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Failure to Plan Is Planning to Fail: An Experience of the Strategic Process

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Summary: This session targets managers of small- to medium-sized pension actuarial consulting firms.

In this session, audience members were responsible for the long-range planning for a pension actuarial consulting firm. They are first presented with the basic elements of the strategic planning process. Next, they review the state of the pension industry with the group. Finally, they participate in a case study and develop an actual strategic plan for a hypothetical pension consulting firms.

Mr. Dorn H. Swerdlin: Bill Horbatt is from Peat Marwick, and I'm from Swerdlin and Company.

Bill and I will go over some strategic planning concepts and leave time for the case study. At the end of the case study, we'll have the audience describe what they have done, have a critique, and draw some conclusions.

There's a sample strategic plan that we've called the ABC actuarial firm, which is a small pension consulting firm. Bill will begin our discussion on the strategic planning process.

Mr. William R. Horbatt: Let's discuss strategic planning concepts. This gives you a framework whenever you're working on a strategic planning issue. There are three critical elements in the overall process. The first one is the environment. You need to determine what's happening around you. Second, what capabilities does your organization have? What can you do? Finally, what are management's preferences? Unfortunately, management preferences draw the corporate decision outside of the loop, and sometimes you get away from that intersection between environment and capabilities and get out of that sweet spot entirely.

Let's come up with an example of an environment that drove some very good strategic planning. In the 1970s, interest rates were rising, but the consumers couldn't get the benefit of them. Banks were limited by laws dictating what interest rate they could credit on accounts. It was a construct and a regulatory framework that dated back to the recession. Some bright people at Merrill Lynch realized that short-term corporate money is just as good as bank money. It is equally secure and equally liquid, but it's yielding much more. They came up with the cash management account, and it took over a sizeable chunk of the individual savings market. That was an environmental change that resulted in a corporate decision which then resulted in what I call success.

In our industry, Life of Virginia followed shortly thereafter with the development of universal life insurance, which has been the nemesis of our industry ever since. It is an inevitable nemesis, but our prices have become unbundled. It used to be our agents could go out and sell insurance products both as a risk protection and as a savings vehicle. Nobody looked at how much we were charging for this service or whether these rates of return or projected values meant anything 30, 40, and 50 years out? People are now asking those questions. They look at a policy and ask, "How much am I really paying for administration? What am I paying for mortality charges?"

This gives you a framework, but before we go on, let's discuss one other issue. Strategic planning is really about companies making choices that are going to influence their future over a long period of time. Strategic planning might be even more important in choosing what you don't do.

Southwest Airlines would be an example. It was formed concurrently with another external event: the deregulation of airlines. Southwest decided it was going to be a low-cost carrier and compete on that basis. Everything it did was consistent with that. It decided to fly between airports that were not heavily used, such as regional airports, so it stayed out of air traffic congestion. It decided to have efficiency in terms of maintenance. It has only one aircraft, a 737. There are many versions of it, but it's only one piece of equipment. It decided not to have amenities like meals on flights, assigned seating, and frequent flyer programs. It decided that it was going to compensate its staff and create an egalitarian culture. Southwest can turn a plane around in 20 minutes. The plane does not sit on the runway waiting in queue for an hour-and-a-half like planes do in Newark Airport.

The net result is Southwest has the lowest cost per passenger mile. No other competitor can get into that niche. We see other startup airlines trying to do it, but it might be too late now. These airlines can't get critical mass. They might serve some local market, but if they start really threatening the industry, there's retaliation. Southwest stays in its markets. It's not trying to compete with the majors, but it doesn't leave them alone. It will go into Providence, Rhode Island so it can start taking the Hartford-Boston market, but it will still be a small segment. I hope that gives you a baseline or a foundation for what we will talk about as we go on.

Mr. Swerdlin: There have been some changes in the environment, but for the most part, for the last 100 years, it has been fairly stable. But it has already started to come apart and become more fluid. Strategic planning is so important because the environment changes so much. You just have to keep your eye on the ball to make sure you know exactly where things are going. You must modify your plan accordingly.

