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The Actuary

REINVENTING THE LIFE INDUSTRY

Can life insurers survive a changing world?

by Jacqueline Bitowt
SOA Public Relations Specialist

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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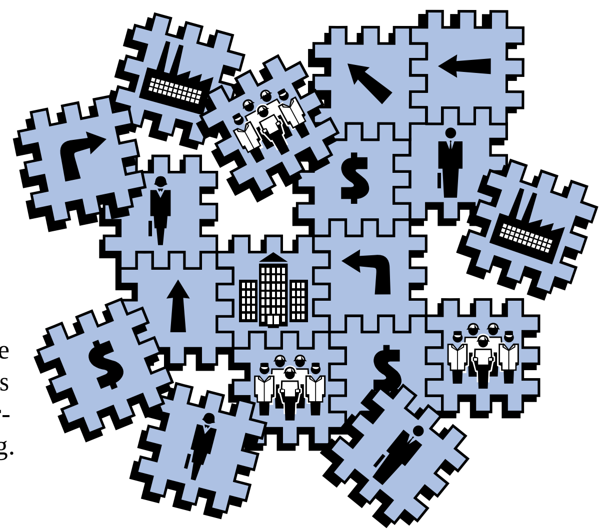

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EDITORIAL

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)

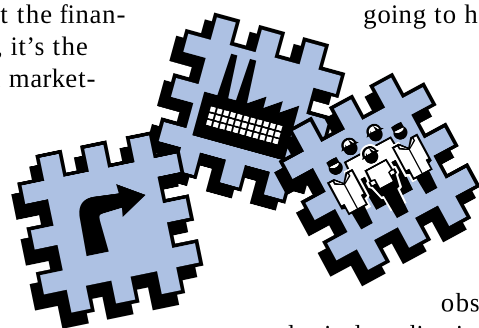
- The wise use of technology is essential.
- Mergers and shakeouts in the financial services sector will continue.
- Changes that have occurred up to this point are irreversible, and others will come.

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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Editorial (continued from page 2)

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*.

Can life insurers survive (continued from page 3)

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."

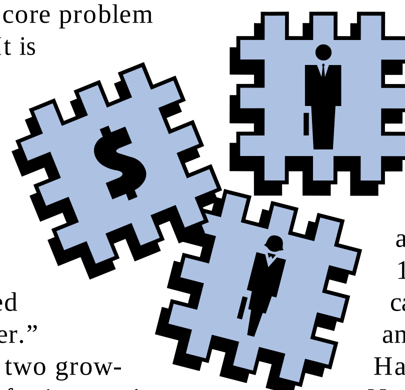
Rohda sees four key factors shaping the financial services industry: price or expense level, the cost to the customer of owning an investment; performance; service technology; and getting close to the customer. Rohda also sees four main shifts that are signs of the life insurance industry's move from 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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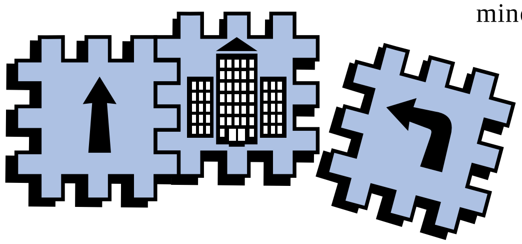
consumer, as the key customer. This situation translates into lost opportunities and inhibits them from effectively competing."

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*.

REINVENTING THE LIFE INDUSTRY

CEO: Consumers need products, not the industry

by Jacqueline Bitowt
SOA Public Relations Specialist

Among the most outspoken of the life insurance industry's authorities is Ronald Butkiewicz, president and CEO, Irish Life of North America (ILONA). In speeches to industry groups, including a 1995 presentation to the Actuarial Society of Greater New York, Butkiewicz makes the challenging statement, "American society doesn't need the life insurance industry."

However, said Butkiewicz in an interview for this article, "It does need our products. I am also quick to add that I don't think American society needs banks, either."

Like many observers, Butkiewicz sees life insurance becoming part of one, big financial services industry. Major players right now are insurers, banks, mutual funds, and investment brokers. "I really think the mutual fund industry — the smarter mutual fund players — are far better positioned to deliver financial services of all sorts than the insurance industry is," he said.

What happened to insurers?

- "The business has operated quite differently at point of sale than it has at the home office. This is magnified now by the class-action suits."
- In the insurer's three-legged stool — company, agents, and policyholders — "the agents and policyholders have ganged up on the company. There's something out of whack when the customer is getting the better value for the money and the agent or seller is getting a larger share of the pie while the company's margins are shrinking."
- Consumers no longer automatically see a need for life insurance as was the case 20 years ago.

