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PROBLEMS, PROMISES AND PROFITABILITY THROUGH NEW PRODUCTS AND RESEARCH FOR THE DIRECT MARKETING DISTRIBUTION SYSTEM

Moderator:	KIRAN DESAI
Panelists:	ANTHONY DARDIS*
	KIMBERLY A. JOHNSON
	SPENCER KOPPEL
Recorder:	KIMBERLY A. JOHNSON

- Long-term care
- Dread disease
- Return of premium (ROP) products
- Long-term disability
- Targeting profitability through research

MR. KIRAN DESAI: The general sense is that in today's direct-response marketplace our title's list is in the descending order of magnitude. Today's consensus is that there are a lot of problems, and some promises, but little, if any, profitability.

I have had the privilege to launch various new direct-response products in many countries. These included bread and butter senior life, hospital indemnity plans (HIPs), personal accident plans (PAPs), hospital accident plans (HAPs), savings instruments, as well as unusual benefits like pet insurance and insurance that guarantees the face amount will be paid within 24 hours of notification. But the most controversial products from the client companies' point of view were the ROP products.

ROP PLANS

The ROP concept generates strong love/hate feelings. Actuaries love this product because it has good response and a high average premium. They hate it because ROP is basically not an insurance product. It requires actuarially tough decisions, and profitability is not within the actuary's control.

Marketers, however, love ROP for the same basic reasons actuaries hate it: It's not an insurance product; it requires tough actuarial decisions; and there's not much profitability. They promote this product as "free" insurance or return of "all" your premiums, often without ever talking about inflation, the time value of money, or the 10-15-year wait.

Before we go further, let's quickly review the basic ROP features. For life products, ROP plans are money-back term (MBT) -- basic term insurance, plus a return of premium at the end of the term (generally 10 or 15 years). HIPs, HAPs, or PAPs use ROP features that allow premium return if claim-free, or in some cases, if the claims are less than 20% of the premium during the term period. Alternatively, some plans return premium less claims as long as claims are less than 25% of premium.

* Mr. Dardis, not a member of the Society, is Assistant Manager of the International Life Marketing NRD/Victory Group at the Victory Reinsurance Company, Ltd., in London, England.

MARKETING APPEAL

Why does the ROP feature improve the direct-response product? ROP is the magical appeal that translates into higher response rates. We have seen response rates on ROP products 3-5 times higher than a non-ROP plan.

ROP basically appeals to greed. Customers want something back from insurance companies whether or not they have a claim. But it also has a savings appeal. It provides tax-deferred accumulation, and a method to save small amounts routinely. It appeals to healthy lives and a younger market than traditional direct-response offers. It's better than cash-value life insurance. Third-party savings institutions prefer ROP because it has higher commissions, higher average premium, and it does not erode their CD turf. Above all, the U.S. marketplace has been extremely competitive, providing excellent value to the ROP consumers.

COMPETITIVE RATES

ROP products are not tough to price from a basic actuarial-techniques viewpoint. It does require some reiterative calculations, but most PC programs can handle that with ease.

The basic problem stems from the fact that the higher premium depresses response rates, and interest on the generated total annualized renewable premium (TARP) is not enough to amortize the marketing cost over the initial term. The two crucial assumptions are the duration of the initial term and expectation of retention at the end of the initial period. We see this as we look at the rates of some of the companies.

ROP TERM PLANS

First let me assure you that the rate variation by countries is not highly dependent on the level of mortality (Table 1).

TABLE 1
MBT-- ROP Term Life
Monthly Premium for a Money-Back Term of $50,000 Coverage Male, Age 40

Company	Country	ROP Period	Premium	Index 1	Index 2
A	US	15	$23	$100	
B	US	15	25	109	
C	US	15	31	135	
D	UK	15	65	283	
E	UK	15	42*/55	183*/239	
F	US	10	50	217	$100
G	US	10	63	274	126
H	UK	10	63	273	126
I	UK	10	93	400	186
J	Hong Kong	10	51	221	102
K	Singapore	10	92	400	184
L	Malaysia	10	101	439	202
M	France	15	105	456	210
Approx	Level Term		$15/20	$74	$34

* Nonsmoker

The cost of a pure term policy is between $15-20, compared with the rate levels of $23-65 for the 15-year product and $50-100 for the 10-year product. It is the competition that determines the variations. With the exception of Hong Kong, the non-U.S. companies price more conservatively.

