Opportunities in a challenging and fragmented landscape

Findings from EY’s retail life insurance executive survey
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Executive summary

With premiums declining by 3% in 2013 (according to the Life Insurance Marketing and Research Association) and interest rates remaining low, the outlook for retail life insurers looks grim. Indeed, many industry stakeholders are wondering whether the industry can survive in its current form, or where it can go from here. But, as formidable as the challenges appear, there are significant and specific opportunities amid all the turbulence. To seize these opportunities, however, insurers must be prepared to embrace change at multiple dimensions of the enterprise, including their strategies and business models.

This report, part of EY’s commitment to continually monitor the retail life insurance landscape, outlines the challenges, opportunities and profound shifts in the market. Additionally, it contains insights and recommended actions for insurers seeking a return to profitability. The content was shaped by extensive interviews and dialogue with CEOs and senior executives from across the industry. The following findings and analysis are organized to include the perspectives of four key players in the life insurance market – customers, distributors, manufacturers and new market entrants.

About the survey

During the summer of 2014, EY interviewed CEOs and executives at leading US life insurance manufacturers, distributors and reinsurers as part of an ongoing effort to understand how the life insurance industry can surmount current challenges and move forward.

The objectives were to understand the views and concerns in the eyes of industry executives and stakeholders – and to outline the industry opportunities and challenges from the perspectives of customers, distributors, manufacturers and new market entrants.

The interviews focused on product design; product management; customer experience; technological and digital advances; the sales process; and the balance of bargaining power between manufacturers, customers and distributors.
Product simplification is critical
As a whole, the industry recognizes the need to simplify products and the buying process as a means to become more customer-centric. Manufacturers are focused on designing better products that are easy for consumers to understand and streamlining sales and service processes. To reduce complexity, companies need to avoid a features “arms race” and create a value proposition that benefits both customers and their own bottom lines. The key will be designing and delivering products that address consumer needs while at the same time are easier to sell and to buy.

Streamlining underwriting is a key priority
While many processes are candidates for streamlining, underwriting is one of the top priorities. In an era where the financial services industry has embraced technological advances to improve and enhance the buying experience, the life insurance underwriting process remains burdensome and invasive – a true pain point in the eyes of consumers. Companies must leverage data and analytics to design a more customer-friendly underwriting process. Such steps are imperative for insurers; those that fail to adapt and make changes will be left behind.

Key markets are currently underserved
The middle-income market represents a significant opportunity, but is currently underserved. Manufacturers and distributors understandably focus on higher-wealth segments, because of the need for scale. Despite this, sub segments of the high-net-worth market are underserved due to a shrinking pool of advisors with the skills to properly address the complex needs of these individuals and families. Younger consumers are another segment that could be addressed more effectively; their preferences to purchase insurance through a different advice model will require adjustments on the part of insurers. Despite recent reports that the life insurance market is shrinking, there are significant opportunities for life insurer’s to grow if they are willing and able to invest the time and resources to target these underserved markets.
The role of advisors is changing profoundly

Today’s consumers can access detailed and reliable information about life insurance products to educate themselves before making a purchase decision. In other words, the transactions are no longer asymmetrical, as they were in the past, when advisors and carriers possessed all the information. Digital channels – including social media – are increasingly popular sources of product information. Consumers are increasingly looking to advisors to validate the information they have found already, rather than seeking out or expecting advisors to do the research for them. Thus, advisors will need to provide holistic advice (i.e., explain how combinations of products work together to meet specific consumer goals). As sources of advisor income become more diverse, manufacturers and distributors will seek to restructure and recalibrate compensation.

Insurers are focused on in-force portfolios

The tightening of spreads and the current economic environment has heightened awareness amongst manufacturers so that robust in force management is the key to optimizing financial results. A number of manufacturers are augmenting product management departments with additional resources to focus on servicing and retaining in-force policies. Companies recognize the need to invest time and capital to better understand and more effectively manage their in-force business for increased profitability and customer satisfaction.

New entrants – especially data aggregators and private equity firms – are ready to disrupt the industry

Private equity firms have already disrupted the annuity market and with their unique business models and higher risk tolerances, they have the ability to enter the life insurance space as well. Furthermore, data aggregators may shape the market in several potential ways – by acting as a data supplier to manufacturers, for instance, or serving as a new distribution channel especially as customer expectations for online interactions have been raised. If the life insurance industry does not meet the demand for better digital tools and enhanced experiences, new competitors that have this capability may quickly step in.
Customers

Rising expectations and evolving needs dictate change

Customers have grown accustomed to the robust services and digital options offered by other financial services companies. Life insurers need to match those offerings if they are to meet rising customer expectations. More broadly, the standard service model – which shifts customer relationships from a focus on sales to a focus on administration once policies are in place – must be updated.

