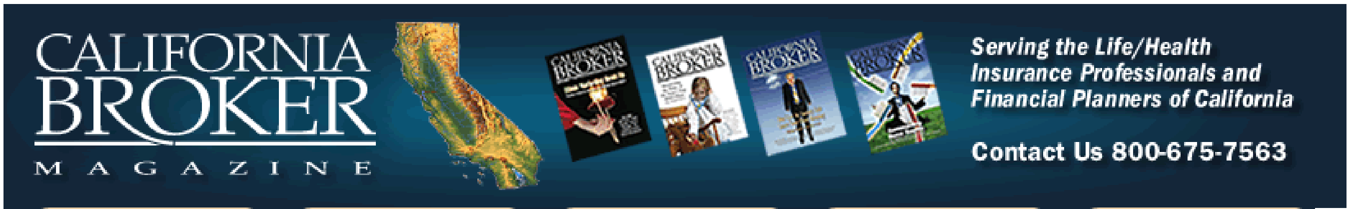

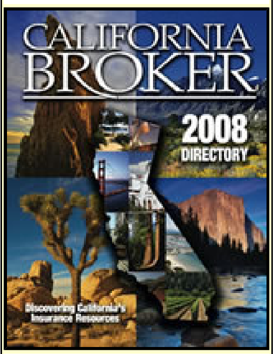

Life Industry Overview

Will Innovation Continue to Elude the Life Insurance Industry?

by Robert W. MacDonald

The future of the insurance industry has more sides than a mutated polygon. On one hand, the changing social and economic structure of the United States has created the most significant opportunity for the insurance industry since the Industrial Revolution. On the other hand, the industry will be relegated to the backwaters of financial services if industry leaders fail to respond to these changes. Unfortunately, trends suggest the insurance industry is more likely to become irrelevant rather than becoming a leader in financial services.

Less than 50 years ago, life insurance companies were the dominant institutions in the financial community and they exerted significant influence on the U.S. economy. The consumer viewed life insurance as almost a necessary purchase.

Today, great companies that were dominant financial institutions in America have become irrelevant, extinct, or owned by a foreign enterprise. The life insurance industry has botched the value of the franchise, the respect, and the influence it once enjoyed.

At least the life insurance industry has been consistent. It has made a royal mess of every opportunity and challenge. There are three areas in particular where the life insurance industry has forfeited its leadership in financial services: product, distribution, and technology.

The life insurance industry seems to view any change as a threat. In the early 1980s, the cracks of old age showed up in the industry standard bearer -- whole life insurance. Despite a decline in sales, the industry fought tooth and nail to resist new products. Whole life was a great product (and highly profitable) when the consumer was concerned primarily with the cost of death. But today, the consumer’s chief concern has become the cost of outliving one’s assets. The life insurance industry spent more time and effort trying to defend and sell a dying death product than it did in recognizing a new opportunity. When universal life (itself a rather primitive evolution of whole life) was introduced, the industry’s initial reaction was to disparage the product and try to have it outlawed. This action damaged the insurance industry’s credibility and allowed competitors surpass the industry in the eyes of the consumer.

Other bank and investment products became more attractive to the consumer, further decreasing the sales of insurance products. The insurance industry tried to mimic these products rather than adopting viable alternatives. Competition is created by being better and different, not by being the same. As the insurance industry has learned from painful regulatory and legal actions, trying to position and market insurance products (especially annuities) as “investment” products may have some short-term benefits, but can be very destructive over the long term.

The life insurance industry has one more chance regain competitiveness or even supremacy in product offerings. If the industry misses this opportunity, its products will become an afterthought. Everyone gives lip service to meeting the consumer’s need for products that will provide retirement living benefits for as long as they live. Ironically, with its unique ability to offer guarantees, the life insurance industry is best positioned to take the lead in this multi-trillion dollar market. The insurance industry has the wherewithal to develop innovative income-producing products that are not available to banks or investment firms. Yet, the insurance industry has shown little inclination to use these advantages to develop such products. Instead, we have seen a continuation of the philosophy of mimicking and tinkering with products rather than revolutionizing products.

