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Have You Recently Considered Reviewing Your Marketing Mix? The UL Story

By José L. Berrios

BACKGROUND

Did you know that Universal Life (UL) products are alive and well in many countries in Latin America? I am a consultant and have worked in many countries in Latin America and have seen quite a few product designs and have designed/priced products according to market specifications. What I can say is that there is a wide range of interesting product designs and features, some pretty good and some not so good (from the consumers and company's point of views). What it is interesting is how the UL product has become popular among companies and consumers and has done well in "unsophisticated" markets of Latin America relative to the more "sophisticated" markets of the United States of North America (U.S.), Europe and Asia. Perhaps some of the discussion below will shed some light if you are re-considering your product mix strategy for Latin America.

PRODUCT DESIGNS

Starting with the U.S. design of the early days, (front-end loaded) this structure eventually made its way to the south and soon customers started to complain about the loads and fees. What is called the "hybrid" UL (front & back end loaded) product eventually became the norm. That design has prevailed for quite some time. In terms of margins, most companies rely on mortality charges for profits since it tends to be the most significant source. Surrender charges are secondary, and interest spreads less significant, with a typical negative expense margin (yes, the field force is well compensated).

With regards to the mortality margin, some countries require the use of their own country-specific mortality table (which in general is more generous than the normal 80 CSO tables, especially at older ages), so some sort of adjustment is needed

on the other margins. Some old products have generous interest guarantees, depending on the currency of the product (I've seen ranges from the teens down to 4.5 percent; local currency products typically have been influenced by inflation, historically high in some countries). The new designs have much lower guarantees, thanks to the Sept. 11 market crash (3 percent to 3.5 percent for U.S. currency), and in many cases there are no guarantees (i.e., a "Variable" UL product).

In the early introductions of the UL products in Latin America, the product was "imported" by foreign insurance companies and basically the designs were a copy of the U.S. prototype. With time, local companies designed their own flavors, in most cases being a term contract with a side fund (or funds) making them much more competitive in terms of price (cheaper) and compensation (lower). One thing to keep in mind in Latin America is that the price component of the marketing mix is very important; consumers are not willing to pay a lot of money for insurance and in many countries "discounts" are the norm in order to retain the business. In some countries the product design can be very complicated; the products have features such as dividends, discounts, COI bandings, gender offsets, automatic face amount increases, education type designs (parent plus children), all sorts of surrender penalties, etc. These make the products sometimes very confusing and hard to administer and model.* The typical product might have many riders

*Local actuaries in some countries are very "creative" and can cost your company a lot of money. A very flexible actuarial software package is required in order to model these products; otherwise some of the features may be mispriced.

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that customers really do not need, but make the product look “sophisticated.”

PRICING

The typical foreign-owned company that operates in Latin America has several disadvantages: 1) Some companies price their product with a significantly higher cost of capital mandated by the home office, compared to local competitors, 2) Require a significantly higher return on investments due to country risk, company ratings, etc. 3) In some cases, and due to specific guarantees, reserve requirements are higher than the local competition (later discussed under Local Regulations).

Due to these complexities, some foreign companies have found themselves in a pricing-bind. The local companies do not have the same capital requirements and are happy to price a product with a lower IRR because the market demands a low price, or there are restrictions on the Cost of Insurance rates, or can operate with much lower expenses.

In general terms, price is a significant decision component for the insurance customer of any product that is offered by several suitors in the market place, and typically, life insurance is not on the top list of priorities for a consumer. Therefore, for some product designs, a lower return is a trade off for customer loyalty and retention. A reasonably priced product (from a U.S. or European perspective with high double digit IRRs) means lower sales and probably lower persistency. The pricing targets, relative to the market and the competition, is a key factor in the success of the product design, launch and achieving a decent level of sales (volume is key in most markets). Unlike the U.S. perspective when companies started sales of UL plans in the early 1980s with fat margins and then those margins were squeezed overtime, the inverse is the case in Latin America; a company

has to start with relatively lower margins (what the market can bear), gain the client and market trust, and then make up for the lower margins as the markets mature and demand complementary products. In any case, for the Latin American culture, the price is typically a big factor in the purchase decision.

INSURANCE MARKETS

In some countries, insurance companies have been able to “transform” their products to meet specific market needs; for example in Chile, UL products are now used as a legal retirement savings vehicle with a limited insurance amount (called APV, *Ahorro Previsional Voluntario*, or Voluntary Savings Plan). Companies have also created an Educational Savings Plan (basically insurance on the parent with a savings component to fund education at maturity of the policy when the child enters the university), and a host of other interesting marketing packages that attempt to emphasize the savings nature (typically for Retirement) of the product rather than the Insurance component. Re-packaging of the UL product makes it more appealing to customers and easier for the sales force to market.