The battle lines are at the length of the period. The premium almost doubles when you go to a 10-year period from a 15-year period. From the marketing point of view, 15 years is too long. Some companies have a reduced payout at year 10 with full pay at year 15, but that is confusing for the consumer.

For the MBT plans, profitability is heavily influenced by expectation of renewal to the end of the ROP period. As compared to level term plans in the U.S., the MBT has 35-80% higher premium levels resulting in probably 50% higher average premium. The response levels are often double, and yet the profitability is fairly low if there are no gains from lapses.

ROP HOSPITAL INDEMNITY PLANS

Now let's look at ROP features added to the HIP.

As compared with vanilla HIPs, the response rates for ROP HIPs are often 3-5 times higher and the premium levels are 25-50% higher for 10-year ROPs. The response variation is known to wear off fairly quickly as more ROP HIPs become available but, they still maintain about 30-35% edge. Unlike the term plans, the HIPs are not skating on thin ice of profitability. Morbidity is generally better than the normal guaranteed-issue plans. The problem with ROP HIPs is mainly the lapse rate. This is generally due to the complexity of the product. Even though lapses should generate profit by releasing the ROP reserve, they tend to come from healthier lives, worsening the morbidity. The overall profitability of this product has to be carefully monitored.

Due to complexity of the product, its financial success depends heavily on product design and competitive pricing, early and continual communication with consumers, and careful actuarial monitoring.

ROP -- DREAD-DISEASE HIP

Dread-disease ROP plans have limited visibility in the U.S. The attractions are lower price compared to HIPs, early success of cancer policies in the Far East, and publicity surrounding accelerated benefit life policies. As is inherent in any ROP products, the lower the frequency of the basic benefit, the higher the cost of the ROP feature. For the dread-disease HIP, the premium for the ROP feature is severely accelerated when you go from 15 years to 10 years. It ranges from 35-40% additional for a 15-year product, to 70-100% higher for the 10-year product.

Other limited benefit HIPs, like HAPs or PAPs, face similar problems because the ROP feature commands a disproportionate share of the premium. Not enough experience exists for estimating promises and profitability for this line of ROP products.

SUMMARY

In summary, the ROP feature can drastically improve the response rate and the average premium of direct-response products.

The promise of profitability can be illusory, however, if from early on the products are not carefully priced, monitored and communicated. What's worse, it may be after many "successful" campaigns that you end up with an unprofitable book. The maximum allowable marketing cost concept requires a very careful review for ROP products.

MR. ANTHONY DARDIS: I'm going to be talking about life insurance where some or all of the death benefit is accelerated on the incidence of certain specified diseases. The dread-disease products I will talk about differ from terminal illness products. Dread disease can be regarded as true living insurance; the policyholder can live for many years after the incidence of a claim-generating event. The great success of a number of companies in selling this type of product should have left few doubting that there is indeed a market for dread-disease insurance. But is it the sort of product that lends itself to direct marketing?

So far very few companies have gone into the dread-disease insurance market by direct response. Certainly there are particular problems to be encountered in using a direct-response approach, but these are a poor excuse for ignoring the approach. These problems are far from insurmountable. Direct response opens up a valuable new area of the market. Not all the public likes to deal with an agent, and direct response is able to tap into the lower socioeconomic groups whom agents are unable to reach.

MARKETING SUCCESSES

In my research, I talked to two U.K.-based companies. Each has had quite a lot of success in launching dread-disease, direct-response products. And I'd like to briefly outline the features of their products before I cover some more general considerations.

The first company is Abbey Life. Abbey is the market leader in dread-disease products in the U.K. Its sales are made mostly through a vast agency network, but it also uses a direct-marketing distribution channel. The original Abbey Life product was a whole-life unit-linked, or variable life, plan. While the plan had reasonable success, Abbey recognized that the whole life design and the relatively high premiums were not particularly well-suited to direct marketing.

