NEWSDIRECT

Newsletter of the
Nontraditional Marketing Section

NUMBER 28 SPRING 1998

Chairperson's Corner

by David A. Seidel

It is that odd time of the year when actuaries everywhere are putting the very final touches on 1997, and marketers are looking to our 1999 plans, leaving one to ask, "Who is working on 1998?"

I work in the direct-response area, marketing through financial institutions, and the still-too-long gestation period for new products and offers has us already looking for 1999 opportunities. I wanted to highlight some trends I see from my perspective and the challenges and opportunities provided to actuaries serving this market:

- In the quest for ever-increasing fee income, financial institutions are going beyond insurance to satisfy their needs. Club programs, noninsurance health discount programs, and service contract/ warranties all compete for the marketing opportunities that had once been reserved for insurance. Implications—there is a huge need for new products and delivery solutions in insurance and, I believe, a huge opportunity for actuaries to assist the noninsurance product arena. And, perhaps, the biggest opportunity of all will go to those who can integrate these well, from marketing and financial standpoints.
- There has been continued rapid change in players and competitors in each and every market. New acquisitions (for example, Cendant buying American Bankers) create great potential synergies but, in my humble opinion, have rarely evolved past consolidation of operations. Implications—huge opportunities for the organizations that capitalize, via acquisition or strategic alliance, to truly add marketing value (for example, more products integrated in a more comprehensive and well-thought-out delivery strategy) instead of merely subtracting

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Analyzing Direct Marketing Business Alternatives Using a "Value" Approach

by David S. Lee and Jay M. Jaffe

Direct-response professionals often address questions such as, "Did we get enough of a response-rate increase from the more expensive, creative package to justify the extra expense?" or "Did we get enough 'bang for the buck' from our free-gift offer?" This article describes an approach to these decisions based on "maximizing value to the company."

There are a number of old profitability "rules of thumb" for insurance direct or data-based marketing that are useful but not sufficient in today's environment. These rules were developed under much simpler market conditions.

Today's insurance direct marketers and actuaries are producing more complicated programs and products in an environment where making a reasonable profit is becoming more and more difficult. It can be dangerous for an insurance direct-marketing company to base "go or no-go" decisions solely on old rules of thumb.

In some cases, profitability decisions should be based on full-cost pricing, but there are situations in which marginal cost pricing is not only appropriate but possibly the preferred approach. The decision whether a program is good or bad should be based on whether the program increases the value of the company and not necessarily, for example, on a simple ratio of annualized premium to marketing costs (the old TARP/MC measure). Deciding on the acceptability of a single campaign or choosing between alternative campaigns requires a decision process based on maximizing the value of the company.

This article describes some of the traditional profit measurement standards and then presents a more comprehensive and up-to-date foundation for insurance direct marketers and actuaries to use when reviewing either individual campaigns or total marketing programs.

Traditional Rules of Thumb

Two of the most frequently used measures of direct marketing success have been:

$$\frac{TARP}{MC}$$

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Chairperson's Corner
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costs. We, as actuaries, can truly place a value on these activities and need to focus on the revenue side more than on the expense side.

- Changing demographics, and more importantly, changing attitudes make the insurance sale more challenging. I know the "changing demographics" theme is trite, but the reality remains that the two-income family already has a built-in life and disability policy— the second income. So, the needs are changing, not based on what happens to us, but on what happens to those close to us when they get sick. For example: The Family Medical Leave Act. Credit card coverages now routinely cover the minimum monthly payment when the cardholder is out on a family medical leave. Implications—for the first time, we are now paying a benefit to a fully healthy individual because someone close to them (child, spouse, parent, and so on) is sick or injured. A huge new opportunity for new product development!

So, again, be aware that the times they are 'a-changing! Many of us will soon be working for noninsurance entities (if we don't already!). Make sure your skills and abilities can adjust to the new world ahead and be sure to take some time to attend seminars and meetings (especially in a different field) to keep your horizons broad and your options flexible.

Now go out and have a great 1999!