Distribution is another sad story. After investing millions of dollars and most of the 20th century building one of the most effective distribution systems in any industry, it took less than a decade for the industry to destroy it. As the sale of high margin insurance products, such as whole life, began to decline, the industry's preferred response was to reduce expenses. With its high fixed costs, the captive agent distribution system became an easy target.

In very short order, agents who had been tied exclusively to one company were sent packing to become "independent." Companies foolishly forfeited contact with and control over the agent for a sugar-fix of reduced fixed costs. Ironically, as the relationship with the agent became weaker, costs of producing business actually increased. And this is not just a cost in dollars. There was an unseen cost in the form of fewer qualified people entering the insurance industry and in the training and supervision these new agents received. With the remnants of the career agent system reaching retirement age, very few qualified and well-trained agents are ready to take their place. As a result, life insurance companies can no longer count on a cohesive distribution system to sell their products. To fill this vacuum, the access and control of distribution is shifting to investment firms and even banks. (See FINRA rule 05-50 and proposed SEC rule 151a.) What the insurance industry failed to comprehend is that if you do not control your distribution then you do not control your future.

The insurance industry will accelerate its decline if it responds to this distribution challenge by entering into marketing arrangements with those who now control access to distribution -- as many insurance companies have done. There is no power in being dependent on others to distribute your product.

Clearly, it is not practical for insurance companies to return to the traditional captive agent system, but constructive actions could turn the situation around. One thing the companies could do (but, don't hold your breath!) is to develop products and services that are needed and demanded by the consumer and the distribution systems. Rather than going hat-in-hand to those who control access to distribution and begging them to make the products available, insurance companies need to develop innovative, value oriented products that will cause those in control of distribution to come to the companies and ask to be able to sell the products.
The final challenge is in technology. If there is one industry that could benefit from e-commerce, it is the life insurance industry, which is seemingly stuck in a time-warp mentality of paper pushing. No industry lags further behind in applying e-commerce than does the insurance industry.

Twenty years ago, investment firms almost imploded under the strain and cost of back-office paper processing. So they embraced e-commerce. Today the investment community uses e-commerce to process in transactions faster, more efficiently, and less expensively than ever before. The banking industry is not far behind. Most bank processing is performed efficiently by use of direct deposit, ATMs, and the Internet.

In contrast, life insurance companies still cling to the outmoded model of paper pushing with resulting inefficiency and increased costs. The industry response has been to cut costs via budget reductions, layoffs, and outsourcing, but this is a futile effort that destroys value. The answer is to embrace e-commerce to improve service, enhance efficiency, and reduce costs while significantly improving the insurance industry's image.

Technology is available that would enable insurance companies to contact, license, contract, and train agents. The system could communicate, inform and assist consumers. E-commerce could facilitate product proposals, applications, underwriting and policy issue – all efficiently on line via the Internet. This could result in better service for consumers and the distribution system at lower costs. We have the technology. The only thing lacking is the willingness and commitment of the life insurance companies.

The life insurance industry clearly has an opportunity to assume its rightful place at the table of financial services. In fact, the life insurance industry has the opportunity to regain its former leadership position in financial services. But to do so, the industry must respond to challenges in product, distribution, and technology. How it does so will determine the future of the industry. However, for an industry that views change as a disease, the prognosis is bleak.

Robert W. MacDonald entered the field in 1965 as a life insurance agent for New England Mutual Life in Los Angeles and retired in 2002 as CEO of Allianz Life of North America and as its chairman in late 2003. In the summer of 2006, he was lured out of retirement to kick-start and serve as the chief executive of Allianz Income Management Services (AIMS), a new company formed by Allianz to respond to retirement income needs of retiring Baby Boomers. He resigned from the position in 2007.
In between, MacDonald, 64, built a successful sales agency for Jefferson-Pilot, served as director of marketing support for State Mutual of America, and was chief marketing officer, chief operating officer, then president and CEO of Minneapolis-based ITT Life. In addition to AIMS, he serves on the board of Minneapolis-headquartered Buffalo Wild Wings and The Windsor Financial Group, LLC, an independent registered investment advisor. He has been a popular speaker before over 100 organizations. MacDonald holds a BSL degree from Western College of Law in Anaheim, Calif. and the chartered life underwriter (CLU) designation from The American College in Bryn Mawr, Penn. For more information, visit www.bobmaconbusiness.com.