Professional Series

# The Art and Science of LIFE INSURANCE DISTRIBUTION

Internet Direct
Financial Advisor
Call Center
Career Agent
Independent Agent
Direct Mail
Home Service
Worksite
MLEA
CMI

Douglas J. Bennett, FSA
Walter H. Zultowski, Ph.D.

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# FOREWORD

Ask what has been the greatest change to come to the life insurance business in recent decades, and the answer is arguably how companies get product to the end consumer – i.e., **distribution.**

It wasn't long ago that the vast majority of individually-purchased life insurance was sold by agents working primarily for one company. This changed as various forms of independent agents and financial advisors began selling life insurance over the years. More recently, the evolution of on line technology has opened up new ways of selling life insurance, either directly or in combination with other distribution methods such as call centers.

At the same time, the discipline of marketing – as practiced in consumer package goods – also gained greater traction in the business. The result has been a breakdown of the "one-size-fits-all" mentality when it comes to life insurance distribution. This has been replaced by the viewpoint that, to be most effective, distribution channels are best matched with various market segments and life insurance products.

Today, multiple distribution approaches, formerly seen as incompatible, are being operated simultaneously in companies, albeit not without challenges. One of our objectives in writing this book was to discuss how these challenges can be successfully managed. It is out of this viewpoint that one comes to appreciate that successful distribution is both an **art** and a **science**.

The Society of Actuaries (SOA) has for years been involved in helping to educate its students and members about marketing and distribution in the life insurance business. More recently, the Marketing and Distribution Section of the SOA was looking to update its educational materials, and to focus more on distribution given all the changes that have occurred in this company function in recent years. The Section supported the effort when ACTEX decided to publish a book on this topic.

The authors are grateful to the leadership of the SOA's Marketing and Distribution Section for its enthusiasm for the importance and relevancy

of this text to the actuarial community, and for the support necessary in making it a reality. We also owe a special "thank you" to Gail Hall, FSA, MAAA, President of ACTEX, for her advice, guidance, and patience as we worked on the text. We are also appreciative of the editorial work provided by Marilyn Baleshiski, and of the cover design provided by Jeff Melaragno, both also from ACTEX.

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Finally, for their non-actuarial support provided throughout our lives, we dedicate this work to our respective spouses, Sue and Linda.

Doug Bennett and
Walt Zultowski

# PREFACE

Life insurance is unique. People don't usually wake up one day saying; "I think I'll buy some life insurance today." Since it is a low demand product that is more often "sold" rather than "bought," it is not surprising that distribution is a major function in life insurance companies. As such, it is also a major topic of debate and discussion both within and between companies. Over the years, for example, arguments have been waged as to which distribution channel is the most effective and efficient. Even within companies, arguments have raged over the "cost" of distribution, whether distribution is more appropriately viewed as an expense to be managed or an investment to generate business, and whether operating multiple distribution channels results in unavoidable conflict. The fact that there are two clear "sides" in these debates, (i.e., home office vs. field sales representatives), often makes these deliberations even more contentious.

One common misperception in the business is that distribution is an exact science that can be managed according to established formulas such as may exist in other company functions. In practice, distribution is more of an art than a science, and needs to be managed within the context of the needs of the consumer being served, and the specific product being sold to meet those needs.

To have an appreciation for the distribution function in a life insurance company, it is important to understand the role of distribution in business in general, as well as how various distribution systems have evolved in the life insurance business to what they are today. Additionally, it is important to understand the functions and roles served by distribution, and how distribution compensation operates in the industry. It is only with this overall picture of life insurance distribution that one can make informed decisions regarding the selection and management of life insurance distribution channels.

A guiding principle throughout this text is that there is no one best distribution channel in the life insurance business, nor is one distribution channel necessarily better than another. Rather, we would argue that certain distribution channels are better than other channels for *specific* situations, typically defined by market needs and products. The objective of this text is to help the reader better understand how best to align markets, products, and distribution channels.

The good news is that the processes of distribution channel selection and management are not difficult to understand. This is the case once one understands and appreciates how distribution evolved to its current state in the industry today, the functions and roles served by distribution, how to use compensation to drive the behaviors desired in a distribution channel, and how distribution serves as one leg of the industry's proverbial three-legged stool comprising market needs, products to serve those needs, and distribution.