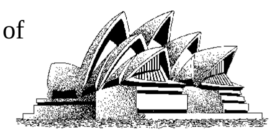
David A. Seidel, FSA, is Director, Product Development, at Minnesota Mutual Life Insurance Company in St. Paul, Minnesota and Chairperson of the Nontraditional Marketing Section Council.

International Insurance Society Seminar

34TH ANNUAL SEMINAR
CREATING SUCCESS IN A GLOBAL MARKETPLACE
JULY 12–15, 1998
SYDNEY, AUSTRALIA

Please join us at the Annual Seminar of the International Insurance Society, Inc., Sydney, Australia.

Each year, the Society creates a timely and provocative program that addresses issues of current interest to executives and academics around the world. Our 1998 Sydney Seminar, *Creating Success in a Global Marketplace*, will give you an opportunity to exchange ideas with other insurance leaders and executives, learn of key innovations and trends, and share experiences with the worldwide insurance industry.



The Sydney Seminar promises to be among our very best and we look forward with pleasure to welcoming you to beautiful Australia.

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NEWSDIRECT
Issue Number 28 Spring 1998

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This newsletter is free to Section members. A subscription is $15.00 for nonmembers. Current-year issues are available from the Communications Department. Back issues of Section newsletters have been placed in the Society library. Photocopies of back issues may be requested for a nominal fee.

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A Call for Papers

The Nontraditional Marketing Section is interested in receiving papers for publication in *NewsDirect* that would be of interest to Section members.

As an incentive, the Section is holding a contest for 1998. A cash prize of $250 will be awarded to the author of any paper accepted for publication in 1998. In addition, at the end of 1998 a prize of $1,000 will be awarded to the best paper submitted. *NewsDirect*'s editorial board will decide which papers are acceptable for publication, and the Section Council will decide the grand prize winner.

Articles should be approximately 500 to 2,000 words. It is suggested that articles be educational, include real-world examples, and cover current issues or original research. A list of suggested topics is as follows:

- Banks and insurance
- Pre-need life insurance
- Credit insurance
- Payroll deduction
- Direct response.

This is a great opportunity to share your ideas and get some recognition, so start writing. If you have an idea for a paper but are not sure if it is appropriate, please contact us. Articles should be typed in Word or WordPerfect and submitted via e-mail to kdesai@voicenet.com or joseph.e.brennan@prudential.com.

Editor's Note

$83 Billion Access Fee or a New Era for Nontraditional Marketing

by Kiran Desai

We have finally come of age. Waving the "red umbrella" and $83 billion, CitiGroup is entering the giant sweepstakes of customer-based marketing. The alternate-distribution method, direct mail, direct marketing, direct-response marketing, database marketing, relationship marketing, and bancassurance were the various monikers for the art and science of nontraditional marketing that I can remember during the three decades that I have personally been in this business (has it been that long?). Increasing the value of the company through efficient access to the customers was (and still is) the name of the game. Not being "mainstream," we, the practitioners of this art, suffered many darts the least of which was being tagged as junk-mail junkies. But finally the vindication has come from the pillars of tradition. Does this mean oblivion of the nontraditional by absorption? Hardly.

Now more than ever, we who have honed this fine art of measuring responses, targeting products based on need (and not greed), and marginal cost analysis (see the article on "value analysis" by Lee and Jaffe in this issue for starters), can make the difference. Travelers and CitiCorp (with possibility of AIG, Merrill Lynch, Chase, and Credit Suisse, et al, following the merger mania) are merely reading the handwriting on the wall long visible to us. In less than two years (three years, if you are a purist) we will enter the new millennium. By then globalization of financial services will be a reality. Survival will require practicing efficient and effective marketing that goes beyond the traditional methods, taboos, countries, and products (like solving the famous puzzle of connecting the nine dots by going outside the box). A company's assets will recognize the value of names and the ease of access to them. That is what this down payment of $83 billion is all about. In describing this "merger heard 'round the world," the *Wall Street Journal* says, "… the transaction hinges on the ticklish strategy of 'cross-selling' products." Well, we do know a lot about what it takes to do successful "cross-selling."

