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Session 13I
Nontraditional Marketing: The Next Fifty Years

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Summary: Not too many years ago, work-site marketing of life and health insurance was considered "nontraditional." Today, bancassurance would be classified that way. Direct marketing probably still qualifies as nontraditional, but the techniques being employed have changed markedly from what they once were.

In this session, the interviewees share their insights into how such nontraditional methods of distributing our products are continuing to evolve and offer their views on what future that evolution may lead to for our industry.

'Mr. Jay M. Jaffe: The objective of this session is to predict the future of the insurance business so that you can be prepared to operate in one of the several new environments that are going to change or be developing in the next half century. Each panelist has a particular view on the insurance business. John Adiletti is a leader of an alternative distribution system for property & casualty (P&C) insurance. Dan Snyder is a former insurance executive and is now providing information services to catalog marketers. He has a different perspective now that he's been away from the business for a couple of years. Walt Roder is a leader in the creation of insurance-type programs by banks, but the banks don't use insurance companies for these programs.

I'm now going to ask each panelist to describe his background.

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Mr. John C. Adiletti: I have 32 years of insurance experience. I started with Allstate as a trainee. I was either the 12th or 13th employee at Met P&C when the company began back in 1973. I then joined the National General Company in St. Louis. National General is involved in direct response and affinity marketing of P&C products. Next, I moved to the West Coast with the Balboa Companies and actually built a personal lines direct response P&C operation from scratch. My next job was in Chattanooga with Provident Life & Accident, where I was instrumental in running Provident General, their P&C company. My next few years were in the Portland area heading up the marketing and sales activities for Nationwide's direct operations in the 21 western states.

For the past three years I've been here in San Francisco with Civil Service Employees Insurance Company, or the CSE Insurance Group. We're a mid-sized regional company. We deal both on a direct basis and also through independent agents. About 50% of our business is generated through government employees or public servants; the other 50% of our business is from the general public. As a regional company, we operate in the eight western states, California being our biggest state.

I deal with our actuaries every day on the company's pricing committee. I have a high regard for actuaries, although some people within the company may not. I see them being very outgoing, scintillating, and sometimes very tenacious, too.

Mr. Dan Snyder: I spent 20 years with Equifax based out of Atlanta, Georgia. Most of my focus has been in the areas of consumer information, database marketing, and target marketing. From 1990 to 1995 I was a senior vice president and ran the accident and health business for Providian Corporation based out of Valley Forge, Pennsylvania (formerly National Liberty.) In 1995 I was asked to assume the presidency of a small, private company based out of Denver, Colorado called Abacus Direct Corporation. After all of those years associated with the insurance industry, it was quite a change to involve myself in a company that was focused more in a catalog direct-marketing arena. In recent years, Abacus has spread its wings and used its database and modeling resources in areas outside of catalog markets.

We took the company public in late 1996. It was a very successful public offering. In June 1999 we announced a $1.4 billion merger with DoubleClick, which is the leading Internet advertising company based out of New York. We're due to close that deal in just a couple of weeks. I don't know where today's discussion will take us, but there could be some interesting dialogue relating to the application of the Internet as an advertising and distribution medium.

Mr. Walter H. Roder II: I'm a noninsurance person. I've spent most of my life in the banking industry. I started off in New York in the late 1970s with Citibank. I was the marketing director for the credit card business. I then moved on to Bank of America in the early 1980s in San Francisco and ran its credit card marketing division. In the late 1980s I went to Providian, which is also a San Francisco-based credit card company.

For the last 12 years I've run my own consulting company out of the Bay area. We specialize in helping card issuers make more money from their current cardholders.
With the exception of charges for interest and fees, the next largest source of income for a credit card company is from credit insurance. My firm has spearheaded the conversion of banks from a traditional credit insurance platform to something called debt suspension. This product is a noninsurance version of credit insurance coverage and a better mousetrap for lenders because it offers similar types of coverages but in noninsurance forms.

Mr. Jaffe: At this point I'd like to introduce our fourth panelist: you the audience. It is incumbent upon the audience members to interrupt, to ask questions, and to challenge the panel.

I'll ask the first question. The world is changing rapidly, even more rapidly than in the past. In the past insurance was sold by agents who had one-on-one relationships with customers. Some insurance was sold by direct mail. Looking into the future, which will be the centers of influence for the sale of insurance and why do you predict that these will be the most important centers of influence? What other focal points do we need to look out for in the future? Gentlemen, who would like to start off discussing the centers of influence in the future?