While the industry must make many changes to adapt to the new world, Butkiewicz said, two stand out: take a customer focus and combine "the right information with the right technology."

"Consumers' needs have changed tremendously, and the insurance industry has not adapted," Butkiewicz said. "Mutual funds have responded most successfully, and banks have adjusted somewhat as well. But there's nothing about the insurance industry that's the least bit appealing to the consumer. When you buy a life insurance product, you get pricked by a needle, fill up a bottle, wait six weeks for a contract, then over the years the only thing you hear is when the money is due. We view customer contact as administrative rather than as service opportunities. If you call a mutual fund company, they work to take care of you and they're positioned to see whether you have other needs. But if you call an insurer and say you want a policy loan, the feeling is, 'It's a chore to us.'"

> In the future, products will "emanate from the customer's needs rather than the company's or agents' needs."

Success in the new business world also will depend on a combination of technology and information. "I believe that in the future, the right technologies with the right information will be far more valuable to a company than capital," Butkiewicz said. "In today's world, our business derives from its capital, because our products require so much capital to support them. But if you look out 3-5 years from now, even if you don't have capital, you'll be able to sell and to build a business if you have the right technology, good information on people, and the competence to design the tools to use them. On the other hand, you can have all the capital on earth, but if you don't have the technology and the information to compete with mutual funds and discount brokers, you're out of the game."

What many life insurance companies have done, Butkiewicz said, is to choose from one of three options: acquire or merge, go "back to basics," or "become a commodity player." The fourth and probably the best option for most insurers, he said, is to "find new ways to engage the customer," providing products "built from the customer's needs outward." These "personal financial products," in ILONA's lexicon, would combine elements of several financial services sectors to support the customer's goals. Butkiewicz offered a college funding example: the product would combine life coverage on the parent to pay the child's tuition if the parent dies prematurely and a funding vehicle for tuition. A third element is information about the customer's specific circumstances, "because it might make more sense to fund to repay interest-free college loans instead of tuition." Such personal financial products would be easier for customers to understand, "but more importantly, they emanate from the customer's needs rather than from the company's or agents' needs."

The turmoil in the industry today reflects trends that are unstoppable. "We're not going through cyclical change. We're going through change that is unparalleled in the history of our industry." From Butkiewicz's perspective, customer focus is the only way to go.

Ronald Butkiewicz can be reached by e-mail at *ron.butkiewicz@irishlifeusa.com*.

REINVENTING THE LIFE INDUSTRY

Navigating the technology course

By Ronald J. Helow

Back in ancient times — say, 20 years ago — technology didn't really make that much difference for one insurer over another. Sure, technology was expensive, but everyone spent relatively comparable amounts. We bought mostly similar policy administration and support software from a small number of mostly similar vendors. Technology was a defensive tool, used to control expenses. There was little competitive difference between the best and average users of technology. Policyholders couldn't tell. Agents couldn't tell. Products were simple, and it took everyone about the same length of time to introduce new ones.

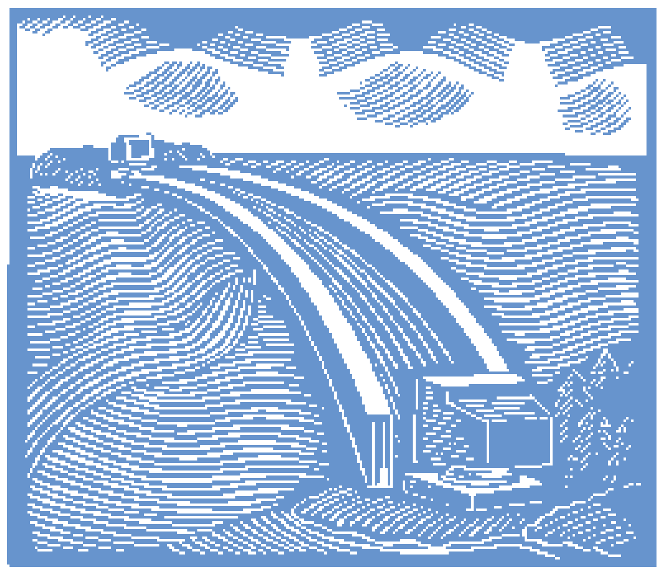
In the future even more than today, the pace of change will increase as will the complexity of products and the impact of competition and regulation. Innovative use of technology will be a key differentiator for success and maybe even survival. Technology will switch from defensive to offensive tool, aimed principally at driving revenues.