# CHAPTER ONE

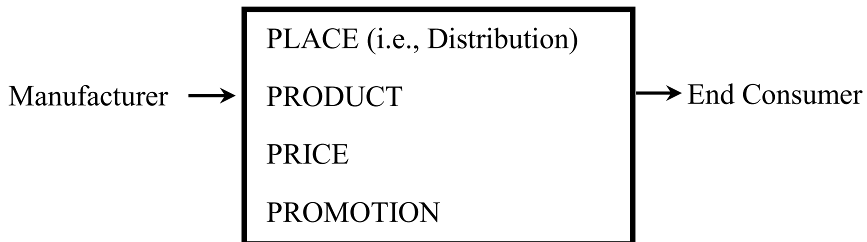
# INTRODUCTION TO DISTRIBUTION

The term **distribution** has multiple meanings in the business world. In the investment world, for example, it is used to refer to the process of paying out funds, as in a "dividend distribution." In the computer business, it is used to mean the circulation of programs, as in the "distribution of software." In the marketing function, however, "distribution" specifically refers to the process or paths involved in moving a product from a manufacturer to an end consumer. It is this meaning of distribution, and more specifically, distribution in the life insurance business, that will be the focus of this text.

## THE BASICS OF DISTRIBUTION

There is no question that distribution plays a key role in efficient and effective marketing. Marketers have traditionally talked about the "4P's" of the marketing function as being place, product, price, and promotion.

**The Four P's of Marketing**




These are the four key elements that comprise the marketing function or "marketing mix". "Place" in this case is distribution. Interestingly, though, distribution is probably the element of the "marketing mix" that gets the least attention, at least in comparison to product, price, and promotion. This is despite the fact that it garners a very large share of the

overall cost of marketing, and as we'll see, can also be the most complicated of the "4P's." Perhaps this is because the distribution function is often delegated to, or aligned with, the sales function. On the one hand, this could be viewed as recognition of the importance of distribution, such that it deserves its separate place right alongside of marketing. On the other hand, as will be discussed later, doing so often causes more problems than it solves.

### Distribution Terminology

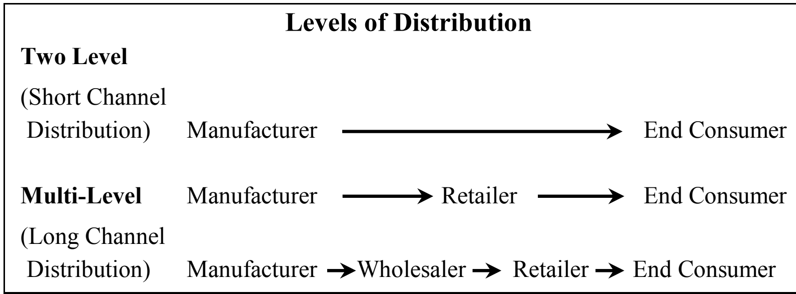
Systems involved in getting a product from a manufacturer to an end consumer are typically referred to as **channels**, while the individuals or organizations involved in distribution are typically termed **distributors**, **sales people**, or **intermediaries**. It is important, however, to recognize that not all distribution channels involve human interaction. We can think of numerous products and services that are marketed directly to consumers. This is also true in the life insurance business, in which direct marketing through the mail, for example, has been done for years. It is only within more recent years, with the advent of online technology, that this form of distribution has garnered more attention in life insurance.

### Levels of Distribution

In earlier times, there was no need for distribution. Artisans practiced their crafts in the backs of their shops, and consumers purchased their products in the fronts of their shops. It is likely that the term "store fronts" was conceived in this time period. This environment still exists today in the form of factory stores, although they are most likely not a manufacturer's primary distribution method. Such systems would be termed "two-level" distribution systems, in that they involve just the manufacturer and end consumer.

One can also envision, however, how the artisans of years ago needed to devise a system to bring their products to consumers who were unable to travel to their shop, and/or needed an additional person to peddle their wares while they worked to create more goods in the backs of their shops. Thus, the concept of distribution was born. Today, simple two-level systems can be replaced by multiple-level systems, as additional intermediaries are added to the network of delivering a product from the manufacturer to the end consumer. Four and even five level systems are not uncommon today. Each intermediary takes the product to the next step in the chain and in return is compensated for that activity. One will often see

simple systems referred to as **short channel distribution** systems, while multiple-level systems of intermediaries are referred to as **long channel distribution** systems.




## Retail vs. Wholesale Distribution

A key concept in understanding distribution is that of **retail distribution** vs. **wholesale distribution**. Simply put, any individual or organization that has direct contact with an end consumer is considered to be involved in retail distribution, or a **retailer** for short. A retailer can take several forms ranging from an actual store to an individual salesperson, or in more recent times a direct mail or online system. Any individual or organization that only brings a product to another intermediary is considered to be involved in wholesale distribution, or a **wholesaler** for short. One will also see these two types of distribution referred to as "B to C" (i.e., business to consumer), or "B to B" (i.e., business to business).