These market practices open up a lot of opportunities to improve persistency and cross-sell other types of products, such as disability, health, auto and homeowners insurance, creating the need for a multi-line company, or finding a complementary joint-venture partner. If you are only in the life business, you may want to think that customers in the long run will need a comprehensive solution. A clear example of that is the Mexican market, where the most recognized companies basically offer an integral solution for customers, not just life or retirement savings insurance, but all sorts of products. Brazil is the opposite—too much P&C and pension funding and not enough life—but I’m hopeful that that market will eventually change.

“A new product launch should be considered a big event for the company since it is an important event for the sales force. A good product launch is a very good way to keep the sales force happy and make them wear your company’s hat (in Spanish we say “*camiseta*”, or jersey, which symbolizes being part of a soccer team).”

PROMOTION AND DISTRIBUTION

I have seen some very well executed (as well as poorly executed) ads and promotions about UL products. Several M&A activities have forced companies to change their message and focus, some very successfully and some not so. Promotion is a big ticket item to gain the client’s trust. In some markets the clients are really the sales force and in some others it is the ultimate customer who buys the product. Also, don’t assume all markets are the same just because they speak the same language. Cultural differences are critical to understand; you really have to do your homework first. The use of language can be a very funny thing in the Spanish language and history shows several years ago some foreign auto manufacturers made big flops when they literally translated their message from their language to Spanish and they either insulted people or the message made no sense. Even today, translations of movie titles from English to Spanish can be hysterical. For movies it does not matter, but for life insurance it does, and it might not be funny. Your company should not make the same mistake. Rely on local expertise when getting your marketing pieces developed—for example, even if you already have it working in Mexico it does not necessarily mean that it will work in Colombia. The use of Spanish across the region is different from country to country and small language differences might carry significant meaning differences among countries.

In general, the sales force has a significant convincing power to “switch” policies for their clients, so whichever company cultivates them will have the business. Since laws are lax on policy churning in Latin America, you are stuck with this *modus operandi*. The brand name is important, but the field force has a significant power to make or break the sale since they usually work as independent producers for many companies and can select where to place the business.

A new product launch should be considered a big event for the company since it is an important event for the sales force. A good product launch is a very good way to keep the sales force happy and make them wear your company’s hat (in Spanish we say “*camiseta*,” or “jersey,” which symbolizes being part of a soccer team). The launch should include some sort of breakfast, or lunch (best is breakfast since most agents will attend a breakfast and then go to work), have the typical “give-away” goodies (product info folder, pens, cups, hats, ties, etc), and a clear overview of the **benefits** of the product, **target** market, **competitiveness**, **bonus** news, some sort of **special announcement** that the agents and managers are expecting, etc). This presentation should be done by the **Senior** Marketing Staff (important invitees from the home office are always impressive). I have assisted in several launches and I always bring my camera to have someone take pictures of the consultant/actuary (me) with the best producers, that way they feel they are part of the show.** Your key marketing guy should be a **numbers person**, not just sales, sales, sales, and above all, must be a tough (but nice) person to deal with the sales force.

REINSURANCE AND OFFSHORE ACTIVITY

You would be amazed that some markets produce pretty significant face amounts (over USD \$1 million) and yes, some reinsurers are making money on the excess above their client’s retention. That is all I will say about that.

**In fact the best producers should become a part of the show during the product design and pricing. I always recommend involving them in the development process—the best producers are your allies and will be selling the new product after all.

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EXPERIENCE DATA

Experience studies are less prevalent in certain markets due to volume and credibility of the data. But as in any business, a judgment call is typically required and your pricing actuaries at the home office may need to get used to living with uncertainty. The local actuaries are well accustomed to living with limited data and uncertainty and because of that, the chances are that local companies get their products faster to the market than the excessively bureaucratic foreign companies. What is important is to have a sound process in place so that the business is well administered, well underwritten, well controlled (in particular with retention), and the rest of the numbers will come sooner or later and will tell you if the actual experience is close to what was assumed; or you may need to tweak or completely re-price the product. That is the life of the pricing folks, nothing new there. In all situations, however, **from the start**, your company should monitor the expense margin, otherwise you may be surprised to find out some sort of special **compensation** (bonuses, special deals, etc.) was paid to the sales force that was never priced for (hard to believe, but it does happen). Persistency is another item to watch, as new product introductions induce the agents to look for existing customers as their best candidates for a “cannibalization fest.” You can’t be careful enough—state the rules of the game and keep an eye on the doughnut.