How will successful leaders in the insurance industry use technology in the future?

Learn from others

The American Airlines reservation system was the first successful online business system. Yet it was more than 10 years before online systems were widely applied to the insurance industry. Today's insurance company leaders must prevent a similar time lag in capitalizing on technology innovation.

Since our industry increasingly depends on investment products for growth, the technology deployed today in the securities business is what insurers will need tomorrow. Companies like Schwab have made massive investments in technology to remove friction from their interactions with prospects and customers. A large and rapidly growing part of their sales and service transactions occur online. People are available for complex activities that require expert assistance and for customers who prefer human interaction. This will be the operational model in the future — not because we want it, but because consumers will demand it.



In today's world, the speedy are rewarded and the laggards are swiftly punished. The top technology companies are probably the best in the world at managing rapid change. Future leading insurance companies will examine them closely and adopt their managerial and organizational techniques. The most important concepts will be fluid, project-based structures rather than rigid hierarchies based on function and line of business.

Focus only on what's critical

The cheapest and fastest technology implementation is the one you don't have to do. Expect to see the steady decline of vertical integration; it's just too expensive and time consuming to integrate systems everywhere throughout the value chain. An example is the mortgage industry. Once fully integrated, it is now split into originating companies, servicing companies, and organizations that securitize debt. Each uses highly specialized technologies.

The growing sophistication of financial services will require huge investments in technology to remain competitive. However, few, if any, companies will have the combination of financial resources and technological expertise necessary to competitively manufacture, distribute, and service a complete insurance and investment portfolio. Bank of America sold a major part of its trust operation rather than make an estimated $500-million systems investment. Insurance companies will be forced to choose where in the value chain they can most successfully compete and will concentrate their investments there. They will need to decide what activities to outsource, virtually all of which are now provided in-house without question as to time-to-market or expense considerations. While operational outsourcing is today a mostly failed experiment, viable alternatives will emerge in the future.

Exploit major technology opportunities

The Internet has spawned by far the most important future technology direction. It is impossible to overstate the impact this will have on the insurance industry, allowing a much closer link with customers, prospects, and distribution systems. For an industry whose major connection with its clients has been taking blood tests and presenting bills, this is a truly golden opportunity.

While products will be sold over the Web, this will happen slowly. However, a rapidly growing group of our prospects and customers with ideal demographics will prefer to conduct their own research and, whenever possible, to execute service transactions directly via the Web.

Your distributors will expect you to provide a fully electronic communications path. They will demand account values, new business and compensation status, service transactions, product information, training, and expert assistance in electronic formats convenient to them. Companies that fail to do this will be perceived as backward and lose ground.

The incredible popularity of the Internet will have an unanticipated benefit. Technology vendors, rushing to make their products compatible with Internet technologies, will inadvertently become compatible with one another — a sort of "technology peace dividend." This will bring us closer than we've ever been to universal standards and will ease interoperability problems.

Other important trends will be the huge and growing shortfall of talented technical personnel and the movement from packaged software toward collections of components. It will be essential to understand the implications of these directions and to plan accordingly.

Investment in technology: manage it like a portfolio

Business can no longer afford costly technology failures. In the future, technology will be managed more like a venture capital portfolio. Projects will compete for resources, with the best receiving small initial funding. Promising projects will be rewarded with later-stage funding, while others will be ruthlessly stopped. Investment criteria will be based on the likelihood of achieving business goals and return on capital rather than on political clout. Successful information technology organizations will adjust accordingly, becoming business consultants and systems integrators rather than just technology manufacturers.

High stakes

The forecast seems almost contradictory. Technology will become a tool for offensive moves, yet acquiring the right technology is necessary and so is, in a sense, defensive. Competence in today's hot technologies is tomorrow's table stakes — necessary just to get into the game — and failing to do so creates high-stakes risks. Tomorrow's leaders will successfully navigate these contradictions and realize that investment in technology is a continuous process, essential for those who are playing to win.

Ronald J. Helow is chief executive officer, Registry Systems Corporation, Sausalito, Calif., which specializes in business and technology implementation services for large insurers.
His e-mail address is *RonH@registrysystems.com*.

SOA board approves new Section

The SOA Board of Governors has approved the petition and bylaws for a new special interest Section, the Management and Personal Development Section. At least 200 SOA members must join the Section before it has the authority to officially organize.

