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Session 22PD
The Future of Agency Distribution

Track: Futurism

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Summary: Contrary to popular belief 98% of insurance sales are still done face-to-face. For years the demise of the agent, especially in all but the affluent market, has been predicted. The panelists discuss distribution systems that are viable in the future with emphasis on the middle markets.

Mr. Paul D. Laporte: We have two distinguished panelists, Dennis Catanzano from Lincoln Life and Jon Louis from Baltimore Life. I am going to begin with just a few opening remarks, just to give you a background of where the agency distribution system has been and where it is now. Then Dennis will provide his perspective and look at his crystal ball of what he sees happening in the agency distribution system, primarily in the upper income market. Jon Louis will give what I believe is a very exciting example of a team concept that they've begun experimenting with at Baltimore Life in the middle-income market.

Dennis Catanzano joined Lincoln Life's product management group in February as second vice president. He is responsible for life product management, product promotion, in-force management, and market intelligence. Prior to joining Lincoln, Dennis consulted with LIMRA-member companies on distribution strategy, field compensation, and profitability. Clients included Prudential, GE Financial, and Allmerica. From 1983 to 1998 Dennis served in a variety of positions with the Life Insurance Company of Virginia and it's current parent, GE Financial.

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Note: The chart referred to in the text can be found at the end of the manuscript.

Dennis received his B.S. and M.S. degree from MIT and his CLU and CHFC designation from the American College. He completed his CPA requirements in 1998.

Jon Louis, also a CLU and CHFC, is assistant vice president of leadership development for the Team Advantage division of Baltimore Life. He's been an international trainer and performance consultant for the insurance financial services industries for over 20 years. Jon has trained in almost every state in the Union as well as Hungary, Poland, Czech Republic, Taiwan, Canada, Spain, Chile, Mexico, and Sicily. Subjects trained included working as a team, sales development, management skills, motivating, overcoming objections, and youth leadership.

He has published in *Inc*., *Business Week*, *Leadership*, *Vision*, *Manager's Magazine*, *Recruiting*, and *GAMA Journal*. Jon writes an in-house bi-weekly publication called *Leading Edge* and expects his first book *Getting There is Half the Fu*n to be published later this year.

I am going to start with some industry statistics, mainly from LIMRA research. Chart 1 shows individual life sales or the number of policies from 1977-1998. You can see after growth in the late '70s, and early '80s we've had a continuous decline. The year 1999 was no exception, although it only went down 1%, but was the 16th consecutive year in the number of policies sold that decreased. This was in spite of what happened with XXX and the sales that went on with term late in the year.

Annuity sales on the other hand have grown tremendously over the last dozen or so years. In 1999 it was certainly no exception, variable annuities went up 16%, fixed annuities 28%. Long-term care has been sort of on a roller coaster, somewhat depending upon what's going on in regulation and taxation. The front-page of the June 22 issue of *The Wall Street Journal* discussed the whole issue that's been going on with premiums increasing.

It's really hard to predict what's going to happen with long-term care. Certainly there's tons of need for it and I expect in the long run it will increase. But again, a lot depends on what happens with taxation issues and really what each individual state is doing in terms of effecting premium increases.

Career agency heads, managers, and general agents have been on a steady decline the last quarter of the 20th century, going from 17,000 to less than 10,000 in 1998. The same is true with full-time career agents. We had more than 250,000 agents in 1973, and in 1998 there were fewer than 200,000.

What's also occurred looking at trends in four-year agent retention and this is looking at what percentage of agents hired make it to the end of their fourth year. Although we did see some increases throughout '80s and '90s. In 1982, we had a 15% four-year retention as an industry and that's about where it is now.

Recently, LIMRA did a study using average industry productivity and retention to determine what is the cost per surviving agent using industry averages. The average was about $140,000, and for those companies that experienced to poor retention, it's more than $200,000. That's obviously one of the problems of a career-agent distribution system.

It's no surprise that for the first time the career and distribution system represents less than half of life insurance premiums sold whereas independent represents half. Independent agent distribution is done via brokerage with personal-producing general agents (PPGAs), the Internet, and direct marketing.

LIMRA also does a study on ownership of life insurance. We have been doing this periodically for almost 40 years. This is basically asking individuals, do you have any life insurance at all? There's been a decline over the years, mainly because of those who have bought face to face whereas those who have bought a group insurance have doubled over the years.

Periodically we do another study that is about the opportunity to buy. This is asking, has the household met with an agent in the past year? There is a very significant decrease over the years, from 39% to 23%. Putting all this together it's really saying that more U.S. households have the opportunity to buy life insurance today, but the main reason is the rising opportunity from direct, group, and worksite marketing.

The opportunity to buy through traditional producers continues a three-decade decline. New forms of face-to-face distribution through bank reps, stock brokerage firms, credit unions, and financial planners who charge fees are making up this decline. While the distribution is changing, it is a slow change. Agents, both career and independents, still account for 97% of first-year premium.

Now Dennis will tell us about the upper income market and what he sees happening.

Mr. Dennis A. Catanzano: I would like to talk to you a little bit about some of what is going on in distribution. As Paul mentioned, I worked with LIMRA, consulting with a lot of companies and working on distribution strategies. A lot of the information presented is from many of the assignments that Paul's group and I worked on.

Everybody is looking at distribution and trying to reorganize it. As we worked with companies, we looked at different distribution strategies, and what we saw were certain major things that were driving the decisions that companies were making. Interestingly, we saw a lot of common strategies.

I will focus these remarks in three major areas starting with a look in the socioeconomic factors. Very briefly we'll look at what's driving some of the U.S. distribution strategies you're seeing today. Then we'll take a look at product and market concentration numbers as well as some product growth numbers, which are having a profound influence on distribution, and how I think it's developing. Then finally we'll take a look at distribution, especially some of the new entrants that are coming in that are really shaking up the marketplace.

Let's start with some of the socioeconomics. Basically a reality today and depending on how you get your numbers and exactly how you define things, you can come up with roughly different numbers, but that's not the point. The point is if you look at the middle and wealthy market you're looking at, in terms of households, ratios something like 10:1. If you're looking at, raw numbers of sales and who you're going to sell to, clearly the middle market is the place to be because there are lots and lots of households out there.

