The Future Isn't What It Used to Be

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This article is based on an initiative that I was part of when I worked in the actuarial department at John Hancock in the late 1960s to forecast the future life insurance marketplace.

Many years later, while I was a senior consultant in the financial services practice of Arthur D. Little, I wrote this article based on the lessons we learned from the John Hancock project for Best's Review. A.M. Best's published it in February 1991 in Volume 91 No. 10 of the Best's Review Life/Health Insurance Edition.

I thought the lessons discussed in the article, including understanding the shortcomings of "trying to predict a future insurance market" and the issues that insurers need to consider – aging population, required products, bundling versus unbundling of life insurance products and services, customer and agent service considerations, customer and market segmentation, and changing mix of distribution channels, continue to have relevance for the 21st century insurance industry.

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The Future Isn't What It Used to Be

By Barry Rabkin

Determining the future depends a great deal on where you place the crystal ball on the table, since its location defines both your perspective and the results. If you went back to the 1960s to determine the potential saturation of the life insurance market by the year 2000, your approach would take into account the environment of that time. Demographic projections would have been influenced by what the traditional family looked like then – working father, stay-at-home mother, and 2.3 children – as well as the societal values of that time. You would not take into consideration single-parent households, significant numbers of women entering the labor force, or the tendency for women to marry later and have fewer children.

Moreover, it is unlikely that the products you projected as being on the market in 2000 would have included equity products such as variable life insurance, universal life insurance or variable universal life insurance. You probably would expect your company's competitors to be limited to insurers you regarded as worrisome. The list would not have included nontraditional players like those in the stockbrokerage, banking or merchandising community.

This demonstrates that as we look into the future of the life insurance marketplace in the 1990s, we must accept the limitations that inevitably cloud the crystal ball. The future is not a clear, straight-shot projection but instead bobs and weaves. New products and distribution methods are accepted at different times for various groups of people and regions. Driving those new products or distribution methods are the changing needs, expectations and requirements of the increasingly fragmented insurance marketplace.

The first life insurance companies in the United States generated business with low acquisition costs by using a target marketing strategy which did not require

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agents. Over time, the industry evolved from that initial target marketing process to mirror the mass market campaigns of other industries. Only relatively recently have some insurers come to the conclusion that segmentation may be a better way to maintain profitability by targeting niches like the newly married, who are beginning their lives, or people who are close to or in retirement. Most insurance companies, though, are still chasing after the nonexistent mass market just as the thirsty person in the desert attempts to reach an imagined oasis.

AN AGING AMERICA

The most important force driving changing customer needs is the aging of America. Currently the median age in the United States is 30. When the first wave of Baby Boomers – those people born between 1946 and 1964 – retires, the median age will have increased to 39. When the last wave of baby boomers retires, the median age of the U.S. population will be almost 42. Moreover, life expectancy is increasing for both men and women, so the elderly will be with us longer.

Insurance customers and prospects are making clear the implications of these figures. They have a well-founded fear of outliving their assets. For consumers, the game is no longer to gamble on whether you will die too soon but rather on whether you will live too long. With the increased age span, it is entirely possible for families to have up to four generations alive at the same time. For such families, nursing home costs, retirement costs and the costs of a college education may all have to be considered simultaneously.

What all this means in terms of the crystal ball is that the insurable event is no longer protecting one's life: the insurable event is protecting one's lifestyle. Customers or prospects want to know that the necessary cash-flow stream will be available when it is needed.

The significant awakening of insurance consumers to the purchase of products that would meet their financial expectations and needs began in the early 1980s with universal life. It was then that disintermediation became a common industry term as customers' buying behavior made apparent their desire for unbundled

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products. Insurance companies, which perceived yet another mass-market product opportunity, leapt into the equity-sensitive market in droves. However, equity-sensitive products were not appropriate for all consumer segments. The customer's propensity to unbundle is coupled with his or her level of sophistication – which, in turn, correlates with sufficient financial means to unbundle.

For people with neither the sophistication nor propensity to unbundle, whole life is one of the products that has been called on to meet a broad spectrum of needs. People with a medium level of sophistication and a medium propensity to unbundle are customers for universal life, financial planning, mutual funds, certificates of deposit and term life. People with a higher level of sophistication and a higher propensity to unbundle are customers for annuities, key person insurance and stocks. An insurer must therefore target those consumers whose needs it can best meet with its resources.

Currently, the product mix is beginning to reflect how the insurance industry is meeting a changing set of lifestyle needs. These needs are being driven by the aging of America and the steady evolution away from the traditional nuclear family into increasingly smaller household fragments with potentially weaker family care networks. Those insurers that have relied on life insurance as the main product line have seen erosion – either to annuities or other savings-type products which offer financial support to this brave new world.

The Life Insurance Marketing and Research Association's Security Expenditure Survey, which looks into both private and public spending to guard against the risks of dying too soon, living too long, or experiencing poor health or disability, bears out this changing product mix. That study's results make it apparent that: (1) Spending on retirement products is increasing significantly; and (2) Spending on health products, while significant at a third of the total, has not increased as much as might have been though, given the rise of health care costs.

