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REINVENTING THE LIFE INDUSTRY

Can life insurers survive a changing world?

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Listen to four executives who earn their living by leading or consulting to life insurers today:

- Bank ownership of insurers is a threat to life insurance companies because of banks' large capitalization, "but mutual funds and discount brokers are more dangerous because of their access to customers."
- In the future, customers "will determine how much and in what form they'll pay for our products and services."
- The recently announced merger between Citicorp and Travelers is just the beginning of activity that will lead to "an emergence of 10 top financial services organizations on a worldwide basis."
- "The changes we're seeing are a long, steady trend that won't reverse itself."

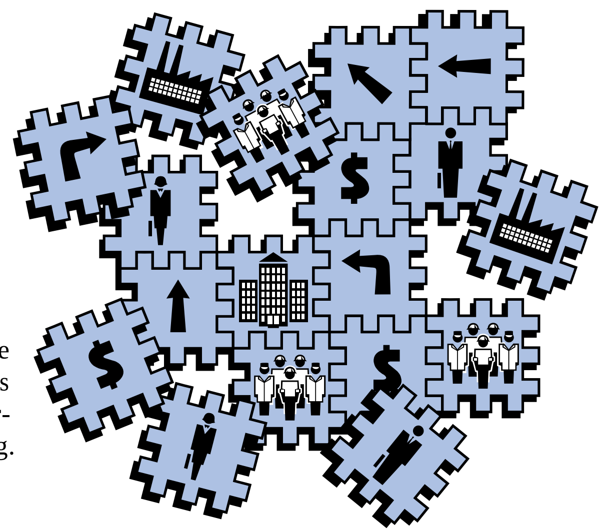
In this article, four experts offer their views on why the life insurance industry as we've come to know it is disappearing and what will be different about the new industry evolving. Offering their perspectives on the industry were:

- Bruce Nicholson, executive vice president and chief financial officer, Lutheran Brotherhood
- Rodney Rohda, chairman and CEO, Fidelity Investments Life Insurance
- Robert Stein, partner, Ernst & Young
- Alan Yurman, president and CEO, Alan M. Yurman and Associates (see sidebar, "A blueprint for the future," page 5)

While many actuaries work in other fields, the life insurance industry was for many years the main employer of actuaries. More than 7,100 SOA members still work in insurance companies, with 3,200 listing "life" as the main area of practice. What will the new world bring for life actuaries?

What's important now

In separate interviews, these executives and consultants stated almost identical



views on how the industry is changing. At the same time, each had a slightly varied outlook on the specifics within or surrounding the major trends.

All or nearly all those interviewed cited several trends for the industry:

- Mutual funds and discount brokers have joined the ranks of banks as threats to life insurance companies.
- Distribution through traditional agents is expensive and ineffective — two traits that won't survive in the emerging world.
- Consumers are becoming more educated, aware, and demanding for everything from products that meet their needs to 24-hour, seven-day service (often via the Internet or other online system).

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Inside this issue

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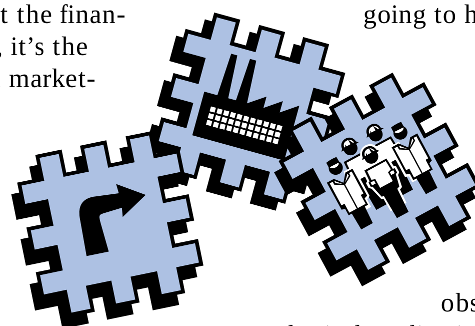
- The wise use of technology is essential.
- Mergers and shakeouts in the financial services sector will continue.
- Changes that have occurred up to this point are irreversible, and others will come.

One way that changes and turmoil are indicated is through measurement of merger and acquisition (M&A) activity. According to *Actuarial Digest* (February-March 1998), 1997 activity for all industries eclipsed “all records for both volume and M&A deals and their average multiples.” The story reported 56 life insurance deals. For life and health insurers, the average price was 1.7 times GAAP book value — considerably higher than that in 1996 and 1995 of 1.4 and 1.3 respectively. “We think such ‘average’ numbers reflect the general upward trend in insurance company pricing,” wrote Peter Mattingly and Bob Shapiro, authors of the M&A story.

‘Power of the retail marketplace’

Robert Stein, Ernst & Young consultant, made the observation on page 1 about life insurance companies’ most serious competitors. “While banks are our competitors in the near term, in the long run I would be much more fearful of mutual fund players and discount brokers,” he said. “Banks might be powerful competitors in basic products, but the fund complexes and discount brokers have a strong franchise with the baby boomers, so they will be able to reach a high-net-worth marketplace as the baby boomers mature and develop substantial resources.”

