter though and same overall underwriting philosophy. But it's too early to really tell persistency, expenses. As I said, we put the onus on the MGA for volume. On the distribution side, internally, there's really no difference. So far, it's too early to tell how the mortality will pan out too. But we put in a little bit of a pricing differential reflecting that so will probably have higher mortalities.

Mr. Robinson: Are you licensed in New York?

From the Floor: Yes. Connecticut General is a 50-state company. When Lincoln purchased the business, Lincoln became a 49-state company, and immediately everybody wanted to know how we would pay not just the 99% commission, but even more than that. I told them you were willing to see the premiums go up or whatever. Because, obviously, the compensation is priced into the product. None of them wanted to do that. So they're feeling OK with the level of compensation which meets New York limits and, you know, Lincoln is not a New York company.

The problem that we've had is that Lincoln is a non-New York company, and that's hurt on the distribution and marketing side to say, that were non-New York.

Mr. Robinson: But they had a New York subsidiary, right?

From the Floor: There is a New York subsidiary, but what I'm referring to is just the financial strength. There's a lot of value to saying your a New York company. Having gone from a 50 state to a 49, our existing producers feel they have lost something.

Mr. Wolfe: We tried to convince the New York Department to remove extra territoriality from the new 4228. They're supposed to do a study by the end of the year either reaffirming extra territoriality or making a statutory change to get rid of it. And yet, we have Lincoln's compensation, which apparently is lower than the New York limit. So, do we really need extra territoriality outing? At least, that's one case anyway.

Ms. Osgood: Does anybody have any specific questions that you would like to ask of the group, or of us that hasn't been covered today? Something that you were hoping would be mentioned or discussed that really hasn't been covered?

From the Floor: I was just wondering, Deanne, if you've seen anything out there on the registered investment advisor, the only financial planner where the company doesn't pay their commissions but they get their commission from the product where they take it from the client themselves. What asset fee is that being taken from and have you see any unusual structures in terms of insurance products.

Ms. Osgood: I haven't. No. And I'm not sure I completely understood the question. They're selling the product and the compensation is being paid by the client?

From the Floor: Fee-only.

Ms. Osgood: There's still compensation being paid for the product that's sold. Can somebody help me out here?

Mr. Robinson: But still, they have to market it. That was the thing that I found in this low-load company. You still have a marketing cost even if you're supporting the financial consultants or just getting it out there. This company had to go to all the association meetings and things like that, so you still have a marketing cost. Now, whether or not fee-only planners or no-load companies are working depends upon the particular product, I think. If you have a heavy premium product, I think it's difficult. Anybody here support fee-only planners?

Mr. Wolfe: Well, there's no question, that to be a certified financial planner, you have to divorce yourself from your function as a solicitor in getting commissions for selling product in your company. The fact that this product wouldn't actually be paying compensation, I think, is a much better situation for the consumer than—

Mr. Robinson: Not necessarily, Joel. Because, again, there are marketing costs. You have to get that product out so people know about it.

Ms. Osgood: Some of the products that I've seen that are being well received in the financial planner market are products that do pay like a 100-basis-point trailer. Compensation will pay that. I've seen one that pays that up front as well as ongoing, so it's sort of a little boost. There is still something that is being transacted, and that's what I'm more familiar with. But those are the products that they are being attracted to. And that may be no load.

Mr. Robinson: What about disclosure? What do people think about that? I think it's something that's coming, and we're going to have to face up to it. Any opinions in the audience?

Mr. Robinson: It's here.

Ms. Osgood: It's here. I don't know what sessions you attended. Obviously, there's the NAIC life insurance illustrations model regulation, which has some huge disclosure elements. There's also the annuity regulation sister regulation that will be following shortly. There's the annuity buyers guide and the equity index annuity buyers guide. You don't have to adopt that yet, but they are encouraging companies to adopt it and use it anyway. Disclosure is critical.

Mr. Robinson: Of course, it may not be fair, to compare the two directly. You always get the full cost involved even in New York. You can disclose commissions, but what about the expense allowance parts of it? Disclosure is probably good, but it's difficult to match apples and apples.