The Section's mission is to plan, implement, and actively promote management and business skill development for members, using a variety of channels, including:

- Seminars, workshops, panel discussions, and teaching sessions at the SOA's spring and annual meetings
- Articles in *The Actuary* under "The Complete Actuary" banner
- Resource materials, such as *The Actuary's Career Planner*, the "Actuarial Competencies" guide, and specialty guides for members

The key objectives of the Section will be to:

- Provide results-oriented skills and knowledge for current and developing managers.
- Build a bridge from technical knowledge to decision-making and its implementation.
- Develop educational opportunities and provide resources for all actuaries who strive to become more effective managing members of their business organizations.
- Provide tools to facilitate personal career development.
- Offer opportunities for managers to network, enhance management practice, and experience professional feedback.

The Section will support all actuaries who can benefit from management development into the 21st century and beyond. Additional information on the new Section and membership dues can be found in inserts in the May and June issues of *The Actuary*. For more information, contact Michael Braunstein, organizing committee member (phone: 860 / 521-7459; e-mail: *aar@home.net*), or Sheri Abel at the SOA office (phone: 847 / 706-3536; fax: 847 / 706-3599; e-mail: *sabel@soa.org*).

REINVENTING THE LIFE INDUSTRY

21st-century leaders will leave old ways behind

by Michael J. Corey

At this very moment in an office in Atlanta, an actuary who once led a life insurance company is creating marketing, financial, and operations strategy for his Fortune 100 manufacturing employer. Another life actuary is reengineering his noninsurance, multibillion-dollar West Coast organization as its chief executive officer. And a third actuary is managing the vast operational and technology areas of a giant East Coast noninsurance financial services organization.

Three significant leaders are succeeding in non-insurance environments. Three pioneers of the profession are creating a new paradigm for the future.

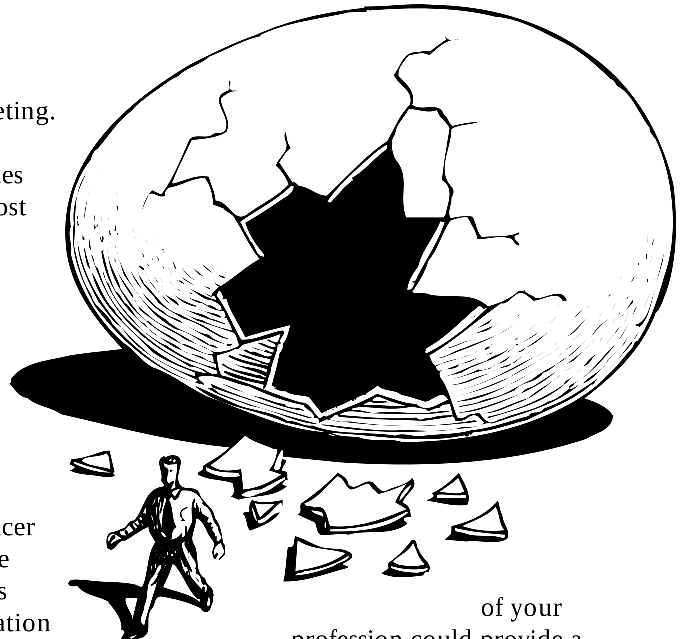
There are numerous others like those mentioned above, but most of those actuaries have similar traits: vision, ability to "think out of the box," initiative, desire, ability to take risk, a high level of intelligence, creativity, leadership, and industry standing. All of those traits plus actuarial skills and training equal a powerful combination.

That mix of high-level attributes will be needed to effectively deal with the transformation of the insurance industry. Banks, mutual funds, investment brokerage houses, financial service companies that have been acquired, international conglomerates, industrial manufacturers, and other industries are becoming players in what is no longer the traditional insurance industry. More and more, we are seeing these nontraditional companies looking for leadership in the areas of product line management, finance, product development, technology, and true marketing. In most cases, actuaries are better suited to the new roles in these companies than most other types of executives.

When a major financial services company recently recruited a senior executive to launch the company's insurance unit, three out of the four finalists for the job were actuaries. The fourth was the chief executive officer of an avant-garde insurance organization. The actuaries had that powerful combination of skills. In addition, they had the creativity to understand how the products of tomorrow fit the unique characteristics of the company's current products and its distribution capabilities. Most importantly, all had vision.

Ask yourself: Are you prepared to deal with the products and projects of tomorrow, probably in an environment completely different than the one you're in now? If not, you had better get ready. The insurance world is changing faster than consolidators can change executive suites. But with change comes opportunity. Chaos creates a need for answers and leadership. The opportunity to fill a void brings success.

