RECORD, Volume 29, No. 1*

Washington, D.C., Spring Meeting
May 29–30, 2003

Session 8PD
Variable Life—Product and Distribution Issues

Track: Product Development

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Summary: Sales of variable life reached a peak in 2000 but have suffered since then. Consumer confidence in these products languished due to market downturns and persisting volatility in the equity markets. Panelists discuss the variable life market, focusing on product and distribution issues. Attendees have a better understanding of market landscape for variable life and market outlook and potential for future growth.

MS. NANCY M. KENNEALLY: We're really lucky to have two very knowledgeable panelists with us today. Tom Kalmbach is assistant vice president of individual life product financial analysis with The Hartford Life Insurance Companies. Tom is currently responsible for pricing individual life business, performing experience studies, managing reinsurance relationships and performing miscellaneous financial analysis. Tom currently serves as the illustration actuary for the individual life line of business for Hartford Life. Tom is an FSA and a member of the American Academy of Actuaries (MAAA).

Dr. Mathew Greenwald established his research and consulting company, Mathew Greenwald & Associates, Inc., in June 1985 and since then has done strategic planning and marketing research for more than 100 of the most prominent financial services companies and numerous other organizations. Dr. Greenwald has a Ph.D. in sociology from Rutgers University. He served as a Congress-appointed delegate to the 1998 and 2002 White House Congressional National Summits on National Retirement Savings and has

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

testified before U.S. Senate committees and the SEC; has published numerous articles in academic journals and trade periodicals and is frequently quoted by national print, radio and television outlets. He has also spoken at numerous press conferences and life insurance and professional meetings.

I am Nancy Kenneally. I'm a senior consultant with Tillinghast-Towers Perrin, and I work out of the firm's New York office. I assist companies in the individual life and annuity business, working mainly in product development and product-related issues with a particular focus on the variable market, both variable life and variable annuities.

Tom will talk this morning about the forces affecting variable life product manufacturers and distributors, what impact these have had and what the likely response to these forces will be. Then Matt will discuss the findings from a recent survey that he and his firm conducted on behalf of the National Association for Variable Annuities (NAVA). They surveyed wire houses and regional firms, focusing on distribution issues related to variable life. But before we get to Tom and Matt, I will talk first about the market landscape for variable life, looking at the evolution of the marketplace with respect to market structure and distribution. Then I'll also share some perspectives for the potential for future growth in the variable life market.

The variable life market experienced remarkable growth throughout the 1990s. Chart 1 shows sales results and market share results for 1990 through 2000. The sales results from Tillinghast's VALUE Survey show that in 1990 sales in the variable life market totaled just over $1 billion but climbed rather quickly to reach their peak of $6.95 billion in 2000, equating to a 21% compound annual growth rate.
Against the backdrop of a relatively stagnant life insurance market, market share for variable life, measured as a percentage of total life insurance sales, increased fivefold over the same period, from seven percent in 1990 to 37% in 2000. This growth was really fueled by a number of factors, but most notably it was fueled by the buoyant equity markets and the low-interest-rate environment that the U.S. financial markets experienced through much of the decade, throughout the 1990s and into 2000.

During this period, both the number of companies selling variable life, as well as the number of products offered, also grew dramatically. In 1990, 36 companies were offering 38 products, roughly one product per company. By 2001, the market had expanded to 54 companies selling 174 products. That's more than three products, on average, per company. So during that time product manufacturers expanded from a single variable life offering to a full portfolio of variable life products. They introduced survivorship versions of the product and single premium variable life. Some companies introduced applications for the corporate-owned-life-insurance (COLI) market. And more recently, companies have expanded their offerings from just accumulation orientations to looking at death-benefit-protection orientations.

As more companies entered the marketplace, market share for the top players became less concentrated. Chart 2 shows market share for the top 10 and top 20 variable life players from 1990 through 2001. Here we've measured market share by new sales. Looking at the market share among the top 20 companies, you'll see that it really hasn't changed that dramatically over time, from a 95% share in 1990 to roughly an 85% share in 2001, so about a 10-point drop. But looking at the top 10 companies, there was a much more dramatic drop. As competition intensified, the market share for the top 10 variable life players shrank from 90% in 1990 to just 60% in 2001.

Changes have also occurred on the distribution side. Variable life insurance, as you know, is sold through an array of retail-distribution channels, from career-agency field forces to independent broker-dealers; stockbrokers, including both wire houses and regional firms; and even banks. And particularly on the independent side, they're supported by a variety of intermediary channels. Chart 3 shows the distribution of variable life sales as sold through retail channels, as opposed to intermediary channels. As you can see, although career agents were still a dominant force in 2001, they have lost share to nontraditional independent distributors over time. In 1995, variable life sales sold through career agents accounted for more than 70% of variable life sales, whereas in 2001 career-agent-sold business accounted for just over 50%. In 2002 we saw a further shift in sales away from career-agency-oriented companies and to independent distributors (Chart 4). Sales through career agents in 2002 accounted for just about 45% of new variable life sales, while sales through independent channels rose to just about 42%, nearly equal.

I would say the growth in the variable life market really came in two distinct waves and alongside which variable life manufacturers have also evolved over time. The first wave of growth was dominated by career-agency-oriented companies, such as Equitable and Prudential, which were driven by capital constraints and the desire to capture a greater share of their agents' business. They focused their efforts on selling variable life and turned them away from selling traditional life products, such as participating whole life and UL (UL). This era of growth lasted roughly from 1990 through about 1995 and resulted, as we saw in Chart 3, in career-agency companies capturing more than 72% of variable life new premium in 1995.

The second wave of growth, which probably began in about the mid-1990s, really saw a broadening of the variable life market into independent distribution channels. With that we saw the emergence of manufacturers and product wholesalers, such as Nationwide, Pacific Life and The Hartford, which really were dominated by independent distribution. These companies emerged as major players in the variable life market, driven in part by their independent distributors' shift and favor toward equity-based products during that time.

During the same time period that this was going on, certain career agency companies, such as Northwestern Mutual and New York Life—which really didn't embrace variable life in the first wave—became more aggressive sellers of variable life. They too increased their sales of variable products relative to their other life insurance sales, although they continued to sell significant amounts of UL and other fixed products. However, the increases in the independent-distributor share more than offset the emergence of these late-entrant career-agency companies and, as we saw in Chart 3, by 2001 the career-agency-channel share of new sales had fallen to about 53%.

More recently, variable life sales have experienced some significant setbacks. Sales in 2001 fell 15% from their peak in 2000, to $5.9 billion. In 2002 sales continued to drop in step with equity market declines, finishing the year down another 32% at $4 billion. And, unfortunately, 2003 shows little signs of improvement. Variable life experienced a downturn in sales during the first quarter of 2003 as compared with fourth quarter 2002. However, this is to be expected and is consistent with the seasonality trend that life insurance sales typically exhibit. However, sales for the first quarter of 2003 were also significantly lower than sales for first quarter 2002. So, results from our VALUE Survey show that sales for the first quarter of 2003 were $675 million. This is a 23% decrease from fourth-quarter 2002 sales and a 41% decrease from first-quarter 2002 sales.

So I would have to say that today variable life is at somewhat of a crossroads. Equity market volatility and the sustained market downturn continue to exert downward pressure on sales and to erode in-force account balances. Consumers have awakened to the risks that are inherent in variable products and might be hesitant to embrace equity-based products, at least in the near term, notwithstanding a buy-low investment strategy. And despite low interest rates, many career agents have turned their attention toward selling fixed products, such as UL, particularly with secondary guarantees, and participating whole life. Additionally, the number of career agents is declining while the distribution costs associated with tied channels continue to increase.

Although investment-oriented independent distribution channels have grown rapidly, the insurance industry's ability to tap these channels remains pretty low, and the required investment to tap these channels is likely pretty high. And finally, although the initial regulatory ambiguity around estate tax laws appears to have abated, many agree that the issue will resurface, and future uncertainty here, as well as the continued scrutiny of the COLI market, could impact some variable life niche markets.

Let's look at the potential for future growth in the variable life market.. To forecast future growth, Tillinghast developed a model to project future sales by retail distribution channel. I won't go into a lot of detail about the assumptions underlying the model, except to make one key point: the model is supply-side-driven. So, it assumes that constraints to future growth will not be driven by a lack of consumer demand for variable life, but rather by product manufacturers' ability or inability to maintain and expand distribution relationships in the various retail channels.

Using the supply-side approach, we've developed a five-year growth profile for the variable life market under three scenarios—a baseline, a high, and a low, each reflecting a different perspective on equity market growth rates. Chart 5 shows actual sales for 2001 and 2002 and projected sales for 2003 through 2007 under our three scenarios—baseline, low, and high. You'll see that under the low scenario, we're projecting 2003 sales to be just about level over last year and slightly increased in the baseline and high scenarios. The high scenario essentially represents a 20% compound annual growth rate from 2003 to 2007. The baseline scenario represents a 12% compound annual growth rate. And the low scenario represents a seven-percent growth rate over this five-year period.

