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Dynamic Product Development

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Summary: The product development process is critical to the success of all life insurance companies.

- *Do you really know how well your company performs the product development process?*
- *How well does it fit with corporate strategy?*
- *How well is it aligned with core competencies?*
- *Do the products match up with strategy and competencies?*
- *Do the products in your portfolio maintain consistency with regard to design, pricing, and profitability?*

The answers to these questions and many other product development challenges are the topics of discussion for this session.

Mr. Mark A. Milton: Capabilities are a kind of key building block and a key competitive advantage. There are new capabilities that you may need to have that you may not even know about yet.

There are many areas to monitor for new product ideas. They include regulatory, tax and demographic changes, the economy, competition, what your competitors are doing, new technologies, unexpected successes and failures, and new knowledge.

I think it's important as you're working on new product ideas that if you want to have a dynamic product development process, you need a guiding vision. Think about the demographics, the economy, and regulation. Think about how in the future these are going to affect each product line that you're currently in or would like to be in. I strongly recommend that you look at alternative time-frames, things that are going to happen in the next 12-24 months or even beyond two years.

Break down the types of new products, whether they are product revisions, new-to-the-company products, or even new-to-the-world products. Then break it down over time-frames and think about what's happening in each of those segments. If we have time later, maybe we can discuss some of those things. I think this is a very powerful tool and you can look at it not only at the company level, but also at the line-of-business level or the market segment level.

What percentage of your sales today are from products that were introduced in the last four years? How many of you think that at least half your sales are from products that were introduced in the last four years? It looks like at least half the group agrees.

I think what this tool is going to help us do is identify some future capabilities that we may need to be building into our organization today, so that 24 months from now we're ready to move on with the products that will be prevalent at that time.

I was reflecting back on the product development projects that I've been involved in and take the most pride in, the projects which were the most successful were the ones where we were stretched the most. It was either the undoable time-frame, or what appeared to be an impossible fit with our distribution strategy that I think has been perhaps some of our bigger successes.

Did any of you follow the Pathfinder in 1998? It was the little dune buggy on Mars that was taking pictures and sending them back. There's a business book out called *High Velocity Leadership*. It reads more like a fun novel, but I think some of the principles they talk about were, if it weren't for trying to stretch success wouldn't have been possible. What they were asked to do was launch this little dune buggy, and get it to Mars in half the time it had taken in previous attempts. At 1/20th of the budget, they were to take risks but not fail, and to do things better, faster, and cheaper. I think they attributed their success on that plan to basically being pushed and really trying to do things better, faster, and cheaper.

I guess I do a lot of things which are happening in the insurance industry that I feel very comfortable with. I do think that we need to take time and maybe go through an exercise and stretch and really try and determine what that means for us so that we'll be better prepared two years from now.

One of the things that we can do is think about the different value drivers of each product line and how they're changing. Maybe this is a fancy phrase for a sensitivity test of the products that you're designing now, relative to the ones you were selling a few years ago. Does a 30-year term product have the same sensitivity to lapses as the 10-year term you were selling a few years ago? Does a hot universal life (UL) product? Not only do we need to identify ideas that will be marketable, both over the next 12 months and longer term, but they've also got to be profitable. The profit patterns may vary dramatically. I think by understanding that, it may help you understand some of the capabilities that you may need to help your organization change.

If you're average in expense performance, how much more profitable would you be if you could make it to the 25th percentile? Same with investment performance. I think that's been valuable for my company to look at value drivers in that way and understand the relative importance of each.

I would like to share some other helpful ideas with you. Again, in the early idea generation process, and I must admit, some of these things I'm not always good at practicing myself, write them down. I make an attempt to ban the word "no." That's an awfully difficult one to do. At least for me it is. I think you start off and you've been trained through years and years to stick to the knitting and know what our companies are good at, and don’t try to do things that you're not good at. I think in most cases, that's probably a good thing. Maybe I'll put a footnote on that one, ban the word "no" at least initially, but know when to say no later. That could be very important. But have an idea in the bullpen.