The question is, will we rise from our obscurities and be heard. One way to do this is to form a network through participation. Come to our annual Section meetings and NTM-sponsored sessions at the various SOA meetings. Volunteer to run a workshop or a panel discussion. Write papers about what you do. We even have a special incentive this year (see Joe Brennan's article on *NewsDirect* articles on this page). If you have questions, call any of the sub-specialties champions (advisors) appointed by the council for mentoring. They are: Rick Bergstrom, Perry Kupferman, Jay Jaffe, Carl Meier, Dave Seidel, and John Yanko. Send your e-mails to the editorial board: Kiran Desai (kdesai@voicemail.com), Joe Brennan (joseph.e.brennan @prudential.com), or Nancy Manning (nmanning@jcpenney.com). We need to build the knowledge base and enlarge the network of our highly valuable members. Someone has just put a down payment of $83 billion to build this. So let us do our share.

"Spring is the time for rejuvenating. Let us revitalize our Section. Come share your knowledge with us."

Spring is the time for rejuvenating. Let us revitalize our Section. Come share your knowledge with us.

Kiran Desai, FSA, is President of Swiss Am Financial Consultants in Cherry Hill, New Jersey, a member of the Nontraditional Marketing Section Council, and editor of NewsDirect.

Analyzing
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where *TARP* is a measure of the annualized premium and *MC* equals the marketing costs associated with the program; and

n = number of months before (Premiums − Marketing Costs − Expenses − Claims > 0)

Some people view n as the number of months it takes for a program to "break even."

Back in the days when it was easier to make money from direct-marketing campaigns, an accepted "rule of thumb" was to break even by the twelfth month, using the above definition. Today, as competition and marketing costs have increased and response rates have generally declined, it usually requires longer than 12 months to break even. The unresolved question—does a company make money just because a product "breaks even" within n months?

Example 1: The "Sick" Hospital Indemnity (HIP) Program

Suppose a company is considering a 100,000-piece direct-mail HIP program. The marketing costs are estimated at $60,000. Based on the expected response rates, TARP is anticipated to equal $54,000. Premium income is expected to begin at $4,500 per month, and decline by $100 each ensuing month.

Applying the rules of thumb discussed above, $TARP/MC = 90\%$ and $n = 20$ months (approximately). Generally, these results would define a "successful" mailing. The *TARP/MC* ratio is high, and the "break-even month" is reasonable. However, let us consider some of the financial data in greater detail.

Suppose the actuary projects the various costs of the program as a percentage of the present value of premium over the expected lifetime of the policies, as shown in Table 1.

Clearly, in spite of the favorable rules of thumb, the actuary reviewing the information in Table 1 would have concerns about mailing a significant quantity of offers.

The problem with the old rules of thumb is that they focus on premiums rather than profitability. The HIP program discussed above does a great job of generating premiums. Unfortunately, the underlying business is not profitable. The approach discussed below addresses this shortcoming.

Maximizing Value to the Corporation as a Measurement Tool

A program is said to "add value to the corporation" if the present value of future profits generated by the program is greater than zero. Discounting of future profits is at the corporate hurdle rate.

Consider the appropriate expenses used in the financial projection. In many cases, the most useful measurements are based on "expenses that are marginal to the program being considered." Some actuaries dislike the idea of using marginal expenses in profit testing. However, for many day-to-day tactical profitability decisions, a marginal expense analysis may be the best approach.

Suppose, for example, we are evaluating the effectiveness of a telemarketing follow-up program to a direct-mail campaign. Corporate overhead is unlikely to change based on this particular "go or no-go" decision. Therefore, if the actuary forces the telemarketing program to "cover its share of overhead," the results may be misleading. The only company expenses that will change are those that are marginal with respect to the telemarketing follow-up, and the analysis should reflect this fact.

Example 2: Using the Value Maximization Approach

Suppose a company is preparing for a 100,000-piece roll-out mailing after pretesting the offer with and without telemarketing follow-up. Assume the expected response rate is 0.2% (mail only) and 0.3% (mail plus telemarketing). The cost of follow-up telemarketing to the entire file would be $120,000. How does the company use "value maximization" to make the business decision on whether to include the telemarketing?