We developed these sales projections in late 2002. Certainly one of the most critical factors that will factor into realizing any of these growth scenarios will be the pace at which, and the extent to which, the equity markets recover. Our projections assumed that there would be a sluggish first half to 2003 with a gradual recovery, varying by scenario, and continuing through the balance of the year and beyond. In light of recent events in the Middle East and other places around the world, further near-term instability in the equity markets might be expected, making even the low-sales scenario difficult to achieve, and I think just looking at the results for first quarter of 2003 sort of bears that out. Certainly significant adverse press concerning variable life or the broader insurance market with respect to market-conduct issues or distribution issues and any unfavorable regulatory or tax events, would also dampen these growth scenarios. The key point here is that realizing any of these growth scenarios will not be easy and will hinge on a few important factors.

Moving forward there are several key factors that will shape the future of the variable life market. In the near term, career and other insurance-oriented independent agents and their customers need to be convinced once again that variable life products represent a superior long-term accumulation and protection and investment vehicle. This could be helped by less attractive fixed-product alternatives. Certainly UL portfolio-based credited rates would be expected to fall as companies have to reinvest in today's continued low-interest-rate environment. With some of the changes around secondary guarantees and the reserving requirements for these benefits, because of the recent adoption of AXXX, the UL market with secondary guarantees is in somewhat of a state of flux. Some products are still in the market that are extremely competitive and were introduced and priced prior to adoption of AXXX. Companies have taken a sort of wait-and-see attitude to see what other companies are going to do before pulling the products.

Newer products that have been introduced have been priced under the new AXXX environment, and I think that as we move forward companies will have to make decisions about pulling those older products and repricing. I think there is general agreement that we'll see an increase in premiums for secondary guarantees, perhaps making them less competitive alternatives.

To achieve the baseline or high scenarios or to sustain growth in the longer term, insurers will need to increase their penetration of investment-oriented distribution channels significantly. We can look at the variable annuity industry as a sort of parallel. The growth in the variable annuity industry was driven to a significant degree by achieving deep penetration of investment-oriented distribution channels, such as wire houses and regional firms, banks and independent broker-dealers. Together, these distribution channels account for about 67% of variable annuity sales. While variable life sales have also increased through independent channels, a closer analysis of the source of these sales increases indicates that it's been driven more by insurance-oriented sales channels, such as insurance broker-dealers and producer groups, rather than the investment-oriented channels that helped fuel the growth of the variable annuity industry.

We'd estimate that approximately 13% of variable life sales came from investment-oriented channels, compared with the 67% for variable annuity sales. While investment-oriented channels have grown rapidly in the past several years, they continue to remain underpenetrated. Today, I would say only an estimated five percent of wire house and regional firms even sell life insurance.

With a client base that's ideally suited for life insurance products—from retirement accumulation to estate planning—these channels and their customers would appear to be fertile ground for life insurance product manufacturers. Yet I think the challenge to penetrate these channels is fairly substantial. Unlike a variable annuity sale that's transaction-oriented and involves no underwriting, the life insurance sale is much more complex, typically, and involves a very intrusive and time-consuming underwriting and new-business process that's really foreign to an investment-oriented broker-dealer channel or a wire house or regional representative.

So I think for significant sustained growth to occur going forward, there likely needs to be some basic redesign in two areas. The first would be solving the intermediary channel puzzle. Insurers need to figure out how best to assist these independent distributors in making life insurance sales, either through using product wholesalers or other means. Second would be a basic redesign and simplification of the new-business process and potentially the variable life insurance product as a whole to make the process much more transaction-oriented, akin to a variable annuity, and to take the whole process of underwriting out of the hands of the investment-oriented representative and to shorten the timeframe.

Just to sum up, it looks fairly gloom and doom for variable life currently, but I think that if we were to see a shift in the equity markets, we would see an up-tick in variable life sales. I think there's also potential for meaningful long-term growth, and I think that product manufacturers who are willing to make the necessary investments to tap these underpenetrated channels will be well positioned to reap the benefits going forward.

With that, I'm going to wrap up and pass it over to Tom.

MR. KALMBACH: Thanks, Nancy. I will take a little different approach to the variable life marketplace. I want to try to step back a little bit and look at the factors that affect the life insurance business in general, those who are writing UL business, as well as those who are writing variable life business, and to look at some of the effects that are impacting companies' choices to sell either UL or variable universal life (VUL) and what that means for the variable life business. I'll do that by looking at some of the forces that are affecting variable life manufacturers, their buyers and their sellers today, which include some of the political factors, the regulatory factors and the economic factors associated with writing this business by discussing their impact and then looking at likely responses of buyers, sellers and manufacturers.

First of all, I think Nancy highlighted some of these. We have to recognize that corporate earnings are down. Unemployment is up. Interest rates continue to be down—in fact, they're at historic lows. The equity markets continue to be volatile. And credit defaults and downgrades are at an all-time historic high. And if that weren't enough, we have a new virus called SARS that's wreaking havoc on the economies of many countries today. If that came to the United States, I think it would wreak economic havoc here too and create some havoc for the life insurance business as well. So, the economy is not helping our business.

Here's an example of some of the historical fallen angels (Chart 6). The dotted lines indicate the number of fallen angels from 1989 through 2002, and the bars represent the amount of principal outstanding among those fallen angels, and that equals capital losses. So, again, it's not too favorable for the life insurance business.

The political environment is not very bright either. Terrorism is a problem. Afghanistan is really still unsettled. Iraq is particularly unsettled and how that conflict will be resolved is still unknown. Issues with North Korea continue. And in recent news, Iran and its connections with Al-Quaeda have come up. Although our relationships with our North Atlantic Treaty Organization (NATO) friends have improved, I think there's still a long way to get that in order. I think that's affecting not only the equity markets, but it's also affecting the buyers and their willingness to spend their dollars on life insurance.

Tax-related issues as well continue to have an uncertain future. Although estate taxes may be on the back burner, the future is uncertain. There's also future uncertainty with regards to income taxes. The recently passed tax bill did reduce income tax rates, capital gains rates and dividend tax rates, but it leaves us in a deficit position. As we look forward, are those reductions long-term or are they short-term? Sunset provisions within those regulations also create some uncertainty about just how long-lived those reductions will be.

On the regulatory front, we have 2001 CSO coming into play. That will help UL writers and variable life writers. It reduces the cost of reserves when we provide guarantees to clients. However, the impact on term and UL is probably moderate, probably low. On the variable life side, a number of variable life products out there today do have no-lapse guarantees. The 2001 table will help that. The impact of the new mortality table on life-insurance-retirement-planning (LIRP) sales, cash accumulation sales, is that it will lower the amount of money that you can get into contracts, but I think that still makes it a relatively attractive sale long-term.

On the regulatory front—this is specific to variable life business—Guideline 37 has come into play, and that will increase the capital intensity of writing variable life no-lapse guarantees. Although the 2001 CSO table will help some, it won't reduce that capital strain. I think companies now are just realizing some additional reserve strain that they hadn't necessarily anticipated on their variable life blocks, given the guarantees that they had in their contracts previously.

What is the impact on carriers? I think there's a game going on in which, both on the UL side and the variable life side, profits are being squeezed. On the UL side, it's coming from historically low interest rates; the spreads companies can achieve are being compressed. I think companies right now are borrowing from the investments on their in-force blocks of business to gain market share by showing favorable rates for new money credited rates to entice buyers to go to the UL sale. If interest rates continue to stay low, that will continue to put strain on a company's ability to maintain its spread. It will be bumping up more and more to guarantees on its in-force blocks, where guarantees have been in the past in the five to 5.5% range. I know we have some products with guarantees that high.

Bond defaults and downgrades equal capital losses, and that has continued to hurt earnings for fixed products. The capital issues associated with no-lapse guarantees, which is really the product of choice today in that marketplace, continue to squeeze profits. On the variable life side, it's not much better. The equity markets being down has reduced the asset base on which fees are obtained, and it's really putting the squeeze on the profitability of variable life business and variable annuity business. Fortunately on the variable life side there is some offset from mortality charges, but it's nowhere near the gain that you get when you have significant assets under management. And on the variable annuity side, guaranteed minimum death benefits (GMDBs) continue to impact carriers.

The Life Insurance Marketing and Research Association (LIMRA) does a study every quarter that asks CEOs what's keeping them up at night. It's their CEO Confidence Index. And some of the things that I just mentioned do keep CEOs up at night. At the end of 2002 they asked CEOs these three specific questions: Do you think sales will be up? Do you think profits will be up? Do you think stock prices will be up?