We've had a majority of ideas that came up from a number of sources and we try to keep track of every one of them, and write them down. It's interesting that last year's idea, which really didn't sound very good, due to the change of distribution approach that we're looking into, all of a sudden becomes a significant opportunity for us.

Involve all the people in the idea generation process. I think everyone has value and I don't think I've ever met anyone that I couldn't learn something from. Even if it was something like, "Gee, you should never talk too much." I think everyone does have a contribution to make.

Encourage risk taking. Now how do you really do that? I think that as actuaries, a lot of times we might be held accountable for some of the experience in our products, and for not designing products with flaws, in spite of the fact that the market is changing and they may be using our products differently than we had designed. But I think we have to take that upon ourselves. I know in a lot of organizations senior management is responsible for this idea generation and setting platforms. I would suggest that product development actuaries are probably uniquely qualified and maybe some of the best qualified people who take an active role and responsibility, even if it does require some risk. If it doesn't work out, I think the Society has produced an excellent career planner.

I think measurement is important and sometimes we should recognize not only big but small innovations. If you've come up with a little rider, if something has happened, you ought to measure that and make sure that you've kept track of it and know the results and its impact on the company. Big or small, measure them. Last but not least, if we really feel that we're not being innovative enough on some ideas, we need to have our compensation structure developed around rewarding and compensating innovation. I think that will help risk takers take risk.

There are things that I think would be helpful. One would be to have a clear decision criteria. If you really know what the rules are, it's a little easier to play. If you understand your strategy, I think you understand a little bit better why a product may work for you today, and may not, but by the way, it may work next year, as rapidly as things are changing. Always keep that in mind.

Market acceptance. Try to understand your customers and your distributors, your partners who are selling the products. Make sure that you have something that is acceptable. Financial performance measures, I think we've spent a lot of time on those. Operational fit of both your current capabilities (I emphasize) and the new capabilities that you'll need.

I think dynamic product development can help turn the value chain around. Start with the customers' priorities and their desired way of purchasing. That's one of the things that drive you to developing the products and services that you do offer. My sense is that in a lot of the cases that's really going to identify new capabilities.

How many of you have ever looked at a product and gotten fairly far down the list and decided this didn't fit your company? You just didn't have the administrative or some other capability? That happen to anybody? One response.

I think product development is really a way to rally the whole company around efforts to change some of your core capabilities, which are advantages, but I also say that core rigidities should be disadvantages. Sometimes we stick to knitting too much and, believe me, the world is much different today than it was a few years ago.

When you look at your physical systems, like your administrative and information systems, I think that's one aspect that could be a tremendous advantage for us. It could also be a disadvantage. Management systems, structures, incentives, knowledge, and skills, several of us are learning a lot at this meeting with all the topics are covered that are applicable to our profession and our companies. Values are also applicable with your attitudes and behaviors.

By the way, any idea which of these would be the hardest to change if you decided that after looking at potential product, that you were having problems in one of these? Are physical systems or are values harder to change? My sense is that values and attitudes are much harder to change. I think that is one area where product development can really help and can certainly identify if it's done appropriately. Communicate, over-communicate if that's possible. I think that can help you in identifying attitudes and behaviors that will help your company survive in the new financial marketplace.

In essence, what I see is new products will not only help you develop new capabilities and then lead you to new ideas that all of a sudden meet your screens and criteria, but they can help generate new products going forward. I think that maybe our biggest challenge in the future is going to be keeping up with the new financial services marketplace. As I reviewed, all the topics going on at this meeting, I'm reassured that at least a lot of the technical answers will be there, if we can address some of these other issues.

Mr. Michael J. Roscoe: I work with Lincoln National Life Insurance and I'd like to say that my years of product development experience is all from Larry. I haven't been around anywhere near long enough to contribute anything additional.

This is an interactive forum and so far, it's working more like a panel discussion, except that we don't have a panel to sit behind. I'm going to do my best to try to turn this into a little bit more interactive by, instead of waiting for you to ask me some questions, I'm going to ask you some questions.

How many of you have heard the phrase "market-driven product development"? Virtually everybody has their hand up.