LOCAL REGULATIONS

Many countries do not have specific regulations about UL products, in particular with regards to reserves such as in the United States (CRVM, guidelines for embedded guarantees, etc.), so in some cases the laws will not fit and in some countries the authorities require companies to hold the fund value (again, with the premise that the product is a term plus a side fund), which for the typical US UL design it can put a burden on the company’s capital and should be

reflected in pricing. In other cases you may be able to convince local authorities that CRVM is sufficient, but first call me to discuss!

Finally, in many countries, the insurance authorities that approve products are understaffed and/or lack the depth or don’t have the time or means to fully appreciate the complexities and/or beauty of a true UL product. That means that you might expect to deal with several iterations in the filing process. When this happens, your best resource is to ask for help from an expert that knows the ins-and-outs of the filing process that can deal with these nuances in order to have a timely product approval. In some countries, the norm is file-and-use, but it is best to have the insurance authorities blessing before the launch to avoid surprises later on (product recalls and such). In any case, yes, the lawyers are also a necessary evil besides the actuary.

SUMMARY AND CONCLUSION

The illustrative exhibits below show: 1) the Annualized Premiums issued by product line for Chile (APV and Other Insurance are representative of the UL business), 2) the Policy Count for Mexico (Flexible Premium is representative of the UL business, Trad with Investment Funds are basically Term plus Side Fund). In other countries that split is not published officially, but most of the new sales are a form of UL product (true UL or Term plus Side Fund). Appreciating the numbers and popularity of the UL product is what keeps it alive and well in Latin America. Well run companies are making good profits in Latin America from sales of UL products and these companies have figured out how to make it under the given market conditions. Common sense and perseverance is a key ingredient for success in a vast market that will be developing over time and benefit companies, as the financial services industry landscape changes in the near future. □

“Well run companies are making good profits in Latin America from sales of UL products and these companies have figured out how to make it under the given market conditions.”

Chile Sample Data

Source: Superintendencia de Valores y Seguros (Government Supervisory Office)

Data as of December, from 1/1 to 12/31 of each year.

DIRECT ANNUALIZED PREMIUM IN PESOS (millions)					
	2006	2007	2008	% Growth	
				2007	2008
INDIVIDUAL BUSINESS					
Burial Insurance	95.27	208.50	285.66	119%	37%
Disability Insurance	46.45	45.57	193.11	-2%	324%
Term Life	19,585.76	23,081.97	26,023.61	18%	13%
Personal Accident	17,569.49	19,971.07	23,739.92	14%	19%
APV (Retirement)(2)	62,132.23	89,476.12	106,153.61	44%	19%
Family Protection	25,686.96	28,093.84	31,100.96	9%	11%
Whole Life	5,330.86	4,981.63	5,047.25	-7%	1%
Health	12,127.21	14,849.30	19,439.83	22%	31%
Payout Annuities	16,626.40	22,701.61	30,609.59	37%	35%
Endowment	30,409.15	27,625.66	29,369.15	-9%	6%
Other Insurance (non-retirement)	1,986.46	657.65	611.73	-67%	-7%
Pure Endowments	-	1,206.20	1,183.01		-2%
Other Insurance (1)	129,156.43	150,686.96	164,610.74	17%	9%

(1) Insurance with an Investment Fund (Author's note: UL and Term plus Funds)

(2) Insurance with a Retirement Fund (Ahorro Previsional Voluntario, Voluntary Savings Plan for Retirement, typically a true UL product)

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Mexico Sample Data

Source: AMIS (Mexican Association of Insurance Companies)

Data as of December of each year.

NUMBER OF INDIVIDUAL POLICIES IN FORCE

Year	Total	Traditional	Trad with Investment Funds	Flexible Prem (UL)	Family Protection
1997	2,891,105	521,820	1,073,009	1,285,893	10,383
1998	3,300,321	916,429	993,524	1,380,793	9,575
1999	3,745,996	1,196,329	980,046	1,491,190	78,431
2000	4,071,977	1,494,815	895,963	1,587,086	94,113
2001	4,536,093	1,759,696	969,837	1,706,247	100,313
2002	4,932,634	2,022,572	1,044,796	1,753,933	111,333
2003	5,389,257	2,262,887	1,178,732	1,837,250	110,388
2004	5,718,367	2,851,556	884,734	1,858,654	123,423
2005	6,127,078	3,166,994	838,073	1,965,633	156,378
2006	6,657,171	3,537,192	866,200	2,055,100	198,679
2007	6,252,820	3,104,702	834,609	2,078,224	235,285