They asked those questions every quarter. In the fourth-quarter responses, confidence in stock prices was quite low, and confidence that profits would be up was also quite low. So, there was a general decline in the optimism from life insurance CEOs. They did think sales would be up, though, and 2002, I think, did show an increase in sales, particularly on the UL side. For the first quarter of 2003, results came up, and the future does look brighter compared with the results from last year. CEOs do believe profits will be up, and stock prices will be up. Maybe that's because it just doesn't seem possible that it could get worse than it has been. But what was odd is that they also thought that sales would be down.

So there's this game of chicken being played with UL. As Nancy mentioned, there are many products out there today that didn't anticipate AXXX and the increase in the reserves that were required for secondary guarantees, particularly prefunded secondary guarantees. Companies are kind of on the fence on whether to introduce the repricing of their new products, which would be expected to increase the price, but I haven't seen that often. Also, the current products, the credited rates, are still high, relative to what market-earned rates are today.

Let me show you a little bit more about that. In Chart 7, the bars are the 10-year Treasury yields at the end of 1999, 2000, 2001 and 2002. Just to give you a reference point, as of Monday, the 10-year Treasury rate is down to about 3.35%. Figure 7 also shows the average UL credited rate among a set of competitors that LIMRA tracks. You can also see the median rate among those companies that LIMRA tracks. As you can see, the average UL credited rates have trended down much more slowly than the 10-year Treasury yield. I would say that today, as new money is coming into UL products, that money is being invested at a rate that's likely lower than what they're actually crediting if you're crediting a portfolio rate to that business. Again, it's part of the profit squeeze on fixed products.

So I think there are some inefficiencies being exposed, and companies are faced with some really difficult choices on the product offerings they have.

How many companies were there in 2000? Fifty-four? Well, over the past couple of years the number of companies that are manufacturing variable life business has gone down. I think they're faced with some critical questions that become more prominent today, given where equity markets are and where variable life sales are: Can I develop the critical mass? Can I get the funds under management to be able to cover the cost of writing variable life business and to invest in the technology that I need to support an equity-based product, as well as to provide all the services that an equity producer is looking for? And do I have the reputation to penetrate the distribution channels where the growth in this market is likely to be? On the UL front, a different set of choices is being faced by companies—are you willing to accept more risk? I think companies need to be willing to accept some secondary guarantee risk that's out there today. That seems to be the predominant product that's selling today. Also, you have to ask yourselves, "How long am I willing to subsidize my new-money credited rates, given where current interest rate environments are? Given that secondary guarantee business is very capital-intensive, do I have the capital that I need to continue to sustain growth in the UL marketplace?" So we're in a very difficult business today.

As far as the impact on variable life buyers, I think long-term there is the general belief that the market will go up. It will come back. But today, I think the short-term view is that I don't want to be in the market. Whether that's rational or irrational, I don't know, but I think it will take some time for investors to forget about three years of poor equity markets. Today they're looking for guarantees. They're looking for safety nets. They're looking for guardrails to keep them on the road and to make them feel more comfortable about the product that they're buying today. I think that's one reason UL products with secondary guarantees have become so prevalent.

Let's step back to 1999 and look at investors who were buying life insurance. I think there was probably a warped view of the risk-reward profile of a typical investor. In buying variable life, the reward was viewed as very high, and the risk was thought to be very low. Given the last three years, I think they may also continue to have a distorted view, that the reward of purchasing variable life today is relatively low, and the risk is very high. To be successful going forward, I think we need to have a more rational and balanced view of the risk-reward profile of variable life. But it may be that not everybody is a variable life investor. If you look back at 1999, given that there was this irrational view of the risk-reward profile, how hard do you think it was to sell variable life? What skill set did you need to be successful selling variable life? I don't think it was as high as what you need today, given the investors' perception of the risk-reward profile. You need to be a lot better at explaining the variable life business. It will take more time, and it's not nearly as easy as it was before. It's easy to sell guarantees, guardrails and safety nets.

So when you look at the seller's perspective, 1999 was easy; 2003 is hard. And, their income is down if they were predominantly selling equity products. Some have left the business over the past two years or so, and a number of them are just very unwilling to call their clients and talk about equity products. They're calling about products that have some types of guarantees within them.
This is a little bit of a different look from what Nancy showed you (Chart 8). This is UL growth versus variable life premium growth, and the middle bar's flat growth, the zero line. If you're below the line, you've had negative growth. If you're above the line, you've had positive growth. So from 1997 to 2000, variable life saw tremendous growth all the way through 2000 and then a tremendous decline over the last three years. Then on the UL side, the story is really just the opposite. UL sales were relatively flat through 2000, and there was a dramatic shift in 2001, 2002 and even in 2003 toward UL products.

Chart 9 compares UL market share, the amount of dollars of life insurance premiums going toward variable UL business, with that going to other life insurance choices—compared to the Standard & Poors' (S&P) 500 index. You can see that as the S&P 500 index has risen, so has the share of premium going toward variable life business, and it's pretty oddly correlated. I think today's probably the best time to buy variable life, but we need to convince the buyers of that.

So, what's been happening with variable life product activity recently? Probably not very much, because most companies that had been focusing on variable life realized that they maybe needed to focus on their UL business a bit more. So, there's a lot of activity on the UL product front. On the variable life product front, there has been some, but it's been the type of activity to put those safety nets in the products—dollar cost averaging bonus accounts—to entice clients to buy variable life business in the first year, to kind of get over a hurdle, to credit a higher rate than what would typically be seen in a fixed-account investment.

Some added the ability to direct monthly deductions so that if you did have a portfolio that was down, you didn't have to sell shares at a loss—you could direct where you wanted to fund the expenses. There have been some fund additions, and I think we'll see some more creative fund additions in the future, as well as adding no-lapse guarantees to variable life products. Some products today have lifetime guarantees, but they are very expensive relative to UL guarantees. More typically you'll see 10-year guarantees or 20-year guarantees within a variable life plan, and the cost of those guarantees can be higher than what's available in a UL plan today.

If we look at some of the likely responses, if nothing's done—if the markets continue as they are and if distribution doesn't educate them about the variable life marketplace and the risk-reward tradeoffs—then I think buyers will continue to choose UL products with secondary guarantees because they will continue to ask for those safety nets and guardrails. For companies, what's the response that they need to give to the buyers? I think they need to provide education and help them overcome the emotions, which requires that a rep actually spend time with that client and talk about the value of variable life. With regard to the seller, we need to provide them the support so they can provide that education to their clients. I think they also need the education themselves. You have to realize that UL with secondary guarantees is easier to sell today than a variable life product, so we need to give them some reasons to sell variable life and, as Nancy said, make the process a bit simpler. And for products, I think we'll see more safety nets and no-lapse guarantees. We may see some unique fund offerings on the secondary guarantee side. I think some of the UL guarantees are very competitive. I think companies are trying very hard to find ways to provide similar guarantees in variable life products and will continue to do so.

DR. MATHEW GREENWALD: I would like to tell you about a survey that we conducted for NAVA among stockbrokers who have sold variable annuities. We went to stockbrokers who had sold at least one variable annuity in the past 12 months because we felt if anyone can sell variable life, these are the ones most likely to do so because at least they got over the hurdle of selling an "insurance" product with some insurance features. This survey was done in September and October 2002, so it was in that investment climate. We surveyed 263 annuity producers. We divided the world up into wire houses—e.g., Merrill Lynch, Salomon Smith Barney—super-regionals—e.g., A.G. Edwards, Edward D. Jones, Legg Mason, organizations with a national presence—and then regionals, which are more localized organizations. We also surveyed brokers who had at least two years experience as a financial professional and had incomes of at least $50,000 a year—people who were sort of in the business and had some expectation of staying in the business.

The first question we asked them was, what are the financial needs of your clients? Most of them said that their clients had a financial need for retirement planning (Chart 10). Only 37% of them had clients who needed estate planning. Only 46% of them were willing to say that tax-favored accumulation was a need of "most" of their clients.

We then asked, where do they recommend life insurance? We see that it's an estate planning thing, but only one-third of them have that as a need for most of their clients (Chart 11). When it comes down to retirement planning needs, only nine percent of them said they would often recommend life insurance. With tax-favored accumulation, only eight percent of them said that's something for which they would recommend life insurance. So in some ways, there's a misfit between their clients' needs and the cases in which they recommend life insurance.

We asked them what type of products they sell, and, as expected, the main one was a term sale, getting down to things being easier (Chart 12). Seventy-four percent sell life insurance. Some of them don't—they sell variable annuities. Of those who sell life insurance, term is the most frequent sale. In that investment climate of 2002, variable went second, and conventional whole life was a distant fourth. Half of them, just about, sold UL.