These trends, along with the diminishing share of the spending for life products, indicate that the insurance-buying public definitely is interested in "living

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benefit" products (used here as a term that encompasses products that supply a cash flow to people while they are living rather than to their beneficiaries or estate after they pass on).

GROWING COUNTERTREND

At the same time that customers are meeting their accumulation needs through unbundled products, as seen by the remarkable surge in annuity purchases, a growing countertrend is evidenced by the converging products, like living benefits insurance, which the industry is offering in response to market needs. Product forms that cross traditional boundaries of life, health, disability or retirement illustrate the product convergence phenomenon taking place in the marketplace.

For example, the living benefit products that feature a long-term car rider on a life insurance policy allow customers to receive their life benefits early and apply these monies to their health or long-term care needs. Further, a few insurance companies are experimenting with mixing some types of annuities with the LTC instrument. These companies recognize the over-riding need for "sinking fund" types of products that will either provide cash and/or benefit payments to support the customer's lifestyle requirements as the years move on.

Product portfolios are becoming increasingly complex because both unbundled and convergent products are being offered to meet similar needs. In addition to the present crop of long-term care products, increasing annuity products will be appearing in the marketplace within the next year. These instruments will provide annuitants with a monthly amount that increases commensurately with projected payments to medical or life care providers.

SHARPENING SKILLS

Insurers will need to improve their field underwriting skills to support this new, complex range of products. Prospects will not automatically quality simply because they want a product. At the very least, the distribution channels will need better tools to help them reach those customers or prospects who are most likely to need the products and to qualify for acceptance. The materials that are used to

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explain the products to the agents or the prospects will have to be more quickly and easily understood. Better and more extensive training of the agent will be required.

As the complexity of the products increases, so will the service needs. Both the field marketing representatives and the customers will be calling with questions. And the answers will have to be provided relatively quickly if the insurance company expects to maintain or increase market share in these product areas.

These trends have implications for the economics of the distribution channels. Not so long ago the insurance industry thought that the marketplace would be seeing iterations of equity-sensitive products, which are basically accumulation-bundling mechanisms. The winning strategy, though, may be reaching customers with unbundled products and then using another vehicle, like a financial plan, to effectively rebundle the necessary cash-flow streams from the various products.

The product mix is changing to products with lower margins, like annuities and long-term care insurance. Will insurers be able to afford their large agency forces with the margins of these products? Will they be able to compete with companies like Fidelity, Vanguard or banks, which can offer no-load/low-load mutual funds with acquisition costs in the 1% or 2% range? Even a 5% to 7% increase in these costs will leave insurers, whose acquisition costs are higher, at a significant disadvantage. Will the industry begin to develop products that can be easily marketed with combinations of direct marketing techniques to find the most likely prospects for agents?

In order to reach the aging and fragmenting marketplace in this new decade, insurers will need to change the place and method of distribution. More time will be needed to close a sale. Insurers will realize that they need to segment and remix their distribution systems by function and type, if they are to maintain reasonable acquisition expenses and be successful. Function covers the spectrum from market development – identifying those prospects whose needs can best be met by both the products and the specific distribution channel – to

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prequalification, qualification, presentation, close, referrals, cross-marketing and service.

Types of distribution will range from career agents to independent agents or personal producing general agents, to contract arrangements with banks and merchants, to use of direct marketing tools, such as direct mail and inbound or outbound telemarketing. Historically, direct mail has represented less than 2% to 3% of life insurance sales. Attempting to replace the agent has been the problem: the trend in the next decade will be to use direct response marketing to augment the agency force, not to replace it.

Complex products such as long-term care do not lend themselves to successful mail or telephone closes. However, to remain efficient, some insurers will need to use these nontraditional target marketing techniques to identify likely candidates for solicitation and prequalification. Moreover, some customer segments will use the telephone to obtain simple answers to questions about fund balances or rates in effect for current contributions to annuities.

The trend will be for insurers to determine the effective balance between the necessary distribution functions, the products, and customers' and prospects' needs. Insurance companies will realize that the right channel will depend on what function is needed at a specific time in the distribution or delivery process. That, in turn, will rest on the nature and strength of the relationship between the customer and the insurance company.

WORKPLACE ISSUES

Workplace or sponsored marketing will increase as employers realize that they will come off as heroes and still not have to change their own administrative systems or employee benefit plans. Employees will continue to realize that the burdens of choice and risk are being passed to them. The skill levels required to make a close in the workplace will be divided. An experienced life insurance representative will need to understand the employer and employee dynamics to establish a relationship with the corporation. A less experienced marketing representative will actually penetrate the account.

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The time to close the sale will increase for the "living benefit" type products – whether we are talking about accelerated benefits, long-term care, increasing annuities, or perhaps a reverse annuity mortgage. The older consumers perceive these purchases as both important in their lives and expensive. Therefore, both the insurance company and the distribution channels will have to make a greater investment of time. The agency force will need to spend more time communicating the costs and benefits of the insurance products and services. The company will need to spend more time up front in the product development process establishing clear and easily understood promotional and marketing material.