Developing business skills can be accomplished in many ways through education and business opportunities. Continuing education is a "must" for product innovation, finance and distribution, technology, and regulatory issues. Continuing education outside



of your profession could provide a distinct advantage if you want to expand your role in the future; try courses in operational leadership and business theory. Stepping away from the secure and stereotypical role of an actuary in a traditional insurance company might be a good idea if you want to be a leader of tomorrow. Take action.

The three leaders described above prepared themselves to be chosen for their current roles. It is no accident that they are at the top of their noninsurance businesses. Their skill set will be what is needed to work successfully in tomorrow's emerging new insurance world.

Michael Corey, a frequent speaker at SOA meetings, is global practice leader, Insurance and Diversified Financial Services, for the retained search firm LAI Ward Howell. He can be reached at *whowell@idcnet.com*.

REINVENTING THE LIFE INDUSTRY

Price vs. service is distribution 'tug of war'

by Marvin Meyer

Competitive pressures are dramatically altering the distribution process for life insurance. Product pricing and client service are cornerstones in the changes to distribution.

Market segmentation is becoming more pronounced. The advent of "bargain-basement" term policies has brought about a commodity-like atmosphere for cheap insurance protection. Simultaneously, the upscale market is increasingly service-oriented. With the rapid accumulation of wealth in the stock markets over recent years and the associated needs for estate, business succession, and executive compensation planning, life insurance competition in the upscale market is becoming more service driven.

These market trends have already impacted distribution channels, and the pace will accelerate in the next several years.

The "tug of war" between price and service is likely to cause the demise of the traditional career agency form of distribution. Two fundamental problems are crippling the traditional system: expense and objectivity.

- Expense: Recruiting, training, and managing career agents is horrendously expensive. Typical costs for agent recruiting and training can exceed $200,000 per retained agent in some companies. A major contributor to this problem is the fact that as many as 80-90% of agents fail within five years of joining the business. The net impact of high distribution costs is that products cannot be priced to both meet marketplace requirements and provide life insurers with acceptable profits.
- Objectivity: Most of our clients are seeking products that are both competitive and customized to their situation. No insurance carrier can compete in all situations; therefore, agents must seek products outside their career company — an approach that is more objective than loyal.

There also has been a dramatic change in the landscape of life insurance products. Guaranteed-level premium term insurance for 10, 20, 30, and even 40 years is capturing a significant market share. These policies have tremendous appeal in most households of moderate means, largely because these products are being differentiated on price. To compete, insurance carriers must distribute these policies more efficiently than the usual career agency economics permit.

In addition, universal and whole life plans are faced with competition from both protective products such as term insurance and equity accumulation vehicles such as mutual funds and variable annuities. Again, more effective distribution is required to enable these policies to retain market value.

The result of these factors is a bifurcation of life insurance marketing systems. We see professional brokerage as a successor to the career agency system. This professional brokerage system will dominate the upscale market. The middle and lower markets will be dominated by lower-cost institutional distribution approaches, including the Internet, banks, broker dealers, credit unions, other work site marketing arrangements, and face-to-face marketing systems that are yet to be invented.

Marvin Meyer is president and CEO, TowerMark, New York, a financial services marketing firm specializing in insurance. He can be reached by e-mail at *mmeyer7444@aol.com*.

All SOA members welcome at June board meeting

Interested Society members are welcome to attend the SOA Board of Governors meeting on June 21 at the Grand Wailea Hotel, Maui, Hawaii, between the first and second SOA spring meetings.

Minutes of board meetings are available by request and on the SOA Web site (under General Libraries at *www.soa.org*). For more information, call the SOA office at 847/706-3500.

What’s the best approach?

Defined benefit vs. defined contribution in social security

by Anna M. Rappaport
1997-98 SOA President

The issues related to the appropriate approach to Social Security are being hotly debated in the United States. One of the SOA’s many contributions to the public discussion was a panel session, “The Old-Age Crisis,” at last year’s annual meeting. As the 90-minute session proceeded, it evolved into a discussion on the value of a defined contribution approach versus that of the U.S. system’s current defined benefit approach. These insights are important for public policy experts worldwide to consider.

Participants and panelists included a number of senior actuaries and economists who have worked with social security systems in North America and throughout the world. Serving on the panel were: Robert B. Friedland, director, National Academy of Aging; Robert M. Katz, principal actuary, the World Bank (moderator); Dimitri Vittas, advisor on pensions and insurance, the World Bank, and a consultant to many governments on social security issues; and myself. Among the session’s active participants were Robert Myers, former chief actuary of the U.S. Social Security Administration, and Chris Daykin, government actuary, United Kingdom, and consultant to many governments on social security issues.