It is also important to recognize that these two forms of distribution are not mutually exclusive when it comes to their usage. Manufacturers may use retail distribution for certain products, and/or in specific markets or territories, and act as wholesalers for other products, and/or in other specific markets or territories. Others may use both systems for the same products, and/or in the same markets or territories. The challenge that this presents is one of **channel conflict**. The management of channel conflict is a subject in itself, especially when it comes to the life insurance industry, and will be discussed later in this text.

## The Functions Provided by Distribution

The discussion up to this point has suggested that the primary purpose of distribution is to provide the end consumer with *access* to product. This

is a large part of distribution, and with many commodity products is probably the only purpose of distribution. Depending on the nature of the product, however, distribution serves purposes that go beyond providing mere access to product. With a very technical or difficult to understand product, for example, an additional role of the intermediary might be to provide *education* or *technical assistance* in the selection and/or use of the product. This assistance might be provided to another intermediary, as in a B to B environment, or directly to the end consumer in a B to C environment. Finally, an additional function provided by distribution is that of *purchase confirmation.* For products which consumers might equivocate in purchasing, an intermediary can serve to get that consumer "over the hump" in their purchase decision, or reaffirm the appropriateness of the purchase for consumers experiencing "buyer's remorse."

### What is the Right Distribution Channel(s) to Use?

This, of course, is not an easy question to answer. The selection of one or more distribution channels is based on numerous factors such as:

- the *nature of the product* (e.g., is it simple or complex?),
- the *characteristics of the market* (e.g., is it well educated?),
- the *simple availability of appropriate intermediaries*,
- the *characteristics of the intermediaries available* (e.g., the ability to understand and communicate product features),
- *resources available for distribution*.

Thus the challenge when it comes to distribution management is selecting the channel that is right for the specific situation. Finding the most efficient and effective match or alignment of product, market, and distribution is a major theme of this text.

## LIFE INSURANCE IS DIFFERENT

While the previous discussion of marketing and distribution is intentionally academic in nature, and applies more readily to the marketing and distribution of consumer packaged goods, it needs to be recognized that life insurance is different. In fact, it is a challenge to

think of another product category that has the same characteristics. For example:

- The life insurance product is an intangible. Other than the paper upon which the contract language is printed, there is nothing to be seen or felt with the product. Moreover, the product itself is *not* the paper upon which it is printed, but rather a promise to pay someone (i.e., the beneficiary) an amount of money upon the death of another individual (i.e., the insured).

- The end user of the product is also typically not the purchaser of the product. Yes, it can be said that acquiring life insurance buys "peace of mind" for the purchaser, and is thus "utilized" by the buyer. There are also valid applications for life insurance in which the purchaser buys a policy on someone else's life (e.g., a spouse) and becomes the beneficiary of the policy when that individual dies. If, however, one defines the usage of the life insurance as the receipt of a policy's proceeds, than in the majority of cases, the user of the product is other than the purchaser of the product.

- While it is an important product to buy, life insurance is an infrequent purchase. These authors are unaware of specific research that documents the average number of times an individual purchases life insurance across his or her lifetime, but the average number of times can probably be counted on one hand. Even in comparison to other big ticket consumer goods (e.g., automobiles) the number pales by comparison. Thus, one often hears that life insurance is purchased and put away in a drawer until it is needed. The time that it is needed is when the insured dies and the proceeds are put to use by the beneficiary.

- It tends to be a difficult product to understand. Consumer survey after consumer survey have, for years, documented the fact that a majority of the public do not see themselves as knowledgeable about life insurance.

- While it is a product that is needed, it is not a product that is pleasant to contemplate. Unfortunately, someone has to die in order to use the product. Thus, is it any surprise that many put off the purchase of life insurance, or would rather put the money

toward something enjoyable today, such as a vacation or a big-screen television?

- Life insurance is an emotional purchase. There are applications for life insurance that relate to the successful transfer of a small business or the payment of estate taxes. For the majority of life insurance sold for basic household income protection purposes, the motivation behind the purchase is one of caring for loved ones following the death of the insured individual.

**How Life Insurance Differs from Packaged Goods**

| Packaged Goods | Life Insurance |
|---|---|
| Product is tangible | Product is intangible |
| Buyer is often the product user | Product user is usually not the buyer |
| Product is purchased more frequently | Product is purchased infrequently |
| Product is understood | Product is not easily understood |
| Produce is pleasant to contemplate | Product is not pleasant to contemplate |
| Product purchase is not likely emotional | Product purchase is emotional |

It is because of all these basic characteristics of life insurance that distribution actually plays a *larger* role in the marketing of life insurance than is the case in other businesses and product categories. This is reflected in several observations and traditional adages about the life insurance product and business.