Mr. Adiletti: You can't discount financial institutions. They're out there. I just gave a talk to about 150 independent agents, and we were talking about where the independent agent was on the food chain; unfortunately, the independent agent fell in the number 6 or 7 position, and the issue was how do you get higher up on the food chain?

Large brokerage and mortgage companies, such as the Countrywides, are there at the time of sale especially in the P&C business. This same benefit also exists when the applicant needs credit life or mortgage life.

The mortgage company is selling the mortgage. It has all of the information it needs to sell insurance. For developers such as Kaufman and Broad, insurance is a very easy sell because they have all of the information on the customer (i.e., when the original transaction occurred).

Automobile insurance could be sold by auto dealers. I believe it was announced recently that Ford Motor Company and Hartford are putting a deal together. In the future, I can see vehicles being insured before they are driven off the dealer's lot. The buyer won't even have to turn to his insurer because the automobile insurance will come as a part of the purchase price.

There are also affinity groups, which can be centers of influence. Affinity groups can be anything from small employers to large associations. They have access to the customer. You're also looking at financial planners and brokerage-type operations where people are looking for financial planning and related information.

The groups I've just mentioned are going to be your centers of influence. It's through them that the products are going to be sold.

Mr. Snyder: It just seems that most of the smart companies going forward are evolving to a point of view that really blurs the lines of traditional distribution. I think most smart companies perceive the need to serve the consumer as he or she prefers, and this concept is not just confined to the insurance industry.

Recent meetings over the last few weeks with Merrill Lynch have been amazing. If you look at their corporate strategy, it is looking to evolve their distribution channels in a way that meets the consumer demand on the basis of how the consumer wants to either get their information or actually transact their business. I think there always is a segment of American households who, on the basis of their demonstrated behavior, prefer to deal in a non-face-to-face environment. We at Providian had difficulty in making things like mail work profitably. We evolved to other channels like television advertising that were more attractive.

The Internet is evolving very rapidly as a means for consumers to get information and potentially transact on that basis. I think the future belongs to those companies that are smart enough to realize that it's important to zero in on those segments of society and how they prefer to transact. Companies need to look at the various tools that are available to them to identify those behaviors and be proactive rather than just reactive to the consumer.

Mr. Jaffe: Walt, do you have anything to add?

Mr. Roder: I have an appointment this afternoon with a little company that offers credit cards over the Internet, and you never sign anything. To get the card you just log onto a screen and apply for the card; then, a few days later you get a piece of plastic that shows up in the mail. And if applicants do what we will suggest, one can check a box and get credit insurance. This program illustrates just one of many that can go directly to the consumer on a tailored basis.

Mr. Jaffe: Does anybody in the audience want to talk about where they perceive the centers of influence to be in the next several years that will be part of the insurance business?

Mr. Errol Kindler: With respect to the Internet, how do you view life and health companies differentiating themselves when they sell products through the Internet?

Mr. Snyder: In a sense, the type of product that you're selling defines the market segment that you're going after. The key, particularly with the Internet, is figuring out how to get that right message to the right person at the right time.

I know Abacus Direct works from our business model, which is the result of taking 1,460 different catalog companies across the country that contribute their entire transactional histories or master files of their customers into one, central database.

We use that database and very strict modeling techniques to mine that data in order to get the right offer to the right person at the right time.

One of the big reasons DoubleClick acquired Abacus was because of the availability of a tremendous amount of behavioral data that could potentially help in getting the right offer to the right person at the right time.

Most people don't understand that behind that PC screen, incredible technologies are at work. Along with collaborative filtering, vast amounts of consumer information can be messaged to select 1 of 6,000 potential messages that are waiting. Pick the right message, and, within milliseconds, serve that advertisement up at the moment that person is on whatever site they're on. I think that the key is not so much just the technology but linking the right data to that technology. Depending on the type of company you are and the type of product that you're selling, it's important to understand who that person is who's visiting that Web site or pecking on that keyboard at that time and getting the right offer to that person at that moment of truth.

Because of an Internet application I think that the companies that are going to win the biggest are those that, regardless of their product set, take advantage of that type of information and that type of targeting technology to make the Internet a much more personalized and viable sales opportunity.