At a minimum, that means providing customers with enhanced self-service capabilities online. Manufacturers and intermediaries must also invest in other technologies, such as data aggregation and predictive modeling tools, if they are to better leverage customer data to strengthen relationships and increase sales and retention. Companies have mixed views on how they will fund investments and are building unique business cases for investing in these advanced technologies, based on their unique product portfolio, customer base and objectives.

Simple and streamlined: what customers want from products and processes

Manufacturers are as focused on streamlining new business processes as they are on product design. The easier and simpler they can make the sales process, the more likely consumers will be to initiate and complete purchases. Simplified products, which address consumer needs without overwhelming or confusing buyers with unnecessary features, can complement efficient processes. Indeed, across all distribution channels, simplified products and processes make it less likely that potential sales are abandoned within the sales pipeline.

The reasons for introducing simpler process and products are clear:

- Simplified processes and scale are needed to control costs and improve product profitability.
- Customers expect quick, reliable, and easy sales and service transactions from all their financial service providers – including life insurers.
- Simplicity makes it easy to educate agents and advisors on new products – an especially important consideration for advisors who offer a broad range of services to meet a variety of consumer needs. Plus, self-educating customers benefit from simplicity, as it’s easier to compare products.
- Even agents and advisors serving high-net-worth individuals would prefer simpler products, although they have the experience and knowledge to recommend and customize more complex products.

What survey respondents say:

“Technological advances embraced by other financial service industries have created a consumer base that is armed with more information and that expects a certain level of service.”

“The underwriting process annoys the end consumer.”
While manufacturers and distributors both express a desire to simplify products, companies are reluctant to move first. Instead, carriers continue to benchmark the competition and make relatively minor adjustments to current products. Despite the imperative for simplicity, some recent products (such as indexed universal life) are among the most complex ever launched. Generally speaking, current products have too many features and lack clear differentiation. The result is confusion for the end consumer, and potentially for distributors as well. Survey respondents agree that companies must stop trying to “out-feature” each other and focus on designing simpler products and supporting them with streamlined distribution and maintenance processes. That combination creates a clear value proposition for both customers and insurers.

Combination products are on the rise

Although customers and agents would like to see simpler products, there has also been an increase in demand for combination products – life insurance products with accelerated benefit riders such as critical illness and long-term care. The increasing prevalence of these products is potentially good news for insurers seeking avenues for growth. As life spans lengthen, health care costs – especially those associated with a critical illness or use of a skilled nursing facility – continue to rise. Combination life insurance products present a less capital-intensive option for insurers to provide these types of benefits. They certainly add value for the many customers looking for an alternative to traditional “use it or lose it” long-term care (LTC) insurance products.

However, these combination products are complex; advisors and consumers need awareness training and education to understand the fusion of life insurance contracts with accelerated benefit riders, particularly if they are to gain traction with the middle-income market.

Manufacturers see combo products as a growth opportunity with a risk profile preferable to that of stand-alone LTC products. The industry has mixed views on the potential for anti-selection when LTC insurance is bought in combination with life insurance. Because LTC insurance is expensive, many customers who buy it may know they will need it. With the right customer education and awareness, these products could drive and sustain further growth.
Key markets are underserved

Despite recent reports that the life insurance market is shrinking, there are significant opportunities for life insurers to grow if they are willing and able to invest the time and resources to target these underserved markets.

Middle income
The market of middle-income individuals is particularly underserved by the life insurance industry, largely because of the economics for advisors. To be profitable in this market, manufacturers and distributors need to achieve scale. It’s no wonder, then, that many choose to focus on higher-wealth segments. However, developing more cost-effective distribution strategies (most likely by increasing the use of digital channels) would help make the middle market more attractive. Such technological advances, along with simplified processes, may lead to future profitability in this market.

High net worth
Despite being a focus area for life insurers, the high-wealth market is underserved as well. The number of advisors with the credentials and sophistication to serve this market is low. Additionally, the distribution force is aging and the industry is struggling to develop new talent to replace retiring advisors. Many prospects have never been approached by an advisor – a situation that will only get worse, given the shortage of suitable advisors. The lack of qualified advisors is especially acute relative to the ultra-high-net-worth market (individuals or families with assets greater than $30 million).

Further, the growing number of wealthy women and minorities are underserved subsegments, as existing advisors traditionally have been targeting white males. Evolving tax regulations, such as estate taxation and gift rules, increase the need (and opportunity) for advisors to serve the high-wealth market.