Abbey started looking at using term insurance as a vehicle for dread disease. In April 1991, it launched a new living-insurance term plan. As an extra feature, the death benefit has been stripped out altogether. This design attracts those who already have their life cover in place, but would like to top up with some dread-disease cover.

The new plan has the two-tiered advantage of giving the agency a potential new client base and giving the direct marketers a more sellable product. Abbey is quietly confident that it has a winner.

The second company was Cannon Lincoln. Cannon was approached by a company specializing in the underwriting of medical expenses insurance. The company wanted to market a dread-disease product underwritten by Cannon. The product was to be primarily promoted to subscribers to the medical insurance. Straightaway, there was a tailor-made mailing list of people who were interested in protection against a breakdown in health.

The Cannon product has proved to be extremely successful. First, people replying to the mailing seemed to assume that the underwriting company knew all about their health problems, so they took great pains to give an amazing amount of data concerning their state of health. Second, the product is being sold as term insurance to 65, which not only has the advantage of keeping premiums relatively low, but also it's an easy product for the customer to understand.

The Abbey Life and Cannon Lincoln experience shows that it is possible to have success with a dread-disease, direct-response product. But outside the U.K., this market remains relatively untrodden territory. Even in South Africa, the birthplace of the dread-disease policy, the attempts to sell dread disease through direct response have been few and far between.

In the U.S. activity has been particularly downbeat. While this means that U.S. insurers considering making moves into this market have little past experience, those companies that do make the first moves are going to be able to dictate how this market looks for years to come.

What then are the general considerations in launching dread-disease insurance by direct response? I'd like to look at five areas: plan design, sales literature, pricing, underwriting, and claims and administration.

PLAN DESIGN

The starting point in settling plan design is settling on a base product. Now it is possible to use a permanent policy of some sort, but term insurance looks like the obvious choice with all the advantages of simplicity and relatively low cost.

Dread-disease products have been traditionally designed to cover the classic five diseases: heart attack, stroke, cancer, end-stage renal failure, and coronary bypass surgery. Companies are becoming increasingly adventurous and are endeavoring to cover an increasing number of diseases. A large number of diseases is acceptable in a competitive agency situation, but not necessarily in direct response where too many diseases will complicate and probably confuse the customer.

One of the major problems with dread-disease products is the danger of antiselection. For direct marketing, this problem is compounded because applicants might be underwritten purely on the basis of their answers to a few simple questions. The simple and effective solution to this is to introduce a waiting period into the plan design whereby no claims are going to be paid under the living insurance aspects of the policy for a short period of time after the policy goes onto the books.

SALES LITERATURE

Direct response campaigns arguably succeed or fail on the basis of their sales literature and, of course, their mailing list. Sales literature is actually an area in which dread-disease products can have a big advantage over traditional forms of life insurance. Because there is the opportunity to emphasize all the advantages of receiving a death benefit while still alive, it would seem much easier to capture the imagination of a prospective policyholder with a dread-disease product than with a product that only pays out on death.

However, it's as easy to go terribly wrong with your dread-disease sales literature. If there's a golden rule in designing good copy, it must be to avoid scaremongering at all costs. In the extreme case, the copy may be so close to the mark, that you could find yourself deluged with letters of complaint rather than completed application forms. In general, the benefits provided under dread-disease insurance allow a company to devise some really creative copy, but experience to date shows that a fair degree of testing is going to be necessary to establish the story lines which motivate the public to buy on a direct-response basis.

PRICING

Ironically for an actuarial seminar, I don't want to say too much on pricing because the principles used in establishing a pricing philosophy for a direct-marketed product are really no different from those used for an agency-based product. Being such a new product, there is limited insured lives data available. So the general population data need to be widely used.

In the U.S. these data are both extensive and readily available. Some companies, such as NRG Victory, have already built up a large amount of data that are credible enough to incorporate into their pricing basis.

Finally, pricing is impacted by the extent of underwriting. Where underwriting is no more than acceptance based on the answers to a few simple questions on the proposal form, the actuary may well incorporate some margins for direct response.