Mr. Jaffe: I would think the biggest challenge to selling insurance on the Internet is underwriting. If somebody logs onto a Web site and wants the product, we should be able to deliver it to them just as fast as they make their decision.

Mr. Kindler: In addition to that, it's the question of competing on cost; that is, if you picture a market where consumers can very quickly price shop, how will companies compete in that environment? How will companies differentiate themselves?

Mr. Jaffe: One of the other issues is brand differentiation. Branding will be increasingly important on the Internet because if you have two companies that are competing and you know who Company A is but you don't know who Company B is, I think you will be swayed, if there's not a significant price differential, to go to Company A. Of course, you have to know it and like it. On the other hand, you may know the company and not like it, which will cause you to go to Company B.

Mr. Kindler: Let's say you know A and B, and there's a Web site where you shop for products from 12 different companies. All are household name companies. What does a company do to differentiate itself?

Mr. Adiletti: The issue there becomes the product itself. For example, let's say you see a Hewlett Packard 5120 model computer at Circuit City. Then you go over to Office Max and they sell a 5130, and at Office Depot sells a 5140. Radio Shack sells the 5150, and Comp USA sells the 5160. None of them are the same so the onus now falls on you the consumer to know what you want. Consumers have to educate themselves or else they're going to wind up buying something that they don't need or want.

Unfortunately, in the P&C business companies are not standardizing the product. Automobile contracts, whether you believe it or not, are not all the same. Neither are your homeowners contracts. It's going to be up to the insurance companies to do some educating, and it's going to be up to consumers to educate themselves to make wise decisions. Decisions are not based on price alone.

Mr. Paul H. LeFevre: I believe that in the next five years or so a significant amount of annuity sales will either be transacted on the Internet or be assisted by the Internet. You can see it starting to happen now. I think the evolution is first going to occur in the distribution area because even the current distribution system, be it banks, financial planners, or NASD firms, etc., are going to the Internet. They're asking companies to utilize the Internet to help them do their jobs. This may create an environment where consumers might go more and more to direct distribution over time and a demand for simplification of the products that are offered could ensue. Could it be that one of the reasons today's products are so complicated is to create a real need for the intermediary?

Mr. Jaffe: I would argue, Paul, that maybe with the Internet you'd have an opportunity to differentiate your product with terms where somebody could actually sit down and explore what those terms are and not get the information secondhand or verbally, but get it in writing. If so, could it be a two-edged sword?

Mr. LeFevre: Let's return to what we were talking about, the situation with Company A, Company B, Company C, and Company D. You go to some site, and all those companies are represented on that site. Whoever is sponsoring that site probably has the obligation and probably would create the comparisons and ensure proper market conduct comparison between the products that are offered on that Web site.

Mr. Roder: That's the point I was waiting for. How many people in this room have bought a car over the Internet? It's a real experience. It's an eye-opener. I would suggest that anyone who is a provider of a financial service, be it insurance or otherwise, should look at the Internet as a double-edged sword. I'll just explain the process real succinctly.

I wanted a Dodge Durango. I wanted 13 specifically features on it. I went to CarPoint, put it out on the Net, and within two hours got 5 dealers in northern California to respond with offers for exactly the vehicle I wanted, and arbitraged the price down $3,000 on a $33,000 vehicle. The Internet empowers the individual to make the selling process perfect because you can present yourself to essentially an unlimited number of dealers in a broad geographic area and get the very best price for exactly what you want. It's going to force manufacturers to have to deal with what I call the perfect market.

Insurance in the end is no different from most other things that consumers buy, and while policies may differ, if you're buying a life policy, you're paying a premium. when you die you know the amount of money you're going to get. And you can simplify these things into relatively bundled packages. So, I would suggest that from a sales technique point of view the companies that don't realize what's going to happen in the marketplace where individuals have even more choices are going to be left out.

Mr. Adiletti: I agree with you, Walt. But you knew what you wanted. You wanted 13 individual features on a Dodge Durango. Unfortunately, many of the customers purchasing insurance products today don't know exactly what they want. They know they want something to cover their home, their liability, their automobiles, their life, whatever it might be, but they don't know those individual 13 items that they're looking for. This is one of the main reasons that a lot of problems arise with the purchase of insurance.