- One of the oldest adages in the business is that “life insurance is sold, not bought.” This reflects the perceived importance of distribution in getting the product to the buyer.

- Probably the second oldest adage in the business is that "the agent is the customer, not the buyer." This reflects the view that marketing should be left up to the agent, and that the company's only purpose is to support the agent in that regard. This obviously wouldn't apply in companies utilizing direct response distribution channels.

- Across the business it is rare to find companies in which the sales function is a part of a larger marketing function. At a minimum they are peers in a company's organization chart. When this is the case, the marketing department plays a much more secondary role to that of sales and distribution. Often marketing is relegated to producing sales materials, and is often referred to simply as "brochure factories."

- If one compares the marketing budgets of large insurance companies (not including their sales departments) with those of other large consumer goods companies, one typically finds that the insurance companies' budgets are dwarfed by comparison. Of course, many marketing departments in consumer goods companies are also responsible for advertising, and in many life insurance companies, management of the advertising function often falls to the Corporate Communications department. Even if the advertising budgets were added into the marketing budgets of most life insurance companies, they would still be dwarfed by the marketing budgets of similarly-sized consumer goods companies.

- More often than not, the term "marketing" is used synonymously with "sales." One only has to look at job openings for life insurance sales positions to see that this is the case. Instead of saying "life insurance agent" or "sales representative," they are more likely to read "marketing representative" or "marketing associate."

- Senior marketing officers from consumer goods companies seem to freely move among different industries and product categories with equal degrees of success. Despite numerous attempts, however, few senior marketing officers from packaged goods companies have found success in the life insurance business.

# CHAPTER TWO

# THE HISTORY OF LIFE INSURANCE DISTRIBUTION

The life insurance business as we know it today is a direct result of the abrupt change in distribution methods implemented in 1843 [10, p 103]. This is the year that Mutual Life of New York was started. Prior to this period, the life insurance business lacked drive [10, p 103]. Mutual Life, along with other newly formed mutual companies, was forced by circumstances to create a distribution channel and related aggressive marketing efforts that significantly accelerated the growth of life insurance sales. The organizers of these mutual companies found themselves in the position of not being able to pay salaries until the company was generating income, and sufficient income could not be generated until enough policies were sold. In turn they were forced to employ salespeople, but could only pay their salaries after successfully completing a sale. Thus was born the modern agency system.

It is useful to examine methods of life insurance distribution prior to 1843 to understand why they were not going to work for the mutual companies, especially since they share some of the same characteristics of methods employed recently. Since the wide-spread adoption of the agency system, there have been many modifications in implementation and influence on the overall management of the company. Tracking this evolution can be helpful in understanding the options available to a company considering modifying their own distribution strategy.

## Prior to 1750

Insurance, in general, has a very long and rich history. It began in the seafaring industry as a way for sea traders to reduce risk associated with voyages they were preparing to undertake. As such, the concept was legalized in the code of Hammurabi in 2100 BC [4, p. 16] and is also said to have been practiced among the Babylonians about the same time [11, p. 46].

Its use continued in the maritime industry in more recent decades. In the 1700s, for example, merchants, ship owners, and underwriters would broker insurance deals in Lloyd's coffeehouse in London, the predecessor of today's famous Lloyd's of London.

For individuals, a major risk in colonial times was destruction of property from fire, but they did not undertake guarding against this risk individually. Rather, individuals formed mutual aid societies to which they made contributions to cover losses suffered by any one member of the mutual society. Such organizations were formed as early as 1735 in Philadelphia with the help of Benjamin Franklin. The first insurance company formed for this purpose was started in 1732 in Charleston, South Carolina [7, p. 51].

While life insurance, as we know it today, didn't appear on the scene until after 1750, it too is said to have had its beginnings in primitive times. Soldiers in the Roman Empire formed "burial clubs" to ensure proper burials for their peers [11, p. 135], since an improper burial was believed to create displeasure among their gods. As with fire insurance, life insurance also began within mutual organizations. In 1706 [13, p. 66], the Amicable Society for a Perpetual Assurance Office was formed In London. Each of its 2000 members paid an annual premium for up to three shares depending on the age of their members aged 12 to 55. At the end of each year, these "amicable contributions" were distributed among widows and children of deceased members in proportion to the number of shares that they had purchased.