The discussion was triggered by the question of whether a crisis truly exists. Myers stated that population aging is predictable and that there is no crisis, especially considering that problems will occur over a period of many years hence. He points out that a crisis is something catastrophic that is likely to occur soon. At the session, he shared his perspective that the imbalance in the U.S. Social Security system can be corrected with modest changes and that radical ones are not required.

Which path?

Social security systems in several countries have been converted, at least in part, to privatized systems using individual accounts, privately managed and invested. The discussion focused on two different categories of reasons why defined contribution accounts might be used in social security systems: philosophy and environment including infrastructure.

The philosophical arguments are related to goals. A social insurance system is redistributive, balancing individual equity and social adequacy. Some citizens want a system to be primarily redistributive, whereas others want a personal savings medium managed on an individual basis. For those whose goals are focused on social adequacy and maintaining a certain level of retirement income for a large segment of the population, a traditional defined benefit plan seems best. Those who see the system as a means of forced individual savings, particularly if they are opposed to redistribution, prefer individual accounts. Under most of the proposed individual account plans, personal savings would be accompanied by a minimum benefit. The higher the minimum benefit, the less the incentive to save voluntarily.

The arguments related to environment and infrastructure are much more applicable in underdeveloped countries without long-term stability. Those situations may lack compliance with a tax system, record keeping capability, fiscal stability, and similar factors needed to maintain a defined benefit system. One difficulty with defined benefit systems is that money waiting to be distributed can be diverted for other purposes. Very early retirement ages is another common difficulty.

Defined contribution systems offer a more workable alternative in countries not ready to manage a defined benefit system, but they, too, are subject to problems including:

- Poor compliance with contribution requirements
- Inability to directly offer a floor of protection
- Significantly higher administrative costs, particularly for those participants who have small benefits
- Inability to provide an adequate income for lower earners and participants who move in and out of the labor force frequently

Perhaps the most crucial of those difficulties is the second. If the system’s goal is to provide a floor of protection to most of the population, defined contribution systems generally will not fit that need.

Should we shift our focus?

The alternatives presented by the last Social Security Advisory Council and now under discussion in the United States include moving to a mixed system with partial privatization, a defined benefit floor supplemented by defined contribution individual accounts invested in the private sector. In the SOA session, Myers, Daykin, and Vittas all agreed that such a change was not necessary in the United States and generally not desirable. None of the defined contribution systems have been in place long enough to show whether they will deliver adequate benefits, which is the ultimate test of a retirement benefit system.

The magnitude of the financial difficulties (i.e., imbalance of contributions and benefits) within the U.S. Social Security system is far less than in many other countries, but there are clearly problems of credibility with many younger U.S. citizens. There also are much larger and more severe issues related to the aging society when one considers health care and Medicare, long-term care and other assistance required for the frail elderly, and Medicaid and other public assistance programs. Resources needed and the affordability of these programs in the aggregate will require major adjustments.

Many combinations of changes are possible. The changes will reflect a balancing of values, needs, and competing uses for resources. One of the challenges is to focus on the big picture. It is difficult enough to understand the Social Security and Medicare programs individually, much less comprehend the intricacies of the relationships between them and with other organizations. However, it is the programs working together that will determine the well-being of the elderly population.

Anna M. Rappaport is principal, William M. Mercer Incorporated, Chicago. Her e-mail address is *anna_rappaport@mercer.com*.

E & E CORNER

161 new Fellows

The SOA welcomed 161 new FSAs at the two Fellowship Admissions Course (FAC) sessions offered March 1-3 in Atlanta and March 11-13 in Dallas. This brings the total of FAC “graduates” to 2,417 since the FAC sessions were instituted in 1990.

E&E on the Web

Developments in the redesign of the basic education and examination system are being posted on the SOA Web site (*www.soa.org*). An example is the final report of the Course 2 working group. The posted report describes the new course in detail, including the learning objectives and the topics to be covered; cites the relevant chapters of recommended texts; and offers sample questions of the type that candidates can expect on the Course 2 examination. Similar reports for other courses will be posted when they are available.

The Web site will include other important E&E information as well, such as clarifications of conversion rules and information about the new education system that would help candidates and employers get a better sense of what to expect.