One of the interesting things about selling life insurance is that these stockbrokers need a fair amount of support. We asked them how often they meet with a client just by himself or herself when selling life insurance, and more than one-third of the wire house brokers said that they don't work with someone else when selling life insurance. They said 63% of the time they meet with their clients by themselves, but the other times, most of the time, they meet with somebody else.

Of course the further you get away from a close relationship with your broker-dealer, the more likely you are to meet by yourself when selling life insurance. The average percentage of the time the following attends life insurance sales presentations is: 29% for life insurance specialists with the broker's company or broker-dealer, 19% with a wholesaler and five percent with independent agents. One of the models is that a broker would work with someone independent—a life insurance salesman, basically—and that doesn't happen. Most of the time when they meet with someone else, it's with a broker-dealer. And, of course, that depends on how comfortable they are selling life insurance. The people who have sold at least five life insurance policies in the past 12 months are much less likely to have someone else attend the sales meeting than is someone who's made just one to four sales. I think we see this throughout the survey. Familiarity leads to more independence and less need for support, which is not unexpected.

And where does the marketing assistance come from, other than just illustration and sales desk help? Forty-three percent of the time, the broker gets information from the company or the broker-dealer; 36% of the time from home office staff, including life specialists and advanced underwriters; and 33% of the time from wholesalers or other field staff. To some extent, this indicates that the wholesalers are an important part of the selling process for these stockbrokers.

We asked to what extent do you agree with each statement, and what follows are the percentages that strongly agree. Thirty-nine percent said that life insurance is an important part of most clients' financial planning. Contrast that to 29% who said it's an important part of most clients' investment strategies. I think that indicates to some extent the differential between life insurance as an investment. For most of them, the investment features are not that prominent. Twenty-nine percent said the tax advantages make life insurance a very competitive product. That was before the recent tax legislation, of course. Sixteen percent said they enjoy selling life insurance, and twice as many said the complexity of life insurance products makes them difficult to sell. I think that says there are some things that are fun to sell, that are easy, that are in their sweet spot, that are the types of things that they're associated with, and there are some things that aren't fun to sell. Life insurance is one of the things that I think is hard for them to sell, and some might think, unpleasant to sell.

What's the biggest potential benefit of variable life insurance? Twenty-two percent said accumulation, growth potential and cash values. Guaranteed death benefit is less, at 18%. Flexibility and estate/retirement planning, protecting against taxes, are both nine percent. So, the biggest advantages to these people are the tax advantages, with the death benefit coming in a distant third.

We asked how useful it might be for clients to get this benefit from variable life. They all say it's beneficial, but when you look at the possibility of avoiding estate and income taxes on large death benefits, 79% said very useful; for the ability to achieve tax advantaged gains on equity investments, 59% said very useful; and for range of options, 54% said very useful. Basically what this says to me is that these advantages are at least something that have some resonance with them.

We also asked, what's the biggest reason you do not sell variable life, or what's the biggest reason, if you sell it, that you don't sell more? And here we're going, I think, to the core of the problems. Twenty-one percent cited difficult sales, a lot of paperwork, too time-consuming or too difficult to explain to clients. Nineteen percent said not appropriate for everyone, must be wealthy, younger or need a certain type of client. I think that to a significant extent, when these brokers meet with clients and establish relationships, they don't try to identify a life insurance need. They don't look for a life insurance need, and they don't find one. So when they say that this is not appropriate for clients, I think part of it is just the process of what they do when they meet clients. I've done some in-depth interviewing of stockbrokers, and I've heard not infrequently that they don't want to seem like peddlers. People go to them for investment advice, they feel, and they feel that if they try saying, "I can do this, and I can do that," there would be a negative reaction. Third, at 18%, is the feeling that the cost and fees are high, that it's more expensive than other investments or it's cheaper to buy other life insurance, not variable life. And then 16% responded that they were not familiar or not knowledgeable, that people are not familiar with the product or the agent was more familiar with other products. We need training. We'll get to that. But there was just a lack of familiarity, which gets down to this being a difficult and unenjoyable sale.

We asked, how much of a concern is this in preventing you from selling more variable life insurance? The thing that came up the most in this list that we presented them was a lack of client interest in the product. As I've indicated, qualitative research we've done doesn't indicate it's really lack of client interest in the product as much as it is a lack of looking for a need. Limitations in your understanding of the product came in second, at 24%. Length of time to underwrite an applicant was third, at 21%. I think there's a feeling that this is a bigger problem than it is. Obviously it's significant, but I've heard a lot of people really being concerned about it. They don't get paid right away. They don't know if the person will be approved. The process takes a long time. It comes up, but it doesn't come up high. Twenty percent cited the amount of sales support available. I'll offer more on that later. The need to collect health and medical information from applicants was next, at 16%. I was expecting this to be higher, that they'd say they don't want to talk about death or don't want to collect health information. And "think of a broker as an investment specialist," which I had mentioned before, came up at 11%.

We also asked, how likely it is that variable life insurance can offer you this advantage? There are two interesting things about this. A lot of them saw advantages in offering variable life. It's "very likely" to 44% of them that variable life can increase their incomes through high-commission sales. I think they do see this as being a high-commission product for which the compensation for the level of effort is reasonably good. Thirty-four percent said that you can gain control of a greater proportion of your clients' assets. That's pretty good. But look at this—32% said it's very likely that they can better meet their client's needs. It seems to me that in reality it's higher than that because I bet that a lot of their clients are underinsured, and I bet this can be a more effective approach for a lot of clients. That's the disconnect between what they know about their clients and their understanding of clients' needs.

We asked, is this a major concern (Chart 13)? And here, I think, is another important finding from the survey. Familiarity changes everything. If you do it once, twice or three times, if you sell the product, it puts you in a different level of familiarity and makes other sales easier. Limitations in understanding of the product are a major concern for 45% who haven't sold the product but for only 12% who've sold at least five policies. The amount of sales support available to the broker is a major concern of 31% who haven't sold the product but for only 14% who have. The need to collect health and medical information is a major concern to 27% who haven't sold the product but to only 15% who have sold at least five policies. That's not much of a gap there. And "think of the broker as an investment specialist and have negative reaction to recommendations" is a major concern to 22% who haven't sold the product but to only 10% who have. In other words, when people actually jump over the fence and do it, the level of these concerns goes down, which means that the idea is to help people jump over the fence and do it.

The most important thing that your company, as opposed to a life company, can do to encourage variable life sales is education, and everything else is second. Forty percent said that. That's what they need to jump over the fence. The most important thing that life insurance companies can do to encourage variable life sales is education and training. Everything else—simplifying, wholesaler support, competitive pricing, sales support—is really secondary.. They need to feel comfortable with this product, and many of them just don't. And again, this is especially true for the people who haven't done it.

It does vary by where people sit (Chart 14). The simplification is more important to the super-regionals, and competitive pricing is more important to the regionals. I take that to mean that the wire house and super-regional people are less competitively sensitive than the regionals and have a different basis in terms of their value proposition to clients. Maybe reputation and brand are more important, they feel, to their clients.

How useful would certain measures that life insurance companies might take to make selling variable life more appealing be? Well, simplified underwriting would be appealing to two-thirds of them, even though they said the biggest thing to encourage them would be education. Better training packages for products was cited by 62%. Simplified products with fewer loads would make it more appealing to 55%. Better wholesale support and better access to insurance specialists were each named by 54%. Improved marketing materials would increase the appeal for 49%. Interesting to me, a clearer, better-defined commission structure, which a number of people have said is important, is at the bottom of this list. Look at it compared with the others. The length of time it takes to get paid and the commission structure didn't come up in this survey. The problem is not when you get paid and how much you get paid. You get paid a good amount. The problem is familiarity with the product.

Let's look at the percentage who say the measure would make them very likely to sell or to sell more variable life insurance. Seventy-five percent of wire house people said better training packages on products is very likely to make them sell more. It's interesting that they are more sensitive to this, maybe because they get more of this. And the regional brokers, who are more out there, don't believe in it as much. Better wholesaler support—again the wire houses led the category, with 67% of respondents. Better access to insurance specialists was cited by 63% of the wire house respondents. The hands-on approach is most appealing to the wire house brokers, but all of them say those would be helpful. People who have sold a lot are most interested in simplified underwriting. Better training is cited by 75% of the people who haven't sold any. The people who haven't sold any are more interested in better access to insurance specialists because they need it more (Chart 15).

This is my take on the survey. There is an opportunity. There should be more variable life insurance sold through the broker channel, and they say that different steps would make them more likely to consider that. Effective education and training are imperative because that is what they identified as something that would get them to sell more. Simplifying products for the channel would be useful. They said that, too, but that's secondary. And targeting approaches by type of firm and type of broker within the firm is important.