Mr. Snyder: I think the reality is that companies will have choices available to them. They may be part of a type of Web site where there is a host and where there is more of a comparison proposition. I also think that companies which are large enough with a powerful brand will be on the Web with individual advertising or offers. I also believe that you'll see a lot of co-marketing or marketing alliances forming with some of the other companies that are garnering traffic like a lot of the major retail and online brokerages.

For certain companies in the insurance industry (those that focus on more high-end or interest-sensitive-type products), it's probably more important for them to pay close attention to what is going on with other distribution channels because their customers are the ones who are using the Internet today and are being contacted by other distribution systems.

The competition is probably going to come from young, upstart companies such as E*Trade, AmeriTrade, Daytech, or DLJDirect. These companies are investing vast amounts of money to corral the type of market segments that will be more likely customers for high-end or interest-sensitive-type products. They're corralling those people and weaning them into an Internet-type relationship. I think you'll see insurance companies aligning themselves with these organizations, which are quickly zeroing in on the preferred market segments.

Mr. Jaffe: What we've been discussing is actually a large part of my second question. While the Internet and other electronic media are going to be important, are there any other marketing techniques that will supplement the Internet?

Mr. Adiletti: No, I don't think the Internet is the only media. I think what you may see in the future is also the bundling at the point-of-purchase, especially in the P&C areas. You buy a home, and included in the price of your home is the insurance for the home itself. As you purchase your home, it's insured. You purchase your car. The vehicle is insured once you've made the decision that you are going to purchase the automobile; the insurance is included in the purchase price.

Mr. Jaffe: I'm going to challenge you on this. How long does this automobile coverage go? Is this an original equipment manufacturer that we have or do we have to go into the secondary market five years later? How is that going to work?

Mr. Adiletti: I think companies are going to have to be innovative. One option would be driving the car off the lot with insurance for a six-month period of time. I think some companies in the future are going to be even more innovative and offer one-year coverage. Companies may look at physical damage coverage of the vehicle for two, three, or five years. All of these coverages could be part of the purchase price of the car.

Mr. Jaffe: If that were to happen, could State Farm start offering automobiles?

Mr. Roder: There's no reason an Allstate or a State Farm couldn't sell automobiles.

Mr. Jaffe: Are there any other techniques that anybody can think of that might be used to market insurance?

Mr. LeFevre: First, there's the possibility of auctioning insurance on the Internet. What about an eBay for annuities? There are regulatory issues to address, but these are probably not barriers. The other concept that strikes me is capital markets and reinsurance. Capital markets have come into an awful lot of insurance-related issues, and you just wonder if at some point that's going to come down to where you might be buying or selling insurance through securities instead of through buying a policy.

Mr. Jaffe: There already is a reinsurance market that has been tried in a way similar to that concept. The Board of Trade in Chicago has tried a reinsurance futures market, but I don't know how successful it has been.

Mr. Roger J. Gagne: I have one other comment supplementing what John said. I think this packaging idea is already being done in at least one instance. For example, continuing care retirement communities sometimes include in their fees, with no choice necessarily, the purchase of long-term-care (LTC) insurance.

I also have a question for the panel. I'm involved in the area of group LTC insurance, and it's a fairly new and quite complex product. I thought marketing this probably won't be very successful because of the complexity, but to my surprise it has been fairly successful. Have any of you seen any limits to how easy or how difficult it is to sell things in a nonpersonal way because of the level of complexity of a product or because of the newness of the product? And if that is a problem that does dampen sales, what would you suggest we could do to overcome the drawbacks over time?

Mr. Snyder: I can tell you from my National Liberty and Providian days that the big challenge of insurance direct marketers over the years is dealing with exactly the complexity issue that you described, and for that very reason the products, mostly supplemental in nature, have been kept to a bare minimum in terms of their complexity, compounded by the fact that you're dealing with a relatively low-income or lower middle income audience that may not be that well-versed in terms of understanding what they need or even what they want. In the traditional insurance direct-marketing arena that problem has been solved primarily by just keeping it simple, but I think that the evolving means of communicating with a consumer (e.g., the Internet) give the companies more tools by which to explain or to bring understanding to the consumer. I think the Internet will evolve also as a very interactive-type medium. Not that many households, frankly, have PCs, but everybody has a television. Just look at what's going on in the broad band arena, and think five years out what the opportunity will be for companies to communicate interactively and inexpensively with consumers. Two, regarding somebody else's earlier point, I think that there are lots of unwritten chapters in terms of being able to move the envelope in terms of interacting and providing quality information to consumers.