Now, how many have actually been involved with it? How many have actually done any kind of market-driven product development that's not just this large producer saying do it? Nowhere near as many hands.

A lot of the themes that we've heard so far include value. We've heard market niches. We've heard dynamic product development. None of us has actually defined what we really mean by dynamic product development. I think dynamic means changing and being ready and willing to change. A subset of that is recognizing that you're probably going to have products, if you're in a dynamic product development mode, that are not one-size-fits-all. I don't think you're really going to get that if you're thinking of the changes.

I'm going to talk a little bit about what I think are some of the important steps in dynamic product development and staying up with the times and acting on some of themes that you've heard already. I'm going to probably add a little bit more. I think the first one that I hear and that I've heard for a while is really understanding the market needs.

There's a question I want to ask, A customer in a hardware store says he needs a one-quarter-inch drill bit. What does he really need?

From the Floor: One-quarter-inch holes.

Mr. Roscoe: Everyone understand? There's a big difference there between understanding what they ask for versus what they really need. Don't confuse the tool that they're asking for with what their need is. Let me put it in different terms. Here's another example.

A business says it wants advertising. What do it really need? Sales. More customers. It gets important to understand that difference.

How many of you have had a producer come up to you and say, "I need a lower surrender charge"? "I need a wash loan"? Any of you involved in estate planning and financial planning markets? How many people walk into their financial advisors and say they need a Crummey trust or an irrevocable life insurance trust? These are all tools for filling needs. It's very important, I believe, having a handle on what that market needed. What do they really need? They need estate liquidity.

Do they need to have low-cost protection for their families, spouses, and other loved ones? Generally, they don't need life insurance. At least that's not what they're looking for. But there is a need.

I was at a presentation a couple of years ago, and it was a producer conference, a very large one. One of the guest speakers was explaining what they do. They were talking about how they'd sit down with a client and try to find out what's important for that client. They did this as role play and they got a guy to stand up to be the client. You know, what does that client want? He started with financial security but ultimately, he ended up with wanting to be a good father because that was what was important to him. The producer stepped through a series of questions, asking after every question, "What is important to you?" The next question would be, "That is important, why?" Then there would be a response. "That is important, why?" Ultimately, he got into wanting to be a good father. That's kind of the thing that` I'm talking about with understanding market needs.

The next thing, and what's one of the beauties about when you really have a good handle on understanding market needs, is that you can now start to be very effective in your product. When you talk about niche marketing, you can now focus on areas where the perceived value is greater than its actual cost. Just think about it. What is the probability that the client's perceived value is going to be greater than our actual cost? I mean, that's where it starts to work.

Likewise, how many times do we have features in our product where the inverse is true? Where the actual cost exceeds the perceived value. And that's one of the phrases again, we heard a little bit earlier. There was a reference to not value but perceived value and that's very important to be in the customers' heads. It's how they view it, and not how we view it. I find it quite relevant to have a good understanding of market need, which then could immediately transfer into the perceived value being greater than the actual cost.

Once we have that we can start getting into some of the things that Mark was talking about with some idea generation. I personally believe that we have to have a good handle on at least what the customers need for sure and better yet, what the customers' needs and their perceived value. We get into idea generation and we can start thinking about features that will help us with filling that need and recognizing that the value to our customers will likely exceed the cost.

Let's step back two years prior to the current wave of secondary guarantees, say on UL. What do we all know about the policy guarantees on a UL policy? What would be a mortality guarantee? How many people have established a mortality guarantee based on anything they think the client needs in terms of policy guarantees? Mortality? Policy guarantees are established for what reason? At what level?

From the Floor: The 1980 CSO.

Mr. Roscoe: 1980 CSO? For what reason? For cost reasons. Right? I mean we've all put this feature in our product. We have 1980 CSO in there in order to address our reserves, in order to keep the cost where we want. But the cost to us of putting in a guarantee any more favorable than 1980 CSO, and I'm going back a couple of years, before people figured out secondary guarantees would have been much, much higher than the perceived value to our customers. Right? Customers were more than willing to accept a 1980 CSO guarantee. They weren't really concentrating much on, especially in the UL market, mortality deterioration. There's an example that I was trying to get at. Where you can look at this a couple of ways.

