

LIFE INSURANCE CFO SURVEY #10: DISTRIBUTION ISSUES

SUMMARY OF FINDINGS

In the 10th installment of its Life Insurance CFO Survey, the Tillinghast business of Towers Perrin focused on issues related to distribution and, in particular, the effects of recent regulatory inquiries and the NAIC broker disclosure model amendment. Not surprisingly, our survey results showed that distribution is a critical issue for most life insurance companies, one that is fundamental to the success of the business. While distribution productivity gaps have challenged the industry for many years, new issues have surfaced recently around distributor remuneration. These issues are creating new challenges for CFOs and their companies, and are likely to lead to significant changes in the operating model and cost structure of the industry.

CFOs AGREE SIGNIFICANT DISTRIBUTION CHANGES ARE LIKELY

Considerable attention has been devoted to distribution practices, producer compensation practices and possible disclosure of broker compensation arrangements in the commercial lines property/casualty and group benefit businesses, and there has

been speculation that these changes might “migrate” to the individual life and annuity businesses. Given the state of flux in the industry, it is understandable that our CFO respondents did not generally agree on the issues underlying distribution and remuneration (*Exhibit 1*). What CFOs did agree on

is that significant changes are likely. Over 90% of respondents said that tightening of regulation regarding the provision of “advice,” mandated disclosure to the consumer of the relationship between producer and provider, and an increase in insurance carrier accountability are likely (*Exhibit 2*).

EXHIBIT 1 Underlying Distribution and Remuneration Issues

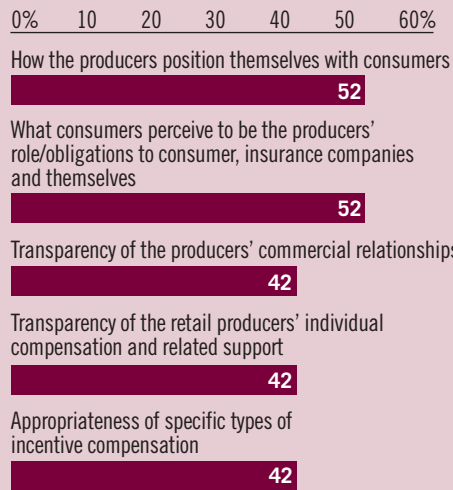
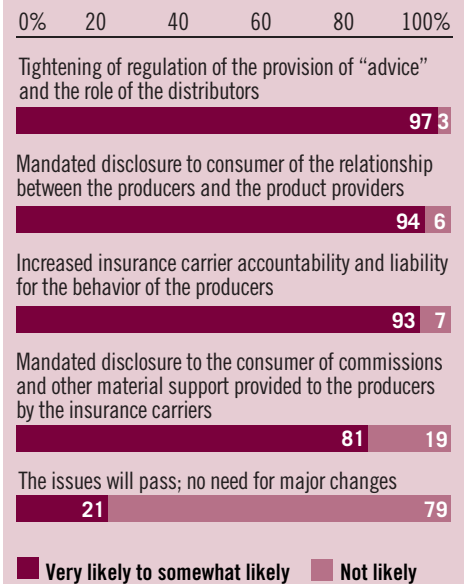