Mr. Horbatt: We talked about some things that were environmental events that have happened in the past. We talked about the change in the interest rate environments as a result of the oil crisis. We talked about deregulation or de facto deregulation with Merrill Lynch and its money market.

We'll be seeing other things happening, but let's look at some things that we think are going to influence the markets for health, life insurance, savings, and pension products in the near term. There is the baby bubble. It's like a python that swallowed a pig. It has resulted in a switch, or migration. We're not selling anymore life insurance than we sold before; if anything, we're selling a little less. There has been dramatic growth in accumulation products, whether they're mutual funds, single-premium deferred annuities, or certificates of deposit.

There is a change occurring in the way people interact. Increased customer sophistication means our customers aren't afraid to invest in the stock market. They are sophisticated and savvy buyers. And there's more price competition.

Mr. Swerdlin: Part of what makes up the environment is the economy. Companies are much more efficient, with reengineering and increasing technology allowing fewer people to do the same amount of output. There's a clear shift from paternalism to individual responsibility. In the old days, the company provided everything. It provided whatever it wanted to provide. It was like daddy taking care of the kids. We're now starting to see companies say, "We'll help you, but you have to take care of yourself." The shift from defined-benefit plans to defined-contribution plans is an example. Of course, 401(k) plans are the biggest example in the pension area, where the participants are putting in their own money for their own retirement, and companies love that.

Competitors are changing. In the past, the competitors of an insurance company were other insurance companies. Now competitors are anyone you can think of in the financial services industry, and it might be people outside of that. In my pension business, we used to compete with insurance companies and other firms like ours. Now we compete with mutual funds and other organizations that we never concerned ourselves with. Banks became competitors that we had to deal with. Does anybody have any comments about this or anything we talked about so far?

Ms. Judy Feldman Anderson: How recent is the shift to accumulation products?

Mr. Horbatt: This has been growing gradually since the 1980s. It's very hard to tell what was happening in the life insurance industry, because so much traditional product business was being replaced by universal life in the late 1970s and early 1980s. There were tremendous sales, but nobody knows whether it was real because the lapses were high. I would say it probably started in the late 1980s.

It's consistent if you look at the housing crisis. When the baby bubble moved into the market for first-time house buyers in the 1970s, there was rapid acceleration in prices concurrent with the inflation from the oil crisis. Now that group is turning 50 and looking at retirement. We've had a pretty spectacular stock market that has been fueled by the same demand to invest and save.

Ms. Anderson: I am wondering if it's really a strategic planning issue. We should have anticipated the baby boom. During the 1980s, most of what we talked about was how low the savings rate was and that people weren't saving, rather than saying these people are going to start getting older and saving a lot.

Mr. Swerdlin: There's another aspect that we didn't touch on that I've heard about in terms of people in the pension side of the business. Another way to look at it is, we're approaching the point where it is going to be retirement. Instead of accumulation, some are at the point where they're going to start drawing out the money. We're getting real close to that because the baby boomers are nearly 50, and some will be retiring at 55.

Mr. Horbatt: The baby boom generation started with people born in 1945 and ends with people born in the 1950s.

Mr. Swerdlin: The older ones are in their early 50s.

Mr. Horbatt: Someone in his or her early 40s has 25 years of savings to go, so this is going to keep going. The savings phase is not over for awhile.

From the Floor: It depends on when they want to retire.

Mr. Robert E. Collins: The definition of the baby boom differs between Canada and the U.S., but it's roughly the same area. In Canada, at one time, baby boomers were those born from 1945 to the early 1960s. The accepted definition now is babies born between 1947 and 1966. That's a long period. One factor was that the birth control pill really took hold in the U.S. around 1961. We were a little slower in Canada.

Mr. Horbatt: What about socialized medicine?

Mr. Collins: It is said that those at the very start of the baby boom lucked out and those at the end got shafted. I happen to have been born in 1945. I was once considered part of the baby boom, but now I'm not. There are those born between 1960 and 1966, which makes me think of the housing boom you mentioned earlier.

Mr. Horbatt: They bought the houses at the highest prices.