UNDERWRITING

The information required for underwriting direct-response products is again really no different from that required for underwriting an agency-sold product. However, the desire to keep the application form as simple as possible with "yes or no" questions calls for a very special type of underwriting expertise in the design phase.

The insurance company must be informed on three particular areas: the applicant's dread-disease history, family dread-disease history and smoking habits. These three areas are the core of the application form. In addition, information might also be required on occupation and avocation if the plan covers paralysis and loss of limb.

The popular U.S. practice in the direct-response market is for a company not to do any follow-up underwriting. If the applicant answers favorably on all questions, then the application is automatically accepted. This also implies that the applicant who fails in any one count is flatly rejected. With the dread-disease products, the introduction of follow-up underwriting could have a number of advantages. For example, if we get an attending physician's statement (APS), we might open the door for an applicant who fails on the application form for something relatively minor. It also enables the company to follow up with another product. If we decline on dread disease, perhaps we could go back to just the basic life cover.

CLAIMS AND ADMINISTRATION

Writing dread-disease cover through direct response causes no particular difficulty as far as administration and claim handling procedures are concerned. The problems that do arise are common to both the direct-response product and the agent-sold product. However, the early claim syndrome I previously mentioned might be exaggerated in

direct response, leading to extra work at the claim stage. One interesting possibility is that the administration could be delegated to the company responsible for doing the marketing.

Looking to the future, it's hard to envision that this area of the market is going to continue to be largely untapped. One thing is for sure, for those companies that are considering taking the plunge into the dread-disease insurance market, the 1990s are going to be a very exciting time indeed. I've written a short paper on dread disease that expands considerably on what I have said. So if anybody is interested in having a look at that, do let me know.

MR. SPENCER KOPPEL: My topic is problems, promises and profitability in long-term care insurance. Addressing problems begins with regulation.

REGULATION

I'm going to be talking about NAIC requirements. However, there are specific state requirements that may be even more stringent than these. Currently the loss-ratio requirement for long-term-care products is 60%. It is likely that over the next two to three years, the requirement will be raised to 65%. Therefore, like Medicare supplement, any company that wants to be in the long-term-care business, direct response or agent sold, is going to have to achieve a substantially higher loss ratio than many other products. For agent-sold business, the response to higher loss-ratio requirements is generally to level and lower commission rates. For direct response, the answer has to be better segmentation to improve response rates sufficiently to cover the loss ratio.

There are additional reporting-form requirements with the annual statement that provide a means to monitor the loss ratios for long-term care. They are not as onerous as the Medicare supplement forms, but that's also likely to change over time.

Finally, every long-term-care sale has to meet disclosure requirements by providing an outline of coverage showing benefits, exclusions, limitations, and a special consumer notice in case of replacement.

UNDERWRITING

Direct marketers do not use full underwriting since costs are relatively high, especially at the older ages. Because few companies are willing to accept 80 year olds with limited underwriting, they often limit issue ages.

The preexisting exclusion requirements are limited to six months, as they are in Medicare supplement. We're seeing some companies eliminate any preexisting exclusion requirements. For some other companies, as long as you disclose the illness on the application, it will be covered from the initial date of the policy.

BENEFIT REQUIREMENTS

Several modifications requiring additional benefits are either in the NAIC model or are being contemplated by the model. The first of these is inflation protection. Currently, the NAIC model requires that a company offer a benefit that provides that, without subsequent evidence of insurability, the benefit will increase automatically 5% per year. The increase can be automatic every year, or it can be purchased at the

insured's option without evidence of insurability. An exception is allowed for policies that provide benefits that are a specified percentage of usual, reasonable and customary charges.

NONFORFEITURE

Nonforfeiture requirements are not part of the NAIC model yet, but it is very likely that something will come along in the next year or two that will either require offering nonforfeiture benefits or will require providing them automatically. The following are types of coverages that could be used for nonforfeiture benefits:

1. Cash-surrender value, with or without a death benefit;
2. An ROP benefit;
3. A reduced paid-up benefit, whereby, if you lapse your policy or if you discontinue paying premium under your policy, the policy continues with a lower indemnity amount; and
4. Extended-term insurance benefit where the daily indemnity amounts stay the same, but the plan continues for a specified period determined by the amount of value in the policy and ultimately terminates without value.