Also on the Web is general information, such as lists of passing candidates, new Associates, and new Fellows; the text of essay examination questions (Series 200-500) from the previous examination session; and the current examination catalog. Printed copies of material on the Web site are available from Pat Garrity at the SOA office. (phone: 847/706-3515; fax: 847/706-3599; e-mail: *pgarrity@soa.org*).

EA-1B restriction

U.S. pension candidates should be aware that credit for EA-1B is a partial requirement for the U.S. Retirement Benefits Course 8 in the new education system. When existing credit is converted to course and unassigned credit in the new system, credit for EA-1B will be reserved for use with the associated Course 8 unless the candidate demonstrates a firm intention to pass a different Course 8 to complete the Fellowship requirements. Evidence of intent is a request for conversion credit for another Course 8, substantial progress toward completion of the track requirements in an area other than U.S. pension, or a formal statement from the candidate that he or she plans to specialize in an area other than U.S. pension. The conversion rules allow credit for each course examination to be used only once; candidates should note the EA-1B restriction so that they do not find themselves unable to complete the requirements for their specialty area of choice.

Professional development update

Candidates planning professional development programs to satisfy that portion of the FSA educational requirements should note that a mechanism is not yet in place for filing or approval of their formal plans. The Professional Development Task Force hopes to complete most of its work in the 1998 calendar year. This would allow the framework and guidelines for both candidates and their mentors/advisors to be put in place in time for candidates to make some progress in the latter part of 1999.

A note on I440C

Syllabus material covering variable life, critical illness, and survivorship insurance has been added to the reading for the fall 1998 Course I440C examination (Advanced Design and Pricing — Canada). With the additional study material and the new topics covered, the course will now offer 20 credits.

on the lighter side

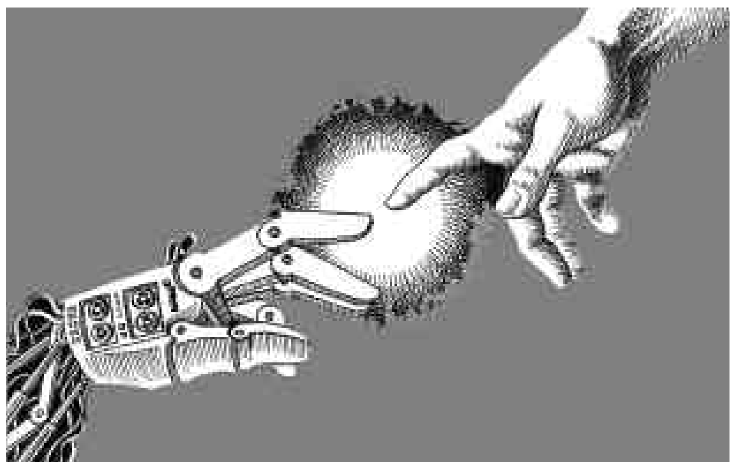
It's all in their imagination

In one small volume, you can read about robot life insurance, a world that rejects computers, a world run totally by computers (and what happens when the mother of them all breaks down), a particularly harrowing role for an education actuary, and what may be an actuary's ultimate fantasy.

It's *Actuarial Speculative Fiction*, version 2.0, the result of the second contest sponsored by the SOA's Computer Science Section for literary actuaries with a science fiction bent. All 16 stories submitted were published.

The competition offered a first prize of $250, which was split by Victoria G. Stachowski and Alice Underwood for their respective stories, "It Will be Partly Cloudy Tomorrow" and "Mec Life." The second place prize of $50 went to David G. Kroll for "Actuarial Examination." Third place was awarded to Margaret Berger for "Breakdown," and honorable mention was given to Carol A. Marler for "Education Actuary." The two first-place stories are posted on the SOA Web site (*www.soa.org*).

Readers of version 2.0 can also enjoy stories by Erik G. Anderson, Bob Berin, Marilyn Dunstan, Christopher J. Fievoli, James A. Kenney, Andrew C. Lang, Gary S. Lange, Steve Maddaugh, Timothy J. Orcutt, Amy Whinston, and Sajid A. Zahid.



Version 2.0 was edited by Carol Marler, and the competition was judged by Robert Mielke, Ph.D., associate professor of English, Truman State University, Kirksville, Mo. Mielke also judged the first contest, held in 1995-96. "If Ray Bradbury's stories are like dandelion wine, these are like dry martinis," Mielke said. "All the entrants deserve a good pat on the back. The range between the prizewinning stories and the others was not that wide, and the decisions were tough."