The issue that a company has to deal with is when you look at wealth distribution, half of all the wealth in the country sits in the 5-10% of households that are in the upper-income high-wealth market. We're really a very skewed society in terms of where income and wealth resides. If you're selling products like ours that makes a big difference.

Paul and I were talking earlier. I come from a company that really is very much focused on the high-end market. We sell about 12,000 policies a year, but we still have new premiums that gross, including dump-ins, in the range of $400 million. We're not selling a lot of policies, but we're selling some very big policies, some jumbo cases, and that's just a market focus versus companies that I've worked with in the past. Particularly in the term marketplace, we're looking to sell $80,000-100,000 a year just to make their economics work.

Depending on how you skew yourself, where you focus in the marketplace, you have very different economics in your business. Our markets cry for different strategies. As you approach those markets, obviously the people in them are dealing with very different realities.

Let's start with the very wealthy market. Almost every study in that marketplace indicates they are the significant buyers of the products we sell. If you look in '99, the fastest growing category in the life insurance marketplace was second-to-die, and within that I think the second fastest growing was variable second-to-die.

Now where are the second-to-die sales being made? Obviously, they're being made in the estate transfer marketplace. Were talking about $1 million of net worth to be able to start playing that game to even be concerned about it.

If you look at some of the fastest growing companies right now, we've taken some of the statistics because we're trying to track our peer group, they are the companies that for the most part have the largest average sizes selling in the wealthier marketplaces. Clearly this is the marketplace that has some growth in it; that's buying a lot of products today. You can argue that nobody buys our product as a product. They're all buying it to solve a problem.

But the reality is in the very wealthy marketplace the problems are much more specific. The product has a much more specific use. They really are focusing on solutions to a tax or an estate transfer problem, something that they need to solve whether it's through life insurance or whatever. They don't care. Just tell them the combination of agreements, trusts, and products they need in order to solve that problem.

It is an adviser-driven marketplace, and that provides some very interesting implications for distribution strategy. It is a marketplace when you look at all the surveys and questions that Market Metrics and other people send out to the clients. Basically, they're looking for unbiased advice. Very high premium is in this marketplace. What you see is a very large number of advisers getting into this marketplace, trying to establish themselves in the lead role and become the focal point for this advice- and solution-based sale.

When you look at studies done a couple of years ago by a survey research firm, high-net-worth individuals were asked: "who are your primary advisers now? Who do you listen to?" Despite what I said in my introduction, accountants were still the primary advisers that folks listen to, followed very closely by bankers and planners. Now the reality was that stockbrokers and insurance agents were way down on the list, but when is the last time that any of you talked to somebody who said they were an insurance agent?

You notice all our distributors are planners, right? They figured that out 10 years ago. The companies are just starting to build their planning systems. It's a very crowded marketplace with lots of distributors in it and lots of people who want to get a piece of this action, which has its own implications for the economics.

You heard the keynote speaker, Jim Benson, talk about the experiences at Equitable and the AXA model that is developed with the financial adviser model there. You look at independent companies that are organizing distribution, like Highland Capital, and of course the granddaddy of all of them, the M Group. What you basically see are distribution models developing even on the career side that are very much independent adviser-focused, multi-product, both direct to the producers and through broker dealers, and competing for products on the shelf. And the reality was there was a time in our distribution strategy where as a company and a manufacturer we could sit back and say, "Okay, those are our agents" although we know some of them broker—most of them are going to sell our product.

Today as companies, we're sitting back and saying, "We need to offer them a myriad of products if they want to play in these marketplaces." That means that as manufacturers we are competing for shelf space among our own agents to the extent we have any kind of semi-captive agents. I suspect today the best anybody has in the high-end marketplace, at least, is semi-captive agents and even I question that. It's a different distribution model and one that frankly the industry is not used to. It is more used to the captive career model that at the very high end of the marketplace I truly believe is a thing of the past, if it ever truly existed.

Now when we look at the more middle-income marketplace, we see a different picture because clearly all the surveys say this is the group of people that wants life insurance. It wants the product for general purpose reasons for general protection—protect my family, help the kids go to school, all those general reasons that we sold so much product on in the past. They definitely need advice and help. They understand that they don't understand; the wealthy don't always. The wealthy use a lot of advisers, but they also tend to think they understand a lot more than they do. The middle-income group is willing to listen, but it's costly to distribute to them. The economics are not very good in this group. The average size sales tend to be fairly small and infrequent.

The strategies that are needed to reach the middle-income marketplace, and I'm not going to focus too much in this particular marketplace, are very different strategies. You go either with a low-cost distribution model, like direct, that lets you go wide across the life cycle of the household to try to sell multiple things over time, or deep, like multiple-line exclusive agent strategy where you'd sell casualty, health, and life insurance or multiple products to the same household.

Again, it's trying to get over these problems of small infrequent sales and the high-distribution costs. There are very real needs to be served in the middle-income market. There are lots of households there but really tough economics. You'll hear from one company that is making it work and working very hard in this marketplace and has realized that it has to maximize every potential touch. They've got to do things differently than they have in the past and use multiple approaches to the same customers so they can maximize the revenue out of each customer.

Now I would like to move from some of the socioeconomic considerations to looking more at our products and talk a little bit about what's going on in the product world that's having a big influence on how distribution is being organized.

Let's start with a study that I did a few years ago when I first rejoined LIMRA. For probably the last decade I've gone to meetings like this and I always hear speakers talk about the 20-30 companies that are going to rise out of this industry and dominate the whole thing. Also, I keep reading about those 2,000-4,000 life insurance companies and the number never changes much. I wanted to figure out why all these people were saying this and yet there are all these companies out there.

I wanted to look at market concentration, so I took LIMRA data and looked at the new premium being written by the top 20 companies as a percentage of all the premium, at least reported to LIMRA from the hundreds of companies that report. What you find by product line is that on the lifelines you range from 80% to 90% of premium the top 20 companies are writing.

If you start thinking about market concentration, the reality of a study like this is when you look at the actual companies like Prudential and Lincoln Life that appear in multiple categories, the reality is that there really are only 30 or 40 companies when you look at fleets that are controlling the vast majority of those life insurance policies and premiums that Paul was talking about.