Younger consumers
Across the wealth spectrum, individuals under 30 continue to represent an underserved market. A rejuvenated distribution force more in touch with younger generations would help alleviate the problem, but attracting new agents continues to be a struggle for the life insurance industry. Additionally, insurers recognize that younger generations will purchase insurance differently, and must develop new products and distribution methods to meet these preferences. If they fail to meet the needs of the emerging generation, insurers could miss out on the opportunity to engage this upcoming consumer base.
Distribution

The source of future competitive advantage
Rivalry among life insurance manufacturers is intense, and copycat products spring up regularly, almost in tandem with new product launches. Thus, differentiating advantages can be found through distribution strategies. That includes new emerging distribution channels and enhanced relationships with current distributors. Manufacturers are giving greater attention to advisor effectiveness.

Advisors maintain their strong influence, but customers are gaining ground
The buyer-seller relationship in the life insurance market has long favored advisors. They have stood as the intermediary between the customer and the manufacturer, with exclusive information that each of the others does not have. However, access to product information is increasingly available, especially online, resulting in more knowledgeable consumers.

As comparison shopping increases, the industry expects more consumers to use advisors to confirm the outcomes of their own due diligence and support in finalizing decisions and assist with completing purchases. This will result in a new purchasing model, and the distribution model will need to be reshaped to ensure it is still bringing value to the end customer. In other words, the model will need to become more customer-centric.

There is still a need for advisors who specialize in the high- and ultra-high-net-worth markets. Consumers in these markets have more complex needs and greater expectations for personal service and tailored solutions that meet their overall financial planning needs. The low supply of qualified advisors relative to the number of product manufacturers in these markets gives high-net-worth advisors greater bargaining power in the relationship.

What survey respondents say:
“‘The life insurance industry has been hardwired to be distribution-driven.’

‘Compensation needs to be more in line with buyer and carrier needs.’
The advice model will change

Traditionally, life insurance was sold as a product to satisfy a specific need. It was a single, one-off transaction. Agents would gather enough information to identify whether a need for life insurance existed, to design the case and help the prospect through the underwriting process. Once the sale was completed and the policy delivered, the ongoing service often consisted of little more than billing.

This approach to life insurance sales has not fostered customer trust or addressed the full range of market needs. Further, certain market segments and geographies have been inadequately or inappropriately served, because the potential commissions have been viewed as too small when balanced against the sales effort. Advisors operated as single practitioners with little recurring revenue, which has led to succession planning issues.

In recent years, consumer expectations have changed, and today’s consumers desire the best information available to make educated purchase decisions. Digital channels provide much of this information, though some consumers still look to holistic advisors to help address their questions. The advice model must evolve to address these shifts. For instance, advisors may help confirm research and act more as facilitators of purchases.

At the same time, there is a need for a holistic, goals-based planning approach. Manufacturers and distributors alike have an opportunity to set themselves apart by engaging customers through the process of retirement and financial planning. Advisors will be called on to help build such relationships. To deliver this level of information, advice and service in a scalable way, significant investments in process and technology will be required.

In this emerging model, advisors could be compensated from many potential sources — including insurance commissions, asset-based fees or salaries. This may help encourage stronger connections with currently underserved markets. In addition, a more structured business model will make it easier to train and develop new advisors, which will in turn help with succession planning.

Compensation recalibration and restructuring

The evolving advice model, more self-directed customers and direct purchase channels will necessitate adjustments to agent compensation. Recalibration may require adjustment to the compensation structure for agents and advisors, including expanding beyond commission-based models. Rather, the sources of income may be expanded beyond commissions to include remuneration for service and advice. Also, advisors should become more productive as customers take on more of the time-consuming tasks of researching product options and analyzing their own needs.

Considerations for a restructuring of agent compensation include a move away from the current front-loaded compensation structure to a more “levelized” structure with meaningful trail commissions to promote continued servicing of an account. Manufacturers are struggling to find a way that works for everyone. The high up-front costs that go into the sale of a new life insurance product need to be considered; however, the current heaped compensation structure has promoted more selling behavior, especially in the term space, that is not healthy for carriers.

Alternative distribution channels can help reach underserved markets

The workplace and the internet are emerging as alternative distribution channels for middle-income and millennial consumers to acquire life insurance.

Workplace distribution

The workplace is another emerging distribution channel that offers life insurers access to a larger share of the middle-income market. Many employers are expanding their voluntary benefit offerings, either as they shift the cost of benefits to employees or as they seek to attract better workers.

Members of the millennial generation are placing a larger amount of trust in their employers over their banks. Thus, workspaces are ideal environments for these individuals to learn more about and purchase life insurance products. Their employers’ implied endorsement of the manufacturer or distributor can be a difference maker in the decision to purchase.

For manufacturers, the risks tend to be lower among a group of young, healthy, employed individuals, and the potential for reward high as these employees explore additional services. The insurance company is positioned to develop relationships with individual customers beyond the relationship with the employer. As there are fewer competitors and room for innovative products with high margins, workplace distribution is an attractive distribution option for insurance companies to explore.