There is currently a lot of discussion concerning appropriate nonforfeiture benefits, but few questions about whether there will be nonforfeiture requirements of some type in long-term care.

EXPERIENCE DATA

Our experience shows that some initial response rates have been promising, but that the conversion results have not been good.

The initial responses were particularly strong in younger groups, where there was an interest in getting more information about long-term care. But the results were not acceptable once the full package was sent out. The most likely solution is to find a product that is attractive to persons aged 50-55, and then keep them through the later years.

Persistency is another area where data are scarce for direct marketers. On the agent-sold long-term care, persistency has been good if the policy was sold properly. The best results to date have been on endorsed products as opposed to those sold through the general marketplace.

Our final problem is the lack of available loss experience. Most of the experience to date is on agent-sold business with different types of underwriting. Attempting to use that experience or general population data to predict experience on direct-response products is really a risky proposition.

HOME HEALTH CARE

One of the promises in long-term care is to include a home-health-care benefit. A home-health-care benefit, added to a long-term-care benefit, is a response builder. People prefer home health care to institutionalized care, and the cost of this benefit looks reasonable. I am concerned about home-health-care stand-alone products both from a claim perspective as well as from the perspective of explaining to a customer

why, at the time the insured's health deteriorates, he's no longer covered under your policy.

MANAGED CARE

Managed care is another area of promise. In today's marketplace it is taking two basic forms. One is called the "gatekeeper" where an agency comes in and determines whether the insured is eligible for benefits or not and what the course of treatment should be. The other is the standard PPO that provides discounted services if you go to specified health-care agencies. If other providers are chosen, the insured might get lower benefits.

NEW MARKETS

Getting younger lives to purchase long-term care, either for themselves or for their parents, is a market that has not been tapped very well by most companies. This need may be best served by using life insurance policies to provide living benefits.

PROFITABILITY

Profitability of long-term care varies by age, sex and living status. Obviously, as the prospects age, the expected morbidity goes up dramatically along with the required premiums. This premium pattern means we should be getting the customer at the youngest age possible. Unfortunately, the younger the prospect, the less his interest in this kind of coverage.

Females have a much greater incidence of claim. This is because women live longer; they're more likely to spend some time in an institution; and they live longer once in the institution. But living status also has a large impact on claim costs. Two people living together, whether they are married, living with sisters or whatever, will have fewer claims than one person living alone. The two living together are able to stay home and healthy, and each partner has the ability to take care of the other.

Living status is also part of the reason for the higher claim cost for females. Of people over age 65, approximately two-thirds are females and one-third are males. If you exclude married couples, single females are a significantly higher proportion of the population than single males.

SEGMENTATION

The required response rates in direct-response, long-term care result in the need for proper segmentation. Not only are direct marketers faced with the overall trends toward lower response rates, but also in the case of long-term care, the targeted segments are very small. A company has to be able to live with small segments and obtain acceptable results.

CONJOINT ANALYSIS

One other promise that can enhance the profitability significantly is the use of conjoint analysis or tradeoff analysis. Conjoint analysis is a market-research process whereby persons are asked to evaluate, not only whether or not a benefit would be meaningful to them, but also how much they would be willing to pay and how much they would be willing to accept as a tradeoff for eliminating another benefit if they had that benefit in the policy. If we know the relative value of all the benefits and the cost of those benefits, we can identify those that have the most value relative to their cost.

Conjoint research will identify the benefits that might enhance the response rates rather than the benefits that we or the marketers think sound good. And, it has been used with some success in the long-term-care area to improve response rates. We find conjoint to be better than other types of surveys and certainly better than focus groups where one person tends to dominate the discussion and to bias your results. Through conjoint analysis, specialized survey companies can get significant volumes of responses and unbiased responses.

SUMMARY

There are clearly problems in the long-term-care, direct-response business. There is some promise. But it remains to be seen whether there is any profitability.