Mr. Collins: I bought a house when it was cheap and a few years later, I sold it for a pile of money. I did nothing special to the house. I just lucked out. By the time the kid who was born in 1960 was buying a house, it was at such a high price that he or she couldn't afford it anymore.

I think the same thing is happening with retirement. You talked about the shift to an accumulation plan. If things work out the way I hope they do, I'm going to be buying into the market at a relatively low price. The rest of them will come after me, drive the prices to the sky, and they won't be able to afford to retire. It isn't just a matter of when you retire. For many individuals, their funds will continue to increase during the early years of retirement.

With that in mind, the ones at the early period should make just a pile of money as the markets go up. It isn't as important when they retire, as when they are age 75 or 80. That's probably where these funds start to peak and drop off. For people in the early period that's probably around the year 2025, give or take a few years. You can almost see a booming stock market going for the next quarter century, followed by something akin to The Great Depression. If we know that, we should be designing products accordingly.

The one group that has been ignored by our industry and by most industries are the late baby boomers. I think there has been a lot said about the early ones who have been shafted over and over again. You might think of those people born between 1955 and 1960. In Canada, it is probably those born between 1960 and 1965. There's probably just a wide open market there if someone could give them a fighting shot at retirement planning.

Mr. Horbatt: Right. We're not trying to say that this is everything; just that these are the kinds of things you should be looking at. We did a strategic plan for a life and health insurance company seminar recently. It was an all-day seminar and it just scratched the surface. We're creating a bridge, but the point is you have to think of the environment and your capabilities.

You can equate strategic planning to baseball. Sometimes you hire a player because he consistently gets singles. He's a journeyman. Most companies are hiring that player. That's where they want to be. They don't want to swing for the fences or take a chance on really petering out. All the strategic planning consultants take examples of those real successes where people have swung to the fences and actually made a hit. They don't talk too much about the guys who didn't make it.

I'll give an example from the 1950s. The chairman of Kresge, a five-and-dime store like Woolworth, said, "This isn't working. We're profitable, but the market's going to change. There's an opportunity to create a discount market." So he created Kmart. In the 1980s, Kmart was surpassed by Wal-Mart.

Wal-Mart took the same concept and decided it could do it better. Wal-Mart located its stores more carefully. and implemented a computerized inventory system to minimize cost, holding, and unwanted goods. If Kmart had made that change, too, Wal-Mart never would have taken its market share. That's an instance where an external environment became internal. The new technology, information management of inventory, was an external thing. But it was adapted internally. With strategic planning, there is no right answer.

Mr. Swerdlin: Technology is another environmental trend. We're seeing phone centers and voice response units that are used in 401(k) plans to communicate with employees about their benefits and other things. The Internet has been a significant factor in technology and communication all over the world. It used to be that, in the 401(k) plans, we always dealt with the employer as the real customer, but now employees are the real customer. We're tailoring all of the services in a plan to make them happy and to satisfy their needs.

Mr. Horbatt: People are demanding instantaneous access to information. They want to call at 2:00 a.m. to find out what their fund price is. If they have a problem with their product, they want to call American Express and get it fixed So it's technology in that they're using the phone and American Express has the call center, but it's also very people-oriented and very responsive.

Look at the Internet. Something like 10% of senior citizens have Internet access. The senior influence on the Internet is significant. There are people who have assets, and they have time to search.

Another environmental factor is the government. On a long-term basis, what the government does is simply going to reflect the demographics and the economy. If the economy is good, whoever is in power gets to stay and demographics will drive what people vote for. The American Association of Retired Persons isn't as powerful as it's probably going to be in a few more years when the baby bubble shifts to retirement ages.

At the same time, we're going to have younger disenfranchised people asking why they are paying so much in Social Security taxes. That could be a very interesting thing as the baby bubble moves on. The seniors have dominance, and then they lose it. Think of the backlash that could occur then. On a short-term basis, everything's expediency. A week ago, people thought there was going to be a tobacco settlement in Congress. It died because of the expediency issue. People do what they have to do now to get somewhere.

Mr. Swerdlin: We'll shift away from the environmental factors to the internal capabilities, starting with the culture of the company. Risk tolerance would fall under culture. Does the culture in the company encourage people to take risks or does it encourage people to cover their tracks and not do anything that will stir up the soup. Companies have both kinds of cultures or cultures that fall somewhere in between.