Maybe we have 3,000 or 4,000 legal entities out there. But the reality is that the business is being written by a relatively small number of companies and that concentration really has some strong dynamics in the marketplace in terms of the products that are available, the distribution systems leverage over manufacturers, and the whole growth of the industry because there's only certain capacity out there.

In the last few years we're all aware of a huge move to variable products. When we look at industry numbers we need to keep in mind the percentage of premium from term insurance. While that hasn't grown very much since the mid '80's, hovering in at about 20% roughly, I'd ask you to keep in mind in terms of policies sold, what's happened to the cost of term insurance since the mid '80's? It's down, it's plunged. If we did a graph on a policies basis instead of a premium basis, what would we see for term policies? Huge growth and a much bigger share of the marketplace than the premium represents. Term is where I am going to get my death protection, if that's what I'm interested in.

What we're seeing is not only is the marketplace dividing along socioeconomic lines, but also if you look at sales term insurance, it is growing very quickly in the number of policies. It is keeping a level of share of premium providing lots of death benefit. Then you have growth in the high-end income marketplace with taxed-favored products that provide liquidity at death as well as favorable inside build-up. We've got a very bifurcated market in terms of the needs.

Annuity sales are growing very quickly. Again, it is largely a variable investment-type play. I think all of that comes down on the product side to saying there are some very sophisticated types of sales going on. The sales which are tax-planning and tax-strategy driven, are very large and are driving a lot of the premium that we're seeing coming to our marketplace today. There are sales that involve very specific strategies to be tailored for a very certain segments, relatively small segments of the population at the affluent level.

Now if you take a look at distribution systems and how distribution and product match up, it's interesting. If you take a look at the different distribution systems, you can see, for example, that one of the biggest selling groups for term insurance are the multiple-line exclusive agents. A lot of that I suspect is driven by State Farm, which is probably either number one or number two in term sales in the country or at least has always been in the top three or four. But what you see are small average-sized sales, very much Middle America.

On the variable side you can see a lot of variable being written in the career systems, obviously because of licensing. Also, a very high average of premium per sale is coming through the PPGA marketplace. I suspect if you could separate the PPGA marketplace from the what I would call the kind of career agents who have become PPGAs versus the true independents, you'd see even a bigger difference in that average size sale.

I think the point here is that certain product mixes and product lines do play better in certain different distribution strategies. As you're developing product, you have to keep in mind who's doing the distribution and how this is going to play with the distribution strategy.

While I was at LIMRA, one of the things we were dealing with were different companies and all these mergers. But if you look at different company's strategies, you found a set of quadrants going on with what we called the stand-alone company. There are fewer and fewer of these. They tended to be specialty product companies focused on a single-product line or a single distribution system. There are very few of the major players in that category, although there are few notable exceptions.

Then as acquisitions kept going on, you found groups of companies who were in a fleet but didn't necessarily have coordinated strategies. AEGON is probably the best existing example today of a company with a large group of companies, common back offices, taking advantages of efficiencies but each company sort of has its own identity and does its own thing.

I used to use ING as another example of that, but it has now rebranded all its companies as ING and at least it were focusing on variable products. At Security of Denver it is focusing the annuity production of what was Equitable of Iowa, so it was focusing product in certain locations. It was focusing distribution channel management in certain locations. It was basically moving into what we saw as the multi-channel, multi-product quadrant. Other examples are GE Financial, ING, and other companies that are essentially setting up a matrix-type distribution product operation.

Finally, independent distributors, like Highland Capital, M Group, AXA, and Lincoln Financial Advisers, are becoming big independent or semi-independent distribution operations. Or they're manufacturers and really taking on a role of their own in the distribution game. That was the layout we saw developing for distribution strategy. We looked at the expense side with the question, is there a particular distribution system that has an inherent expense advantage?

Marketing expenses of weighted new premiums are in Table 1. This table is ranked from the least expensive average unit cost to the highest. You can see banks and direct response tend to have very low unit costs. There is a question on how this data is collected on the bank distribution side, whether there really is a proper allocation of costs here. Nonetheless, in terms of what they think they're spending to distribute through banks, there is a fairly low unit distribution cost.

TABLE 1
MARKETING EXPENSES PER $100
OF WEIGHTED NEW PREMIUM

Distribution	Low	Average	High
Banks	$84	$109	$136
Direct Response	64	109	163
Brokerage	72	115	144
Career GA*	101	133	155
MLEA	85	139	230
PPGA	94	153	197
Career Manager*	118	156	198

*Includes home office marketing expenses

Source: *LIMRA's Distribution System Costs Studies (1997)*

The thing I really find interesting is that in most cases if you look at the low end, you can find in almost each of the distribution methodologies a significant example of companies that are distributing at extremely competitive unit cost and any unit cost below about 100 in my mind would be pretty competitive. You can definitely see that in the PPGA world and in the brokerage world. And then you've got some pretty big examples of career companies that are getting close to that level.

The point is there isn't one quite right distribution strategy. There are just different ways that you can get to market. The question becomes organizing the dynamics of the distribution strategy to make it as efficient as possible given the market you're trying to reach and what your product will bear.

Now to a large extent as you look at the distribution evolution today, you find more and more companies that are organizing themselves, first around the consumer and second around the distributor. We've always basically as an industry stayed away from looking at the consumer, but more and more we're seeing companies today that are organizing themselves to reach both the distributor and the retailer. These companies are asking the questions: what are these people looking for? How do I lay out a value proposition of services, product, compensation, and support that are going to attract those retailers to me, and going to help maximize the value for them?

Some of that is being driven by the new entrants. Now we've got accountants, independent broker dealers, and security brokerage firms. These are some of the fastest growing distribution segments in the industry. If you look at some recent studies on security brokerage firms, their total production, while still fairly small, is growing at a very significant double-digit rate relative to other more established distribution systems.

A lot of companies are pouring money into that particular distribution outlet and it has some very unique demands. As a customer they're trying to protect a fairly wealthy clientele. They tend to be fairly upscale and they make some demands on insurance companies, both from a product and a technological standpoint, which we're just not used, to responding to. More and more they will be required to find creative ways to respond to those requirements.

