News Direct Newsletter

Winter 2001 – Issue No. 36

NEWSDIRECT

Newsletter of the Nontraditional Marketing Section

NUMBER 36 WINTER 2001

To Infinity and Beyond! The Future of Insurance

by Steve Konnath

Editor's Note: This article is reprinted with permission from the DMA Financial Section Newsletter, Spring 2000 issue.

The future for the insurance industry offers huge challenges and opportunities. The current portfolio of products and distribution methods will continue to dominate for many years, but there will likely be some dramatic changes. New processes and products, including how contracts are created and prices and benefits determined, will influence even the traditional products and distribution methods. The following is a discussion about future products, distribution, insurance laws, and contracts. Some ideas might not be possible today, but it is offered as food for thought.

The old axiom about insurance — it's sold, not bought — is still true, but it is not quite as black and white as it once was. Term insurance, Medicare supplement, and annuities have all moved toward becoming commodity products that are bought. With the slim profit margins of commodity products, target marketing, expense management and market share will determine successful players. Economies

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Chairperson's Corner

What's Up for This Year?

by James B. Smith

When it becomes difficult for me to find the time to write an article (such as this), I get my inspiration by reflecting upon the efforts of so many Council members/ friends who give unselfishly of their time to our section. This article will focus on some of these people, and the activities being sponsored by our section during 2001. I am hoping that you might also choose to participate in an activity that interests you. Volunteers are always welcomed!

At the spring meeting in Toronto, our section will sponsor a track (series of sessions) on customer relationship management (CRM). The customer is often overlooked by actuaries due to the intense focus on products and distribution channels.

The track will cover a broad array of topics — including basic principles, modeling, case studies, privacy issues, and new distribution channels. **Mike Presley,** who is serving as coordinator for the spring meeting, is also planning insightful sessions on hot topics covering bancassurance, virtual insurance companies, and credit insurance.

The planning for sessions at the Society's annual meeting in October is just beginning. If you have any suggestions for topics or would

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of scale and customer relationship management will be the profit levers.

Internet Environment

The Internet will create an environment where more products are bought (vs. being sold), creating more demand for commodity products. Very few people challenge the notion that the Internet will impact the financial services industry; the question now is to what degree. Auctioning sites have already changed the forces of negotiating power for nearly all other types of products except financial services. It is just a matter of time before financial service products are offered in a similar manner. From a price and benefit perspective today, insurers offer only one price and benefit structure for individual policyholders within a given risk class. The individual policyholder can't change the price offered by a company. In the future, potential policyholders could have access to distribution channels that will allow the prospective policyholder or groups of policyholders the ability to negotiate both price and benefits. The industry will be challenged to ensure fair pricing structures that don't invite state regulatory action.

> *"The trend in the 90's has been to move away from complete medical exams toward the use of parameds. The trend in the next decade will be processes that can be conducted completely by insurance producers without the use of a paramed."*

Prism Effect

The prism effect of the Internet on target marketing remains mostly untapped. The Internet takes the white noise of the masses and produces laser-thin streams of light, broken out by almost any demographic profile one could ask for. Internet profile mining will be a discipline in high demand by direct marketing companies. Advertising on different Web sites is already a common practice, but determining the right sites to find the right customers is a monumental task. Portals, vortals, and community forum sites will continue to refine and separate Internet traffic demographic profiles.

Market pressure from the Internet demands that the underwriting and issue process become instantaneous. Issuing and fulfilling contracts completely online will soon become commonplace. Underwriters and testing labs are racing to create non-invasive medical testing methods and other underwriting processes to shorten the fully underwritten policy process from weeks to hours. The trend in the '90s has been to move away from complete medical exams toward the use of parameds. The trend in the next decade will be processes that can be conducted completely by insurance producers without the use of a paramed. One testing lab recently discussed the conceptual design of body fluid testing modules being built into laptop PCs. This testing module, combined with a wireless Internet connection to the home office for DMV and MIB checks, would allow a producer to complete the underwriting process and issue a policy during the same visit to a prospect's home or business. Underwriters are also developing non-medical underwriting techniques that are almost as predictive as medical underwriting techniques. Direct marketers will quickly employ them as they become available.