In these situations, the actuary should calculate the expected present value of future profit for the additional 100 policies (100,000 × 0.1%) that result from the telemarketing follow-up by using expenses (including the $120,000 telemarketing expense) that are marginal to the additional 100

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TABLE 1
Projection of Costs as a Percentage of the Present Value of Premium

Component	Present Value of Premium
Marketing Costs	35%
Acquisition Expenses	5
Maintenance Expenses	10
Premium Tax	2
Claims	55
Total	107%

TABLE 2
Expected Incremental Results from Telemarketing Follow-Up

(1)	Number of Policies Issued	100
(2)	Annual New-Business Premium	$50,000
(3)	Telemarketing Costs	$120,000
(4)	Present Value of Premium Income	$250,000 (100%)
(5)	Present Value of Investment Income	$12,500 (5%)
(6)	Present-Value Death Benefits	$75,000 (30%)
(7)	Present Value of Surrender Benefits	$25,000 (10%)
(8)	Present Value of Marginal Expenses (excluding telemarketing)	$7,500 (3%)
(9)	Present Value of Reserve Increases	$20,000 (8%)
(10)	Present Value of Book Profits = (4)+(5)−[(6)+(7)+(8)+(9)]	$135,000 (54%)

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policies. If the present value of future profit, discounted at the corporate hurdle rate, is positive, then the telemarketing follow-up adds value to the corporation. Basically, this means the expected future profit on the additional 100 policies must equal or exceed the $120,000 telemarketing cost. Sample results are presented in Table 2 on page 4. The percentages are ratios to the present value of premium income.

The expenses in (8) include the marginal costs of issuing and maintaining the additional 100 policies directly resulting from the telemarketing program. In this example, book profits are "before tax." An after-tax approach can be used if the telemarketing expense is adjusted to an after-tax basis.

The present value of book profit exceeds the telemarketing expense by $15,000. Therefore, telemarketing follow-up is expected to add $15,000 of value to the company, meaning telemarketing follow-up is probably a sound business decision for this situation. "Conventional" analysis might have led to a different conclusion. (The $120,000 telemarketing expense is generating only $50,000 of new business premium. The *TARP*/*MC* ratio is only 42%. The number of months until "break-even" is probably in the 30–40 range, well in excess of the old 12-month rule-of-thumb. The reason for the difference in conclusions is that the "value" approach recognizes that the product being marketed in this example is very profitable. Therefore, the program can afford more marketing costs for each dollar of TARP and still add value to the corporation.

Conclusion

The approach to decision making presented in this article has numerous applications in marketing situations. To the extent companies are using the traditional "rule-of-thumb" methods, an actuary should consider other profit perspectives, including the use of marginal costs as described above, as a tool to help make more effective business decisions.

David S. Lee, FSA, is a consulting actuary at Actuarial Resources Corporation in Omaha, Nebraska. Jay M. Jaffe, FSA, is President of Actuarial Enterprises Ltd., in Highland Park, Illinois.

"Emerging Markets for the New Senior Citizen" Seminar Rescheduled

The Product Development and Nontraditional Marketing Section will co-sponsor a seminar entitled "Emerging Markets for the New Senior Citizen" designed to help actuaries and other professionals learn more about the needs, desires, demographics, and influences baby boomers and their parents have in today's world. Attendees will find out how insurance companies and service providers might want to position themselves in the coming millennium to take advantage of changes in the health care system, tax reform, technological advances, and underwriting protocols. Topics to be addressed include:

- An overview of market demographics
- Implications of recent tax law changes
- Mortality trends and underwriting issues
- Potential changes being discussed relative to valuation and nonforfeiture regulations
- Distribution issues using state-of-the-art technologies
- Overview of current products and services
  - Life insurance
  - Reverse mortgages
  - CCRCs
  - Long-term care
- Insights into senior marketing

This seminar, originally scheduled for March 1–3 in Charleston, South Carolina, has been rescheduled to November 15–17 at the same Charleston location. The day-and-a-half meeting will begin on November 16, with a reception that night.

For further details, please contact Sheri Abel at 847–706–3536.