Historically, if you look at the way the distribution system industry was laid out, we have some very large manufacturers. We have a group of career companies organizing across the chain. Then we have a lot of independent cottage retailers out there with smaller middlemen. Now that's the scene of today's world.

But you think back to historical precedence, if you think back to, say, the mid '70s and you think of the retail world, the mid '70s retail distributors looked very much like very large manufacturers. Procter and Gamble (P&G) was the ultimate retail distributor in the mid '70s. That was the company if somebody said, "Tell me about a retail company," people would immediately say, " P&G is the leader in the retail world." If you ask that question today, whom are people going to say is the leader in the retail world? Wal-Mart is a company that'll come to mind. Do they manufacturer anything? They're a distributor.

Basically what's happened in the retail world, and I think what's happening in our world, is that among price competition, consumer demand, squeeze on margins, and a reorganization of the distribution channel, we are seeing the distributors becoming or trying to become the Wal-Marts of the financial service industry with the manufacturers now suddenly playing a second fiddle role. P&G is still out there; it's still a big company, but its multiples don't command the multiples that a Wal-Mart does. Its growth doesn't have the growth that a Wal-Mart does. It's just a change in focus that's happened in a number of industries and we're not immune. We may actually be more susceptible, and I think that time is coming quite honestly.

Let me wrap up with the question of, where does all this lead? Number one, I think you have to clearly understand what value you're adding in the basic economics of our business, at what we do as an industry. We manage risks, we manage assets, and we package our products around solutions, a lot of them tax-driven. We administer and manage information, although many companies, including ones I've worked for, never do it well, but we do it, try to, and we provide advice and solutions.

Now the question I think companies have to really ask is, what can we afford to do as a company? Where can we add maximum value? You're going to get continual squeeze in our margins and continual pressure on prices, and if we don't find the places where we can add the most value, someone else will do it more efficiently.

The bottom line is we can't be all things to all people. We have to pick those things that we do best, whether it's packaging the risk, providing the advice, or whatever. Focus our energies there, and then frankly let somebody else do the other things and pay them what it's worth to you to have them done.

I think companies have to make a clear decision. Are they a manufacturer or retailer? If they're a manufacturer, they're going to be very focused on product, probably focused on multiple channels and on those things that are really distribution-based. If they're a retailer, they are going to be focused on the customer and solutions. What are they trying to deliver to that person? What's the advice the content of their message? How are they going to get paid for their advice?

If we look at the distribution impact as we move forward, more and more product design, at least in the high end of the marketplace, we're dealing with wealthier clients and advisers who package products and solutions. Our products have to start fitting in those packages. That's happened in the corporate-owned life insurance world. And as we move more upscale, you're going to see more of that in the retail world, too, where you have to make the products fit within the packages. This means you have to understand what the distributors are out there selling and that the distributors are going to have a very clear idea of what it is they want. They're going to have access to train their underlying distributors better than you will. You have to figure out how you're going to fit in that world.

Then finally on the compensation front, we move towards bigger retailers. As we move towards more of the Wal-Mart-type distribution outlets, whether it's security brokerage firms or banks or some of these producer groups, the reality is that we have to be very careful with our traditional compensation structures.

Now today if you want business from the M Group or some of the other big producer group, or even the Salomon Smith Barneys of the world, they're going to basically look at you and whatever your street contract is. That's where they're going to start negotiating, and if you've got a leveraged contract that leverages you up to a 130 or a 140 and you priced at a 110, they say, "What can you give me above 140?" They really don't want to listen to the fact that your compensation plan is leveraging and you don't really have any money there, because they're big, they've got lots of premium, and they deserve the best. I think it goes without saying that distribution manufacturer profit differently. Compensation designs are changing. You don't see that many compensation designs today with persistency factors. You see more money up front.

You see more money that's being driven into distribution without a lot of the hooks that used to be in the career contracts, especially in the independent side. That means we've got to even be more vigilant about the fact that distributors take their money in the short run and manufacturers get it in the long run. How do we balance those? Especially as we're more accustomed to designing products that are going to take away some of our traditional ways of getting it back from the client, if you will, for surrender charges and things like that.

We have to realize that there is taking place a fundamental shift in controlling the retailer even at the most basic level of who pays whom. To the extent you're working for institutional distributors, they're their distributors. They pay their distributors and you pay the institution. That changes the dynamics very significantly of your relationship to that distributor.

It was an interesting idea because they basically said, "You know, if you think about what the different distributors do and you think about what different elements of the distribution chain do, one question you have to ask yourself is, "do you really always need an insurance company?" And let's face it; we let out a huge amount of our risk to the re-insurers. In the more sophisticated business markets we already let the third-party brokers package the sale and a lot of the administration. They do the selling. What is our real value added? Again, I go back to that earlier question; we really need to understand what is our value added in this chain? What are we bringing to the table in the more sophisticated markets? Why are we there? And once we answer that, then we can focus our resources and I think we can succeed.

Mr. Jon B. Louis: Our division at Baltimore Life is under reorganization. I'm going to share with you some of the things that we're doing, why we're doing it, what's working, what are some of the challenges we're facing, because it is a unique way of taking a look at what's happening.

Hopefully at the conclusion of the session, you will have an understanding of the distribution system that we're still trying to understand. It has unbundled the role of an agent. We've found that agents weren't effectively doing everything that had to be done in order to make more sales, so we unbundled the role and you'll see how that happens. It has increased agent first-year commission and application count.

We're breaking the mold. We are having increased application count per sales representative. Our commissions are going up. We'll take a look at the major issue we're facing, which is decreasing the expense gap. That's one of the major reasons we got into this particular system that we're in. We have a long way to go, but we're heading in the right direction.

The agenda that I have for this particular piece is first, who are we? Second, who were we? Third, why did we change? Fourth, what has been the impact, what are the challenges, and what are the next steps?

Baltimore Life is a 119-year-old mutual life insurance company with $745 million in total assets, so that doesn't make us that small or that large. We have partnerships with independent marketing organizations. They supply products that generally aren't readily available off the shelf in funding specific needs. Worksite marketing is about two years old and has been very successful as it started out. It basically has strong sales in areas where we're looking at new product development and using technology for the enrollment system.