## 1750 – 1799

During the following fifty years, insurance flourished, but primarily for general insurance purposes. A total of 24 charters were granted for insurance between 1787 and 1799 [7, p. 65]. Much of this business was still maritime-based. In one twist, ironic by today's realities, one company started offering ransom insurance for the purposes of "…insuring persons against capture by Algerians, etc." [7, p. 66]. If the insured individual died before the ransom could be delivered, however, the company was not obligated to pay the benefit. For whatever reason, many of these early general insurance companies did not survive.

This time period, however, did witness further development of the life insurance concept. In England, for example, a rival to the Amicable Society – The Society for Equitable Assurances on Lives and

Survivorships – petitioned for a charter to start a life insurance business in 1757 [7, p. 39]. This business model was different from that of the Amicable Society in that it accepted insureds from a wider range of ages, and insurance premiums were established based on the age of the insured. The "Equitable" was granted its charter in 1762, and is typically thought to be the first example of today's modern life insurance company.

Meanwhile, at approximately the same time, the life insurance concept started to develop in the United States in religious communities. In 1759, for example, ministers of the Presbyterian Synod of New York and Philadelphia created a "widows' fund" [13, p. 78]. Unlike the Roman soldiers, however, their purpose was not to keep the gods happy, but rather to provide relief for the poor and distressed widows and orphaned children of Presbyterian ministers. Episcopalian priests formed a similar organization in 1769 [7, p. 58]. It is also said that the benefits of life insurance were extolled during annual sermons, perhaps providing the earliest example of the saying "life insurance is sold, not bought."

While several charters were granted to insurance companies to offer life insurance during this time period, there seemed to be little demand for the product, and these efforts were largely abandoned.

## 1800 – 1849

It was not until the early 1800s that life insurance began to gain some traction in the United States, but even then it was a slow start. Early companies selling life insurance, for example, were in business for reasons other than distributing life insurance [7, p. 114]. The primary examples were trust companies, and even by the end of this period, these companies were still more focused on receiving and executing trusts [7, p. 87]. Yet it was during this period that the ground was laid for the concept of the mutual life insurance company.

Chartered in 1812 [8, Table 1], the Pennsylvania Company for Insurance on Lives and Granting Annuities was formed as the first commercial company to engage exclusively in the life insurance and annuity business [7, p. 75]. The company employed no sales agents, but rather "depended on intelligent publication to point out the needs and create the demand for its policies." The company sold more annuities than life insurance, as these were popular at the time in Europe to raise money for the government and private

investors. Once the company received authority to enter the more profitable business of executing trusts in 1836 , its life insurance business declined, and no new policies were issued after 1872 [7, p. 82].

Similarly, the Massachusetts Hospital Life Insurance Company was chartered to sell annuities in 1814 [7, p. 82] to raise funds for Massachusetts Hospital. The company was essentially given a monopoly in Massachusetts by the Commonwealth, but focused primarily on annuities and trusts since it was required to share its profits from life insurance with the hospital. Their life insurance premiums were very uncompetitive with other upstart life insurance companies in New York, Philadelphia, and Baltimore toward the end of this time period, and the company lost its monopoly in 1843 [7, p. 84].

Also noteworthy, from the point of view of distribution, was the establishment of Nautilus Insurance Company in 1845. Like the artisans of old, this insurance company attempted to sell life insurance from a storefront in New York City with little success [7, p. 102]. Shortly thereafter it was renamed The New York Life Insurance Company, and became the first life insurance company to build a significant agency system for the distribution of the product [7, p. 89]. In a nod to its heritage, the name “Nautilus” survives today in New York Life’s organizational unit that supports agents in more sophisticated applications of life insurance.

Perhaps the flash point that ignited the growth of **mutual insurance companies** (i.e., companies owned by their policy owners as opposed to shareholders), however, was a devastating fire in 1835 [7, p. 90] in the central business district of New York City. This fire resulted in an estimated total loss of $15,000,000 [7, p. 91], and numerous fire insurance companies went bankrupt as a result. Up until this time, fire insurance company stocks were seen as good investments, but this event turned investors away, leaving businesses and residents without adequate fire insurance protection. Consequently, mutual fire insurance companies were formed in large numbers, with 44 being chartered between 1835 and 1837 [7, p. 92]. Also contributing to this continued growth of mutual insurance companies was the subsequent financial crash of 1837, which resulted in a lack of investment capital for stock insurance companies [7, p. 92].

Consumers became increasingly aware of the participation rights that came with being a mutual company policy owner through their experiences with

fire insurance, as well as the mutual model for life insurance that existed in England, and their initial experience with mutual life insurance companies was positive. It was out of this environment that several large mutual life insurance companies, such as New England Mutual (1835), Mutual of New York (1842), Mutual Benefit Life (1845), and Connecticut Mutual Life (1846) [8. Table 1], were born. By 1850, life insurance sales were surging.