Stein sees the life insurance industry becoming part of one, large financial services sector, where many different industries are converging because technology allows fewer players to access a substantial marketplace. “The message is clear,” he said. “When you look at the financial services sector, it’s the power of the retail marketplace — the very large, very powerful, very wealthy retail market — that is driving the convergence of financial services companies. It’s the strength of the retail market, more than anything else, that will shape financial services in the future.”



Stein sees another potential major threat in addition to mutual funds and discount brokers. “Although it’s probably a little farther down the road, I think ultimately we’ll see more invasive cost disclosure and commission regulations,” he said. “There may well be full disclosure for the customer, and that will be a significant problem for many in the industry.”

How should life insurance companies face these problematic scenarios? To have a chance to succeed, companies must develop a coherent marketplace strategy, orient themselves to the customer, increase technological capabilities to improve interactions with customers, and focus on customer needs for products and services and on product innovation and quality. Above all, they must “improve the cost and productivity of the distribution channels — i.e., their basic effectiveness.” The last is urgent, Stein said, “if the traditional player is going to have any future at all.”

So is the use of technology. “All the interactive applications for customer service that the mutual funds have will be important for insurers,” Stein observed, as will technological applications that “provide for more accurate information gathering and a smoother flow of information among customers, the sales force, and the company. Our competitors have a much greater level of capability. We’ve paid some attention to the back-office functions, but very little to the front office — that is, where customers are served.”

Stein said that while strategic focus should be directed to distribution and technology, insurers need to get better at execution. “I think the industry has typically executed major change very poorly,” Stein said. “What will make the difference is basic, careful, high-quality execution.”

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overcome a pervasive industry “immune system” that rejects ways of doing things that are not direct extensions of the past. Actuaries can and should play a major role in enabling their companies to change and compete. To do so, they will need to create more appropriate models for designing and pricing products as seen through the customer’s eyes. They also will have to develop greater understanding of marketing and management and increase their propensity for facing and managing risk.

The industry leaders who have contributed to this issue of *The Actuary* provide a window into our future potential. There are many other professionals in the Society who are involved on this frontier of change. If you are one of them, please let us know what you think.

Bob Shapiro’s e-mail address is *73231.102@compuserve.com*.

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The life insurer existing in a mutual fund company

Rod Rohda leads the life insurance charge from the heart of the industry's competition — the life insurance division of Fidelity Investments. His 34 years in business included more than 20 with a traditional life insurer before he moved to Fidelity, and this experience led him to say, "The changes we're seeing are a long, steady trend that won't reverse itself."

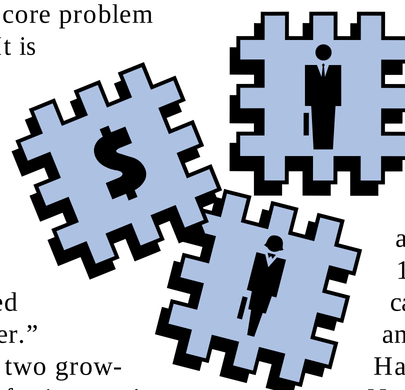
Rohda sees four key factors shaping the financial services industry: price or expense level, the cost to the customer of owning an investment; performance; service technology; and getting close to the customer. Rohda also sees four main shifts that are signs of the life insurance industry's move from the old world to a new one:

- Annuity sales are growing while those of traditional policies are shrinking.
- Variable products are gaining consumer preference over traditional fixed products.
- Consumers are becoming more educated, aware, and empowered, leaving behind the days when consumers placidly accepted the ideas presented to them.
- Technology's enhanced role — such as use of the Web to find information and make transactions all day, every day — is raising the bar in customer focus.

"Companies must take action in three areas," Rohda said: "become more attuned to the customer," increase technological competence and application, and greatly improve financial accountability. "Life insurers need a far more detailed and accurate understanding of a product's real returns to the customer and the company." Among the challenges is that the traditional player's products "are not in tune with the realities of today's economy. Customers are looking for much more of an equity focus — 'What's my return each year?' You won't find this with a whole life contract, for example."

Three companies "successfully making the transition" from the old world to the new, Rohda said, are Allmerica (formerly State Mutual), Equitable Life, and UNUM. "All embody those three opportunity areas for improvement."

A fourth area insurers will have to improve is distribution, Rohda said. "Inefficient, expensive distribution is absolutely a core problem and concern. It is critical at this point that the issuing company can be confident of how the product is being presented to the customer."



Rohda sees two growing challenges for insurers' customer service.

One is the aging of the baby boomers. As they grow older, they'll rely on their investments (particularly annuities, Rohda said) to support them. "When that monthly annuity check becomes very important to them, you must be very good at dealing with their questions and concerns. I've already begun talking to our customer service management about the issues related to dealing with increasingly more feeble contract holders."

The other is the Internet, which will help consumers become "more educated about financial products and more self-reliant." Fidelity won't have its insurance accounts online until midyear, and "this current inability is our number-one customer complaint."