Repackaging insurance benefits with non-insurance products will likely be a future trend. Some recent conceptual trial balloons include combining P&C coverage with a new car at the time of sale and packaging health benefits with output shares of organic farms. Unbundling and repackaging of traditional benefits will help create products that better serve niche markets and avoid the slim profit margins of commodity products.

Although products might be combined in the future, the entire insurance process is likely to be taken apart. The process of unbundling the manufacturer, administrator and producer, will occur more often. We will see more and more companies focusing on their core competencies due to pressure from Wall Street.

Direct Mail and Telemarketing

The future of direct mail and telemarketing will be dependent on the efficiency of target marketing. With the costs of mail, paper, and phone time continually increasing, identifying more qualified potential customers is critical. This is nothing new to any of us in the direct marketing business. What will likely change are some of the products offered. Today, there are a number of insurers offering guaranteed issue or near-guaranteed issue life and health products. As players in the industry learn to target market more effectively, guaranteed issue products might become less profitable because of the law of large numbers.

Guaranteed issue products work today because an insurer can acquire a pool of both good risks and not-so-good risks. As the good risks become more targeted with products that fit their needs better, the pool available to buy the guaranteed issue products will have a higher proportion of the not-so-good risks. The challenge to direct marketers will be to come up with new profitable products that meet the needs of this market.

HR-10

A discussion of marketing efficiency would not be complete without talking about some possible implications of HR-10 (a.k.a. S900 or the Financial Services Reform Act of 1999). HR-10 repeals the Glass-Steagall Act, which effectively removes the barriers of banks, insurers and security firms from owning each other. In addition, HR-10 allows subsidiaries with common ownership to exchange customer data freely. Customers must be given a chance to "opt out" of the process.

This could put mutual insurance companies at a competitive disadvantage, further fueling the demutualization and consolidation trends. Industry analysts predict that it will be the banks acquiring insurance companies, as opposed to the other way around. A direct marketing insurance company that is owned by a large national bank can significantly reduce its acquisition costs if it has access to the bank's customer data.

Another interesting aspect of HR-10 deals with customer privacy issues. The privacy provisions within HR-10 can be superceded by state law if a state has stronger privacy laws than HR-10. This could give banks a taste of the environment that insurers have always had to deal with — state-special laws that increase the cost of administration. Regardless of who will be regulating privacy issues, the use of disclosure will increase for most companies.

There will be growing pressure to unify state regulation with regard to insurance products. The pressure exists today when banks can offer products that look and smell like insurance products, but escape state regulation. The cost of administering national bank products that behave like insurance products is cheaper than the cost of administering insurance products that require individual state filings and state-specific versions. This cost savings will be passed on partly to the consumer and partly to the stockholders of the banks.

The unification pressure will increase with time. States will have to learn to agree with NAIC model regulations without modification or they could ultimately lose power to regulate insurance products, either directly through legislation or indirectly through market forces.

Banks will continue to gain market share with regard to distributing insurance products. They have succeeded with annuities, but have struggled with other product lines. California Federal Bank is now successfully selling life insurance. Their success came with many failed attempts, but they now have a sales model that works. If this success spreads nationally, more products will be attempted in the future.

Insurance Contracts

As mentioned earlier, it is likely that prospective customers will gain negotiating power with regard to price and benefits through auctioning methods as well as others. This trend also could impact contract language as well. Today, insurance policies are considered contracts of adhesion, meaning that the insurance company writes the contract language and offers the contract to a prospective policyholder on a "take it or leave it" basis. Because of this, courts have sided with policyholder in the cases where there is any ambiguity in the contract language. As marketing becomes more individualized, insurers could allow prospective policyholders to participate in negotiating contract language. The insurance contracting model that's common today is the insurer making an offer with an insurance contract and the policyholder accepting the offer by making a premium payment. This model could change to one with iterations of counter offers. If this became reality, insurance contracts would no longer be considered contracts of adhesion, and we would have to hope that the courts would adjust.

Looking Ahead

It is fun speculating on the future. How will the Internet affect direct marketing? How will HR-10 affect the industry? What new products will we see? It's clear that we have many challenges ahead of us, but the next couple of decades will be exciting for those who are creative and nimble.

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