EXHIBIT 2 Likely Actions/Responses



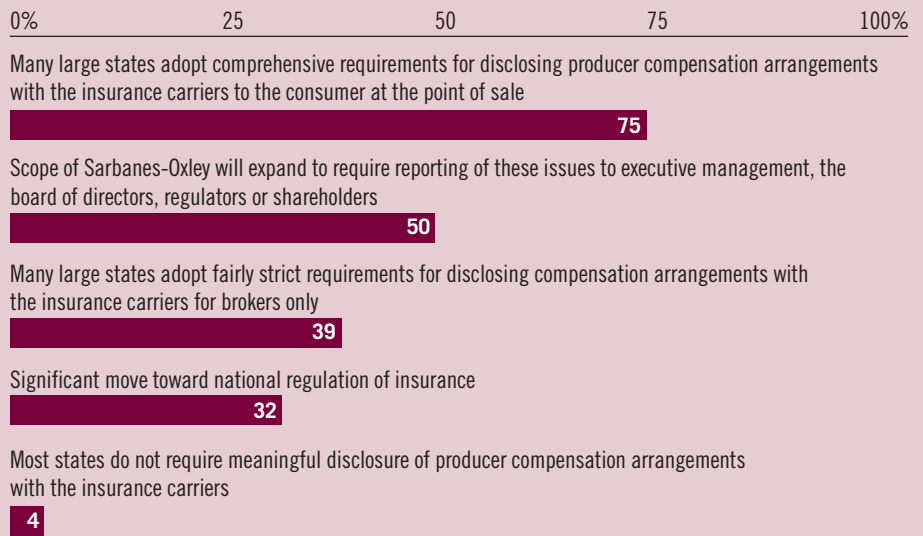
MANDATORY COMMISSION DISCLOSURE EXPECTED AT THE POINT OF SALE

Three-quarters of CFO respondents expect that many large states will adopt comprehensive requirements for disclosing producer compensation arrangements with insurance carriers to the consumer at the point of sale within the next two years (*Exhibit 3*). If such disclosure is mandated, respondents said that insurers will be forced to increase the infrastructure, transparency and discipline devoted to managing non-commission remuneration and support.

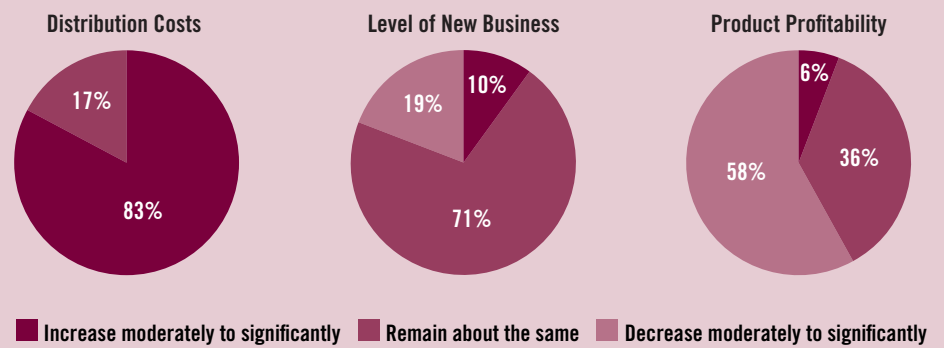
DISTRIBUTION COSTS WILL INCREASE WHILE PROFITABILITY SLIDES

CFOs expect that the regulatory and distribution issues facing the industry and likely company responses will have a significant impact on the broader life insurance industry over the next three to four years. Over 80% of respondents expect distribution costs to increase, while nearly 60% expect product profitability to decrease (*Exhibit 4*). Interestingly, CFOs do not expect a significant positive or negative impact on the level of new business written. Clearly, profit margin pressures will continue to increase.

**EXHIBIT 3
Regulatory Changes Expected Within Two Years**



**EXHIBIT 4
Effect of Regulatory and Distribution Issues on:**



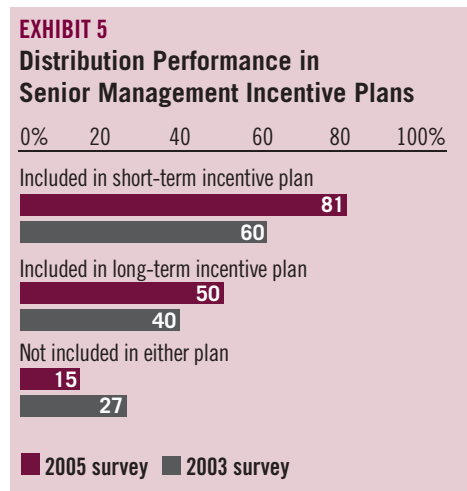
DISTRIBUTION IS KEY ISSUE FOR CFOs

In a recent Tillinghast survey, CFOs identified distribution effectiveness and efficiency as one of the top three challenges to achieving their company’s growth and profit objectives in 2005. In the current survey, nearly 90% of CFO respondents considered distribution to be the most important issue facing their company or of high importance relative to other issues. Given the significance of this issue, CFOs are very involved in a number of high-level distribution decisions. Their focus is primarily on investment decisions, expense budgeting, revenue forecasting and proprietary product strategy. They are much less involved in day-to-day decisions and operations such as improving agent productivity. Particularly given the industry’s overall growth challenges and the persistent nature of distribution productivity gaps for many companies, it is no surprise that management is focusing increasing attention on understanding and managing the underlying economics of their distribution “business.” Accordingly, an important partnership is emerging between CFOs and distribution/marketing leadership to better manage a shared set of challenges.

