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ACADEMICS CONFIRM WISDOM OF CUSTOMER LIFETIME VALUE

BY JAY M. JAFFE, FSA, MAAA

A few years ago insurance direct marketers and actuaries understood, recognized and adopted the concept of customer lifetime value (CLV). A recent article in the Winter 2004 issue of the *Sloan Management Review* confirms not only the validity of the concept of CLV but also demonstrates how it has been integrated into many well-known companies. The article is titled "Creating Growth with Services" (a reprint can be ordered from *http://www.mit-smr.com*).

One of the examples cited by the authors and which relates to financial services is Deere & Co. The authors explain that "John Deere's brand, forged over 160 years, allows the company to sell credit-card and operating-loan services to farmers and ranchers." (The emphasis on the word "forged" is made only to show that academics' feeble attempt at humor cannot escape the keen eye of a sharp actuary.) But this logical extension of a company's operations is not new to any of us who have worked in markets including retailers, banks and others with large customer bases and an affinity with the sponsoring entity.

It is even more important than ever for insurance companies to adopt a CLV-focused strategic plan. As the financial services marketplace continues to contract, there is heightened rate competition between insurers and the consequential lower-profit margins. One of the easiest ways to counteract these trends is to implement effective CLV programs.

The first and most crucial step before implementing a CLV program is to create a master plan which covers all CLV activities. This plan will include not only the plans to be marketed but also how to do the marketing, the handling of channel conflict issues, financial implications and value of the programs, etc. Without the plan, marketing chaos will prevail. The next impact will be marketing gridlock followed by a cessation of CLV activities when distribution system noise develops.

Companies should consider offering both insurance and non-insurance products in a CLV program. For example, accidental death riders would be an insurance benefit but a dental/vision discount program is a non-insurance program.

The advantages of the non-insurance programs include:

- NO filings/approvals required
- NO agent licensing required
- NO premium taxes to pay
- NO risked-based capital requirement
- NO minimum loss ratios

The non-insurance programs can be furnished by any number of sources. There is no need to deal exclusively with one single provider. The cost of the programs is generally guaranteed (at least for a period of years) so the only major unknown profit parameter is the marketing expense.

It is recommended that if an insurance company uses agents and the agents' insureds are going to be solicited for any programs, the agents should be made aware of the programs, and some level of compensation should be paid in the event their insureds purchase any benefits.

The largest barrier which prevents most carriers from offering CLV programs is the lack of skills to run the marketing programs (whether they are direct mail, telemarketing, or use any other media.) Fortunately, these responsibilities can be contracted to a third party which will assume the project leadership role and be responsible for implementing the programs. When outsourcing the marketing tasks, it is recommended to have the marketer assume an equity position rather than work only on a fee-for-service basis so that it has "some skin in the game."

WIIFM (what's in it for me)? As the insurance company, CLV programs are immensely profitable. What's special about many of the CLV programs is that they are win-win situations. Not only are they good for the insurance company because they contribute additional profits and usually improve policyholder persistency, but the insureds value the programs because of the direct savings for purchases they would have made regardless of

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Jay M. Jaffe, FSA, MAAA is president of Actuarial Enterprises, Ltd. in Chicago, Illinois. He can be reached at jay@actentld.com

NAIC'S LHATF APPROVES CREDIT MORTALITY REGULATION

BY CHRIS HAUSE

Hot off the presses! The Life and Health Actuarial Task Force (LHATF) has approved a model regulation that sets the 2001 CSO Male, Composite, Ultimate Table as the minimum reserve standard for credit line insurance liabilities. According to the normal course of events, final NAIC approval wil come at the June meeting.

Many thanks go out to the SOA's Credit Insurance Experience Committee and industry representatives, who put in many hours on the sturdy and several drafts of the model.

The job still remains to secure adoption of the model on a state-by-state basis. We hope with the new model and the acceptance of the 2001 CSO for ordinary issues, that will be a smooth task.

If you have any questions about the model, feel free to contact me at chrish@hauseactuarial.com.

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and similarly for critical illness coverage and unit-linked policies. These developments will continue as the market and the buyer evolves.

Individual life premiums make up about 0.5 percent of GDP and so as the economy recovers and prosperity levels improve, there is room for growth, even more so in the retirement savings and medical care side. While the HMO story has been one of lost credibility, there have been isolated successes as well. These are operations that are very well managed (along the U.S. business models) and run by U.S. experienced management and are doing very well in a "retrenched" supplier market.

Currently there are about 20 insurers (offering life insurance) serving a population estimated at 32 million, including some well-known foreign companies. There is likely to be consolidation in the market. Increasingly the companies will also find growth opportunities in neighboring countries and so will become more regional in their operations.

There is a will to progress in the country and that, along with an investor-friendly climate and a genuine commitment to openness and accountability, will provide the key ingredients that will fuel the growth.

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whether they participated in the program. The participants may even feel that the programs become a "no-cost" benefit.

Even small insurance companies have a sufficient number of insureds to make CLV programs operationally and monetarily feasible. While each situation stands on its own, it is possible to work with relatively small numbers because of the high response rates.

The additional revenue from CLV programs must find its way into the actuary's profit calculations. Depending on the circumstances, it might be easiest to reduce marketing costs by the CLV profits, but it would also be appropriate for the company's actuary to create a more detailed customer lifetime value model which includes both the original insurance and the CLV programs when testing profitability.

Regardless of the specific CLV programs used, the most important step is to get started. If needed, start with a very basic step but implement a CLV program. If you need confirmation that CLV should be initiated, remember that academics have finally confirmed what actuaries and marketers have known for a long time: CLV programs work!