That ties into identifying effective features. Somebody years ago figured out that we can have a feature in our UL insurance policy that allows mortality to fluctuate and go from current levels up to 1980 CSO. What do you think is the need they were trying to fill? The need was current costs for the life insurance protection at the current level a much more attractive cost and low-cost life insurance protection.

Here's a feature that you can put into your product that did not affect that cost at all. It did not build that cost up, but didn't address that client's concern in a negative sort of way. You see what I'm getting at? You can put in a feature, fluctuating mortality. Fluctuating interest was very important in that product. Fluctuating mortality, how many companies actually put in current and guaranteed costs of insurance (with 1980 CSO and back then it was 1958 CSO) and left current mortality down here with the anticipation that they might rise to that level? In a sense, that's an effective feature for accomplishing what they wanted.

This is consistent with some of the comments that came up earlier: these market needs do need to be in line with your company strengths. Try to avoid areas where the market needs are not aligned with company strength. Let me give an example of one that's a lot easier for me. I think probably the mathematical nature is you can prove something doesn't work by just coming up with one example. Let me give you one example of where it's probably inappropriate product because the market need is not aligned with the company's strengths.

Take a company whose strength is in the financial planning marketplace, say Crummey trusts, advanced sales, and estate planning. A company that has huge wherewithal on the advanced design. The advanced design supplies for attorneys and tons of software to support that type of market. I happen to work for a company that's in that kind of market. I can certainly relate to it, but can you picture what I'm talking about?

Take a market where the need is low-cost death benefit protection for 10 years or term insurance. Is there much of an alignment there? There's certainly a need out there for short-term life insurance. Right? But a company like the one I'm describing, probably won't find itself lining up well. They probably have a lot of infrastructure to absorb that doesn't bring anything to bear into that kind of market.

I think most of us get intrigued when a lot of the analytical fun comes in. A lot of the creative process is accomplished by getting into those focused designs and starting to work on product designs and seeing if things fit the bill or don't fit the bill. I came from a session earlier where the speaker was talking about some back-of-the-envelope pricing and figuring out whether or not these things work and you can have some focused design, and it's a lot easier to focus on your design when you have that overall market need. I think I'm repeating myself. Understanding the market need—you can see how important I think it is.

Let me give you some examples of focused product design when you understand what you're trying to do. I'll call my first example Product A. I've really got our three moving parts, right? Investments, expenses, and mortality. Our job is to put some loads and margins on all three of these. When you get right down to it, if you're pricing the life insurance product, you're going to put a load or a margin in each of these three components and you might put a negative margin if you want it, I suppose. But you're going to put something there on each of the three.

To tell you the truth, I think that when you look at a lot of life insurance pricing over the years, you have some fairly robust product designs where the product is designed to work in a variety of spectrums. To be honest with you, the focus was very broad. It wasn't a narrow focus. We're trying to fit in a lot of spectrums and you might have an equivalent type of load or margin on all three. Not necessarily the same dollars, but you want to be able to work and have the product cover itself on all three of those areas.

For what I might consider a Product B, I would reduce the amount of load and margin coming out of the investment component and I increase the amount coming out of the mortality component.

Now think for a moment the type of sales opportunities where Product B might work better in, than Product A. Product B might be a better design. Anybody want to venture a guess as to where Product B might have cash accumulation? Obviously, Product A is going to suffer on a cash accumulation versus Product B, because of the shift in the way that the loads and margins are coming out of policy.

Now that leads to another question. What are we talking about with trying to balance profitability and competitiveness? Because the inverse of returning more value to the policyholder is probably less value to the company. It also has a lot to do with eliminating some of those higher cost benefits that don't have much perceived value.

A typical profitability curve would graph profitability relative to premium per thousand. I will use an example where I have a $5,000 premium and a $10,000 premium on the same individual. Let's just assume that this product has a profitability curve where there's a low point somewhere in the middle.

I'm not telling you whether or not the bottom is 15% rate of return or 5% present value of book profits over premium. Or however you want to look at it, but let's say that I'm a relatively conservative actuary, I don't want to see us losing money. And that this is a product that will perform well in that $6-9 range. And will hit company objectives no matter what.