In some companies, making a change is like declaring an act of Congress. Other companies are flexible or set up to anticipate change and deal with it.

Mr. Horbatt: We've seen more migration to higher risk tolerance and more receptivity change. We've watched people who weren't receptive thrown out the door. Companies and boards of directors are willing to make big changes. When Art Ryan was put in charge of Prudential, it became the first mutual insured ever to have a chief executive officer brought in from the outside. He turned that company upside down. It went from 50 actuaries at the corporate vice president or higher level to five, all in the span of two or three years. So the world has changed.

Mr. Swerdlin: The world has to change if it's going to survive.

Mr. Horbatt: I don't know about that. When we went into the 1990s, people were worried about the shortage of young people to hire. What did we do? We went through a massive reengineering of the workplace. America became the most effective global competitor as a result of that in broad terms, but we now have the culture that we are hungry.

Mr. Swerdlin: The third item related to culture is continuous learning. That's real important, and I think it's starting to happen. We need to go a long way to develop a learning organization where everybody in the organization has its focus on learning and trying new things. It has to do with the risk tolerance and the receptivity to change. They're all related, because, in order to continuously learn, you have to be open to change and taking chances and not just stay within your secure boundaries.

Mr. Horbatt: Actuaries have been very good in this sense. We come to meetings like this one and keep reading our material. We're not so good at getting outside of our existing boundaries. Look at the derivatives market. That should have been an actuarial market, shouldn't it? It's mathematical. Why did that market attract so many Ph.D.s on Wall Street? It's probably because we weren't that interested in learning. We weren't aggressive enough to go beyond our sphere. However, within our core disciplines, we're generally up to speed no matter what age we are.

Mr. Swerdlin: Many actuaries didn't think they had to do any of that because they felt secure in their area.

Mr. Horbatt: I guess we weren't.

Mr. Swerdlin: We've had a long history of being able to stay in our area and being happy about it and having a monopoly. That will not continue.

Mr. Horbatt: You were lucky in the sense that you set up your own firm just under 20 years ago, and it was almost entirely defined-benefit pension consulting. But as the business changed, you craftily migrated to become only one-third defined-benefit pension.

Mr. Swerdlin: It's about 20%.

Mr. Horbatt: I was able to feel the change another way, through the loss of job security.

Mr. Swerdlin: At my firm, in the beginning, we had mainly all actuaries. Now I have four or five actuaries and 25 other people who are not actuaries. I call myself an actuarial firm, but actuaries make up a small portion of my employees at the moment.

Mr. Horbatt: Let's continue with internal capabilities. Look at your cost structure and look at where you are in the life cycle. Decide if you are a startup company versus a mature company. These types are dramatically different. A startup company has some bright, hardworking people and doesn't generally have a lot of corporate or specific knowledge, but it is a cheap operation. Mature companies have a lot of overhead. As we've been dealing with that, they are prematurely retiring some of that overhead.

Relative efficiency is something that pertains to the Citicorp-Travelers merger. Those guys are gambling. They, as well as certain other players in the financial insurance services type industry, are going to push very hard to get the regulatory environment changed. Don't expect those barriers that we had between us and other companies to be there. Now you're in an international market. Those barriers can be found in most places, so you're out there dealing with that competition. However, you do have a real advantage. You have the ability, in most cases, to move money offshore from your local environment.

Mr. Joseph E. Freedman: We usually try to keep our capital to the bare minimum in each of these local operations. We repatriate all the monies to the corporate area, which can be consolidated and used for other strategic ventures.

Mr. Horbatt: I did some consulting in Latin America, and there were certain barriers to getting money out, but people found ways to do it. My favorite story is about a power of attorney to solicit an application. This was in Guatemala. If you had a high net worth individual, he didn't want to have his money in quetzals; he wanted it in U.S. dollars, before he would sign this application The agent would supposedly fly to Miami with it and submit the application, but I'm sure it was going through mail drops.