Home Mutual, interestingly, merged with us two years ago. Home Mutual is a traditional home service company. You may wonder why would we in this new era of all the new and exciting things going on merge with a traditional old home service company? The answer is a lot of profit in premium, a 20% increase in weighted premium last year. Consequently it's doing something right and the additional weighted premium in the coffer isn't bad.

Let's talk about Team Advantage. Before it was our sales organization Team Advantage was our career distribution system. About 20 years ago, we had been a debit-type home service organization. Then we changed to career ordinary and then into this Team Advantage concept.

Now when I say we, I have only been with Baltimore Life for about a year-and-a-half, so I'm using the editorial we as I explain it. One of the things that we decided to do was to go after the middle-income market, mainly in Pennsylvania and Maryland. We defined the middle-income market between $30,000-50,000 in family income. As I talk about the challenges we face, there's something that we've discovered fairly recently that's had an impact on this. We work in the small communities. We are not in Philadelphia. We're not in Harrisburg. We're not in Pittsburgh. We are in beautiful downtown Pottsville. We're in Somerset, Hollidaysburg, and other towns that you have probably never heard of. We are in about 20 of these communities around the states of Maryland and Pennsylvania.

One of the things that happened was as you take a look at the middle-income markets for the state, because it includes the larger cities, middle income is $30,000-50,000. Our sales reps were calling on the middle income within their communities and so the application and the income area were smaller premiums, which created some issues that we had to take a look at.

Here's the cultural strategy that we were facing. The culture before the change was typical managerial, very top down, very authoritative, almost to the stage of, "If I want your opinion, I'll give it to you." But it was a very loved and still is a very loved firm. We've got three generations still working in the firm, well respected. The strategy incremental change equals good performance. Just keep your nose clean, do a little better year after year, make an occasional company convention, and you're a good guy. By the way, good guy is the correct phrase. There were very few women in the distribution system.

We tolerated average performance. The culture was "Don't rock the boat. We're not going to make any waves, we're just going to go through and do the things in a daily life that we're suppose to." There was inconsistent treatment of managers by the regionals.

Now I'm painting kind of a tough picture. But the interesting thing is when I was a consultant with LIMRA and I went out and worked with many life insurance companies, this was pretty typical of what you saw in the distribution system of many companies. When I say this is what we saw, this is what many of you may see in your own organizations. The challenges were very high cost distribution system, low agent productivity, and recruiting disadvantage.

There was nothing that we could hold out that said, "Hey, come join us." There was nothing that particularly got their attention. Interestingly enough this new Team Advantage has been a great recruiting advantage, doing some great things there.

Other challenges were high turnover agents, 9% four-year retention. Again, the expense gap was bad and the trend was worse, so we had to do something. As we looked at the marketing strategies that we had at that time it was ongoing client contact. Now that's not a bad deal, but you take a look at how much our business came from our existing clients and many times it was because we're still in the same community that these people grew up in.

Many times when I go around to the agencies, when I first joined the company, I would ask the people that I was meeting with, "Are you from here originally?" And they said, "Oh no, I came from," they'd mention a place that was 15 miles away. They are very territorial and therefore an agent had a good block of local policyholders to draw on and a very good reputation in the target markets.

Our objective is that we wanted to build a distribution system that would reduce the expense gap. Now there's an easy way of doing that. You close down and there goes the expense gap. We said "growth," and that was a key phrase, and as we talk about it, this is known throughout the field. The sales rep, if you say, "What is our strategic objective?" They say, "Reduce expense gap through growth," so everyone knows that's what we're after. Focus on local small-to-medium communities. We decided we were going to stay in that and build on the company identity. Even though I talk about Team Advantage, we are Baltimore Life. That's the name on our policies and on our doors.

Establish the vision. We took a look and asked, "How are they going to put this together?" Then we took the best practices approach and the committee came together, both from the field and outside consultants. We took a look at the insurance industry and what were they doing in this area and how can we could use what they had.

General Agents and Managers Association had a model that they had pursued that had to do with unbundling the sales rep's job. Also, outside the industry there are a number of Fortune 500 companies that had done a lot of work with teamwork. One of the reasons that I came on board at Baltimore Life was that I had a background in team building throughout CIGNA for a number of years as an employee there and then also my background in the insurance industry. We put those together and established the new structure.

We now have teams led by an agency team leader. The manager is an agency team leader. Interestingly enough that manager may not have had any practice or experience at selling life insurance and that has been a big change. We have unbundled the sales rep's job. The strategy is to make each agency profitable. We don't add up all the numbers and take a look at the bottom-line balance sheet. We take a look at each agency. In fact, the agency team leader as manager is compensated to a certain degree based upon the ability to meet the objectives and profitability lined up for that agency for the year.

Build franchises for future growth. We want to put this together in such a way that we could package it and walk into a new community or area, and unroll it. We would have everything put together much like if you'd bought a McDonald's franchise, but the systems and process are in place.

The cultural, collaborative, and cooperative. It's been interesting because we've gone through a number of changes within the organization. Earlier this year we changed the compensation plan. Now you know what happens when you change the compensation plan. We didn't have a lot of complaints or a lot of people upset, even though there were some challenges to the people by doing it. But because we have a very definite involvement of the field in any change, in any discussion, they're in on the discussion. It's been very collaborative and very cooperative.

The agency team leader and a number of staff positions in the agency are licensed, too, entrepreneurial versus bureaucratic. Right now many of the decisions are made at the team agency level, including hiring new sales reps. If a new member of the team is to be hired, then the team makes that decision.

The Team Advantage structure is led by an agency team manager. This person originally was one of the managers who possibly came over from the prior organization. Many of them had a hard time giving up the control type of environment and changing it to an empowered type of environment. They brought in an outside consulting firm that tried to help build the organization into teams.

They did a pretty good job, but they got so team-oriented that they forgot, "Oh yes, we're supposed to produce." One of the challenges we found is that as we solved a problem, the only problem we solved was the problem we solved. There's a thought that says, "If I change my recruiting processes, I will now solve all of my recruiting, my selection, and my first-year production processes." And of course I don't, I just solve one step at a time. Every time you solve one step you've got to keep looking at the next one.

