FUTURE MANAGEMENT: THE NEW INSURANCE BUSINESS

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Current public surveys reveal a consistent message: the insurance industry is suffering from an increasingly poor public image, with a low level of public trust.

There are cries for increasing government involvement to "protect the public" and regulate insurance products and price. There are even calls for certain segments of the current industry to be replaced with other players. This is a strong indication that the industry is failing to meet changing consumer expectations.

Consumer needs should define the business, and there is increasing evidence these needs are changing. The insurance industry has the opportunity to redefine itself to meet changing consumer needs and increase opportunities for financial success into the next century. Failure to accept this challenge to change will continue to erode the value of our products to consumers. The result: loss of the business.

The Call To Change

We live in a world of great uncertainty. An exploding global economy, a new world order in international relationships, and the economic upheaval of major corporations "downsizing" are sending shockwaves through our economy.

These changes have a tremendous impact on consumers' sense of security. Company/industry restructuring and over-crowded career paths have led to more frequent job and career changes. Technological developments require on-going education and retraining. Failure of financial institutions and predictions of insolvency for Medicare and Social Security add to doubts about future security and stability for families.

The definition of family itself is much more diverse than it used to be. Today, two-income families, single parent families, and other "non-traditional" family groups outnumber yesterday's family, so memorably represented by Ward and June Cleaver and sons.

Because the insurance industry developed as a response to the need for financial security in the face of future uncertainty, the insurance industry is greatly impacted by environmental changes that increase consumer insecurity.

Nationwide Insurance Companies, Columbus, Ohio.

This isn't the first time that the insurance industry has had an opportunity to respond to changes in public expectation. Originally, insurance was designed to protect businesses and individuals from catastrophic financial losses due to acts of nature or accidents. Life insurance protected assets of families and businesses from untimely death. Hospital insurance protected assets while assuring access to medical services in the event of accident or serious illness. Auto insurance protected car owners from personal financial disaster due to liability for accidents.

Over time, insurance products increased to include financial management or cash flow protection in addition to protection against catastrophe. New products provided protection from less than catastrophic losses and for intended use of financial resources. Annuity products were offered to provide retirement income. Medical insurance now covers office visits and routine preventive care. In auto insurance, a variety of coverages provide cash-flow protection at a less than catastrophic level: comprehensive, rental car, medical payments.

Today, the insurance industry is being asked to respond with yet another evolution of the product. Calls for this change are seen most easily regarding health insurance, but the evolution of personal lines products in response to changing consumer demand can be seen in auto and life insurance, as well.

<u>Health Insurance:</u> During the last several years, the rising cost of health care and the increased importance of insurance for access to needed services has led to marketplace demands for protection against rising health insurance costs. The industry has responded in a variety of ways to reduce premium costs including:

- increased consumer cost-sharing - co-payments and deductibles, "bare bones" benefit options
- increased underwriting and the use of pre-existing condition exclusions
- increased scrutiny of utilization - preauthorization, second opinions, concurrent review.

While these approaches were intended to slow the rate of premium increase, they also increased the consumers' wariness regarding continued access to medical services in the event of illness or injury. Most industry solutions to health care system cost problems continue to embrace "premium-controlling" strategies rather than "medical cost-controlling" strategies. Even within managed care systems, much of the early focus has been on cutting costs through price discounts rather than through effective management of medical care.

Public concern over rising costs and limited access to medical care has become fully politicized. Surprisingly, strong public and political support for the elimination of the existing U.S. health insurance system in favor of a Canadian-type publicly financed and managed system of guaranteed access to services sends a clear message to the insurance industry. The consumer's test of product value in this marketplace now goes beyond efficient claims payment.

The public is asking for – and may be ready to demand – assured access to services. This is the consumer's definition of value. Meeting this consumer need will require an ability to control the cost of care itself.

Auto Insurance: The auto insurance market shows interesting parallels to the health insurance market. The cost of auto insurance has risen rapidly in many areas of the country, driven by increased costs of auto repair/replacement parts, theft and fraud, and the rising cost of medical care in both first-party and third-party coverages. The industry has attempted to control the price of the product through administrative efficiencies and through increased emphasis on underwriting, location of agents to avoid high crime areas, and pricing designed to reward and attract lower cost insureds.