Regionals need a somewhat different approach than wire houses. People who haven't sold the product need more support and help than people who have. Different people identify different target markets—some who have estate planning needs and some who don't. But the biggest thing, I think, is to get new people into the game. I think if you do that, they'll produce more sales.

Reinforcing how life insurance can help many clients with estate planning and death protection needs would be useful because they don't see it, and they don't know to look, I think, for these needs. Helping brokers analyze their client base to identify those with strong life insurance needs, I think, will help stimulate sales because they don't know how to do that. They have these relationships that they're not leveraging, despite the stated goal of many wire houses and super-regionals to try to get more share of wallet and to identify more need. I think they're hearing the message, but it seems to be, based on this survey and others, that they're not really going through their book of business to identify life insurance needs.

Many brokers appear uncomfortable discussing life insurance with clients until they have established a strong relationship with a client. It's hard to get them to establish a life insurance need at the initial sales meeting, but it's a useful strategy to try to get them to do it after someone's been a client for a couple of years. They're less likely to think that the person's looking at them as a peddler, and it'll be a more comfortable conversation with everyone. At any rate those are the key findings of the survey we did, and I hope you find it useful. I guess now it's time for questions.

MS. KENNEALLY: Thanks, Matt and Tom. We do have quite a bit of time left for questions.

FROM THE FLOOR: I have a quick question for Matt on the mechanics of the survey. I think it was 263 respondents?

DR. GREENWALD: Yes.

FROM THE FLOOR: How did you survey the respondents, and how many did you go to? What was the take-up rate of your survey?

DR. GREENWALD: We surveyed them by telephone. We identified the firm and there were different samples available of brokers. We screened them for the two years experience, that they sell variable annuities and the income level at $50,000. I don't recall what the take-up rate or the response rate was. In general, response rates have been low and I think for this audience that was also the case. I think we did five callbacks. So we did go back to them.

Technology is causing problems with consumers because they have caller ID. So there are different impediments to sampling here. In terms of surveying brokers, it's not. They answer the phone. They don't screen calls. If you call them, you can get to them. So that's not a problem. That's probably a longer answer than you were looking for.

FROM THE FLOOR: The other question I had was with respect to the split of the responses. What was the percentage split—by wire house versus super-regional versus regional and the percentage split in responses of zero sales versus one-to-four sales versus five-plus?

DR. GREENWALD: The split was evenly divided, basically, between the three types of firms. As for the proportion that had zero sales, I'll have to get back to you on that.

MR. EDWARD L. ROBBINS: I'm with Allstate Life Insurance Company. I wanted you to elaborate, if you would, on how you're defining simplified underwriting in terms of the preferences for simplified underwriting. That can encompass a whole range of how simplified. Is it a reversion to a three-question-type application? Did you have a clear definition of what was meant by simplified underwriting?

DR. GREENWALD: No, and actually that's a good point. I think that's probably something that we should have done because that's an important strategic issue. I think what we have is some guidance on, in general, the simplification of the process.

MS. KENNEALLY: I'll just add that in my presentation where I discussed that to penetrate these channels, we need a simplification of the new-business process and the underwriting process, there I really wasn't talking about going to simplified underwriting in which you go to a three- or a five-question questionnaire. That obviously impacts your mortality experience and would impact your premium rates and COI rates. What I was suggesting was a simplified process. Some carriers have actually started to do this with the wire houses—I think Nationwide and even The Hartford have made some inroads into simplifying the process. The models I've seen are that the wire house rep or the regional rep makes the initial contact with the client, and once the sale is underway, then the whole underwriting process is taken out of their hands and put into the hands of a specialist who follows the process of underwriting from start to finish. The specialist is generally an employee of the product manufacturer. They do a lot of Web-based communication. They might call up and do a phone interview with a client and answer some questionnaires that way. They would schedule physician's visits, if that's what is needed. They're doing your typical full underwriting process, but the actual reps themselves do not have to sit down with the client and ask them all the questions. They've actually diverted that process to people who are just specialized to do that. It takes it out of the rep's hands because they feel uncomfortable doing that, and it also speeds up the process.

FROM THE FLOOR: Do you see any interest in a socially conscious fund perhaps?

MR. KALMBACH: I haven't really seen any interest in that at this point. I had a question for Matt. You had mentioned that there didn't seem to be much sensitivity to price within the super-regionals and wire houses, but there was to the regionals. As a person who develops products every day, I just find that hard to believe. Could you please explain what that means, that they weren't sensitive to price?

DR. GREENWALD: I was making a comparative statement. When asked about the most important thing that life insurance companies can do to encourage variable life sales, 13% of the regional brokers said competitive pricing compared with six percent of the super-regionals and two percent of the wire house brokers. I think comparatively the regionals were more price-sensitive. That's Chart 14. It seems to me that price isn't the key impediment here, and in some ways this gets back to the issue of simplified underwriting. Price is always important, but that's not what's stopping these people from exploring clients' life insurance needs. I think there were just other things going on. Maybe when it comes down to picking a particular company the price story is important, but my guess is that's not the case. Training will be important, and getting there and giving them good support is important and, to some extent, the simplification of the underwriting process is also important. Getting them comfortable is more important. If they have a good relationship with people, I think they could withstand any pricing. So, that's what I was referring to. But the tenor of this research, at least, suggests that if you want more life insurance sales, you have to put in more support and price it that way. That will be more successful than having the cheapest price in town.

MS. KENNEALLY: I would agree with Matt's comments. In some of the research that we've done, the wire houses typically have pretty buttoned-down processes in place to do due diligence and select carriers to provide their products. Generally you go through this long process, and they're not only looking at price, but also at compensation structures, they're looking at servicing, they're looking at your wholesaling capabilities and your marketing materials, and they're looking at the whole thing as a package and what kind of service you can provide to their firm. That's essentially how you get on their preferred list of carriers.

One observation that I would have is, in speaking to some of the wire houses that are particularly big in selling variable annuities, one thing that they said would be preferable to them would be to have the same carrier for both their variable annuity and variable life offerings. That would provide some continuity in the servicing and the funds that underlie the product so that a representative wouldn't need to relearn the various fund offerings. They would already be familiar with them.

FROM THE FLOOR: I have two questions. With respect to the survey that you performed, I wonder if you could opine on what you think the responses would have looked like when sales for variable life peaked. My other question is, with respect to renewal premium for variable life, what pattern would you expect to see in the future? And I wonder if for variable life renewal premium it is similar to first-year premium, if that's indicative of poor sales or lack of suitability of the product in the first place.

DR. GREENWALD: One of the good things about stockbrokers is they believe in equities, so they'll sell equities and tell an equity story. That's the argument for them being a natural channel for variable life. So it seems to me that whatever's happening in the equity markets, they should feel good about variable life.

The other thing that I think is favorable is that they are talking about getting greater share of wallet. These companies, in a bad equity market, should be looking for other things to sell and should be looking to leverage their relationship more. That's one way of dealing with the decreasing pool of people who are interested in equities, and life insurance is such a natural. That means that there's another thing I think that should drive further interest in this in terms of the tough climate that Tom and Nancy were talking about. All the trends in some ways are favorable for this channel. The channel's looking to leverage people more.

As for your second question, it seems to me that it's driven by other things than inappropriate sales. There certainly are some inappropriate sales, but I don't see any reason why the inappropriate sales have changed, and there's nothing to suggest that. There are some things to suggest tough economic times and other things like that.

MR. KALMBACH: I think the problem might be that they don't have the premium to put in. I'm not sure that it was necessarily inappropriate at the time of the sale.

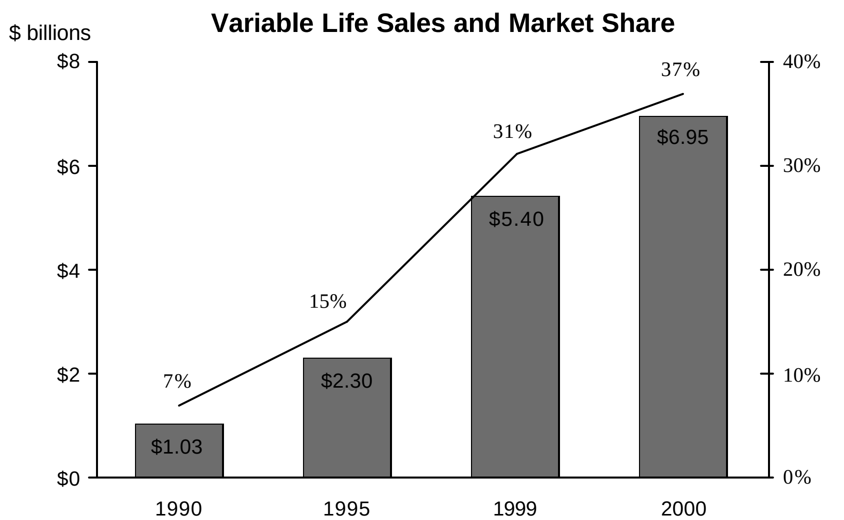
A source of funds that was to be used for the purchase of life insurance, maybe the earnings from their business, is down because of the economic environment. They can't put as much in, or they don't have the premium to put in at all. There's a real benefit within this marketplace in that you can put more premium in when you have it and put less in when you don't.