SENIOR MANAGEMENT PAY LINKED TO DISTRIBUTION PERFORMANCE

To reinforce the importance of distribution and ensure that they “get it right,” more companies are linking distribution performance to senior executives’ pay. In fact, over 80% of companies surveyed said that distribution performance is included in short-term incentive plans for their senior managers, up significantly from the 60% reported in our 2003 CFO survey on distribution (*Exhibit 5*). However, the measures used to evaluate distribution performance remain fairly traditional. The vast majority of companies evaluate performance on the basis of sales growth and persistency of in-force business, and these measures are gaining in popularity.

Only about one-quarter of respondents appear to manage distribution as a separate business and evaluate performance on the basis of distribution profitability. Some leading companies are focusing on more sophisticated and challenging performance metrics, reflecting their recognition of the need to capture the entire economic contribution of the distribution function. Examples include use of a P&L framework that incorporates distribution revenue (allowances priced into the products sold) and expenses, or application of economic value concepts to enable analysis of the economic contribution of new business from distinct distribution channels. Companies that understand the profitability of new business produced by various distributors and channels tend to be more disciplined in their investment and management decisions.



**INDEPENDENT LIFE AGENTS/
BROKERS ARE TOP CHANNEL**

Over 60% of CFO respondents reported that independent life agents/brokers are a significant distribution channel (i.e., more than 10% share of new business) for life insurance products (*Exhibit 6*). The findings were identical for annuity products. This represents a shift from our 2003 survey, in which the career agency/controlled channel was listed by the majority of respondents as a significant channel. Compared to the 2003 survey, banks have gained in popularity, while wirehouses, direct response/Web and financial planners have all dropped fairly dramatically for life insurance products.

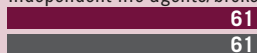
EXHIBIT 6

Significant Distribution Channels

(more than 10% share of new business)

0% 20 40 60 80 100%

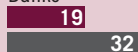
Independent life agents/brokers/PPGAs



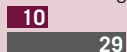
Career agency/controlled



Banks



Wirehouse/regional firms



Direct response/Web



Financial planners



■ Life ■ Annuity

For annuities, companies are increasing their focus on independent life agents/brokers/PPGAs. Fewer companies are focusing on career systems and we see a decline in reported emphasis on financial planners. (We note that other industry trends indicate that financial planners are an important and increasing source of annuity production.) We believe that this reflects two important distribution trends. First, fewer companies remain truly committed to the comparatively fixed costs of career or proprietary retail distribution, notwithstanding the comparatively consistent production that results. Second, most companies continue to expand into multiple distribution channels as they pursue growth opportunities in a relatively mature marketplace, while favoring more variable cost operating models. However, while most companies are using multiple channels to distribute their products, only one or two of them are typically dominant for the distribution of life insurance and annuity products.

**POSITIVE OUTLOOK FOR FIRST
QUARTER 2005 RESULTS**

Despite concerns about distribution, CFOs' outlook for first quarter 2005 results was generally positive, particularly for new life and annuity premiums. Nearly three-quarters of respondents predicted 4% or higher growth in new life and annuity premiums over the same quarter last year, and over half expected first quarter revenues to increase by 4% or more (*Exhibits 7 and 8*). In addition, nearly 60% expected first quarter net income to increase 4% or more compared to the same quarter last year (*Exhibit 9*).

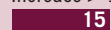
EXHIBIT 7

New Life and Annuity Premiums

(predictions for first quarter growth)

0% 15 30 45 60%

Increase > 10%



Increase 4% to 10%



Stay about the same (+/- 3%)



Decrease



EXHIBIT 8

Revenue

(predictions for first quarter growth)

0% 15 30 45 60%

Increase > 10%



Increase 4% to 10%



Stay about the same (+/- 3%)



Decrease



EXHIBIT 9

Net Income

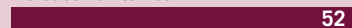
(predictions for first quarter growth)

0% 15 30 45 60%

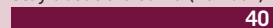
Increase > 10%



Increase 4% to 10%



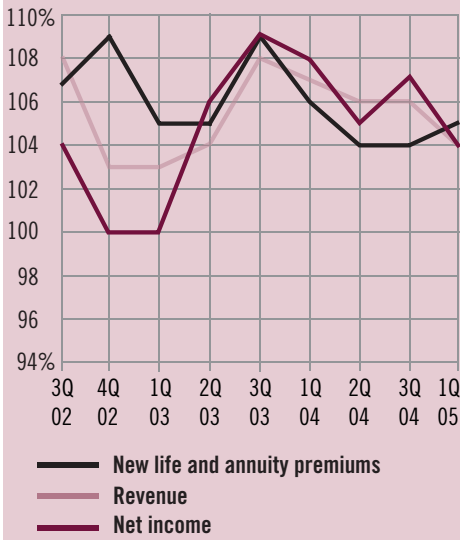
Stay about the same (+/- 3%)



Decrease



EXHIBIT 10
Year-Over-Year Growth Index*



*Data for 4Q 03 and 04 are not available.

