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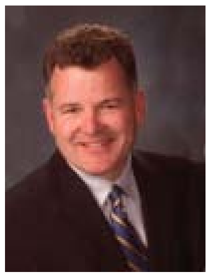
CHALLENGES OF PRODUCT DEVELOPMENT WITHIN MIDDLE MARKETS

By Brian Grigg



I was invited to write an article on the challenges of product development within middle markets (64 million people strong). I currently deal with annuity product marketing and distribution, so you'll have to forgive me for extending my opinions in to other product realms, but I think they apply (and I do have a number of years of work under my belt in life marketing and product development).

I find the concept of "challenges" in the middle market to be an interesting angle. It implies that there are product design or pricing challenges, that it's difficult to determine what needs are unmet, and that we need to focus on that and solve "real" problems. Quite the contrary, it's relatively easy to figure out what middle market needs.

The middle market needs life insurance protection. It knows it; it admits it. Sixty-six percent of the middle market tells us that all adults should have life insurance. Seventy-three percent tell us that life insurance is "... a necessity, not an extra." Yet, the middle market is incredibly underinsured. It's also confused.

Despite the proclamation that life insurance is necessary, protection goals are not a top priority. Where 53 percent believe that having enough money to start a family and 50 percent believe having enough money for comfortable retirement are top priorities, only 7 percent believe having adequate life insurance is a top priority. Not quite the necessity they say it is.

Could this be due to debt burden? Twenty-nine percent of the middle market says it is struggling to pay off debt. Another 5 percent is still growing dept. Forty-seven percent have some debt but are "comfortable" with it. C'mon, who's "comfortable" with debt?

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The middle market needs to save more and more appropriately to their own situation (stop chasing returns and focus on what's appropriate for their individual situation). Our culture promotes getting the most, the biggest, the best, etc., only to fall short on explaining the cost of getting there. I once heard a so called "expert" in investing, an "esteemed" professor from some top eastern school tell a whole conference of retirement specialists that the solution for retirees is to take on more risk. They need more return. This was prior to the 4th quarter of 2008 and boy did he get it wrong, but it's not the timing that was so wrong. What so many experts don't even understand is that it's not about the market. It's about the individual and what is appropriate for him/her. What's appropriate?

Let's say you spent your whole life living beyond your means, saved little, and your employer bailed on a defined benefit pension plan long ago. "Ah," say the experts. "You need more money so the important thing is to take on more risk." Bunk. Sure, you need more money, but chasing good or better returns risks being even poorer than you were before. Going "all in" for equities or some other high-risk vehicle doesn't make sense for someone at or near retirement . Unfortunately, you didn't have a good professional nagging you to save more earlier, when you had enough time to withstand a prolonged depression in stocks or, for that matter, were in a good time for buying equities. Now, what is likely appropriate is to reduce lifestyle to make sure there are some resources to live a minimally acceptable financial future. Of course, you could gamble a good chunk of what you need to live in the near future and get lucky. Our culture, of course, says that if you do this and win, you're a winner. I don't agree. You just got lucky and the cost is more than most can afford.

The real challenge is getting the middle market to respond, to do more, earlier. It's key for insurance companies to understand that motivations can't be taken for granted. They must be influenced. In other words, influencing them do the things that they identify as important and necessary is the key to understanding how to grow middle market share. This is not easy.

Distribution plays a key role in designing products that will help the middle market take a step in a positive direction. Earning enough to survive and thrive is the question every fee- or commission-based person deals with constantly. Even the really big hitters are challenged with the cost of getting in front of qualified individuals. Contrary to some ideas that people line up outside the planners office for service and product (they don't), it's tough finding good clients. And, it's expensive. Good planners tell me that they are spending at least 30 percent of their revenue on marketing to find new clients. This with additional overhead of staff, compliance, tools, etc. An average producer could very well spend more than 50 percent of their revenue on expenses.

Distribution is concerned about sales flow and compensation. They know how difficult it is to establish good flow. If sales flow was high, compensation might be less. However, reality is that it's difficult to find new clients and challenging to get commitments. This puts pressure on all financial products, perhaps more so in middle markets, to pay a reasonable commission. Also, despite many front-end commission products being a low burden on product cost, many, including regulators, see commissions as negative. Ironically, fee-based products, many with higher overall costs (they're just measured in a different way), are seen as client friendly.

Of course, "optimal," perhaps a code word for "without commissions," could produce a better solution. Good producers, however, will employ themselves in another field and no one will be served. Insurance companies know that the "best" product, the one with the least compensation and the lowest expenses, will sell zero to the middle market because good sales people aren't out there influencing motivations.

Sales flow is also influenced by product that works in the sales world, i.e., motivates clients to take action. I've had many conversations about whether a premium bonus on an annuity is a good thing or a bad thing. It's neither. Of course, nothing is free; bonuses are paid for by spread, reducing the declared rate; or, in the case of fixed indexed annuities, spread that is used to buy options, reducing the cap. A bonus in an FIA is a bird in the hand, two in the bush argument. If you take the bonus, you have it, but reduce the potential return over time. If the crediting method doesn't perform well over time due to the underlying index performance, a bonus approach could very well produce a higher return.

Let me end by expressing my appreciation for agents–annuity, life, LTC, Medicare Supplement, final expense, etc. The best of you are truly magical. You know how to motivate people to take steps in the right direction, to do something about the challenges we all face. You use your behavioral knowledge of people for their own benefit.

Brian Grigg is vice president Annuity Distribution Old Mutual Financial Network, Baltimore, Md. Brian may be reached at brian.grigg@omfn.com.