The United States has new competitors, and if we haven't benchmarked ourselves against them to determine our strengths and weaknesses, then we could be in for a problem. For example, adaptation is important. We know Wall Street adapts fast. It's brutal. They make people work really hard, pay them a lot of money, and throw them out the door when they're no longer needed. Can we compete against that? I think that's going to be interesting.

Mr. Swerdlin: The next aspect of internal capabilities is your company assets. First, are you up to date with technology, such as computer systems and phone systems?

A second asset is intellectual capital, which is obviously the people. Do you have the right knowledge and experience from your people, and are they continuously learning?

Infrastructure would include office space and client relationships, which is a third asset. Other infrastructures need to be in place to make things work.

Flexibility is going to be a more and more important asset in the future, simply because you're in an environment that's changing. Your environment is changing so fast that you must be flexible to be able to move in time to keep up with the changes to keep yourself competitive.

The final asset is capital. This would include your cash flow, your lines of credit, and whether you have enough money to grow as much as you need to?

Mr. Horbatt: This is an interesting issue. Some management consultants came up with a proposition in this world of change. Some companies are event-driven. You just continue to do what you're doing until events force you to change. However, some very successful companies are time pacers. Intel is a perfect example and a very interesting organization. In 1985, it sold off its random access memory manufacturing operation and said it was going into processor chips. Intel made a decision that it was going to become predominant in its market by product innovation, and it has a schedule. It also coined the term Moore's Law, which says that processor capacity will double every 18 months. That's not a physical law. It was a business principle and Intel followed it religiously. It always has a product in the pipeline. It is always ready to get that next one out. Intel builds plants two years before it knows what is going to go into that plant. It knows it is going to have an innovation, perhaps another processor, and it is going to need that plant.

I don't think I've seen an insurance entity in the United States taking such a driven stance that it knows that it is going to come up with some new major product every *x* number of months. Companies have cycles. They must decide what products they are going to bring out this year. Many are fine-tuning or tweaking, but nobody has a distinguishing feature or niche that its following. Perhaps we have too many competitors in our industry, whether it's asset management or health care. Maybe we just can't do that, but some other companies like Intel have.

Let's discuss management preference. Does the management have a preference to build or buy? Joint ventures are very popular nowadays. Federal Express is an example. Private package delivery was a new concept and the company hired management consultants to review it and help make a decision. Federal Express could have, in essence, bet the ranch by investing its capital to buy the airplanes, the sorting facilities, and the trucks Or they could have leased all of these things. They could have leased airplanes from other airlines and flown at night or leased them from a cargo carrier. They could have used somebody else's truck system. The second solution is a saving-your-bet type strategy, but Federal Express bet the ranch. It had an infrastructure and a market lead. United Parcel Service (UPS) has been able to respond to it, but Federal Express is also encroaching on UPS's market for third-day delivery. Federal Express made a strategic decision that is being followed through, and it has been effective well over a decade.

Mr. Thomas Bierley: I have another comment on the build versus buy concept. Our company traditionally was a builder. We went into HMOs and built them from the ground up. When we went into international markets, we built our organization from the ground up. What we found was that it took a tremendous amount of capital and affected our bottom line for years before we would get the HMOs to the point of a critical mass where we could start going to providers and negotiating the right to a contract. And this affected how the rating agencies viewed us. So a lot of the build versus buy mentality is also the tolerance for a quicker bottom-line profit. Is there a shorter horizon before things can turn around? When you folks talk about strategic planning, do you have a time horizon in mind? Are you talking about strategic planning for the next five years or in a fairly short time frame?

Mr. Horbatt: It depends on what you're trying to do. Are you trying to be an organization that is, in essence, just staying in the competition? Most companies wouldn't fall into that category. If they did, they would have a shorter horizon. Somebody from General American said that the company's horizon is three to five years. If you have some concept that you are enamored with that is unique, you might have to think of a 10-year horizon. When building an international market, you might have to think of other horizons. But the point of build versus buy is a very good one. You found that, in certain areas, building doesn't give you the rate of return you desire, and maybe that's because of the marketplace. Maybe you're never going to get a strategic advantage by building something that will offset the cost of it. When you explore a strategic option it's important to ask, whether it is better to build or buy? It is different option by option and opportunity by opportunity. You have to make that decision.