Copies of *Actuarial Speculative Fiction* were distributed to all Computer Science Section members in April. Others interested in receiving a copy can obtain one through the literature center at the SOA spring meetings or by contacting Sue Martz at the SOA office (phone: 847 / 706-3543; fax: 847 / 706-3599; e-mail: *smartz@soa.org*). Copies are free of charge.

New contest

Another competition is planned for this year. Watch *The Actuary* and the SOA Web site for more details.

Assistant puzzle editor: Does your name fill the blanks?

When you're working on a puzzle, do you get the urge to try your hand at creating your own puzzle? Have you developed puzzles in the past? *The Actuary* needs an assistant puzzle editor, and you may be the one.

This volunteer role involves creating puzzles and editing puzzles submitted by others for *The Actuary*. The assistant editor works with the puzzle editor, Louise Thiessen, to produce puzzles for up to nine issues of *The Actuary* each year. Currently, the position does not involve formatting or word processing.

Details are available from Thiessen at her *Directory* address and from Jackie Bitowt at the SOA office (phone: 847 / 706-3566; fax: 847 / 706-3599; e-mail: *jbitowt@soa.org*).

Exchange views via the Web with SOA president-elect candidates

Do you have suggestions to improve the Society or the profession? Are there concerns you'd like one or more Society president-elect candidates to address? "Talk" with this year's three final candidates through the Society Web site's Discussion Forum section from June 15 through July 7.

Candidates will answer all questions in a timely fashion, and questions and answers will be posted on the Web site. A dialogue of several questions, answers, and comments can be formed between the candidates and questioners.

This is the second year that the president-elect candidates have participated in online discussions.

The upcoming online session has been timed so Fellows can have their questions addressed and make a more informed choice before the second ballot voting begins.

On the SOA home page (*www.soa.org*), click on Discussion Forums and then on President-Elect Candidates' Dialogue with Members. Then choose an existing discussion thread or key in a new topic.

Questions on the process can be directed to Debbie Jay at the SOA office (phone: 847 / 706-3539; fax: 847 / 706-3599; e-mail, *djay@soa.org*).

Also, candidates will offer their views in a special supplement to the June issue of *The Actuary.*

Second ballots due Aug. 7

Second ballots for the SOA 1998 elections will be mailed to all Fellows on July 7. To be valid, ballots must be received in the Society office no later than August 7. If you are a Fellow and do not receive the second ballot mailing by July 20, please contact Lois Chinnock at the Society office (phone: 847 / 706-3524; fax: 847 / 706-3599; e-mail: *lchinnock@soa.org)*.

Preferential voting

Fellows have had some questions about the preferential voting process on the second ballot for the office of president-elect. The following brief description is offered to shed some light on the subject.

Preferential voting is a two-stage election process. To win, a candidate must receive a majority of valid votes east. First-choice votes are counted initially. If no candidate receives the necessary majority of first-choice votes, the candidate receiving the smallest number of first-choice votes is eliminated. Votes for the second-choice candidates named on that candidate's ballot are added to the remaining two candidates' first-choice votes. The winner, one of the two remaining candidates, is the one with the most first-choice votes plus distributed second-choice votes.

The second-choice votes have determined the outcome of several recent elections. This shows the need for Fellows to carefully consider both their first- and second-preference votes for president-elect.

DEAR EDITOR

Questions on indexing

The article by Steve Kellison on social security and indexing ("In praise of indexing," *The Actuary*, January 1998) raised many good points. It also made me wonder about a life expectancy index. What was the life expectancy of someone aged 65 when the U.S. Social Security system was first started?

Also, regarding the fertility rate index, another factor to consider in that index is the number of immigrants coming into the United States and their age distribution. In fact, one way to increase the ratio of young workers to retirees might be to open the borders to younger immigrants.

Art Garrison

Steve Kellison responds

The author raises some interesting questions.

First, life expectancy at age 65 in 1935, when Social Security was enacted, based on U.S. Population Life Tables (census data) was 11.9 years for males and 13.4 for females. Life expectancy at age 65 today is 15.5 and 19.2 for males and females respectively.

Second, immigration does have an effect somewhat like an increase in fertility. Cost estimates from the Social Security board of trustees already include an immigration assumption, so the question now is how future experience might vary from that assumption.

IN MEMORIAM

Thomas N. E. Greville
FSA 1947, MAAA 1965

H. Charles Kwasha
ASA 1932, MAAA 1965, FCA 1959

Charles Maidanick
ASA 1962, MAAA 1966, FCA 1975, EA 1976

Evelyn Stravolemos
ASA 1991, MAAA 1992