Almost always we seem to revolve back to the same issue: whether a consumer is talking into a telephone or whether they are filling out an order form or pecking into a keyboard. In the end it's always the same challenge for the marketer to understand in advance who this person is, to anticipate the person's wants and needs, and to tailor the message for that particular market segment. I think the good news is that the different evolving communication mediums are going to give companies more choices in how to address these concerns.

Mr. Gagne: It is an intriguing idea certainly that you could have this interactivity. But when you're talking with a prospect and they ask a question about a product, they want an answer right away or they may go away. I think someone earlier had mentioned that was a challenge in underwriting also—trying to do it quickly.

Mr. Snyder: They're actually doing that in a small way now. A lot of consumers are using, for instance, the Internet to establish their preliminary information, and then they are literally going from the screen to an 800 number and then connecting to a live person. Actually, the vast amount of products being sold right now are not reaching the final transaction stage on the Internet. But the Internet is creating a platform for that type of interactivity to occur in a much more real-time environment, depending on the company's ability to respond immediately to that inbound 800 call.

Mr. Gagne: I am concerned with having somebody being able to respond immediately on a 24–7 basis. How do you do that and still keep your price down? One of the big advantages obviously of nonpersonalized marketing is that you don't have to pay a person to sit across the supper table and explain it person-to-person. Do you think possibly by referring them to an existing operation that already has people staffed perhaps 24 hours a day you can do that and still keep costs down?

Mr. Snyder: For those people in the room who have evolved in direct marketing over the years, you know that it is a myth that direct marketing is a cheaper distribution channel. It's not. It's just a different set of marketing activities. But there are evolving things like the Internet that can at least create the possibility for improving direct marketing. As the bandwidth issue becomes addressed, and it is most definitely being addressed, with companies pumping in untold hundreds and hundreds of millions of dollars right now to expand that bandwidth, there will very definitely be the opportunity for companies to interact in real-time without even picking up the telephone.

Mr. Steven E. Konnath: I'd like to steer the conversation in a little different direction and talk about data, data sources, data mining, privacy issues, and the implications of HR-10.

We're having some issues at our company dealing with third-party-type arrangements, primarily with banks and credit card issuers. I know there are some recent litigation issues with sharing of information between the direct-marketing insurance company and the bank. There are some future implications of HR-10, including whether or not you're going to be part of a financial conglomerate. The access to information which such relationships provide must be balanced against privacy issues. Please comment on these topics.

Mr. Jaffe: I'd like to add some things to your question. For example, not only do we have privacy legislation, but we have other developing areas, the most significant of which is gene research. I don't know if you're all aware that the gene mapping project has the prospect of mapping all the genes in the body in a couple of years. We're going to know a lot about people. What implication does that have with respect to the selection and sale of insurance, privacy legislation, and HR-10? As people learn more about themselves, what are the implications for the insurance business, particularly with respect to risk selection? Should we, or will be able to, even underwrite insurance in the future?

Mr. Adiletti: We tried to do something innovative in California recently, and that was to look at credit scoring, or credit history, as it relates to loss costs because there is a correlation between credit score and claim costs.

Credit scoring is when you take an individual's credit record and put an actual score on it, based on such factors as whether they've had bankruptcies, stability of job, location, and many other factors.

Our company went out and set up our homeowners policy so that it would be rated according to credit score. Our filing was denied by the department of insurance, stating that we could not use credit score as a criteria for rating. However, it can be used as a criteria for risk selection, but not to actually come up with the premium that you're going to charge as a result of it. No matter how far we try to push the envelope, there's going to be a group on the other side trying not to allow change.

Mr. Roder: Does everybody in the room know how HR-10 is dealing with privacy? I'll give you a quick review of what it's all about.

HR-10 essentially removes the Glass-Steigel Act, which separated insurance companies and banks. But HR-10 allows the Citigroups of the world to put insurance companies and a bank together, whereas before HR-10 they were prohibited from doing that.

Part of HR-10 arose to address the concern of sharing customer data once you put a company together. The insurance company has a certain piece of it. The bank has another piece of it. They can build profiles and figure out who they want to make loans to and who they want to issue policies to. HR-10 requires a bank and/or an insurance company to allow a customer to opt out of having his or her information shared with an affiliate or a third party—an affiliate being part of the larger company; a third party being an insurance company doing business with a bank.