Internet distribution

The internet’s power to transform has not yet been fully felt in the life insurance industry; however, many in the industry do expect that, in the future, more customers will be able to initiate and finalize purchases of high-quality products online.

Simpler products and processes, enhanced underwriting capabilities and changes in the advice model will foster the shift toward digital distribution of life products. Companies that invest in technology to distribute life insurance online will be better positioned to meet the needs of younger generations of customers, and reap the benefits of the speed and simplicity of online purchasing. In addition, this channel will be ideal for capturing share among middle-income individuals.
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Companies need to rationalize product offerings

The market currently offers more products than customers and distributors can digest. This proliferation of products has resulted from the “copycat” tendency, as insurers respond to new products from competitors with similar products. A large set of disjointed products makes it harder to focus resources on high-value activities and to build economies of scale.

Instead, manufacturers need to specialize and segment their products, presenting to customers and distributors a unified set of products that is easily understood and evaluated. The first step for manufacturers is to carefully analyze existing and proposed products within the portfolio. Given the costs involved in putting new products on administration systems, companies should work to develop a uniform product development process that considers the entire portfolio of the company.

Manufacturers are looking for ways to manage retention on in-force blocks and optimize portfolios

Manufacturers are considering a number of ways to increase retention on in-force blocks of business. In fact, many insurers have formed teams or departments solely focused on servicing and retaining in-force policies. Retention techniques include adding options to in-force policies that are currently available on new products. Others are attempting to incent policyholders to switch products early by using data analytics to create preapproved upsell offers. It has become clear that simply administering in-force blocks is no longer an option for manufacturers. Instead, they need to invest the time and capital to understand opportunities within the in-force book and find new ways to grow these existing relationships.

Underwriting processes need to change dramatically and immediately

Among survey respondents, underwriting was the clear top-choice process that must be improved. Insurers are working on streamlining and shortening the underwriting process. Information technology and better use of new and existing data have the potential today to create a more efficient and simpler underwriting process, with the end result of improved service and shorter times from application to final sale.

Yet advisors note that as information technology has improved, life insurance underwriting has become more invasive. Survey respondents believe that, within five years, an advisor serving a high-net-worth client should be able to implement a life insurance policy within an hour. These individuals have a low-risk profile in a highly competitive environment for expensive policies. Why delay the process when solid offers and qualified customers are in place?
New data sources — including electronic health records, prescription records and credit histories — can speed the underwriting process for these and other individuals. Access to a patient’s electronic health record will be mandatory under the Affordable Care Act; thus, insurers must be prepared with systems and processes for using the data within these records. Every year, the number of policies that are underwritten with prescription data is increasing. Credit data may provide additional insights for underwriting functions that can apply analytics to correlate data sets to make predictions about overall health and risk profiles.

New devices have the potential to provide applicants and insurers with more information

Information asymmetry is building as individuals become more aware of their health status. Home cancer testing kits, genetic testing and other technological devices give potential customers an information advantage over underwriters and insurance companies. Insurers must be prepared to manage this anti-selection risk.

On the other hand, wearable fitness devices and pedometers provide carriers the potential to incentivize customer behavior. For instance, consumers who exhibit healthier behavior and are willing to share data from wearable devices may enjoy reduced premiums. In 5 to 10 years, these devices may also change underwriting to an ongoing process that is actively managed throughout the life of the contract, rather than a one-time activity completed at the outset of a contract.
New entrants

Data aggregators and private equity firms may disrupt the market

Data aggregators and other companies that can provide real value to life insurance underwriting may decide to enter — and profoundly disrupt — the market. The potential new players include internet search engines, credit card companies and medical labs. Their competitive advantage would come from the ability to mine data to identify customers with low overall risk scores and/or a high probability of purchasing life insurance products. They may choose to serve as suppliers to the industry, as a new distribution channel or even as a new carrier, depending on their willingness to assume mortality and morbidity risk.

Many of these data aggregators offer experiences that meet elevated customer expectations for online interactions. If the life insurance industry fails to deliver a better digital experience, these companies may quickly step in. Reinsurers, too, may find that data aggregators are able to provide the same business value they do, but with a better business model.

Having overturned the annuity market, private equity firms may turn their attention to the life market as well. Their unique business models and higher risk tolerances may enable private equity firms to gain market share in the life insurance industry. It remains to be seen whether traditional providers will adjust their risk appetites and business strategies to keep up, another potentially disruptive development.
Bottom line

Finding opportunity among the challenges

As difficult an environment as life insurers appear to face, there is also significant opportunity, according to the executives who participated in the survey. To seize the opportunity, carriers will need to take strategic risks in designing new and simpler products and adopting new distribution approaches to reach market segments they are not effectively serving today. In some cases, fundamental business models will need to change. As with other sectors, in a time of widespread change, the advantage will go to those firms that act as first movers and take bold strategic steps forward.

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