Well, as I mentioned, you can view that in the inverse. The inverse of profitability is going to be competitiveness. When you think about it, if I had a range in there where the profitability was well above our target, and if I assumed that our management is establishing targets for me that are roughly equivalent with what your management is establishing as targets for you, and they're probably in the same general range. One of you is probably going to undercut me in those two tails, below $6 and above $9. In a sense, the only place that my product is going to be competitive is in that same $6-9 range.

The focused product design can allow you to at least pick on the area that you want to be, but what else can we do with that focused product design is we can try to figure out a way to expand our horizons, expand our opportunities. We can have a product that probably works fairly well in the $7-8 range. We can probably also design two other products. We can kind of, in a sense, ladder our products and have one at the low end and one at the high end. What we've been able to accomplish by that is to expand our horizon of the competitive opportunities beyond a narrow range but into a broader range.

You do need to understand and start with the market need, and when you follow some of the things we heard from our other panelists and focus on your product design, you have a good chance of filling in that strategy Mark was talking about.

Mr. Larry N. Stern: If a company chooses to offer more than one product in order to expand its opportunities within a market, how do they make sure that the right product is chosen at the right time? For example, is it possible to have a design or profitability if Product A is less than Product B and also, less than the company's target.?

Mr. Roscoe: You could have different versions. You could have a company where the profitability was inverse. The profitability really had low end and when you have Product A, B, and C, you might have products out there where profitability falls well below your target. On Product A, you're hoping as a company that Product B is going to be sold. But if Product A is also in that market, and has a lower rate of return, it's probably more competitive. It's probably got something that the market is going to select against you, and choose it.

Part of the answers are obvious.—to put in face amount, minimums, and premium limits. Some of those things are relatively easy to do. Another level that you can do is adjust commissions and compensation, perhaps band it, as necessary. Force your producers to walk away for it, or perhaps restore the profitability but with the loss of compensation. It's not competitive on its own regard, it's now a controlling factor.

But I think another way to do that is to take a look at some of the features that you have in your product and remove them when they're not important. In a sense, you also have that opportunity to bring up the profitability from an area that might be a little bit too low. Focusing on what that market need is, if you do have a series of products out there, your market niche, as Larry referred to earlier, you have the opportunity to remove some features, perhaps, the cost of a guarantee, if the guarantee is not important in that particular market.

Mr. Stern: When you're developing a product, say, a UL product, that your company has decided to price, and you're the pricing actuary, and you keep going back and forth to the marketing people, and they say it's not competitive enough, how many different measures are they looking at from the standpoint of measuring that competitiveness? Are they looking at more than five different things? Say premium cash values at different durations, load structure, cost of insurance structures? Anybody have to deal with more than five competitive measures? How about four? How about three? How about two? Good.

We have found in talking to companies about product development process efficiency, that the more objectives that you have to meet from a competitive standpoint, the longer it takes you to get the product out to market, the more broad that product is going to be. It's not really being designed for a particular niche marketplace.

Another question. How much time does your company spend in the idea-generation and screening phase? One month? Less than one month? Some show of hands. Two months? Three months? Four months? Five months or more?

How long does it take for the actual pricing? Say, for a product that you're adding to a portfolio, products that you already have and say you've already got some UL, you're adding another UL? Does it take four months to do the pricing? Less than four months? Good show of hands. More than four months? Okay. I'm going to ask Mark, how long do you think it should take?

Mr. Milton: As I said, better, faster, cheaper. I guess that may be the reality of the marketplace going forward. Personally, I think the more time you can spend thinking about the environment, thinking about future product needs, for your target customers, the better off you'll be and the quicker your time and development. One of the things that we run into more often than not, when we haven't done as much work up-front as we should, I think it ends up taking certainly more of my time.

I'm kind of directing the whole process at Kansas City Life, but I end up spending a lot more time on the tail end than I ever would have. We just spent a little more time up-front, fully defining what we're trying to do. I would encourage you that that time spent up-front is well worth the investment.