MS. KIMBERLY A. JOHNSON: Once upon a time selling life and health insurance in the direct-response marketplace was simple. No more. Across the industry, companies are struggling with a multitude of challenges on the top line and the bottom line. Response rates are eroding. And many companies are posting limited or no growth. We've seen relatively little product innovation, even at a time when mailbox glut has made it extremely difficult to catch the consumer's eye. And like other businesses, direct-response writers have had challenges facing increasing costs and changing technologies.

Faced with these problems, companies have turned to many tactics looking for the promise of increased profitability. Creative talent has been focusing on innovative ways to offer existing products. We've seen increasingly sophisticated targeting techniques and claims for astounding database marketing. Many companies have expanded their distribution methods or their product portfolios in attempts to reach new customers. And the marketing of upgrades, add-ons and cross-selling has been touted as the answer in an environment where finding new customers is costly and difficult.

At Allstate Life, we're pursuing a new promise, one with many times the leverage of those listed above: customer retention. Simply put, we're focusing our activities and research dollars on getting the right customers and then keeping them. The relationship between customer retention and profits is easy to see.

Chart 1 shows how the present value of profits from a new insurance customer grows as the length of the customer relationship increases. (This is only a hypothetical example for a very low premium product.) Anyone can construct a similar chart for his or her own products.

Assume that the average customer in this company stays with the company for about nine years. This company would then expect to generate about $70 in present value of future profits from this customer. For a customer who will ultimately terminate at the end of year three, however, the company would lose $20.

It costs this company $90 in present-value future profits for each customer who terminates at the end of year three. With this perspective, every individual working in direct response can understand the value of keeping customers. And if you total up these costs for an entire year, the results can be staggering. For a company like ours

CHART 1

The Value of a Customer

with almost two million direct-response insureds, even a small reduction in the lapse rate can have significant leverage on the bottom line.

These economics were so compelling that we began to focus our research dollars and activities at improving customer retention. I'm going to cover two of our major retention initiatives. The first one focused on getting the right customers and the second, on keeping them. But before I get into the details, let me briefly describe the direct-response business at Allstate Life.

Allstate Life has been in the direct-response business for over 25 years. Our clients include not only the Sears family customers, that's Sears, Discover Card and the Allstate customers, but also customers of Shell and Texaco.

We solicit these groups for a variety of supplemental life and health products, including AD&D, accidental hospital income, term insurance, credit insurance and since 1987, we've also offered long-term care.

Direct marketing at Allstate is conducted with the cooperation of two major areas, the Life Direct Response Profit Center and the Allstate Research & Planning Center. The Profit Center is responsible for marketing, product development, operations, customer service and financial analysis. The Research Center manages all of our consumer research and does our segmentation or scoring models. By combining the household data maintained at the Research Center with the extensive claims, lapse and customer data at the Profit Center, we began our search for ways to improve customer retention.

Our initial research was aimed at identifying the characteristics of our best or most valuable customers (MVC). The purpose of the MVC project was ultimately to improve our targeting. Instead of selecting those customers most likely to respond to our offer, our goal was to target those customers most likely to establish long-term, profitable relationships with the company.

Before we implemented MVC, our segmentation methods could be labeled traditional. After a test mailing, we conducted an analysis to identify the characteristics of the customers most likely to buy our product. Scores were assigned, and those scores were used to predict the response rates of any given segment.

The actuaries then took a look at the average annual premium for the plan, an assumed policy life, and an expected loss ratio. These factors allowed them to calculate the cost per sale guideline or the marketing allowance for the mailing. The targeting decision was then relatively straightforward. We mailed the largest group of prospects we could.

After all, if profit is roughly proportional to the premium generated, a sale is a sale. We were looking to maximize the number of sales as long as our marketing expenses did not exceed the allowable cost per sale.

But clearly all customers are not alike. Some pay higher premiums than the average, or have higher expectations for upgrades or cross-selling. Others are more likely to lapse early, or to generate higher than average claims.

To learn to segment based on these profit factors, we studied our own experience with the Sears charge AD&D customers, which was our largest block. Through our experience, and industry and population data, we determined the customer characteristics that correlated well with varying levels of premium, claims and persistency.

