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Profile of a Term Leader

by John A. Tak

Today, as we watch term insurance rates continue to move downward, all of us are asking the following questions: “Can the rates get any lower?” and “How can a company make money selling term at the current rate levels?”

For many, the gut response to these questions is: “Reinsurers are driving the prices lower. Without them, direct companies cannot offer a profitable term product line.”

As I see it, the answer to the first question continues to be “yes,” although one has to wonder when the underlying mortality (the largest factor in term premiums) will reach its natural floor, reserve issues notwithstanding.

The answer to the second question is a bit more complicated. While I agree the reinsurance industry has contributed to declining term rates and has bolstered the profitability of some carriers, I believe the true term-market leaders exhibit the following four major characteristics, which have made them successful in this incredibly competitive market.

- ***Dedication to the Term Market*.** As with any other market, the companies leading the term-insurance market are those that are dedicated to being successful in that market. In these companies, term insurance is a major line of business that is given significant management attention and support.

  These companies know their customers (both insurance buyers and producers) extremely well and develop products and services that satisfy their customers’ needs. They know who their major competitors are (both in terms of product offerings and agent recruitment) and follow their competitors’ movements carefully. They use the information they collect to frequently review “the state of the market” to determine how, if at all, they should adjust their products, commissions, and services.

- ***Innovation*.** The term leaders are constantly looking for new ways to be more effective in the marketplace. One major innovation is the proliferation of underwriting classes.

  Some companies currently offer as many as eight underwriting classes. Realistically, it is impossible for all but the largest companies to track the mortality of eight underwriting classes with any statistical confidence. However, this innovation results in lower rates for the best classes than would otherwise be available. From a marketing standpoint, this approach has proven successful, as evidenced by the number of term-market followers that have increased the number of classes they offer to avoid being selected against.

  In terms of product innovations, the most notable is the lengthening of the level premium-term period. A number of companies are now offering level rates for 20, 30, or more years.

- ***Superior Operating Fundamentals*.** The term leaders are very effective in all phases of managing the term business.

  The management team is intimately familiar with term insurance and offers insightful direction to the company, and the marketing organization is very efficient in its distribution of the product. The producers receive competitive compensation that aligns the goals of the producer with those of the company.

  The underwriting team develops and follows effective underwriting requirements, supporting the product’s class structure. While being flexible, the underwriting team does not make exceptions that will have an adverse impact on the mortality of the block.

  Finally, the business, once issued, is maintained on an easy-to-use policy administration system that provides a wealth of management information to help the company track the business and to determine next steps.

- ***Financial Management*.** Term leaders watch the business very closely to be sure the business is performing according to expectations.

  They keep close tabs on actual mortality and expense experience and make adjustments (to the product, price, underwriting, etc.) to reflect material differences of actual to expected experience. Because of their superior operating fundamentals, these companies generally have mortality and/or expense assumptions that are lower than the industry average.

  With these favorable assumptions reflected in the price, these companies have a price advantage over other term writers.

The Role of Reinsurers

Because some reinsurers are charging historically low prices for reinsurance, many companies are reinsuring larger portions of their term portfolios than ever before. Because of the increased volumes, reinsurers are offering volume discounts, making reinsurance rates even more competitive.

While the fierce competition among reinsurers *and* direct companies is contributing to lower term rates, there are notable differences between reinsurers and direct-writing companies that are also important.

Reinsurers are exposed to the mortality of all their clients; therefore, they can spread the mortality risk over a larger base than a single direct writer can. This allows reinsurers to accept a larger risk tolerance.

Further, reinsurers typically have lower expenses than most direct companies. Because the direct writer normally administers the reinsurance arrangement, reinsurers require fewer resources to administer the same business. Reinsurers may also have lower target surplus and profit requirements than the direct company.

Finally, reinsurers are in a position to help the direct writer address other product issues, such as deficiency reserves and distribution risk. Together, these aspects of reinsurance help the direct writer produce a more competitive product.

In conclusion, while reinsurance helps many companies compete in the term-insurance marketplace, the leaders in the term market share four distinct qualities that set them apart from the competition. These qualities: dedication to the market, innovation, superior operating fundamentals, and effective financial management, combined with the benefits of reinsurance, give them the competitive edge.

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