Mr. Stern: Where do you get ideas as far as what you think customers want? Surveys of current policyholders? Couple hands. Focus groups of potential customers that may be invited to a focus group meeting? Agents themselves? Field advisory councils? Purchased market research. Okay. What's the role of market testing in the emerging competitive environment?

Mr. Philip J. T. Cernanec: My question here supports that. One of the things that many organizations have found is a huge amount of requirements around putting a new product to street. What is happening particularly with regard to some of the companies that we've worked with in Europe, which is a slightly different regulatory environment, is they're learning from the marketplace. They are finding that there is enough turbulence and dynamics in the marketplace that conducting information that's based in the past on research as to what even happened last year is not addressing all of the needs or dealing with the complex aspects of the product.

There have been a number of property and casualty organizations we've worked with recently that are using state or geography experience. The question would be with regard to some of us, how can we take some of the products we work with and put market test out there? Recognizing the technology around administrative platforms is becoming such that actually maintaining a product, even though it might be a test product, that cost has come down dramatically in the last 20 years.

The aspect of market test and using the customer service or call center environment to test product needs and product ideas has become a rich database for contact information from which to mine. That contact information is often something that's not valued in an organization trying to move towards an information culture. For example, how many of us might wish what would be the impact of underwriting criteria on our mortality as we move into more innovative approaches to that? The Society is taking on a piece of study, but there are ways to actually mine your own customer base and use that contact that's out there.

Mr. Stern: For companies that have multiple distribution channels, is the product that you put through one channel the same as the product that you put through other channels and the only thing that changes is the compensation to the distribution system? How many have situations like that? Maybe a third. I'm assuming if you have multiple channels, you have different products that go through those multiple channels?

Which area will have the biggest impact on product development over the next year? There are five answers here. Regulatory and/or tax changes, demographic changes, economy, competition, or new technologies. This is within the next year. Show of hands to regulatory and tax changes? Wow! Demographic changes? Two brave souls. The economy? Three brave souls. Competition? If I said the term marketplace and competition? New technology? Most of you said regulatory and tax changes. That's interesting.

Mr. Cernanec: Technology over the next five years is a major driver. Competition comes in very closely, but it happens to be competition from additional new, non-traditional environments.

Mr. Stern: Mike, can you give an example of how a life insurance product might meet a market need that doesn't cry out for life insurance, and that's not the banking community?

Mr. Roscoe: I think it's almost an obvious answer. I don't want to give myself any hard questions. What are two of the most common things that you hear about life insurance? Think of all the life insurance out there that's sold where the death benefit is somewhat incidental, you have deferred compensation arrangements, nonqualified deferred compensation executive bonus-type plans, all sorts of them where there's a nice value to have in a life insurance, but the life insurance itself might be needed elsewhere.

As a matter of fact, it might already be taken care of elsewhere. It could be a life insurance need that is fulfilled elsewhere. There's also a savings opportunity and the chance to marry the two together and continue to fill that need. But really, the life insurance is designed to handle that tax-deferred cash accumulation. I mean that's actually how easy it is to start to think about what that client is looking for.

How many of you are involved in markets where cash accumulation is the focus on life insurance? Consider how many times the buyer of that policy walked into some producer's office and said, "I want to buy a life insurance policy in order to save money." Do they ever say that? Yet, it turns out to be a very effective way for them to fill that need.

What kind of products will we have five years from now? Will they look the same as they do now? Will term insurance still be around? What about fixed annuity? Not so many hands. What about variable annuities? How about UL fixed accounts? What about variable UL? How many think there will be a product that will come in the next five years that is not here now? What's the Dow Jones going to be in five years?

Mr. Terence R. Narine: My question is, where do you see the future of product development and insurance products, related to that question you just asked, in terms of packaging of life, disability, and health-care products?

Mr. Stern: Well, I think if we can get over the regulatory hurdle, we would probably already have integrated products. But that's going to be the biggest hurdle. I know that a number of my clients have looked at the possibility of trying to develop something along those lines, by packaging different coverages within a common life wrapper, but it's still not manufactured by the same company. I thought that with the advent of UL, which came on the scene 15-20 years ago, that was the direction the industry was headed. That we could have homeowner's insurance, car insurance, health and disability insurance, life insurance, and savings all come out of a fun concept.