Nontraditional Marketing Sessions in Hawaii

June 15–17, 1998
Maui, Hawaii

Monday, June 15

5PD CREDIT DISABILITY TABLES

Moderator: Craig A. Squier
Panel: Robert J. Butler
Christopher H. Hause

Credit disability has had no generally accepted continuance table to be used for pricing and valuation. The industry has struggled with this shortcoming for most of its history, finding deficiencies in all previously proposed tables. Recent work has resulted in ways to adapt existing tables to match the needs of a credit insurer.

Attendees will gain an appreciation of the strengths and weaknesses of these tables for pricing and valuation and learn how to adapt them to the needs of a credit insurer. These techniques can be applied to pension plans.

17PD MILITARY MARKETING: NOT JUST TAKING ORDERS

Attendees explore the entry and exit barriers present in this market and learn more about the significant differences in marketing to enlisted personnel versus officers. Questions to be discussed include:

- Can a war exclusion apply in this market?
- What are the underwriting requirements?
- What products are successful?
- How should you approach market segmentation?

This panel addresses why affinity marketing provides advantages and explores the demographics presented by this market.

29CS SUCCESS IN BANCASSURANCE: A COIN TOSS?

Panel: Kent Griffin

Different models are used in what is known as the "bancassurance market." Which models are successful and why? As bancassurance is increasingly being considered by many insurers in North America and regulations are facilitating its use, attend this session and learn how bancassurance has been implemented by insurers in other countries in this case study format.

Tuesday, June 16

46OF PASSPORT TO A NEW COUNTRY

Why are nontraditional techniques required to enter a new country? Entering a country without any insurance delivery systems, or even with existing delivery systems, may require approaching markets in a more nontraditional manner than is customary for many insurers.

At the conclusion of the session, attendees will have learned how others have dealt with difficulties in establishing insurance operations in new territories and some of the pitfalls along the way.

64WS PASSPORT TO NEW COUNTRIES: PLEASE SIR, MAY I HAVE MORE?

This is a follow-up to a previous panel discussion (46OF). Participants will have the opportunity to question the panel and share their own experiences.

Wednesday, June 17

70PD POLICYHOLDERS: YOUR LUCKY CHARMS

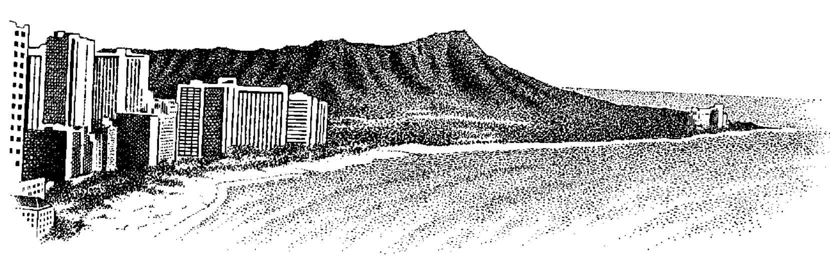
Moderator: Jay Jaffe
Panel: Nancy W. Church
J. Terrance Dunn

Perhaps your best prospect list exists on your own mainframe. But even if you can access this file, what can you do with it? This panel will share how to overcome the obstacles presented by this tantalizing source of guaranteed success. Then explore what might be in the future as nontraditional techniques are brought to bear to realize this "pot of gold."

105WS HOT TOPICS IN DIRECT RESPONSE

Chairperson: Steven Fedele

Participants will have the opportunity to discuss specific topics on items of critical interest including the impact of postal rates, television marketing, and more. Attendees may ask questions, raise issues, and gain a better understanding of current thinking among their peers.



Autumn in New York—The Nontraditional Way

by Carl Meier

Although its only spring, it's not too soon to begin thinking about the SOA Annual Meeting to be held at the New York Marriott Marquis on October 18–21.

If you've ever tried to score a pair of tickets for a hit Broadway musical, you know that timing is of the essence. In fact, the best seats for the current blockbuster, "The Lion King," are already sold out past the end of this year. That's why you should be making your plans now to attend the Annual Meeting, especially the great lineup of sessions that the Nontraditional Marketing Section is planning to offer. Seats are limited and you wouldn't want to miss out on any of these great presentations.