However, for at least some companies, the Internet will have a definite upside. "We put term insurance information on the Web a year ago, thinking we'd pique consumers' interest and then they would talk to a representative. To our surprise, today 25% of our term sales are Web-only," Rohda said.

The industry's competitors will come from many different fronts, Rohda said, including a variety of countries. He cited a property and casualty company in the United Kingdom, Direct Line, that was a start-up 10 years ago "and is today the U.K.'s number-one seller of retail auto and homeowners insurance." The company has a pilot operation in the United States, "and now they're going after life insurance, primarily term, and they've just started."

One of the major trends Rohda sees is the rise in sales of annuities and the decline of traditional life policies. Among the 100 largest life insurers (ranked by 1996 year-end assets in *Best's Review*, November 1997) are several whose growth came primarily or totally from annuities. These include The Hartford, Nationwide, SunAmerica, North American Security Life (now Manufacturer's North America), American Scandia, Keyport, VALIC, IDS, and Fidelity. "Three of those — North American, American Scandia, and Fidelity — were hardly even around 10 years ago, and today they're significant players in the life insurance industry," Rohda observed.

This in part reflects the market's move to variable products, both annuities and life insurance. "This movement can help drive improvement in the industry," Rohda said. "Because these products must be sold with a prospectus through a registered representative, you have substantial, basic discipline regarding disclosure built into the process."

A company's best

Bruce Nicholson of Lutheran Brotherhood believes that customers will "call the shots" on the form and amount of payment in the future. His comment was one point in his discussion about the roads insurers must start to take, beginning with a critical look within their own organizations.

"You must discover the key competencies of your organization," Nicholson said. "They might be managing risk, servicing customers, providing advice, managing assets, or something else. You need to focus on the one or two things you do well and, perhaps, find partners who have the skill sets your organization lacks."

"This approach is critical in a highly competitive time," he said. While Nicholson sees banks and mutual funds as primary competitors, unlike most other observers he sees competition coming from surprising sources. "Competition will come from any company whose primary business can be leveraged into our business," he said, citing a casket manufacturer that formed a life insurance company to sell funeral policies. "Five years ago, who thought Microsoft would be in the travel business? You never really know where competition will come from."

So Nicholson's advice to the industry is, "Don't compete on the same terms as everyone else. Have well-established core competencies, build a distinctive business strategy around them, and execute better than anyone else."

Nicholson sees emerging trends in regulation, technology, and demographics as the forces driving change. As they unfold, a noticeable shift in the attitudes and behavior of customers will occur.

"Most life insurance companies have built their business by providing face-to-face advice, and I believe that will continue to be important," he said. "The question is how much the customer will be willing to pay for it. It may well be that our perception of what they are willing to pay is different from theirs. If so, we could be extremely vulnerable to new entrants who can deliver a more attractive value proposition."

Global financial dominators

Multi-industry consultant Alan Yurman has experience with dozens of companies, including insurance companies, reinventing themselves for the future. His observations of the financial services industry and the business world in general led him to predict the eventual rise of a very few powerful global financial services firms.

"During the next millennium, there will be an emergence of 10 top worldwide financial services organizations," Yurman said. "This will occur because of mass consolidation, global expansion, and changing governmental legislation that creates more flexibility for organizations selling multiple products and services."

Yurman sees this as just one key factor shaping the financial services industry. Another, he said, is that over the next few years, "a significantly better understanding of consumer and customer wants and needs will arise, leading to more innovative product offerings and customer services." A third influence he sees is "a proliferation of delivery systems due to significant expansion of technology."

Yurman sees life insurance companies facing competitors from everywhere in the financial services sector. "Any financial services company will compete that believes its delivery system will enable the company to profitably enter the market, that it can effectively use database marketing to build initial company and product awareness and cross-product purchasing, and that has the reputation or brand image that will carry weight with prospects."

This means life insurers must seriously alter their focus, Yurman said. "Today's life insurance companies generally are more internally than externally driven. In many cases, they view their sales force, not the

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A blueprint for the future

Any company fighting to survive in the new business world should take the following steps, said consultant Alan Yurman.

- Redefine the company's vision and mission in light of the changing nature of the life insurance business and its competitive environment.
- Assess the company's current organizational structure.
- Review the skill sets required to be a best-of-class organization.
- Create a strategic plan comprised of expanded training, effective redeployment of personnel, and, when necessary, attracting additional superior people.
- Invest in research and development to understand the consumer (or the customer, if it's a business-to-business endeavor) and to create products of value and effectively introduce them in the marketplace.
- Create a corporate culture that is innovative, risk-oriented (within reason), forward thinking, and that empowers people to make meaningful decisions.
- Become much more attentive to customer and consumer service.
- Develop products from a consumer perspective more than insurers have in the past. Products must be more innovative and of real value to consumers.
- Identify the wants and needs of a changing population, one in which people are living longer and healthier lives and have different wants and needs at different times.
- Introduce products first or early in the market to maximize the opportunity for success.
- Balance the use of technology with an ongoing building of people relationships, both externally with the consumer and internally with sales personnel and other employees.