I think it can work outside of the U.S., because they don't have as big a regulatory concern. Until the regulators allow us to mix the coverages, I think it's going to be a long time coming. Now we're getting close in the standpoint that we've been able to put critical illness and long-term-care benefits on annuity and life insurance. But I just think that's the beginning. It could go a lot farther .

Mr. Cernanec: One thought is very often we get stuck in our own box as to what product and the service aspects which get wrapped around that product. Certainly Larry described elements of coverages that we can't quite commingle within a product being perceived as a contract form. What is happening in a number of organizations is they look at the customer account that has a number of coverages that might come out. If we change our view to be that those are different insurance contracts wrapped within a customer account, and that the relationship we have with that customer (around that customer account) as being the product that includes all of those coverages, i.e., contracts.

That's where some folks are beginning to change some of their thinking around what is being offered and packaged out there and dealing with that account. We do have issues around different taxations of the products or our contract forms that might fit within that. But that's dealing with some of the legal form issues. If we think about what the customer is interested in. ,what we do with regard to that relationship is to have that be a learning relationship where the coverages and the pricing that is placed into that customer account are based on what we've learned about each other together in that customer.

It makes it then more difficult for that customer who's tapped into that account to then change the provider. It’s hard to change the account and go somewhere else. Thinking about what is it that the customer is really looking for becomes a higher value item. The quarter-inch hole, not the fact that they're coming in looking for an health or life insurance policy. Turn it into a positive buying experience. How many folks are aware of what Saturn did with regard to the automotive buying experience? How many folks are familiar with Woody Allen's image of a life insurance agent? Okay. How many folks would agree with that image?

What can we be doing as part of our definition of product to include the buying and service experience that the customer is going to have? Think about what Merrill Lynch tried to achieve with the cash management account when they first came out and what they've done since.

Mr. Stern: Getting back also to the concept of perceived needs. Just take a look at what American Express did with gold card. They put the cost of the gold card at $250 a year and people were flocking to buy it because they perceived that the gold card was a status symbol. It is the same thing that Chrysler did with the mini vans. They made more money on the mini vans because they created a perceived need in the marketplace for that vehicle and their mark-up on mini vans is higher than it is on any other car that comes out of their manufacturing plant. It's creating something that in the eye of the buyer is something that they want or need and they perceive it to be the best.

Ms. Kristal E. Hambrick: You've all talked about understanding market needs. We're not known as an industry which has good market researchers. How do we become good market researchers? I'm from Cincinnati, so do I follow Proctor & Gamble (P&G)? Do I hire a person? What about shadowing agents? Have we done a lot of that?

Mr. Cernanec: On the market-need front, there are a couple of things to think about that have happened in and around financial services. Is this whole aspect of call-center customer contact and turning that into a knowledge base feasible? If you do have a call center, then you're dealing with the technology that's out there. I'll refer to some generic terms like business intelligence, data mining, or decision support systems. Some things that actually are actuarial skills. How do you determine what's significant? There's a little bit of analysis that might go in. There are elements out there from a mathematical perspective that are kind of fun in getting into the various different algorithms that are used.

How many of you, as product-development actuaries, have spent a week in the field? There are a little more than a handful.

Being able to walk in their shoes will help you to understand your distribution channel. How many of you have listened into your call center and to calls that come in from customers in dealing with their issues? Similar-sized group, still very small. How many of your organizations have contact reports where whatever distribution channel management that you have when they go out to visit agencies, come back and have a form with agenda items that were covered in that as to who are they working with? Why? What's their market? What are some of the issues and needs? Tap into that on a regular basis? What do they see as new? None of these are yet along the lines of having to actually go out and do a commissioned research, that P&G might take a look at. The one element that I would look at from the P&G model is the urgency with which information is treated.