Mr. Swerdlin: Our example has a 10-year horizon. The person wants to retire in 10 years, and that was the plan for that company. It depends on what the main focus is. That person said, "I want to retire in 10 years. What do I have to do to make the company more valuable or whatever during that next 10 years?"

Mr. Horbatt: Dorn made a similar decision. When you started going into the daily pension valuations, you leased somebody's computer.

Mr. Swerdlin: Right.

Mr. Horbatt: You used somebody else's software. Later on, when either technology changed, like when PCs came along, or when you grew enough of a business, you then migrated it in-house.

Mr. Swerdlin: The best example is the daily valuation for 401(k) plans. About five years ago, we decided we had to get into that business if we were going to stay in the 401(k) business. Even though we had all these reasons why it wasn't good for the participants, it was inevitable. At that time, it would have been too disruptive and expensive to do it ourselves. It would have been too disruptive to our operation because it is so different. The kind of people that are doing it are different from what we have, and it just was too big of an undertaking to deal with. We found a company that was doing it for firms like ours, so that was the answer to our problem. We signed up and then the company went out of business six months later. By the time we signed up three or four plans and the company went out of business. Then, a year ago, the costs came down, we had enough experience in the field, and the technology had gotten better, so we can do all this in-house and it is not that expensive. Sometimes you try it one way and it doesn't work and things change so you have to try it another way.

Mr. Horbatt: The next issue is risk aversion. There really are differences in firms. Some firms are more willing to bet the ranch than others. Who dominates? Is the marketing element or the cost-cutting attitude more important? The chief executive officer of Sunbeam had a cost-cutting attitude, but that wasn't working and now he's gone.

Another interesting question is, what relative value do you put on various stakeholders, be they customers, employees, or shareholders? Once a corporation uses the term stakeholders, it's obvious that it is giving its stockholders de minimus value.

Ms. Marilyn Dunstan: I think you should include your agency force on that list of stakeholders.

Mr. Horbatt: We can get very confused. We must decide whether they are customers or employees and that is a real challenge. Ten years ago if you went into some major mutual insurance companies, they'd say your customer was the agent.

Ms. Dunstan: I'd still put agents in another category. I think they have different needs, different desires, and different methods of control.

Mr. Swerdlin: The last topic under management preferences is generic strategies. Bill mentioned Kmart. Are you going to be the Kmart of the world and provide the lowest price in town or are you going to pick a niche, be the best—provide the best product and the best service—and be able to collect a higher price for your product or service? Let's move on to the case study.

Mr. Horbatt: Your mission is to understand your organization's strengths and weaknesses. Pick one of your companies And identify potential new services.

The opportunity is that Newt Gingrich is elected president and Congress privatizes Social Security exactly one nanosecond later. Under the new law, employers have the right to establish their own private plans, providing they satisfy certain minimum requirements. Other firms like Principal, CIGNA, Merrill Lynch, or Nations Bank can all set up and manage these plans just like they do in Chile, but it will be better. Every citizen has the right to opt out of Social Security into a private plan. He or she doesn't have to go into his employer's plan. He or she can go to Merrill Lynch's plan.

The AAA Task Force on Social Security has reviewed the law and concluded several things. This is important to help you feel comfortable as actuaries. Whether it's true or not, at least we know somebody has looked at this issue. AAA says the expected gains in investment performance will outweigh any expected increases in expense levels for the private plans. That includes some substantially higher expense levels for marketing and distribution, where Social Security has virtually none now or at least no explicit ones. They have a lot of inherent ones in the federal bureaucracy, but they are not explicit.

Expected claims costs for medical insurance in the private plans are expected to be lower because of the availability of managed care and the competition in managed care. Disability and life insurance claims costs are expected to be the same.

Here's the question. What changes will your company make in its strategic plan to respond to the introduction of privatized Social Security? Some things to think about when you're trying to do that is, how will the change affect existing clients? Where are you likely to lose them? Which of your clients will be affected and what kinds of services will they require? Do you have the capabilities to perform these services? Does it open a new market for your firm? Perhaps your firm has been out of a market or maybe it exited the market. Maybe it's the time to get back in. You might say, "We sell disability insurance, so, to have a comprehensive product, we don't want to label somebody else's product for the accumulation product. We want to have our own bundled product."

