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EDITORIAL

Facing the revolution

by Robert Shapiro

The life insurance industry as we've known it — i.e., whole life insurance sold by traditionally developed and compensated insurance agents — is disappearing. Turmoil exists in many old-line companies as their immune systems continue to reject this reality despite a relentless increase in competition and escalating pressures on sales and costs. Evidence of the emerging new industry is mounting in many areas: in eclectic life insurers, in other financial services organizations, and even in organizations outside of our normally perceived financial services industry.

Under the banner "Reinventing the life industry," several articles in this issue of *The Actuary* explore this momentous revolution. Articles cover both the autopsy of the old life insurance industry and the design of the emerging new one. We don't pretend to have fully explored this topic. But we do hope we will provoke you to share your thoughts on and experiences with this phenomenon with the readers of *The Actuary*.

The cover article, "Can life insurers survive a changing world?," presents a series of provocative observations from interviews with thought leaders in the financial services industry. To assure a broad spectrum of views, both actuaries and nonactuaries were interviewed. The magnitude of industry change and the tremendous opportunities created by this change are emphasized in the comments from these industry leaders.

In his article "Price vs. service," Marvin Meyer forecasts that accelerating marketplace changes will result in a bifurcated life insurance marketing system. Meyer, president and CEO of a financial services marketing company specializing in insurance, sees professional brokerage systems succeeding the historic career agency systems in upscale markets, with lower-cost institutional distribution approaches serving middle- and lower-income markets.

Mike Corey, who has built and now manages a premier international financial services search practice, describes how actuaries can best assist current life insurance industry employers in making the needed transformation. His article also suggests ways in which actuaries can prepare themselves to support new players that are rapidly appearing on the financial services playing field.

Technology will play a critical role in the industry's transformation. In his article entitled "Navigating the technology course," consultant Ron Helow shares his thinking on what winners will look like technologically and what traditional companies must do to compete. Winning will, according to Helow, require insurers to reinvent their managerial and organizational techniques to become much more competent at managing rapid change.

Three themes run through the articles in this issue:

1. Our industry is fundamentally and irreversibly changing, and the companies within the industry must change to succeed.
2. Two key drivers of this change are continuous breakthroughs in technology and the consumer awareness and access enabled by this technology explosion.
3. Our historic approaches to selling life insurance are increasingly inefficient, ineffective, and uneconomic — on top of being unappealing, perhaps even frustrating, to consumers.

To make the needed transformation, life insurers must have the leadership, vision, and management systems to

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Can life insurers survive (continued from page 1)

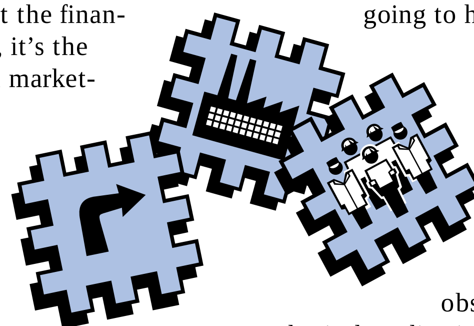
- The wise use of technology is essential.
- Mergers and shakeouts in the financial services sector will continue.
- Changes that have occurred up to this point are irreversible, and others will come.

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.

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