It is no coincidence that the companies driving the majority of life insurance sales by 1850 were all companies that employed life insurance agents. As mentioned earlier, attempts to sell life insurance direct in these early days of the industry were not successful, as is often the case with many new products. Consumer purchase preferences, however, were not the primary driver of the growth of agent distribution. Rather, it was a result of company finances. Mutual companies had no means of generating capital outside of the income generated from business in force. Thus, companies relied on revenue from aggressive sales activity to fuel their growth. As is often the case in developing life insurance economies, life insurance agents in these days were also often engaged in other business activities. Commissions on life insurance sales were approximately 10 percent of first year premiums, and 5 percent [7, p. 126] or less on renewal premiums. The big payday for a life insurance entrepreneur, was thus the landing of an executive position in the company’s home office. These positions were typically reserved for the most successful agents in the field, which helps explain why a sales mentality, rather than a marketing mentality, is so pervasive in many life insurance companies, even to this day.

It can be argued that the life insurance business as we know it today was born in the last decade of this time period. Up until this period, companies accepted a minimal amount of annual new business, since up until that point life insurance was only an ancillary part of most companies’ business activities. The revolution that allowed for greater sales growth was the emergence of the agency distribution channel in the 1840s.

### 1850-1899

The early years of this period saw continued growth in the number of mutual life insurance companies utilizing agents to distribute their products. Examples were Northwestern Mutual in 1858, and The Equitable

Assurance Society in 1859 [8, Table 1]. Once the country returned to normalcy following the Civil War, the life insurance business witnessed several significant changes. It was during this period, for example, that the general agency system emerged and was refined. This was inevitable as the growth in the mutual companies' business, and its spread west, necessitated the development of a field management organization to oversee an increasingly large and increasingly dispersed field force.

With increasing competition came more aggressive marketing [7, p. 138], increasing sales commissions, and sales practices that heretofore were considered inappropriate for this traditionally well-mannered industry. For the first time, agents could be heard disparaging their competition, and replacement of other companies' business also began to appear. Companies also responded to the increased competition in the business with creative new products, some of which were subsequently ruled illegal. The best example of this was the "deferred dividend policy" created by The Equitable in 1867, also known as a tontine [9]. A portion of the premiums for this policy went toward the policy itself, while another portion was directed into an investment fund with a set maturity date that benefited a restricted group of policyholders. Agents aggressively marketed this new product, often with inflated estimates of future returns, and shortly after the turn of the century, it is estimated that two-thirds of the life insurance policies in force in the country were tontines [9]. This, along with other sales practices lead to the well-known Armstrong Investigation in 1905, which established regulations on sales practices and controls on sales expenses, many of which still exist over a century later.

Other companies, during this time of heavy competition, chose to compete by avoiding competition head-on, and instead looked to do business in under-served niche markets. It was during this time, for example, that fraternal benefit societies began to underwrite and distribute life insurance. [13, p. 93] These organizations were voluntary service and social benefit associations organized around a shared characteristic such as ethnicity, religion, or profession. While these organizations have operated throughout the history of the country, it was during this time period that they grew significantly, and expanded their member services to include life insurance, which was typically sold to working-class Americans. The life insurance operations of these societies were most often organized as mutual companies, and by the turn of the century there were over 600 [8] of these in existence. While they are no

longer the competitors of the main line life insurance companies that they once were, many of them have survived to the current day.

One of the industry's best examples of niche marketing, however, was also launched during this time period. Companies such as John Hancock (1862), Metropolitan Life (1868), and Prudential Life Insurance Company (1875) began to market **industrial insurance** [8, Table 1]. This concept was imported from England, and involved selling low face amount policies to lower income families. Agents collected premiums (often ranging from $.05 to $.50 [8]) on a door-to-door basis every week coinciding with the day these workers were paid. Medical examinations were often not required for these small amounts of coverage, and policies were also often written on the lives of children in these families. This life insurance business model, known as the **debit** or **home service** business, still exists today, mostly in rural and inner city markets. It is, however, a fraction of what it once was, and home collection of premiums is not commonly found. Yet it is significant to note that many of the giant companies in the business today were built on the nickels and dimes spent by lower income Americans out of love for their families.

### 1900 – 1949

By the turn of the century, many of the life insurance distribution models that characterize the industry today were firmly in place. Yet there continued to be changes in the marketplace that resulted in further evolution of the business and its distribution methods.

