Insurance Companies In 2020

by John Aprill

A financially sound, operationally efficient, growing and profitable company operating in the insurance sector in 2020 must have the following attributes:

- It must KNOW its customers and its production system.
- It must KNOW its risks and how it will address its risks BEFORE they actually occur.
- It must be nimble.
- It must grow real profits from the current products it sells.
- And most importantly, it must be able to integrate each of these cohesively.

The Company Of 2020

Knowledge Of Customer

This has several dimensions. It must deal with today's known risks and tomorrow's unknown risks. Scenario testing will only be a starting point; the real test must be in the extremes. The action plan must also be specific for the next quarter and next several years. There will be no forgiveness for a solution that addresses a problem in one period and falls apart in the next reporting period.

The company cannot guess what its customers want nor hope that the products it produces will be welcomed in the marketplace; it must know its customers and their needs and it must create products that its customer base will purchase. The insurance company must be able to produce a product batch of one—a broker or agent selling one contract to one individual. This is not the generic term product nor is it the asset.

Also, it must be totally attuned to the changing social mores. For examples, baby boomers are about to retire and will create the largest group that will CHANGE the way we retire and die. Over the next 10 years, there will be profound changes to the way retirement and life choices are considered. The main thrust is the baby boomers moving through the later stages of life. This will have an impact on both the insurance risks and equity investments.

Investments will change. Equity product pricing will decline. The normal price to earnings multiples will decline. Why pay for 10 years' worth of future earnings if we can no longer predict how long an organization will remain in business? This will reduce the value of stocks. To increase portfolio yield, there will be a need for speculation, which will encourage assets moving into small- and medium-sized companies.

Instead of a large group of people saving for retirement, the assets will be cashed out. This will put pressure on asset prices, as the number of retirees increases relative to the purchasers of assets.

Insurance risks will change. There will be continuing discussion of the quality of life and whether death is an appropriate alternative to a poor quality of life. This has come to the forefront in recent health care discussions—is a hospice more appropriate than continuing medical care? Death may no longer be determined by medical doctors. It will be determined in part by each individual. We already see signs of this occurring—the growth of hospices, individuals taking charge of their medical care and, regrettably, the high cost of a final illness.

This might mean that the mortality experience for the older ages may be worse than expected and pricing will need to reflect it. Before it does, the impact will be a loss to life insurers and health insurers (especially Medicare), a gain to retirement and social security.

Knowledge Of Risks

This group may not live as long as originally priced. Many pricing models assume mortality improvement over time. But what happens if the mores of the population change to remove the social stigma of an earlier death than medicine would allow? And, how quickly would our pricing models adjust to this change?

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The nature of financial shocks and their frequency will accelerate. Why? Because there is such fear concerning the current financial fiasco, there will be a need for greater amounts of hedging, even at the individual level. As individuals move to a specific solution, the mass exodus risk may not be considered. So, if everyone heads for the exit doors at the same time as occurred in portfolio insurance, the hedging will fail and result in a market downturn. Also, individuals do not always act in directions that may be rational, which may cause market anomalies for little apparent reason.

A Nimble Company

It must be able to move quickly from one product to another or one distribution system to another. It must contemplate an exit strategy and be able to execute it. It cannot commit to a strategy that may become obsolete in a short period of time. It cannot have the huge costs to exit that exist today.

In the present economy, we have learned that organizations that become too large are not good for the economy because if there is a failure, the impact is huge. This philosophy will be carried out through capital restrictions and no doubt through the anti-trust policy preventing new large institutions by disapproving them. As a result, we should expect to see many more small- to mid-sized organizations. These organizations will be able to react quickly to changes in the environment and not be subject to legacy issues discussed below.

Profits From Products Currently Sold

This means the profits must come from the products that are sold today, rather than the products that were sold generations ago when interest rates were low, mortality was decreasing, and expenses were decreasing products. This is the often ignored revenue portion of the balance sheet. To meet profit goals today, costs are cut; to meet profit goals in the future, the profits must flow from the products sold today. And the increasing revenue stream means increasing profits. Only with a thorough knowledge of the customer base and the risks insured is this possible.

An Integrated Company

Each of these items is a formula for success if applied at the same time, and yet a formula for failure if applied selectively. It is possible to know your customers intimately and deliver products that meet their every need, but if they are not profitable in the near term and the long term, the company cannot be successful.

Critical Issues To Be Addressed

The critical issues that must be faced are the workforce, technology and legacy product administration.

Workforce

The workforce will continue to be an issue. There will be an increasing need for actuaries, but it takes time to produce new actuaries. Baby boomer actuaries will retire, reducing the workforce at the same time that the need for actuaries will increase. This may increase actuarial salaries over the short term, but it will also increase the workload for actuaries.

This is a good news side to the workforce equation. Actuarial work and evaluation of risk exposures have become extremely sophisticated and require thousands of iterations. The time frame for reporting has progressively shortened. Systems can only take the process so far. At some point the human element is required to explain what has taken place and what actions are needed to resolve them. There will be a need for experienced actuaries to work. This is the perfect job for experienced “retired” actuaries.

Technology

Technology has moved forward to make production faster and has also made testing feasible, but it has not addressed a fundamental issue—instant results are not always understood and may not be actionable. The development of artificial intelligence systems is needed to assist the human component, but these systems are not there yet and will not be fully functional over the next 10 years. Insurance companies will be spending a lot of research dollars to achieve this goal.

Legacy Product Administration

Legacy product administration will become even more burdensome than it is today. Imagine another 10 years of product development that must be administered even if only one product is sold. Whenever an administrative system or valuation system must be updated, every product must be moved. This will benefit newer companies without legacy baggage over companies that have been in business with generations of legacy products.

John Aprill, FSA, MAAA, J.D., CFA, CHFC, is an independent consultant in Boston, Massachusetts. He can be contacted at johnaprill@hotmail.com.