Shortly you're going to be getting in your credit card statements and mortgage statements a notice saying if you don't want your data selected, call 1-800 and put your name on a file and/or return a certificate that says I don't want my information shared. If you don't act your information will be shared, with the exception of medical and specific credit data. In the end, keeping more accurate files of who wants their information shared probably won't be that much of a hindrance to the cross-marketing of products, whether the marketing will take place with an affiliate or with a third-party partner.

Mr. Snyder: If you think HR-10 is onerous, it's nothing in comparison to the evolving warfare that's going to emerge relative to privacy and the use of information on the Internet, which is extremely sensitive. Over the years there have been certain data sources that have been traditionally very inflammatory, such as Social Security numbers, your payment history on your credit report, and medical information. These areas will be carve-outs and get special attention regardless of whatever model legislation or set of standards evolve. The key, though, is that despite different media's attempt to sensationalize the issues around privacy at the end of the day, it ends up boiling down to having a mature and respectful attitude for the consumer's privacy. The greatest path to staying out of trouble for everyone will be to evolve policies or company ethics that deal with complete and full disclosure to the consumer.

On the Internet you're going to see things already evolving into what's called "double opt out," which means that not only you have the chance to read a company's privacy policy when you visit a site, and also when you sign on. You would be saying, "I agree with that privacy." Then companies will come back and actually make a second attempt to confirm that you want to stay in the pool. Much of that is damage control because of the marketing opportunities that companies perceive associated with these different emerging advertising media. They want to make sure that the audience that they're addressing is a high-quality audience that has had two opportunities to opt out.

MatchLogic is a direct-marketing subsidiary of Excite, which is owned by At Home, which is mostly owned by AT&T. They are signing up something on the order of 64,000 consumers a day with double opt in. There are very, very strong disclosure and registration opportunities for consumers to tell a lot about themselves as they register. Excite intends then to leverage that self-disclosed consumer information in the form of very aggressive but controlled e-mail marketing. E-mail is not as intrusive as a telephone call coming into your house, but when you look at companies piling onto this as a marketing medium it has the potential to be very annoying if you could open up your screen and have 3,000 unsolicited e-mails. So they're taking great pains, for example, to opt in and opt in and opt in. Every single e-mail message they send to you has this red, bold disclosure at the top of it that says this e-mail is being sent to you as part of your participation with Excite. If you do not wish to receive any further e-mails, please check the block here, and you'll be forever removed from the database.

I think companies that take responsible, respectful attitudes toward the consumer's privacy demands will be the ones that are most successful in their marketing efforts. I know the Direct Marketing Association, out of New York, has taken a very strong stance in this general area. They have created mail and telephone preference programs; 3–4 million consumers have strongly objected to receiving unsolicited offers of any type. Responsible companies wouldn't dream of doing anything with these consumers.

Privacy was a hot subject when I started with Equifax back in 1970. It never goes away. It's always a sleeping giant, and it's awake today more than ever.

Mr. Adiletti: One quick question. Most of you, if not all of you, use the Internet. How many of you, when you're using the Internet, have clicked on and read every privacy policy of every site you've visited? Raise your hand. (Not many.) I rest my case.

Mr. Jaffe: We've been talking about distribution, but let's talk about product. We must have something to sell. Are we going to sell the same thing all over or are we going to sell something new? We'd appreciate if you would justify or explain why your new product will sell.

Mr. Roder: Our company has been focused on major banks. We were advisors to Citibank, which introduced something called their credit protector product. It is a variant of credit insurance referred to as debt deferment, which is part of a contractual agreement. They've effectively stopped selling credit insurance.

Banking laws allow banks both on the federal level and the state level to contractually enter into agreement with their customers to either defer a payment or cancel debt in return for a fee under certain circumstances rather than use a traditional credit insurance policy.

Why have banks now started to effectively offer these products as an extension of their lending agreement as opposed to a traditional credit insurance policy? First, it is a more effective marketing tool, a more flexible product, and a more economic model. You're all aware of the fact that if you want to introduce an insurance product, you have to get 50 state insurance commissioners to approve a product. Most likely, you'll end with approval in less than all states and, in fact, different products priced differently with different features.

With a debt suspension product (a generic name for the products I'm describing), you can have one product nationwide with the same terms and conditions. That obviously makes it easier to sell and to service.