The industry has also sought to influence the systems driving cost: national crime prevention initiatives, campaigns against drinking and driving, calls for improved safety features in cars. The support of no-fault auto laws is another attempt to influence costs by addressing – and avoiding – fundamental problems in the tort system.

In several states, continuing upward pressure on costs, coupled with the sense of entitlement and legal necessity that surrounds auto insurance, has resulted in legislation to control insurance prices and underwriting. The best known public reaction to costs is probably California's Proposition 103. This law sharply restricted the ability of insurers to raise premium in response to the rising costs of services covered by auto insurance.

By limiting the ability to be a "pass through" mechanism regarding system costs, Proposition 103 changed the role of auto insurers. More recently, California has begun to debate a proposal to replace the private auto insurance system with a "pay-at-the-pump" system of universal coverage.

As with the health system reform debate, these and related activities in other states are sending clear messages regarding how the public will judge the value of the auto insurance product in the future. Consumers are demanding a mechanism that will provide increased security regarding continued affordability of auto insurance – and therefore, of the car itself.

Life Insurance: It might be argued that the life insurance industry has responded most recently to the public's demand for fundamental product evolution. When years of high inflation in the cost of living caused the perceived value of whole life and annuities to decline during the 1970s, the life insurance industry had to respond to changes in consumer demand. The industry developed new products that combined the benefits of term insurance with investment options, offering products aimed at countering the impact of inflation on future assets and retirement income. Some companies now emphasize a wide range of investment and financial planning products and services, going far beyond traditional life insurance products.

Life and financial security products are still evolving. Ever-increasing longevity, uncertainty over the adequacy of Social Security, escalating costs of medical care for the elderly, and growing uncertainty over whether public (Medicare and Medicaid) and traditional private health coverages will be able to meet an aging population's long-term care needs are increasing financial uncertainty for future retiree populations. This will increase consumer demand for new alternatives from the insurance industry. Innovative companies are seeking new ways to offer increased security to consumers through insurance and financial products. Increased flexibility to address a wide range of financial needs, from retirement income to nursing home and community-based long-term care, is becoming an important feature in assuring future financial security for consumers.

It can be expected that consumers will, ultimately, seek insurance products that serve to assure access to needed services and desired financial security. As this happens, it should come as no surprise that the public will be less tolerant of ever-more-sophisticated risk selection practices made possible by advances in medical underwriting. The value of these new life and investment products undoubtedly will be judged on the ability of insurers to offer affordable products that assure access to needed services.

Future Management

If we view the marketplace changes described above from a traditional understanding of the insurance industry, we might conclude that consumers are irrational, regulators are unreasonable and neither group understands the insurance product. If, however, we attempt to understand consumers' needs and how their perception of value is changing, clear patterns emerge in the marketplace. These patterns should influence how we define and develop our business into the future.

In each industry segment outlined above, today's consumer feels increasingly insecure regarding assured access to a needed service or outcome (health care, an affordable car, adequate retirement income). The consumer naturally turns to the insurance industry to seek a response to this increased threat to financial security.

Responding to this consumer need requires that insurance companies go beyond offering catastrophe management and financial management. The new consumer demand is for a product that we call future management. Future management requires that the industry influence (or neutralize the impact of) the events or systems that are impacting consumer access to desired services or financial security.

In both catastrophe and financial management (see *Figure*, page 324), the relationship between consumer and insurance company is sufficient to meet the consumer's security needs. In catastrophe management, the consumer elects to have a relationship with the insurance company that modifies the effects of natural disaster or serious accidents on financial assets. The relationship between consumer and insurer does not in any way impact the likelihood or intensity of disaster; it instead protects the consumer against the full impact of the consequences of that disaster.

In financial management, the consumer elects to have a relationship with the insurance company that provides predictable cash-flow or income protection for a planned or predictable event. Like catastrophe management, financial management only requires the industry to fulfil an agreed upon set of activities in response to an identified event.