We hoped to have four to 10 sales reps per team. We started with four sales reps per team and then said, "Let's have a second team." We found that we ran into some cost challenges on that.

In addition to the group leader the teams have a market development coordinator. Usually, this is an individual who has a degree in marketing. This person is responsible for creating an image of the agency in the community. The person goes out and is involved in all sorts of community events. This person holds community events that get us recognition and involvement in the community.

Out of these marketing types of events, the individual gets leads. From these leads the market development coordinator is responsible for getting five appointments per week for each sales rep up to six sales reps. And that's pushing it when you have to get 30 appointments per week out of leads that you developed from various marketing events

Now marketing events go everywhere, such as sitting down with a sales rep and asking, "Do we have a particular market that you can identify with that we can help you build in that market?" There is one community in Western Pennsylvania that is very strong in Ukrainians, a lot of Ukraine clubs and associations. This person came from that heritage so the market development coordinator built a marketing plan based upon working in that group that this person knew and could work with.

Other things have to do with going out and doing fingerprinting. They do fingerprinting and picture taking of tots and build a card that is given to the parents to use for identification in case anything ever happens to the child. That's been getting a lot of support from the police and other organizations and so it's a very popular activity for getting leads and getting names. Then the market development coordinator calls back and says, "Your card is ready. We are ready to come out and deliver it. We'll have Mr. Smith talk to you when he comes out."

The client manager is responsible for managing everything that has to do with the policy and the client. In other words, any changes, beneficiary, bank, annual reviews, or anything that takes place. When I bought my first policy from Baltimore Life, I got a phone call from the client manager about a week after it was delivered. The client manager introduced herself and said, "I'm the client manager. If you have any questions about your policy give me a call. I'll be more than happy to take care of it. Feel free to call the sales rep if you desire, but I'm here to take care of you and to service your policy and if you have any questions give me a holler." That person also will call me back once a year to try to make an appointment for the sales rep, usually the same sales rep, but not always, to come out and see me and review the policy. That person also makes five appointments per week, per sales rep.

When the sales rep starts the week, the sales rep already has 10 appointments made for him or her. It's sure a lot nicer than when we had to go out and find all of our appointments. The other thing that happens is that as a sales rep I would have to also make five appointments per week myself. But some of them can be second calls on these appointments that were made by the market development coordinator and the client manager. If it's a two-interview sale, I've automatically got one of my appointments right there.

The sales support assistant is the traditional person who handles the people who come in the door, answers the phone, things along that line, and the mailings. There are some other things that we're moving in that area. We've got a computer process of client data collection and that person is putting the information into the computer. That's the typical organization. What we then have is marketing handled by the market development coordinator. This person develops the annual plan, the marketing plan, and holds the events. The customer service is done by the client manager and this frees the sales rep for doing selling, and it means that we can now focus on this person doing the one thing that's really important, that is, to bring revenue in the door. That's where we're coming from.

Mr. Laporte: Jon, how is each individual compensated?

Mr. Louis: The entire system is based upon a team compensation system. The sales rep does get first-year commissions. The sales rep gets a base salary as do the other positions, but the base salary will adjust on a quarterly basis based upon how the team does against certain standards on an annual or quarterly basis. They also go to conventions as a team, so the whole team's total production has to hit a certain level for them to go to conventions.

Mr. Laporte: How do the market development coordinator and client manager get compensated? Do they get a salary?

Mr. Louis: They get a base salary, but they also get a changing salary based upon the production of a team. Since they are licensed, they can get compensation based upon the production of the organization, but they don't directly get first-year commissions.

Why use teams? Could this whole concept of work in a hierarchical organization? Our thoughts are, "Yes, it would." In fact, in one of our agencies we keep saying, "He's not working like a team. He's not doing it like a team and he's in first place." Don't change Fred, just keep doing it that way and forget about the team.

For the most part we find that teams result in higher productivity. The teams are easier to lead. One of the things that happens is the people on the team support other people on the team so you had that motivation. We don't do a lot of big contests. We don't really do a lot of big motivation things. Teams are easier to expand because what happens is that when the team has six sales reps; the market development coordinator has to make 30 phone calls and to keep 30 appointments.

That market development coordinator is saying, "Hold it, what happens if we get one of their sales rep?" What we say is, "Well, we're going to hire another person to come on the team in order help make more phone calls so the workload will go down and be more distributed." They are going to go right to work to help us recruit more sales reps because it means more production for the team, which means more money for them. Everyone wins through that whole process.

Teams are most successful when they're designed to deliver quality to the customer. I've worked with most major life insurance companies in the U.S. and many of them around the world I was on the road 140 nights of the year, and I decided I wanted to spend more time at home. I had not a moment's hesitation as to what company I wanted to call and this isn't a sales pitch for my company. It's the fact that it had the customer focus that I think is so very valuable in our industry and we saw some of things that Dennis was talking about.

How are the teams working? Compensation based on team results, has enhanced our local image. By the way, one of the things we do is hand out, in each one of these communities where we work, depending upon the size of the agency, somewhere between five and 12 grants every year to non-profits. The grants are $500 grants. They're not a big deal, but they sure are in the community. The press covers it. The recipients have quite an event. It really has enhanced our local image.

We were branded by our offices. Our offices used to be a traditional brick building that everybody said, "Oh, there's another Baltimore Life building," without even seeing the name on the building. But they've aged and they were sort of like a mall front or storefront type of operation. It was nicer looking then, but we've upgraded and we're now in a much nicer office type of environment.

I mentioned team decision-making. They are definitely involved directly in almost all the decisions. Client-for-life concept is working very well because the client manager is calling the client and establishing that ongoing relationship and it helps in a proactive client contact. The strategy was to build on the strength of the company and we feel that we've succeeded in that area.

Build on the system in place. We are much smaller in number of sales reps. Our production went up but we're much smaller in number of sales reps, so we did build on the system in place. We made each agency office profitable, redefined our marketing efforts.

Marketing is defined from two areas. We are centralizing marketing from the home office in some areas, but the marketing development coordinator every month gets a budget dollar, based upon the size of the agency, to use for helping support in handling these events locally.