DR. GREENWALD: One of the things that struck me while doing consumer research is the proportion of people who lose their relationship with the life insurance agent. They have a life insurance agent. They buy life insurance when they have a child or buy a house or something, and that relationship withers and is gone by the time they're in their 40s and 50s. So they have life insurance portfolios that are way out-of-date and are inadequate. My guess is there's a substantial portion of people who have relationships with brokers because they see an accumulation need and who also have inadequate life insurance, and no one can effectively address that. I think it's much more likely that there are people who are underinsured, have a significant need and are not buying the product—they're not being offered the product—than there are people who have too much or buy inappropriately.

Another attractive aspect of this market is that these people tend to meet people and have relationships with people, whereas standard life insurance agents don't. It's an effective way of reaching this more affluent and somewhat older population that has life insurance needs.

Chart 1

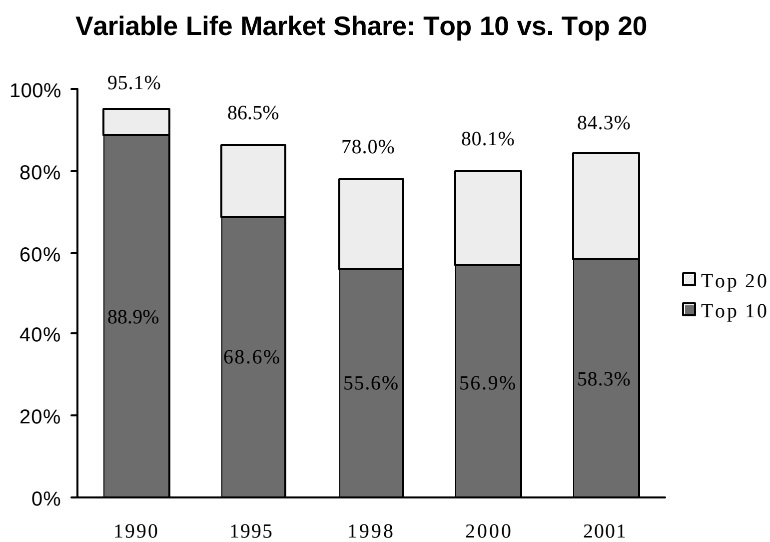
The variable life market experienced remarkable growth throughout the 1990s



Source: Tillinghast VALUE Survey. Sales include first-year target premiums, 100% of dump-ins and 10% of single premium. LIMRA International (market share data).

Chart 2

As more companies entered the variable life marketplace during the 1990s, market share of the top players became less concentrated

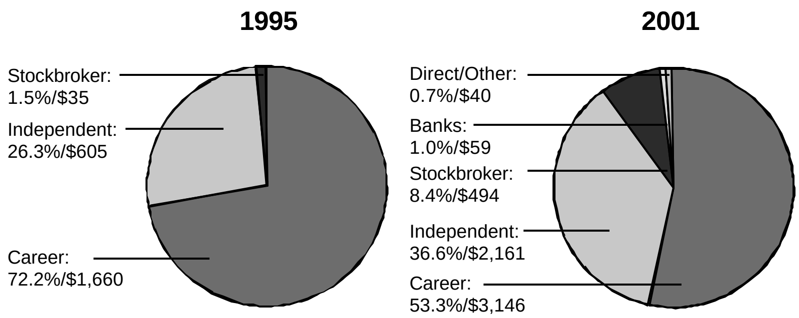


Source: Tillinghast VALUE Survey. Ranked by sales.

Chart 3

Although still a dominant presence, career agents have lost share to nontraditional independent distributors

Distribution of Variable Life Sales by Retail Channel



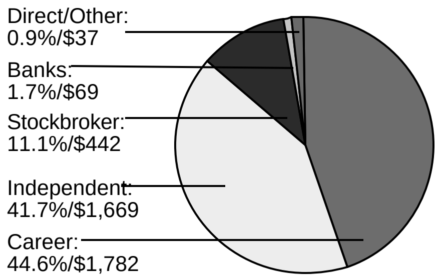
Results reflect retail channel as opposed to intermediary channel

Source: Tillinghast VALUE Survey.

Chart 4

2002 saw a further shift in sales from career agents to nontraditional independent channels

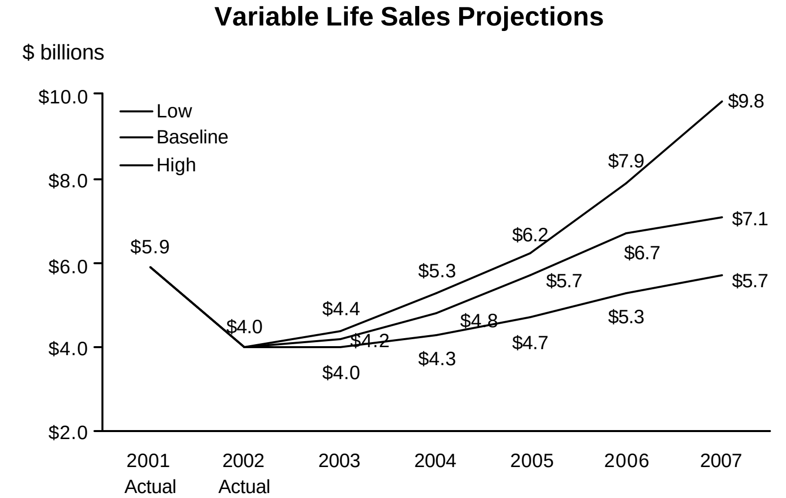
2002 Variable Life Sales by Retail Channel



Source: Tillinghast VALUE Survey. Results reflect retail channel rather than intermediary channel

Chart 5

Realizing any of these growth scenarios will not be easy and will hinge on a few key factors



Source: Tillinghast analysis. Sales include individual variable life, survivorship VL and single premium VL. COLI, group VL and private placement are excluded.