Second, unlike most insurance products you can give away debt suspension coverage or provide incentives. In the case of a debt suspension product, Providian, which was actually the first company to do this about 12 years ago, has been offering 3 months free coverage. As you well can imagine, three months free coverage gets you a much higher response rate and higher penetration levels over time than other marketing methods.

Third is the costs. The basic debt suspension model offers a bank product as opposed to insurance and without the requirement to pay premium taxes. That alone saves about 3% of premium. The product has no underwriting, sometimes referred to as ceding or fronting fees. Even if the bank is a participant, ceding or fronting fees are usually run two or three percentage points. Servicing, because it's one product nationwide, can be done for about half the price that the insurance companies charge the banks, which is around 9% on average but about 5% as a noninsurance product. Most importantly, when you defer debt as opposed to making the payment in the classic credit insurance model (which costs about 24% of the balance per year or 2% per month in the credit card model), the cost is only the insider's monthly minimum payment. Under debt suspension a bank provides essentially the same coverage by deferring the payment, but just deferring the minimum payment reduces costs to 18% (which is the high end of the bank card world right now), or 1.5% per month. This translates into a 25% savings. The average large credit card company is offering rates more in the 16% range over time, and that's a 33% savings. As you go down the scale, the economic cost of providing the coverage reduces materially.

From the bank's perspective, it is carrying the debt at its cost of funds, which is really 6% today. So the true economic savings, on a severity basis, between the identical coverage is 6% versus 24% per year. Because the bank, more or less, charges the same rate that you would charge for a credit life policy in the form of debt suspension, guess where that margin goes? It goes to the bank.

Mr. Jaffe: Walt, you seem to be talking about a scenario in the banking environment that might eliminate the role of an insurance company. Did I understand that correctly? Can that be extended to other products? If so, can or should insurance companies survive? What meaningful contribution will insurers bring if they are going to survive?

Mr. Roder: The answer is for any lending relationship where there's a national bank, a state charter bank, a finance company, or literally a retail installment contract, which virtually any retailer can issue in the U.S., the same principle can be applied, with some exceptions in certain states. What you have is the ability for the banks to disintermediate the insurance companies for the purposes of ending any lending relationship to include just not loss of life but loss of income and loss of property. The breath of coverage has been stretched by GE Capital to something called GAP, which is a policy sold for automobiles primarily where it covers the difference between what the loan balance is and what the cash value of the asset is at the time of total loss.

Mr. Jaffe: Under this scenario where does that leave the actuarial profession? What will we do and which companies, if any, will use our services?

Mr. Roder: Actuaries still have to figure out what the loss ratios are and be certain that requirements of the Office of the Comptroller Currency (OCC) or the bank examiners, are met. A bank must properly accrue for the expected losses, and that obviously sets up what you need to charge in the way of fees. The mechanics don't change, but rather the legal form of the offering does. Actuaries are probably going to be in business for a long time, maybe even more so in this area, but they're not going to be working for insurance companies. They're going to be working for banks.

Mr. Jaffe: In the future, employers of actuaries might be significantly different. In the financial area we could be employed directly by banks rather than by insurance companies.

Mr. Roder: If you think about it, lending is the mirror image of insurance. A lender extends credit for which you have a certain expected loss profile. If you're extending coverage, you have a certain claims ratio that you're expecting to have, and you price it accordingly. The banks are risk-takers, and they understand risk well. The extension of going from making a loan decision to making a loss decision is not a big leap either from a mental point of view or from an actual performance point of view.

As you know what your claim incidence and severity and duration is, you can price accordingly. Banks are very prepared to do exactly that.

Mr. Snyder: It starts with the consumer mind-set. Consumers don't set out to buy a credit insurance product, per se. They respond very impulsively to protecting themselves for certain things that they can identify with very readily, such as when something happens to your employment and you are upside down with your mortgage payments. You need to make sure that you have 6 to 12 months worth of mortgage payments covered in case you lose your job.

Providian realized that these concerns weighed heavily on the minds of many consumers. They developed a distinctly noninsurance product to address this need, which was the genesis for several other interesting products relating to consumers' daily mind-set.

Mr. Jaffe: Are there any products that people can think of that are on the horizon in the next five or ten years?