Build a franchise we can grow with and increase production in productivity. How did we increase production and productivity? Two things. First year commissions have increased. The latest number I saw was since we went into this we are now about double what we were doing per sales rep per week. I'm not going to throw out the specific number because we are so far down from where we need to be. But we're headed in the right direction; we're growing.

The real thing that I want to stress is not where we are, but the incremental increases in the right direction. We're training in the right direction. We were at 0.8, applications per sales rep per week before we started this. We are now at 1.6. I am very disappointed with that number. By the end of this year I am hoping we're going to be up to 2. My goal is to get us at two applications per week, per sales rep.

We had no basic marketing plan in place a year and a half ago. We're using mainly the financial needs analysis (FNA), which it gets us into a two-interview sale process. How's it working? Doubled minimum standards and we're holding people accountable to those standards.
We had a consultant in our office the other day, and the person was quizzing us as to how things were going on and he said, "Yes, this culture change took place two years ago." And I said, "The first cultural change took place two years ago." And he said, "Well, what do you mean?" And I said, "We have gone through three culture changes." The first one was obvious, when you go from a hierarchy to a team. It's a big cultural change.

Interestingly enough, that wasn't the toughest change to take place. The second change took place last September when the head of our division stood in front of the group of managers and said, "We're requiring 15 appointments per week, five from three different sources." He stood up and he said, "Fifteen is no longer empowered. You must have 15 appointments per week." It's the first time that I know of that we set in place a non-empowered standard. You can't beat it. You go below that standard, you've got serious problems. They start seeing the serious problems that were taking place. The second cultural change was the fact that we were holding people accountable. That's a huge cultural change.

The third one is taking place right now. The memos are going out within the next day or so and the analogy I use on this one is Tiger Woods. When you saw Tiger Woods last weekend, he didn't have to play that hard. He was so far ahead he had the thing won. He could have just coasted the back nine. Right? But he kept striving to raise the bar on himself. And so the new cultural change of minimum standards is no longer acceptable. Striving is the acceptable standard. Head for something above the standard. That's big cultural change.

Teams are accountable for results. Marketing expenditures are being controlled. Team-building sessions were designed originally to handle all the conflict, provide feedback, and open communication. It is not that big an issue anymore.

Great news in the recruiting area. Our recruiting is up but our retention is up. So far this year 40% of our recruiting is women. That's a step in the right direction. Last year we appointed our first woman manager. We now have five women managers. Now out of 20 agencies, that's not bad, and we've got three right now that are in the loop. We have management training; we redefined what a manager is, so this has been a major step.

We have standardized the processes. We started at the first of the year and did a complete analysis saying, "What's missing?" We did a gap analysis and we found out there were 32 gaps in the things we needed to get done in order to help them get the job done. We had already filled 28 of those gaps.

Increased retention: Since we rolled out our new recruiting process and our new agent training process, which happened at the first of this year, we have had 100% new agent retention of those agents hired under this system, except for one agency, and we've talked to that manager. That agency has lost two of the three that he recruited, but I don't think we'll have that problem again. The system is working. We're building bench strength, people are anxious to move into the plan.

The other thing is that because we've changed the definition of our manager, we're hiring people who have never sold life insurance to be managers. We just brought on board a dynamic manager to manage our agency in Erie. She's 24-years-old and has never sold life insurance and she is doing a phenomenal job.

Challenges, sticking with the process: What happened is that we took a year spinning our wheels while we tried to get a feel for what we're doing and we wasted that year and that really put some challenges to us because we've got to catch up.

Continually raise the bar: How do you keep telling the field that we are incrementally eliminating the expense gap? They make it this year and we're going to raise it this far, and it's not a little bit, 20-25% increase in minimum production standards on an annual basis and you do that over a four-year period of time. What's going to happen to morale? It's a challenge.

Combine accountability with empowerment. Getting an understanding of the fact that empowerment and accountability can take place in the same sentence and in the same team and that's a challenge. Improving open communication is always a challenge. Create new and better ways to market, particularly as we take a look at the fact that we've been hitting the bottom of the production line, the market red and the top of the market in the communities.

Those are the challenges that we have to face. Ingrain the new culture, understand team management, and there you have it. You've had kind of an overview of what we're doing.

Mr. Joel I. Wolfe: Paul, I have a question for you. You said the number of agency managers is decreasing from about 17,000 over a 25-year period to something around 10,000. Has anyone delved deeper into why that's happening? Is it the economic inefficiencies of running small agencies, companies have realized they just can't continue to run small agencies? Is it because people just aren't interested in getting into agency management as a career or a combination of both or what?

Mr. Laporte: Yes, I think it's some of those. I think it's consolidating agencies, certainly. Most companies have done that. I can think of one of two who have done the opposite but most have consolidated. I think it's also in terms of companies getting out of the career business. It's more, as we've seen, independent agents. Dennis mentioned a lot of business coming from the broker dealers, and business is not coming as much through career organizations anymore.

I also think that it comes from the lack of bench strength. Jon mentioned that bench strength is a huge problem in our industry. Second-line management, in a lot of cases, is that to become a manager you have to take a cut in income initially and good agents aren't willing to do that.

Mr. Thomas E. Rhodes: My question is on new agents who are being recruited. Are they coming more from people with prior sales experience in life or from people without prior sales experience in life, recruiting, and growing new agents? Have you seen any trend over the past few years on whose being recruited as a new agent for companies?

Mr. Laporte: Are you asking industry overall or in Jon's company?

Mr. Rhodes: Both.

Mr. Laporte: I'll respond to the industry overall. I think over the years we've certainly seen an increase in hiring experienced agents. There are few and fewer companies that are hiring green peas, no question about it, and even in some of those companies that traditionally have had close to 100% of hiring inexperienced agents, are now hiring experienced agents.

Mr. Louis: I'm embarrassed to say that unfortunately we are hiring too many experienced agents. It is an area that we are working on and we are raising the bar on the requirements. If you're going to hire an experienced agent, these are the requirements. One of the things has happened, and this is a cop-out but the excuse we're getting is in Pennsylvania the licensing exams are very difficult. If you get a 69, you fail. If you get a 70, you pass. That's no problem, but if a lot of people are getting 69 rather than 70, and that's the fail number that almost everybody's getting, it indicates the tests may be altered to a certain degree to make sure that people fail to maintain a certain level of number of sales reps in the community, and as you know, that's been done in some states.