One of the biggest changes in the country was the mass distribution of the automobile, which obviously created the need for automobile insurance. This also spawned a variant of the agency system that remains a major force in life insurance distribution today; i.e., the multi-line exclusive agent. Farmers and other rural residents, complained that they should not be charged the same rates for auto insurance as drivers in the much more congested cities. As a result, Farm Bureaus started offering general insurance, and over time added life insurance to their portfolios. The agents of these companies to this day sell a wide portfolio of products, but only for their company (i.e., they are **exclusive** to their companies), and have expanded way beyond their rural, Farm Bureau heritages.

Another innovation came in 1911, when Equitable Life Assurance Society wrote the first group life policy covering 125 employees of the Pantasote

Leather Company [8]. Within eight short years, a total of 29 companies were issuing group life insurance [8]. Such policies typically provided coverage to workers without applications or medical examinations as a part of their employment contract, with premiums fully paid by employers. As this business developed, it took a separate direction than the individual life insurance business, and companies in this line of business typically developed distinct group insurance departments and specialists who marketed these products to corporations rather than individuals. In fact, in many companies, group insurance was viewed as a competitor to individually purchased life insurance. Group life should not be confused with individual life insurance marketed at the worksite, which appeared on the scene later in the century. In **worksite marketing**, individual employees are solicited at their place of work for individual life insurance coverage, often sold as coverage to "supplement" their group policy. Such policies are, however, owned by the individual, not the employer, with the premiums being paid by the employee. Such payments, though, are usually made through payroll deduction.

Finally, during this time period, several companies found and exploited niches in the marketplace for specific product offerings and services. Northwestern Mutual, for example, is often credited with developing applications for life insurance in the business market for such purposes as insuring key employees or arranging for the orderly transfer of a business in the event of an owner's death [12]. Prior to the advent of Social Security in 1935, other companies actively marketed life insurance as a way of ensuring a comfortable retirement. Phoenix Mutual Life, for example, was known for decades during this time period as the "Retirement Income Company."

## 1950 – 1969

These two decades were a relatively quiet period for the life insurance industry. Both the business and the country were settling down after the turmoil of the Second World War, and there was little new when it came to the individual life insurance product and the way it was sold. The industry basically sold whole life, term, and endowments through career life insurance agents, albeit endowments were significantly declining in popularity by this period of time.

Given the dramatic changes that were about to emerge in the decade of the seventies, it is important to take note of the interest rate environment

of the decade of the forties and most of this period. Not only were short-term interest rates historically low for most of the 1940s, but also the relative spread between long and shorter interest rates was historically high. This was ideal for selling a product such as whole life that provided consumers at least partial access to long-term interest rates. Once the interest spreads narrowed towards the end of the 1960s, the advantage of whole life's static long-term returns began to disappear.

## 1970 - 1999

This period in the industry's history is best described as the "product revolution." Perhaps the tipping point to this revolution was in 1979 when the Federal Trade Commission (FTC) published a report that strongly criticized whole life insurance. Among other things, it made the strong suggestion that consumers would be better off if they **bought term, and invested the difference**. This appeared to launch greater interest and competition for term life insurance, but it was coincidently a time when other forms of permanent life insurance – universal life, variable life, and variable-universal life – also arrived on the scene.

This product revolution was not independent of changes occurring in distribution, and served to fuel some of these changes. Specifically, the 1980s saw more and more companies exiting the agency building business, as many viewed it as a more expensive distribution channel. Instead of recruiting and training new agents, their strategy turned to selling through independent agents (many of whom had "outgrown" their agency management structures) or agents of other companies. In the life insurance industry, this strategy is known as using a **brokerage** distribution channel.

At this point, it is important not to confuse the life insurance business's use of the term **brokerage** with how this term is used to describe investment advisors, property and casualty agents, or agents who sell employee benefits. In the context of life insurance it simply means selling products through independent agents or career agents of other companies. The company that has chosen to be a "brokerage company" has simply decided to compete as a manufacturer and wholesale distributor of product, and not as a retailer to the consumer. Not surprisingly, it is mostly these companies who argue that their customer is the producer and not the end buyer.

Brokerage business was nothing new to the industry, but until now had been mainly reserved for specialty products or substandard business that

a company did not want to write. Many of the main-line mutual companies fought the trend toward cheaper term and/or the proliferation of new products sweeping the industry, allowing brokerage companies to gain market share among agents whom the career companies had spent money to recruit and train. This became a major strain on the successful financial management of the agency system.

Whether the growth in the brokerage distribution channel was a result of companies exiting the agency building business because of expenses, or of career agents outgrowing the need for support provided by an exclusive agency, the product revolution created an ideal environment for such a transformation. These new products gave agents an opportunity to introduce customers, both new and current, to new and potentially valuable features and benefits, especially when compared to traditional non-par whole life or yearly renewable term.