Finally, what is the expected competition in the new market among existing competitors and new ones? Dorn would see that. He does certain kinds of consulting. Will this mean that a whole new group of competitors are going to come in and grab your clients? Will you be able to come to market quicker with a Social Security plan tailored to the employer?

The study was going to be for consultants. We were asking, Should you become a manufacturer, a distributor, or change what you are? If you're an insurance company, you should say, "There's plenty of capacity to manufacture this product. I've got a great distribution system. I don't want to reinvent the wheel. Why doesn't SAFECO go to Principal and ask for a private label deal that would guarantee that you're going to deliver an expense level equal to your expense level plus 10 bps." If you think, say, the Principal Group is going to be one of the top competitors, that might be a very wise move to make.

From the Floor: You're saying that Social Security was privatized. By that are you saying that there's mandatory enrollment in plans sponsored by employers, or are you saying that the Social Security Administration (SSA) is investing in private markets?

Mr. Horbatt: No, the SSA stays the way it is, but everybody can, once a year or once a month, fill out a form and say I want out of SSA and I'm joining this qualified plan. Then that's filed with your employer. Your employer then files it with the SSA. When your contribution gets down to Bethesda, Maryland or wherever it ends up, it goes to that plan.

Mr. Swerdlin: It could be a group plan or an individual plan. It could be a plan through your employer or a plan from Merrill Lynch.

From the Floor: Are qualified plans either defined benefit or defined contribution?

Mr. Swerdlin: Let's say they're defined benefit.

Mr. Horbatt: No, let's not say it. They said it's privatized. Your contribution is going into this plan. You can pick a defined-benefit plan and a defined-contribution plan.

From the Floor: Okay.

Mr. Horbatt: So we're going to get unlimited market competition. If you look at the Chilean experience, virtually everyone who was over 55 didn't opt for the new privatized plans, and they were allowed to continue with their old ones. The younger people went with the privatized plans. That's where returns have been spectacular. They said it was going to be a defined-contribution plan with an insurance wrapper. But I don't see why we would have to say it has to be that model as long as you can stay in Social Security as it is.

Mr. Swerdlin: You should all first decide what kind of company you are and then decide how you're going to respond to this change.

Mr. Horbatt: Who wants to tell us what you decided?

From the Floor: I'll give it my best shot. I think we all recognize that, with the Social Security programs in place, there will be two types of markets. There will be older people who are probably better off keeping their defined benefit or whatever the Social Security program has, and a younger group of people who probably would be more interested in a defined contribution.

We said we were a life insurance company involved in all aspects of employee benefits, so we assumed that we have the expertise and infrastructure set up to support defined benefit as well as defined contribution. One of the things we were toying with was aligning our resources by customer segment, or employer groups. We could market to the employers to try to get them to sponsor our program. That would satisfy the first aspect. The employers have the right to establish their own private plan. We're assuming in this case that they are not setting up their own plan. They would basically be aligning with an insurance company, which would be our company.

Mr. Swerdlin: Right.

From the Floor: But then there would be several people that could opt out, in which case there's an open market for individuals. I would imagine that there would be some brokers or other distributors trying to market these particular plans. We didn't get to the point of how would we service those distributors. That's about it.

Mr. Swerdlin: So you definitely would develop a product to sell to employers and a product for individual citizens?

From the Floor: We assumed that we had the employer relationships already, so we would be able to service that need. As far as the individuals are concerned, if we had an individual market, we would have to set up resources to service brokers who would come in offering our products and services.

Mr. Horbatt: That's good. I think you addressed some of the critical issues and hit the high-level ones. You didn't get mired in the details. You probably discussed a few details as you went along, but that was a very important issue because that's the strategy level where you decide where you're going. One of these days it would be nice to find a group that says this kind of product targets a small segment of our market, so let's just exit.

Mr. Swerdlin: That would be a legitimate decision for some companies.