Similar to more traditional lines, gender and age were good predictors of future claim frequencies and lapse rates. Plan choice was indicative of all three profit factors: expected premium amounts, loss ratios and persistency. As a matter of fact, we found that customers who purchased the less expensive plan, often persisted better than those who purchased the higher premium options. This offset, at least in part, the lower profitability associated with the lower premium payments.

Since our billing is through the Sears charge card, card usage and average balance were extremely useful in predicting lapse behavior. This makes sense, since if you have a customer who is commonly using his Sears charge, he might have a closer relationship to the Sears family. Other Sears family relationships such as being a Discover cardholder, an Allstate customer or catalog customer, were also important predictors of future profitability.

Based on those predictor variables, a scoring system was developed to estimate the expected future profit for customers who responded to a test mailing. Modeling then proceeds as before. The targeted segments now represent not the best responders, but those customers likely to be the MVCs over time.

We're in the process of implementing MVC targeting for our AD&D marketing to the Sears list. As time goes on, we'll be monitoring our experience and refining our models. We're also planning to expand MVC research to our telemarketing and to other products and lists.

MVC targeting will help us get to the right customers. But to address keeping those customers, we have to look beyond the point of sale.

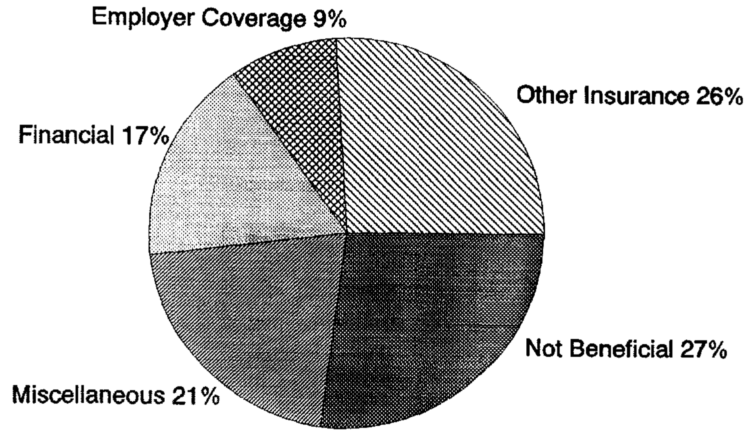
Allstate is committed to meeting customer needs and continuously improving the quality of our products and services. Over the years, we've extensively used customer satisfaction surveys to measure progress and to identify opportunities. If we were only measured on the results of those surveys, we would feel quite proud of our results. But the ultimate measure of customer satisfaction is customer retention. And since we didn't see significant improvements in our lapse rates, we initiated further research into why customers terminate.

During the past year we've monitored over 20,000 calls from terminating AD&D customers, and conducted many exit interviews. Chart 2 shows the top reasons for customer defection. Armed with this information and the supporting detail, we began to develop targeted initiatives to improve customer retention.

Our customer service recovery program is really an extension of the idea that the best offense is often a good defense. When any insured calls to cancel his coverage, our customer service resentatives are now equipped to reinforce the sale and to counter the most common reasons for termination. Since the program began almost 18

CHART 2

AD&D Reasons for Lapse



Based on 23,260 Terminations

months ago, our representatives have recovered almost 10% of the customers who called to cancel.

We're also testing the impact of a contact mailing to our insureds. This is a basic package that simply says thank you and reinforces our service capabilities and the key product benefits and features. Since mailing efforts can be costly, we're testing this in the durations with the highest lapse. The jury's still out on whether this is going to be cost effective in the long run.

Our single most important retention initiative is more in-depth research. We'll be investigating the root cause of lapse, that is, the real reason customers terminate rather than the reason they might give us. We'll also be analyzing lapses by duration to identify the messages and services we need to provide to the customer over the lifetime of that customer relationship. And finally, we will be continuing our research to better understand customer values, so that we can more accurately develop the products and services that meet customer needs.

Problems? We all share them. Promises? We've got more than we can effectively act on. But, "it pays to discover the promise that might pay you back." Take a look at what customer retention can do for you.

MR. JACK R. DYKHOUSE: With respect to long-term-care insurance, Spence stated that the claim costs for two people living together is less than the cost of just a single person living alone. Is that true throughout the term of the policy? Consider a husband and wife situation. As long as they're living together, the claim cost would be less, but when the husband dies and the wife lives alone for another ten years, is your statement still true?