With current clients, in many situations agents could rationalize replacing in-force policies with ones better suited to the current economic environment. To the extent these clients had built up equity in their current policies, products were designed such that this equity could be rolled right into the new policy. For new customers, the transparency of the new products, especially the concept of credited interest made the products easier to sell in the eyes of many agents. It became an investment sale rather than simply death protection.

For many career agents, with current clients as a primary market, this meant they had a product, not necessarily even manufactured by their current company, which was relatively easy to sell to those clients. The relative ease of the sale reduced the need for them to rely on the support and services provide by their company to effectively convert their clients to these new products. For new agents, if they could identify customers who already owned some life insurance, they could position themselves to do essentially the same thing without relying on the extensive training and support provided by career companies.

At the same time, companies that did not use career agents recognized that there was a growing pool of agents that would sell their new products without the expensive financing, training and sales support. They could use the money they did not need to spend supporting a career agency force to increase agent commissions or their products' competitiveness. This left career companies with competitors that oftentimes had more attractive

agent compensation packages or products, while they were spending money on expensive agent support systems not always valued by their agents. For many but a handful of companies using career agents, the only solution was to abandon that form of distribution.

The last decade of this century also witnessed experimentation with a wide variety of new ways to distribute life insurance to the public. This experimentation was enabled during this time by the slow erosion of the 1933 **Glass-Steagall Act** that had erected barriers between various financial institutions, culminating in the 1999 signing of the **Gramm-Leach-Bliley Act**. This Act allowed financial institutions to participate in each other's lines of business. As a result, this period saw attempts to market life insurance through kiosks in shopping malls, department stores, grocery stores, commercial banks, savings & loans, credit unions, and stockbrokers. Of these, the most successful were banks and stockbrokers, but even here these success stories were for specific products and/or in specific sales situations (e.g., estate planning) that were mediated by a life company wholesaler.

Direct response marketing of life insurance, while never achieving a large industry market share, also grew during this time period. The primary success stories here, were in very targeted marketing approaches or in affinity group marketing. Examples would include USAA, serving the insurance needs of military officers; Gerber Life, selling small juvenile policies; and Amica Life, serving the life insurance needs of its parent company's auto and homeowner clients. Since this time, each of these companies has widened its marketing efforts, and this entire business model has shifted away from purely direct mail, to direct mail combined with call centers. The direct response business continues to evolve today as companies experiment with online marketing through the internet and the use of social media.

It should be noted that the 1990s witnessed major scandals and investigations involving inappropriate and aggressive sales practices by agents. In addition to costing many companies hundreds of millions of dollars in lawsuits and penalties, these also resulted in the emergence of large and powerful compliance departments in life companies, and increased scrutiny by company broker-dealers in agents' sales of variable products.

## 2000 – Today

This brings us up to the present, and the distribution landscape continues to evolve. The turn of the century brought with it significant consolidation of companies through merger and acquisition activity, some of which was driven by overseas companies. (It is interesting to note, however, that as this text is being written, acquisition activity by overseas companies has slowed, and several European parent companies are actually divesting themselves of their North American subsidiary companies. This is in part driven by greater financial pressure on these parent organizations resulting from new, and more stringent, solvency reserve requirements on the European continent.)

During the first decade of this century, the industry also saw a wave of demutualizations as companies sought new ways to raise capital. Today, the number of major life insurance companies operating as mutuals can be counted on two hands. In a sense, the industry has completed a 150-year journey from the mid-1800s, when the number of stock companies could be counted on two hands. This is significant for the distribution of life insurance in the fact that few stock companies are actively involved in the recruiting, hiring, and training of new agents. Stock companies that maintain retail agency systems also appear to be putting greater resources in the pure manufacturing and wholesaling sides of their business. This has caused more than one industry executive to observe that the industry has "too much manufacturing capacity chasing too little distribution." Consequently, in many companies today, "distribution is king."

With fewer companies recruiting and hiring new life insurance agents, there is a lack of new blood to fuel the independent agent system and a succession challenge in the independent agency world. This is resulting in a wave of mergers, acquisitions, and restructuring of independent agencies. Many of these agencies are building their own support structures and services for their producers (e.g., marketing), as companies are trending toward pure product manufacturing only and discontinuing such services. Recent years have also seen agents banding together in various types of **producer groups**, often in order to pool production for the purposes of achieving higher compensation bands.

Finally, although not new to this decade, recent years have also seen growth in so-called **Independent Marketing Organizations** (i.e., IMOs). These are typically large independent agency-like organizations

that provide many of the sales and support services traditionally provided by companies. With many companies exiting the agency building business in the final decades of the century, IMOs may be viewed as filling this void.