Chart 6

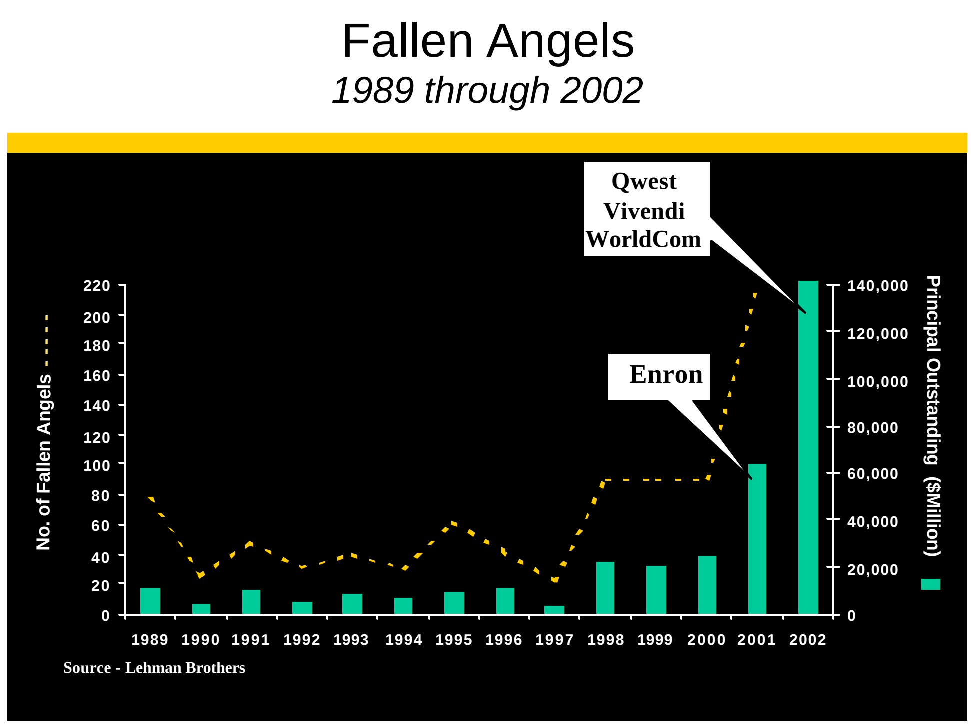


Chart 7

Impact of Forces
On Carriers

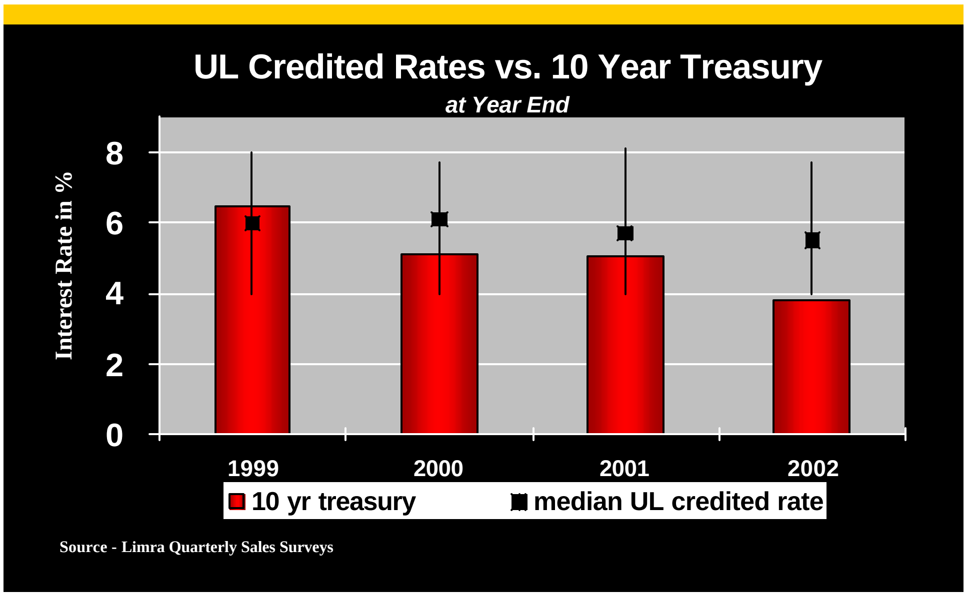
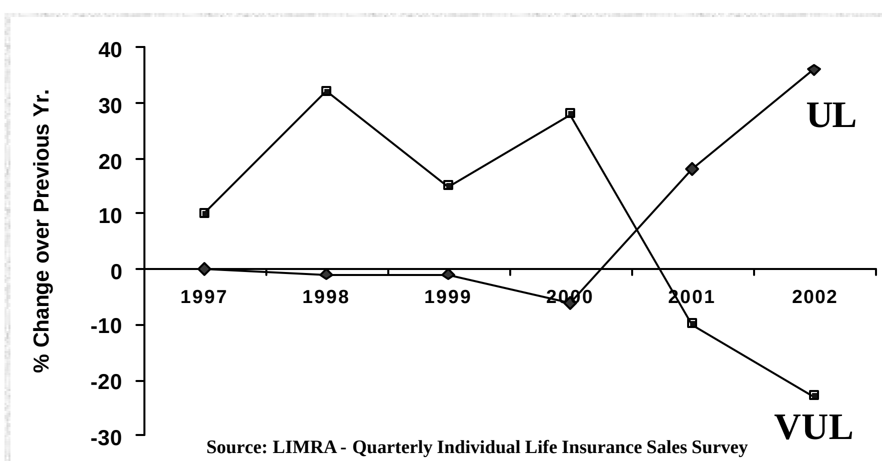


Chart 8

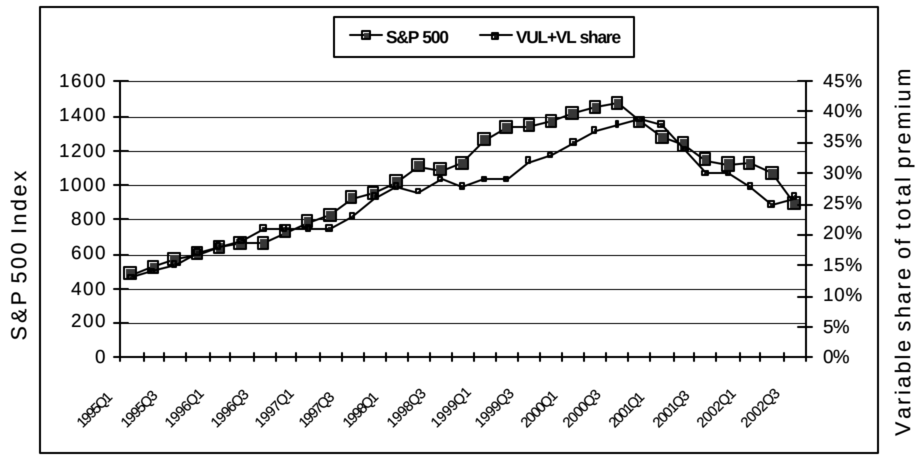
UL vs. VUL
Annualized Premium Growth - U.S.



(Source: LIMRA)

Chart 9

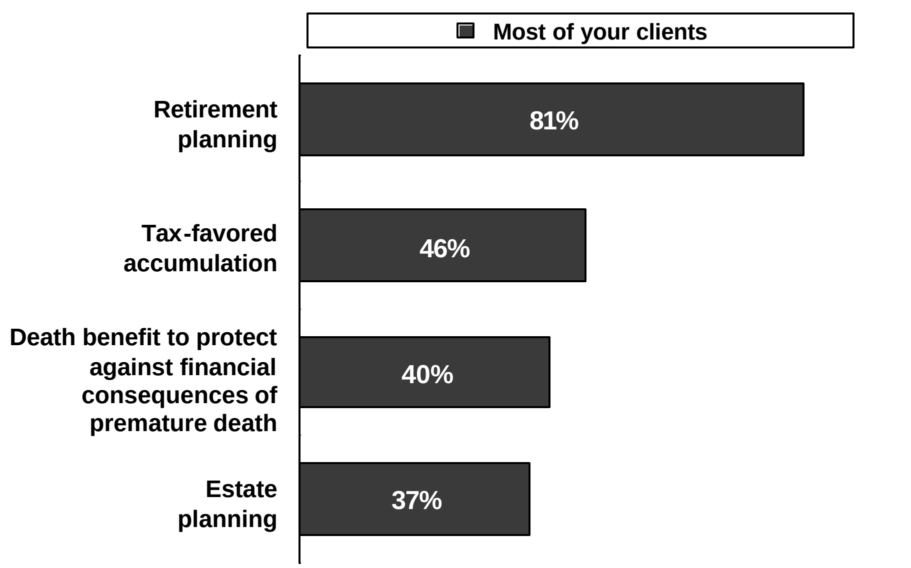
VUL/VL Market Share
vs. Stock Market



Sources: LIMRA's US Individual Life Insurance Sales, LIMRA estimates, Economy.com

Chart 10

Retirement Planning Dominates As the Primary Financial Need Brokers Say Most Clients Have