Four recommendations come out of the crystal ball with regard to the distribution process. First, the industry must practice economies of scope by developing product forms to cover more than one risk and by training agents to prospect for more than one risk in a household. It will be critical to success to extend the customer relationship through cross-marketing. Second, to effectively reach the markets, products, and their requisite services must be better matched as they go through the distribution channels. In addition, insurers and agents will need to understand the local area markets to bring the prospects the products that meet their needs.

Third, insurers should look to other industries for examples of exemplary retail marketing and satisfaction of customer needs. Companies like American Express, The Limited or L.L. Bean are reaching out and serving more clients every day. Finally, field underwriting will have to improve. As insurers match products to distribution channels and markets, they will also ask the agency force to better qualify their prospects. More training and tools will be required. Direct marketing techniques will have to be more finely tuned to reach the right people with the material best positioned for that market.

NEW PATH TO SUCCESS

In the coming decade, new players will enter the market with their own values and strategies rather than being limited by the experiences of the traditional

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players. Moreover, the probable changes in the regulatory constraints and new competitors oriented to the customer perspective will alter the dynamics and conditions of success.

New entrants into the marketplace include possible competitors like Axa Midi, the Parisian insurance company that attempted unsuccessfully to acquire Farmers Insurance Group. Axa Midi's chairman has said he will continue to try to enter the U.S. insurance market. And established competitors will try new customer-driven tactics. One insurer, for example, is entering into a joint venture with a Japanese company to penetrate the Japanese market in California.

Increased competition will certainly put the "gentlemen's club" out of business. Companies fighting for the same market or a diminishing share tend not to be too friendly. Throw in the trend away from life insurance as a mainstay of asset accumulation and you will have a downright donnybrook.

The competitive picture wouldn't be complete without a few thoughts about the individuals who have the resources to provide for themselves what insurers generally offer. For example, dual-income couples perceive less need for life insurance or even disability income insurance. With increased income the tendency to unbundle is greater, and the foreign competitors and banks will step in to compete in an obviously attractive market.

MASS MARKET OF ONE

The crystal ball shows three ideas relating to the competitive situation. First, the insurance industry will need to think globally but act locally. This ranges from keeping up with global competitors and their tendencies in their own markets, to realizing that to be successful you need to understand and reach a "mass market of one." All marketing is really local area marketing, and customers appreciate and stay with providers that know and service their territories.

Second, insurance and financial services companies will be regulated for each of the functions they are in: insurance, banking and mutual funds. This concept of the level playing field will accelerate as more Canadian, European and Asian

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firms enter the United States. In some of these countries, one institution provides all of these financial services.

Third, foreign competitors that now regard their customers as customers and not just holders of so many policies will force all financial service institutions to manage their total customer relationships instead of simply administering policies or accounts.

This last point has a significant bearing on the concept of customer service. More complexity in the product set, combined with an aging customer base, reinforces the need to continually improve the service the industry delivers. The industry will need to become much more committed to the customer and his or her needs. When that person calls with a question, the insurer must be able to offer the relevant information immediately, without asking for a policy or account number.

KNOW YOUR CUSTOMER

This can be readily accomplished since the industry is blessed with a great deal of knowledge about its customers. Insurers must begin to build, maintain and use customer information files. And this means files with information about the customer, not just the policies that he or she owns. That knowledge base must include when and what services the customer uses, what mailings he has been sent and his responses – or nonresponse – and what complaints he has registered. The files also should contain all relevant agency force information, including specifics about the marketing representatives who sold and are servicing the clients.

It is critical to recognize that customers view the insurance company as a whole entity; the insurer, in turn, must look at its entire relationship with each customer, not view him merely as a set of individual policy administrative records. It may help to consider the competitive ramifications of not keeping up with or surpassing companies like Fidelity and American Express, which use customer information extensively to provide quality service to their mutual fund and annuity customers, respectively.

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In the last few years the industry has heard much about getting back to the basics of life insurance: back to needs selling, back to traditional products and, naturally, back to the support of the agency system, which has been the backbone of the industry. The crystal ball suggests that demographic forces – the aging population, continued fragmentation of markets, and even a slowing population, particularly when compared with the baby boom population – along with lower margins on products and an increasingly larger mix of nontraditional competitors, will make the marketplace much more complex.

CLEARING THE HAZE

To clarify the haze in the crystal ball and to ensure their success in the coming decade, insurance companies should develop answers to certain questions:

- What set of distribution channels is best – including mix of function and type – for the markets the company is in or wants to be in? Are they the same ones the company has now?
- How will the company match the acquisition costs of its distribution channels with the products it is delivering to the market and still compete effectively against the mutual fund providers or banks?
- Is the company emphasizing the products needed by its markets or its agencies?
- Is the company choosing the appropriate group of competitors against which to measure itself? Is it taking into account the potential for foreign competitors to accelerate their designs on U.S. markets?
- Does the company have in place the necessary systems and procedures to supply the service requirements of its customer base, its prospects and its distribution channels?

The crystal ball will show that companies which address these and other strategic questions about the marketplace, distribution, delivery and product development will be profitable in the coming decade.

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