Take a look at the brief summary of the program our Section will be offering:

- **Monday, October 19**

  HOT TOPICS IN CREDIT INSURANCE

  This workshop will provide attendees with the opportunity for an open discussion of important and timely credit insurance topics. Subjects to be covered include: the regulatory environment, marketing approaches, product development, financial reporting, and the lending environment.

- **Tuesday, October 20**

  BANCASSURANCE: A GLOBAL PERSPECTIVE ON CUSTOMERS, PRODUCTS, AND DISTRIBUTION METHODS

  This panel discussion will look at the subject of bank distribution of insurance products from both the banker's and the insurer's perspectives, examining the experience with annuity sales in the U.S., as well as with a wider range of products in Europe and Latin America. Topics to be covered include:

  – Insurance products. What are the proven and emerging product lines?

  – Bank distribution subchannels. What methods of distribution, or subchannels, are banks using to sell insurance and why?

  – Matching customer needs, products, and subchannels. What is the optimal matching for maximum profits?

  – Marketing support. What competitive advantages does marketing support offer bankers and insurers?

  – Profit-sharing arrangements. What different types of profit-sharing arrangements between banks and insurers are in use and how have they evolved?

- **Tuesday, October 20**

  LIFE INSURANCE AND THE INTERNET: WHAT DOES THE FUTURE HOLD?

  This session will be conducted in a talk-show format, with an interviewer soliciting the views of four very able panelists representing a broad spectrum of backgrounds and opinions, and of the audience itself, on effects of the Internet on: agent/company relations, client education, prospecting, sales promotion, administrative operations and policyholder services, as well as the cost implications and legal ramifications.

  This session is being cosponsored with the Actuary of the Future Section.

- **Tuesday, October 20**

  VISIT TO DIRECT MARKETING ADVERTISING AGENCY

  This field trip will visit the offices of an advertising agency that specializes in direct marketing. The agency is located on Madison Avenue, only a 10-minute walk from the Marriott Marquis. Case studies will be used to illustrate both the strategic and creative aspects of developing and executing a successful direct-marketing campaign, with emphasis on the marketing of financial services. Attendees will also get to see examples of the latest innovations in direct-marketing techniques as used by firms from a number of other industries.

  There will be no charge for this session, but advance registration is required, and attendance will be limited to the first 35 registrants.

- **Tuesday, October 20**

  RECEPTION

  This reception, hosted by the Nontraditional Marketing Section, offers beer, wine, and munchies along with the opportunity for Section members to further network with each other. A short business meeting is also planned.

- **Wednesday, October 21**

  A CALL TO ARMS: BREAKING THE BARRIERS TO LIFE INSURANCE DISTRIBUTION REFORM

  This session will cover results of a not-yet released study by the Washington-based Insurance Advisory Board into what life insurers are doing (and not doing) in the area of delivery-system reform. As consumers become more and more acclimated to purchasing products and services through nontraditional distribution channels, major changes in the way life companies address their distribution function ought to be occurring, but are they? The presentation will review industry progress as well as some of the success stories that have emerged in the marketplace thus far.

  This is a subject that should be of interest to all Section members, and we are fortunate to have lined up an extremely dynamic speaker to guide us through the findings and present us with his organization's vision of the future for life insurance distribution strategy.

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Autumn in New York
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- **Wednesday, October 21**

CREDIT DISABILITY TABLES FOR PRICING AND VALUATION

This presentation is directed at addressing a problem with which the industry has long struggled—the lack of any generally accepted continuance tables for use in pricing or valuing credit-disability insurance. Panelists will discuss the strengths and weaknesses of disability tables currently being used for the pricing and/or valuation of other types of disability insurance, and then proceed to show how these tables might be adapted to meet the needs of a credit insurer.

The complete meeting program will not be distributed for a few months yet, but we hope that this brief look at the NTM Section offerings has convinced you that this is a meeting you'll want to attend. We look forward to seeing you there.

Carl Meier, FSA, is Second Vice President and Actuary at Pan American Life Insurance Company in New Orleans, Louisiana and a member of the Nontraditional Marketing Section Council.