I don't know if it's being done in Pennsylvania. But we do need to bring green peas and we're bringing in a lot of young people now. This team concept has been able to recruit young people from colleges who've used teams in college and they like the idea.

Mr. Stephen L. Kossman: It seems Baltimore Life has been concentrating on increasing sales. How does it impact the first-year persistency?

Mr. Louis: Another thing we're doing is installing new systems but unfortunately I don't have up-to-date information. There's no indication that it's gotten worse, with no indication that it's improved significantly.

From the Floor: Jon, did you imply that your recruiting has been better lately?

Mr. Louis: Very much.

From the Floor: In this tight labor market? What do you attribute it to?

Mr. Louis: There are a couple of things. One of them is a fact that we put in place a system. The system basically says we know that it takes 40 contacts in order to hire one sales rep. That's a number that's been proven out over the years. Therefore, if I talk to two people a day, I will end up hiring one sales rep a month. I don't want to hire one sales rep a month, but it's nice to have that type of a selection.

What we're doing is we say talk to two people a day and ask them the old Tom Wolfe question, "Are you in the job you're going to keep for the rest of your career?" Now interestingly enough, as you know, we have very low unemployment in our area, but we do have a lot of people who are not happy with their current position, and so we've been successful in increasing our recruiting and our selection process. We really focus heavily on selection processes too.

From the Floor: And the leads that you're providing help retain agents because they're happier or they're seeing people more, more prospects?

Mr. Louis: Two things have happened. One of them is, I'd like to think it's because they're happier. I think one of the things that's happened is that the first thing that we're teaching a new sales rep is a work ethic culture because I don't think knowledge is why so many people fail. Knowledge is knowing, wisdom is doing, and what happens is we've trained a lot of people, but we haven't had behavior change. The real focus we've been working on is, how do we make sure that they implement sufficient number of times what they've learned in order to be successful? The training program is very structured for the first two weeks and then we stay in touch with them to make sure that they meet those standards.

From the Floor: You are succeeding now that you have a structure on how to see a lot of people, then you're training them and providing a way that they know how to work.

Mr. Louis: Not a bad idea.

Mr. Laporte: Jon, you mentioned that you've redefined the manager's role. Could you elaborate on that?

Mr. Louis: We took a look at the managers that were out there and some of them were doing a great job and some of them weren't doing a great job, and we tried to say, "What is the commonality, what's going on? Why is this person good and this person not so good?" Particularly when we realized there didn't seem to be that this person has a strong personality or this person's laid back or expressive. We tried to find out what was it that was a secret of success. The successful manager was the one who followed the processes and systems. Up until then we've said successful management is recruiting, selection, training, and supervision. We've said, "No, that's not it. The successful manager is one who follows processes and systems."

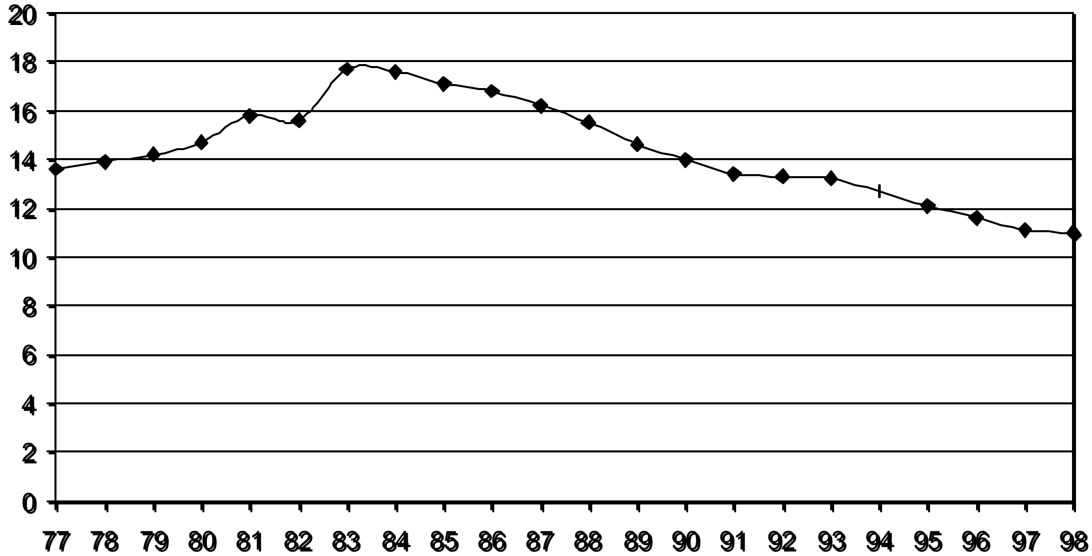
Now that put the monkey on our back because we had to have process and systems there and I took a look around and we didn't have them. And interestingly enough when I was a LIMRA consultant and I would go into training organizations, I would ask the head of the training department, "How would you know what your job is?" And the majority of them could not answer the question. The job of the training department is to put in place the behavior changes necessary to achieve corporate objectives. I don't think the majority of training departments know that.

Mr. Albert E. Easton: I have a question for Dennis. You discussed the distribution of life insurance sales by four different kinds of agents. I would have been interested as to how annuity sales would have played into that categorization and I'd be interested if you or any of the panelists have any viewpoint on that.

Mr. Catanzano: It's an interesting question. My impression from when I was working the variable annuity world is that security brokerage firms were pretty much the most significant distributor of variable annuities, although on the fixed annuity side. I think there were independent marketing organizations and career agents, so it depended on which of the two products you were looking at. Not surprisingly, the fixed annuity sales, especially through the banks, tended to be smaller than they were. They were the independent marketing organizations of the career agents. That's kind of my memory but that goes back a little bit.

Mr. Laporte: Yes, I was just going to add that. Banks have a very significant market share in annuities but Dennis is right as far as variable annuities. Obviously, the stockbrokers sell much more than what you saw in life insurance.

CHART 1
INDIVIDUAL LIFE SALES
1977-1998
POLICIES SOLD IN THOUSANDS



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