Tillinghast has also developed growth indices (based on the weighted average of survey responses) to summarize respondents' year-over-year growth outlook. Values between 97 and 103 are taken to be basically flat growth. Indices for the current quarter indicate little growth, ranging from 104 for revenue and net income to 105 for premiums. CFOs' confidence regarding the outlook for growth in year-over-year revenue and net income has slowed since the third quarter of 2004, as evidenced by *Exhibit 10*. These results reflect the comparison with a strong first quarter in 2004 as well as the current economic uncertainty and weak stock markets.

Note: These results reflect CFOs' outlook at the time they completed the survey and may or may not reflect company performance actually emerging.

ABOUT TILLINGHAST'S NORTH AMERICAN LIFE INSURANCE CFO SURVEY

This Web-based survey, which was conducted in February 2005 and March 2005 by the Tillinghast business of Towers Perrin, is the 10th in a series of pulse surveys that explore issues important to the North American life insurance industry and its CFOs. This three-part survey focused on issues related to distribution, effects of recent regulatory inquiries and CFOs' expectations for first quarter results.

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PARTICIPANT PROFILE

In this survey, 31 CFOs (44% of the program's 70 registered members) participated. Since all survey questions were not applicable to all companies, the respondent base varied from question to question. Respondents primarily included CFOs from large and midsize North American life insurance companies; 55% had assets of \$5 billion or more, and 16% were multinationals (*Exhibits 11, 12 and 13*).

EXHIBIT 11
Company's Primary Line of Business

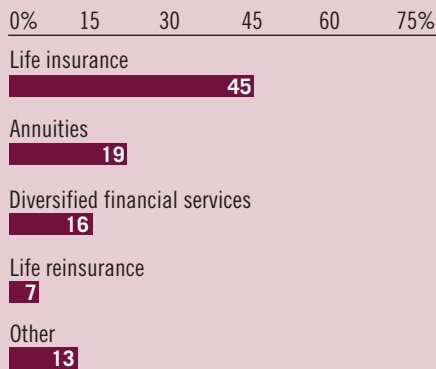


EXHIBIT 12
Life Insurance Organization Structure

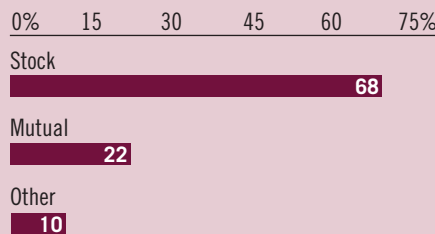
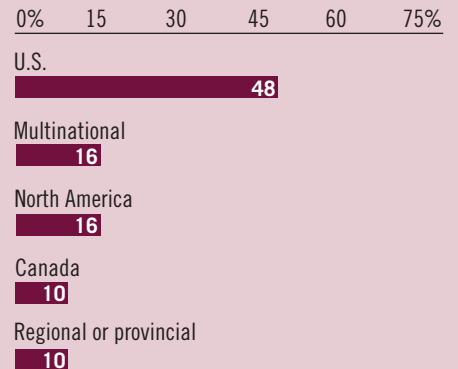


EXHIBIT 13
Scope of Company Operations





Towers Perrin is a global professional services firm that helps organizations around the world optimize performance through effective people, risk and financial management. The firm provides innovative solutions to client issues in the areas of human resource strategy, design and management; actuarial and management consulting to the financial services industry; and reinsurance intermediary services.

The firm has served large organizations in both the private and public sectors for 70 years. Our clients include three-quarters of the world's 500 largest companies and three-quarters of the *Fortune* 1000 U.S. companies.

Towers Perrin has offices in 24 countries.

Our businesses include HR Services, Reinsurance and Tillinghast.

The Tillinghast business of Towers Perrin provides global actuarial and management consulting to insurance and financial services companies and advises other organizations on risk financing and self-insurance. We help our clients with issues related to mergers, acquisitions and restructuring; financial and regulatory reporting; risk, capital and value management; products, markets and distribution; and financial modeling software solutions. More information about Tillinghast is available at www.towersperrin.com/tillinghast.