For future management products to have value, they must assure that services remain affordable and accessible to the consumer.

Accomplishing this requires new relationships, new competencies, and a new understanding of the business. For health insurers, impacting the cost of the health system itself is requiring new relationships with consumers and with providers and suppliers of services. For auto insurers, the new business may require new relationships with auto parts manufacturers and repair facilities, with medical providers and with the tort system. In life insurance, providing future management may involve establishing relationships with the long-term care system.

Changes in Market Opportunities

Not everyone in the industry will fully embrace the new business of future management. They will argue that the insurance industry should not play such a role, that the business of insurance should not be about impacting systems. "We sell insurance, not social change. Insurance is about underwriting and pricing risks and processing claims." This view, however, is analogous to that of the railroad industry, which dominated commerce before the turn of the century. They decided they were in the railroad business - and missed the opportunity to develop the transportation industry.

The consequences of the insurance industry ignoring the consumer's demands are the same as they were for the railroad industry a century ago: a shrinking market for traditional products (catastrophe management and financial management) and new entrants responding to the consumer's call for future management.

Note that the marketplace changes described above for health and auto insurance both include strong public response to perceived failure to meet consumer demands for assured affordability and access to needed services. Consumers have first appealed to regulators in an attempt to force a more acceptable insurance product, and then have begun to consider alternative arrangements (government programs) to provide financial security.

Today's consumers are well educated and aware of their power in the marketplace. Consumers demand quality and responsiveness from sellers of products and services. There is less tolerance for businesses that do not meet their needs. In the marketplace, if the consumer wants it, someone will produce, deliver, sell and service it.

Who are the potential providers of future management?

- Established competitors (insurance companies), which decide to embrace the new business. This can be seen in the health insurance system as some insurers (e.g., those which participated in the Jackson Hole proposal development) have made early commitments to managed care and to making the investments and changes needed to compete as Accountable Health Plans or managers of Health Insurance Purchasing Cooperatives/Alliances.

- Recent market entrants (banks, associations and other organizations), which have less invested in traditional products and may see an opportunity to make market share gains against established competitors.

- New market entrants, including system participants, which may be well-positioned to impact cost and other problems (medical providers, employers, auto manufacturers, repair facilities, etc.).

- Government, which may be called on by consumers to create publicly-managed solutions if the private sector fails to deliver perceived value through future management.

Companies which reject the concept of future management are likely to increase their advertising, government relations, and legal department budgets in an attempt to protect existing markets. At best, these are delay tactics. Efforts to sell a product that no longer meets the consumer's needs, pursuing or extending insurance purchase mandates, and even seeking to exclude potential competitors through regulation cannot sustain business success. The consumer will prevail.

Redefining the Business

Defining a new business direction begins with exploring answers to the following questions:

- Who is the consumer?

- What systems impact the consumer regarding asset protection, cash flow protection, asset/cash flow sufficiency, access to services?

- What is the company's current capacity to influence these systems? What are the skills and relationships needed? (It's important to note that, in each of the product lines considered in this article, the ability to interact with the health system becomes a needed skill of future management.)