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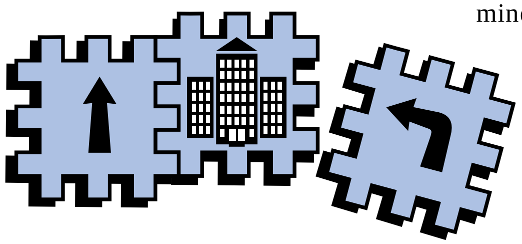
consumer, as the key customer. This situation translates into lost opportunities and inhibits them from effectively competing."

Yurman suggested several capabilities that insurers will need in the future: a clear strategic vision held by top management and the senior management team; broad-scale strategic planning expertise; marketing capabilities (e.g., database marketing and marketing communications, such as advertising); the ability to assess varying global opportunities; and highly cost-effective use of technology across the company's operations.

Above all, Yurman said, insurers must be willing to branch out. "Traditional life insurance companies that market only whole or term insurance, annuities, or other 'basic' life insurance or related products are not strongly positioned to be successful. Companies that make the commitment to offer multiple financial services products — with life insurance as an integral and important component — will be better able to compete in the years ahead.



"The recent Citicorp and Travelers merger is a good example of two organizations that made a decision to become a preeminent global organization by leveraging their financial and strategic strengths and preemptively moving into a strong leadership position."

Actuaries in the new world

How should actuaries and their professional organizations help in the transformation from the old world to the new for life insurers and other organizations employing actuaries?

All those interviewed agreed that actuaries must begin to think of their skills and roles in the context of financial services rather than a limited, practice-specific area.

Said consultant Alan Yurman, "Based on my involvement with actuaries, I've always found them to be a smart, committed, hard-working, professional group that is not given ample credit for its expertise or contributions.

"However, the profession still needs to redefine itself in light of the changing financial services environment. What is the value of current skill sets? What should be retained, what should be modified?

"Today's actuaries should be given the opportunity for expanded training to better enhance their capabilities and stimulate professional growth and career path opportunities in the future. Additionally, college-level actuarial courses should be reviewed to determine whether they really meet the future needs of the various emerging market sectors in light of the changing competitive environment." Yurman added that members of actuarial organizations should hold those groups accountable if they don't adequately address the profession's current and future needs.

Bob Stein insists that actuaries must step out of traditional roles if they are to have a major impact on the emerging financial services environment.

"Actuaries need to be more supportive and more creative in analyzing alternative strategies and the effectiveness of paths their companies are taking," said Stein. "They must step out from behind the pure analytics and the numbers and talk more about implications for the organization in the marketplace."

Stein also observed that actuaries won't have an impact on the new world if they insist on remaining in the old one. He said that recently, a major bank offered the job of building its insurance business to three senior actuaries, and all turned it down. "We need to take a much broader view of what's happening in the industry and be a little bit more entrepreneurial in nature," he said. "I think the risk-averse nature of the profession was behind its inability to get actuaries in place on Wall Street. Many of these lost opportunities won't come around again."

Bruce Nicholson believes actuaries "are well positioned to take the core skills and apply them to new areas." He said Lutheran Brotherhood has actuaries engaged in investment management, policy administration, and computer systems development. Actuaries also have applied life insurance pricing and financial analysis techniques to the company's mutual fund business.

Nicholson said individual actuaries need to see their skills as critical to risk management and useful in a wide variety of nontraditional situations. "The professional organizations need to be at the forefront in stimulating discussion on how our actuarial skills can be applied across the broader spectrum," he said. "We need to build awareness in other businesses about who we are, what we do, and how we do it."

Rod Rohda suggested actuaries look at alternatives in addition to the traditional life insurance industry when evaluating career choices. "There are fewer policies being sold by fewer agents, with fewer households reporting that they've been called on by an agent," he observed.

"Actuaries can't rely on established industry patterns at this point," Rohda said. "They need to be clearer on what they do and why it's necessary. They must develop a better understanding of how their skills can relate to the broader financial services industry.

"I've been in business for 34 years, which included several with a traditional life insurer, and I've been watching trends develop. The changes we're seeing are unstoppable."

Comments may be forwarded by e-mail to Bruce Nicholson at *nicholson.bruce@luthbro.com*, to Rodney Rohda at *rod.rohda@fmr.com*, Robert Stein at *robert.stein@ey.com*, and to Alan Yurman at *ayurman@aol.com*.