MR. KOPPEL: The lower expected claim costs certainly apply for the duration of policies as we're seeing them. I don't believe you expect the lower costs throughout the life expectancy of both insureds. This change in living status is also difficult to put into the pricing equation.

MR. DESAI: Has anybody had any experience with dread-disease ROP products in the U.S.?

MR. H. MICHAEL SHUMRAK: I've done probably four or five products. Some of them never left the testing phase and some were reasonably successful. From a marketing point of view, the declining response rates on the old bread and butter hospital indemnity offer were greatly enhanced by the dread-disease offer. Dread-disease, if presented properly, still covered a fairly wide spectrum of the more important long-term hospitalization risks, and with the ROP feature, it also reached people who otherwise would say, "That's not going to be my problem." So it really is a good win/win situation.

The difficulty of the product is that it is fairly complex to price properly. And, I heartily agree that monitoring, even from the beginning, is extremely important. In addition to protecting the company by monitoring experience, I believe tracking experience will give a company a competitive edge in marketing and financial areas. The few companies offering this product now haven't been doing so long enough to

develop enough experience, so that whoever has that first, is going to have a technological edge.

I have also done some work with an accelerated-death-benefit, direct-response term product offer in the U.S., and it wasn't all that successful. In terms of the more recent success in the U.K., can you, Tony, characterize the benefit design and roughly the range of premium offers? What are the key things that are making it work now? From what I understand, a few years back, Abbey only had mild success with the concept in direct response.

MR. DARDIS: Both Abbey Life and Cannon Lincoln have brought out term insurance products, and the term plan design has had a lot to do with their recent success. They also pumped quite a lot of money into designing some very good sales literature. And the other success factor for Cannon was its mailing lists. Cannon was already effectively dealing with people who were interested in medical expense insurance. So it had a tailor-made mailing list of people who were going to be interested in dread-disease-type insurance. In my limited experience with offers in the U.S., companies have either been too ambitious with the plan design, or their sales literature hasn't been impressive, or the mailing list hasn't been appropriate.

FROM THE FLOOR: Kim seems to be expecting a lot from research activities. Our experience and my personal bias is that research can be predictive of ideas that will flop, but not necessarily those that will succeed. Also, it is hard to find the real reason people don't stay with the coverage. Can you just give us some additional comments on the confidence level you have as to how well the research will help move Allstate forward on improving its retention?

MS. JOHNSON: I believe the research that we've done to date points us in some of the right directions, and our biggest initiative is more research. We've already seen different reasons customers terminate by duration, and that might lead us to take action at the point of issue in the fulfillment kit, or five years later, when they may have forgotten the key benefits or features and why they purchased the plan. Since we're doing most of our billing through the charge card, the customer really doesn't have any interaction with Allstate, and I'm confident that, based on our research, we can design positive contacts that will generate increased persistency.

I'm not sure yet whether the MVC targeting methodology will actually result in significant improvement in our persistency rates. I agree that research does better predicting flops than successes, but even in that regard, we have some advantage. We now have the customer characteristics of people who are most likely to lapse, and those people won't be in our targeting solutions in the future.

MR. DESAI: Kim mentioned they mail out contact pieces as a welcome booklet when a customer is brought in. Do you also mail a thank you periodically, say on the customer's birthday or anniversary, without asking for an upgrade or cross-sale?

MS. JOHNSON: That is in fact the nature of the contact test that we have out right now. The mailing was to consumers who have had relationships with us anywhere from eight months to five years. It was simply a thank you, and not a contact to upgrade or purchase additional insurance.

MR. DAVID M. KLEVER: Spence mentioned that adding the home health care makes a more attractive product, but as you add benefits, the policy seems to be pretty expensive to sell through direct response. Can you comment on that?

MR. KOPPEL: That is clearly a problem for direct-response writers, and as a result, direct-response products have typically provided low daily indemnity benefits on home health care. Sometimes the home-health-care benefit is illustrated as dollars per week in order to make it sound more attractive.