2002 NAVA Survey of Brokers 3

Chart 11

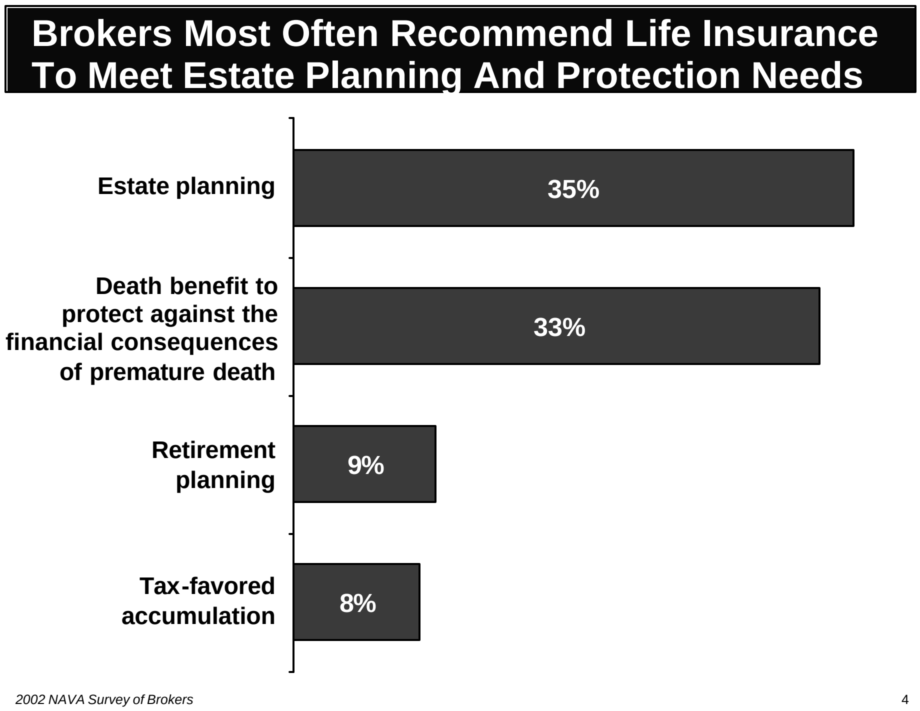


Chart 12

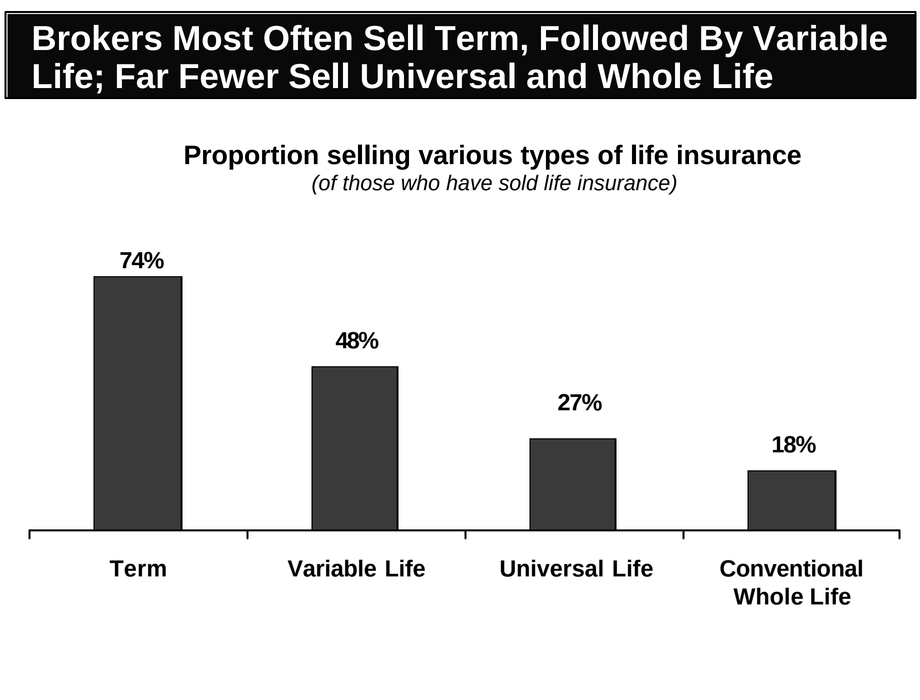


Chart 13

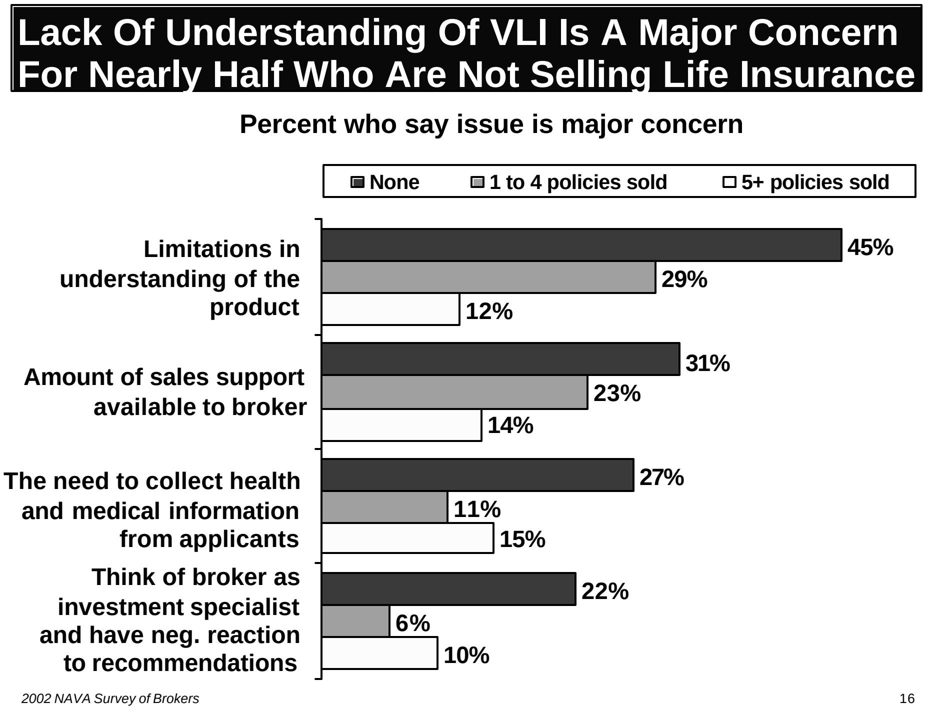


Chart 14

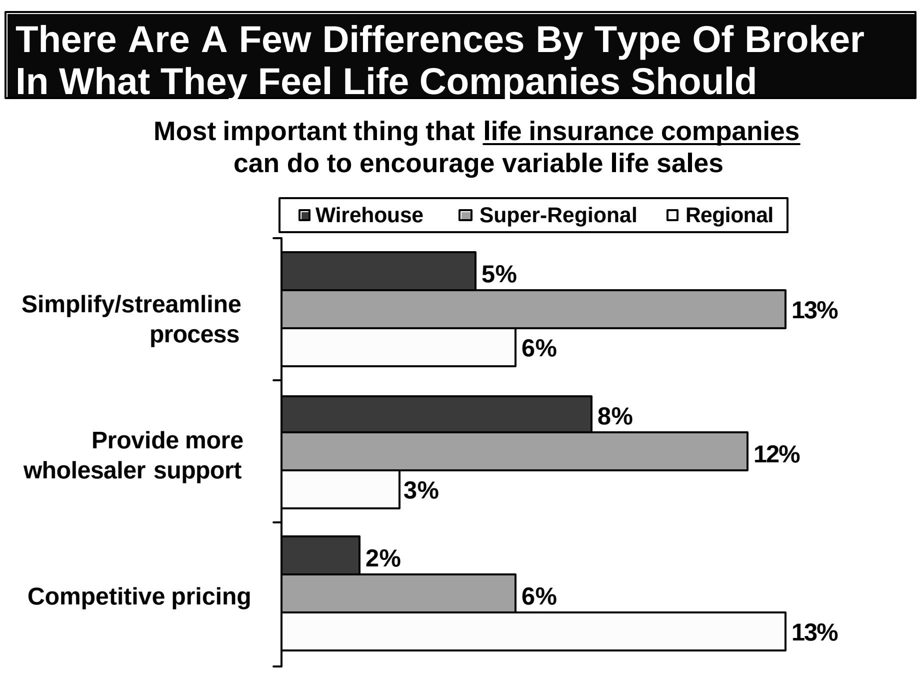
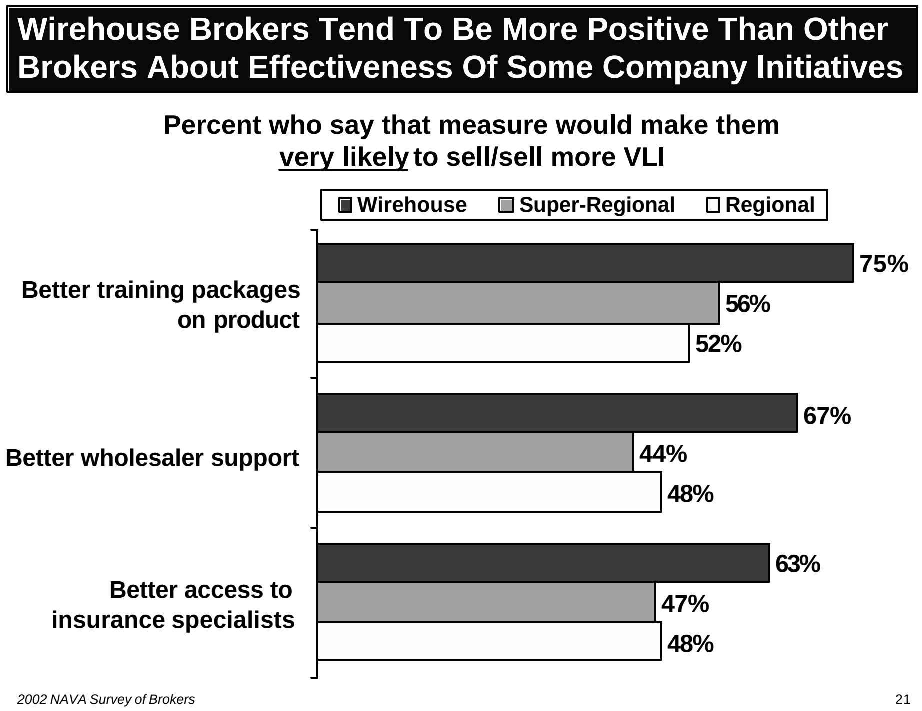


Chart 15


Wirehouse Brokers Tend To Be More Positive Than Other Brokers About Effectiveness Of Some Company Initiatives
Percent who say that measure would make them very likely to sell/sell more VLI
Wirehouse
Super-Regional
Regional
Better training packages on product
75%
56%
52%
Better wholesaler support
67%
44%
48%
Better access to insurance specialists
63%
47%
48%
2002 NAVA Survey of Brokers
21