Mr. Stern: We collect an awful lot of demographic information about the buyers of our products on the application. It goes into the database, but how many companies actually take a look and analyze that data? It's right there. It's readily at hand. You know what they've bought and you know all the demographics about them. It should be good information for you to think about going forward with the kinds of things that you want to offer.

Mr. Roscoe: I can echo a little bit on that. Start with your existing business. You ought to have a handle on the needs of your existing customers. Take a look at that, see if you can distinguish between the drill bit and the hole. Again, nine times out of 10, they're not coming in looking for the life insurance product or feature that you're selling but that's the tool that is accomplishing their needs. It's a great way to start the exercise.

When you get a good handle on what that need is of your existing client base, you'll see that you have current features where the cost exceeds the perceived value. By tweaking those features, you're going to have a more competitive product. Some features where they exceed the perceived value. The comment about, "Have you ever spent a week with a producer?," spend a day! You really don't need a week to do it, it helps. But that's your first touch with the customer most likely is your producer channel. Sit in on the call centers.

Mr. Cernanec: Absolutely. For various different reasons, you're kind of locked into your four walls. Somewhere in your pricing, if you're dealing at all with any flexible premium contracts, you've made some assumptions as to payment patterns and coverage amounts. Is reality compared to your assumptions? Just go through that exercise and ask, why is it different? That gives you some insight.

Mr. James A. Wiseman: I wanted to ask the panel if they thought that the virtual free fall in term prices over the last few years indicates that term was grossly overpriced prior to that? If that's the case, maybe a lot of life insurance in this country is very highly priced relative to the value that has been given to the ultimate customer. Following that chain of thought, what could the product development actuary do to try to drive prices down?

Mr. Stern: Well, if it weren't for the fact that the reinsurers were trying to buy market share, I don't think the term prices would be as low as they are.

Mr. Roscoe: I'd say that the prices are high relative to the actual costs as opposed to relative to the value. I think that there's a number of things that are driving the price down now. One is capacity and that's really coming out of the reinsurers. Another is awareness. It's very easy for almost any individual to find out what a cheap term product costs. I mean, you have the Internet, direct mail, and newspaper ads calling their agents. Awareness is going to drive the competitive price down, but we all make money. The rates are higher than the actual cost. There's no crime in that. That's the way we want it to be. There was a lot of room, I believe, in having those rates come down, but are the rates higher than the value perceived by the client? No. They wouldn't buy it if it was.

From the Floor: Are life products in the same situation?

Mr. Roscoe: Sure. I mean, one of the nice things about term also is, it's simple. It's a relative commodity. It's one rate. It is one of the things you see in some of the other, more complex products, which makes it a little bit more difficult to ascertain the actual cost that's being paid.

Years ago I had the opportunity to pick if I wanted to work in life insurance or annuities. Anybody who knows me knows the company I work for. I picked life insurance and the very next day, annuities went through the roof at that company. I took life insurance because there are a lot more moving parts.

When the cost becomes readily apparent, it forces the company to drive that feature down. Today that happens to be guaranteed. Secondary guarantee has become an important element. When that cost becomes apparent to the marketplace in one area, there's something in another area that still allows you to charge more than its actual cost. It still would be less than the perceived value. You have the opportunity to make some money over there. It's one of the things that I liked about permanent life insurance. Personally, I don't see it driving as much down as the term wars have done.

Mr. Cernanec: Jim, on some sides it starts to get to where we, as organizations, choose to take our position on the value chain. Where is it that we're looking to make money? For example, 20 years ago, IBM was in the computer hardware business. The way they sold that was to say, "We will sell you the hardware and, oh by the way, we'll do the installation." You get the installation free, but you end up paying for the hardware. What does IBM do now? They almost nearly give away the hardware and sell the installation service. The integration occurs with the rest of the operation.

As we, as an industry, look at term insurance, okay, is that going the road of the computer hardware? What are folks looking for as they become financially savvy to have their needs addressed? We need to move ourselves to a level of providing the service, the counseling, the planning, and all that's involved around that. That is what people need. How often do you hear people say, "I need life insurance"? We've fallen into a rut, as to offering that. We have commoditized it ourselves as an industry. Yet there are niche players out there that have not gone that route.