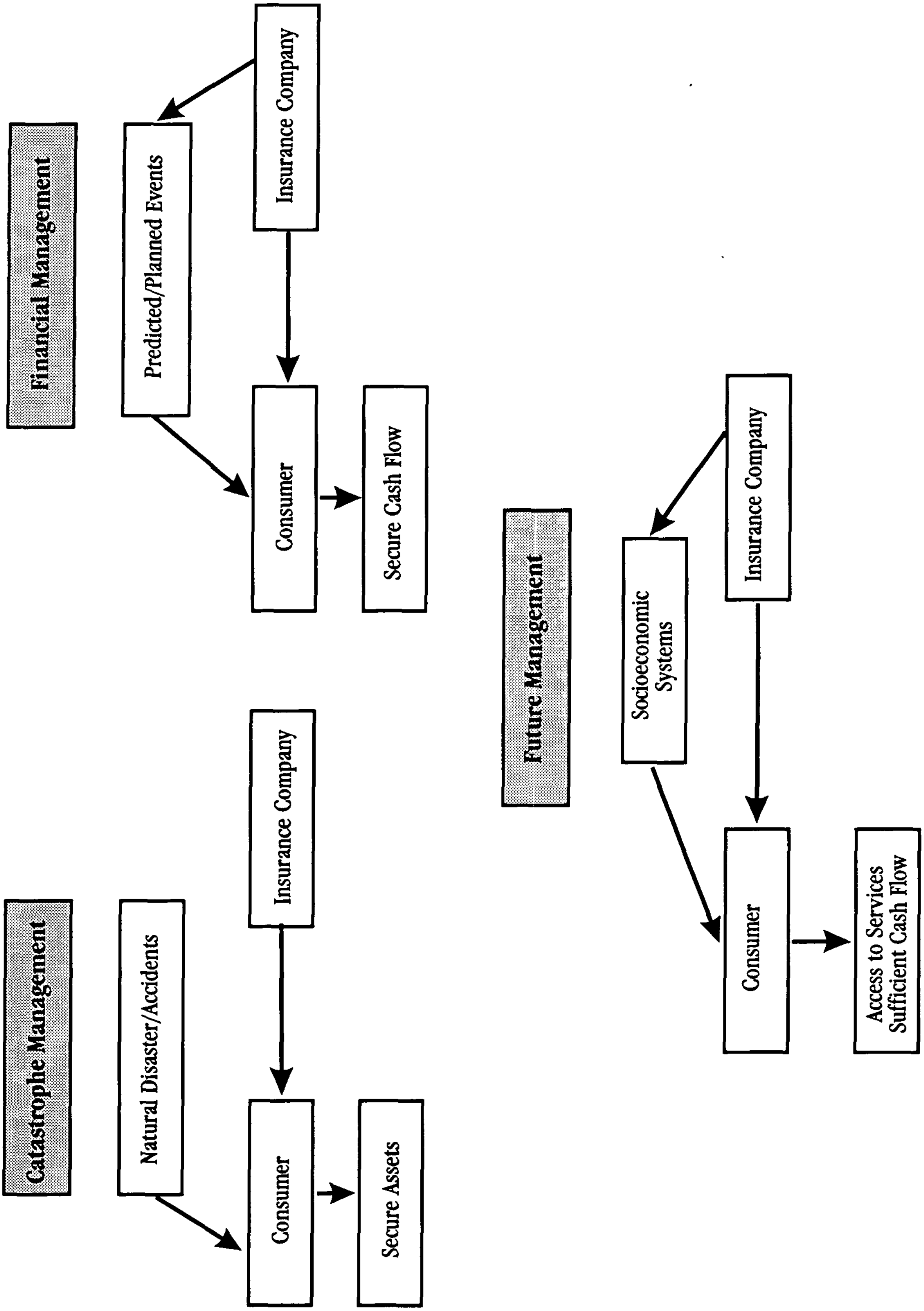
- Where are the company's future management market opportunities given its strengths (ability to impact systems, significant competencies) and consumer demands?

Once the gaps in a company's ability to influence targeted systems are identified, options for filling those gaps can be considered. While some necessary skills may be "grown" internally, many may be best acquired through strategic partnerships with other system participants. Examination of current and potential competitors may reveal opportunities for alliances which can complement a company's capacities to influence these systems. Future management will require new relationships and a new way of perceiving opportunity.

Conclusion

Vision has been described as "an organizing principle that allows one to see what has never been." Redefining the business of insurance as future management allows us to perceive and capitalize on opportunities for innovation and growth. This new perception of marketplace opportunities allows strategic action and encourages proactive choice; it discourages simple defensive reactions to regulatory and market changes. By offering future management to meet consumers' needs, the insurance industry will be managing its own future, as well.

Figure


Financial Management
Predicted/Planned Events
Insurance Company
Consumer
Secure Cash Flow
Catastrophe Management
Natural Disaster/Accidents
Insurance Company
Consumer
Secure Assets
Future Management
Socioeconomic Systems
Insurance Company
Consumer
Access to Services
Sufficient Cash Flow