Ms. Linda H. Andreae: I'd like to hear about the role of market research and market segmentation because I think that's what the insurance industry has not done well in the past. When we talk about products are we asking the consumers what they want? When we talk about innovation does that come from research identifying what the consumer wants, or from sitting in an ivory tower guessing what a good product would be?

Mr. Snyder: I think the reality is there's probably more ivory tower stuff than people would guess. But there are smart companies that define their core competency as a company, and one of their key competencies can be market classification or market segmentation. Providian, for example, defines markets on the basis of behavior, so they're constantly looking for information or data sources that allow them to first complete their market segmentation homework and, second, look at things like distribution preferences. This is true whether there is a direct mail focus, a television focus or even a targeted television advertising based on where you buy your spots and how you buy them.

Mr. Jaffe: There are two schools of thought. There is a push-pull model, and then there is a pull-push model. The pull-push model is more similar to the Microsoft philosophy. Microsoft develops products that the public doesn't know about and then convinces the public that it can't live without the product. The other way is the push-pull where you develop a product, and then you pull the market into the product. I think you'd have to look at both of those two models as working but under different circumstances.

Mr. Roder: The people in the insurance industry are often hamstrung in terms of what they can do in many cases with the product. Let's use the example of credit life. People don't want to pay more than $25 a month for this type of coverage and the result is about a 2% monthly attrition rate when the monthly premium reaches $25. At a $40 monthly premium you have a 7% per month attrition rate. That means you run through the whole file in about a year

Using credit insurance you can't easily go out and put a cap on your premiums because you have to file that with the state insurance commissioner. They have to agree with you whether the consumer wants it or not. In the case of debt suspension, Citibank product wrote in a clause that said your maximum premium will be $25 per month, regardless of what your balance is. It's much smarter to take $25 from the customer and keep them than try to get $40 from them when they're going to cancel because 100% of $40 isn't the same as 98% of $25.

Another product change is that we doubled the coverage periods from 12 months to 24 months to make it a better product because people like the idea of more coverage. More importantly, the cost of increasing the maximum benefit from 13 to 24 months was just 2%. You could easily add the benefit to the product, but if you had to get that modification approved by 50 state commissioners, you'd be working on this simple change for the next 3 years.

Mr. Michael A. Steinman: What are the legal risks for a financial institution to offer a non-filed and non-approved insurance product to their customers?

Mr. Roder: The OCC, which is the regulatory body for banks, has opined that banks can offer debt suspension insurance. For regulation purposes, it's not insurance. The concept has been taken to court. In one case, the Supreme Court of Alabama said, banking law supports the rights of the banks and their regulator supports this. Four or five other tests also support it being a noninsurance product, even though it looks like a duck, it walks like a duck, and it quacks like a duck.

Mr. Steinman: How do the banks or the financial institutions treat the reserves that need to be held?

Mr. Roder: They treat it from a banking accounting point of view or an FASB point of view, which is identical to a long loss provision. Effectively, that's how it's set up on the books of the bank.

Mr. Steinman: You're saying it's part of the loan contract?

Mr. Roder: Exactly.

Mr. Steinman: Are most major financial institutions willing to take 'insurance' risk? Is it worth it to them for a couple points? I don't understand why a big financial institution would go out and take that risk.

Mr. Roder: First of all, it's not for a few points. If you're charging 59 cents per $100 outstanding balance per month, which is the Citibank product, a debt suspension program raises the APR almost 6 percentage points. It takes the bank's effective rate from 18% to 24%.

Mr. Steinman: How would you reinsure a noninsurance product?

Mr. Roder: Today you can buy corporate indemnification for credit losses. I can go to AIG or any of the reinsurers, and for a fee they will sell stop loss on credit losses. The same principle applies here for a noninsurance exposure.

Mr. Steinman: How does this product fit under Regulation Z? Does it count into the APR?

Mr. Roder: In an attempt to resolve this issue American Bankers sued the Federal Reserve Board around April of 1989 on this very point. The suit basically said the Federal Reserve cannot opine that these fees should be considered finance charges because it's part of the lending agreement. The Federal Reserve said no, they can be excluded so long as they're disclosed and they are not mandatory.

Mr. Jaffe: We've tried to give you some thoughts about the future and some of the things that you may run into. These are not the traditional actuarial type of issues that you're going to encounter when you go back to your offices, but rather these may be some of the issues that you'll be encountering 5, 10, or 15 years from now. Thanks to the Nontraditional Marketing Section for sponsoring this session.