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The Key to Growth in U.S. Life Insurance: Focus on the Customer

Financial Services Practice

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Introduction

Although life insurance is a mature industry, its mission is as relevant as ever: protecting individuals, families and businesses from life and retirement risks. In the years since the financial crisis, U.S. life insurers have improved their risk management skills, de-risked their balance sheets and focused more sharply on cost and efficiency. Growth remains anemic, however, even though millions of Americans need annuities and life insurance coverage.

Slow growth in the U.S. life insurance industry is not new, but it is now being exacerbated by the failure of carriers to keep up with changes in consumer behavior and preferences. The long-term shift from death benefits to "living" benefits and the ubiquity of digital commerce together are making the growth challenge more difficult than ever. To return to growth, life insurers must build value propositions that connect with consumers' concerns about lifestyle and income preservation in retirement and develop more sophisticated ways to engage with consumers on their terms.

Impediments to Growth

The U.S. life insurance industry's average annual growth over the past 10 years has been less than 2 percent in nominal terms and negative in real terms. Annuities performed a bit better, with annualized growth of just under 4 percent, but they lagged far behind the 7 percent growth in contributions to retail asset management funds (Exhibit 1).

This downward trend is nothing new. In the last 30 years, the number of life policies sold annually has fallen by almost half, from 17 million to fewer than 10 million. Meanwhile, the average face value has steadily increased from $110,000 to over $170,000, indicating that life insurers are failing to reach the middle market. According to McKinsey mass affluent research in 2015, only 65 percent of Americans who are married with dependents have a life or an annuity policy, while 97 percent own an investment account.

Four phenomena are hindering growth: poor market positioning; "pain points" along the value chain that degrade the customer experience; low consumer engagement; and a failure to adopt new technologies to meet evolving consumer preferences.

Poor market positioning

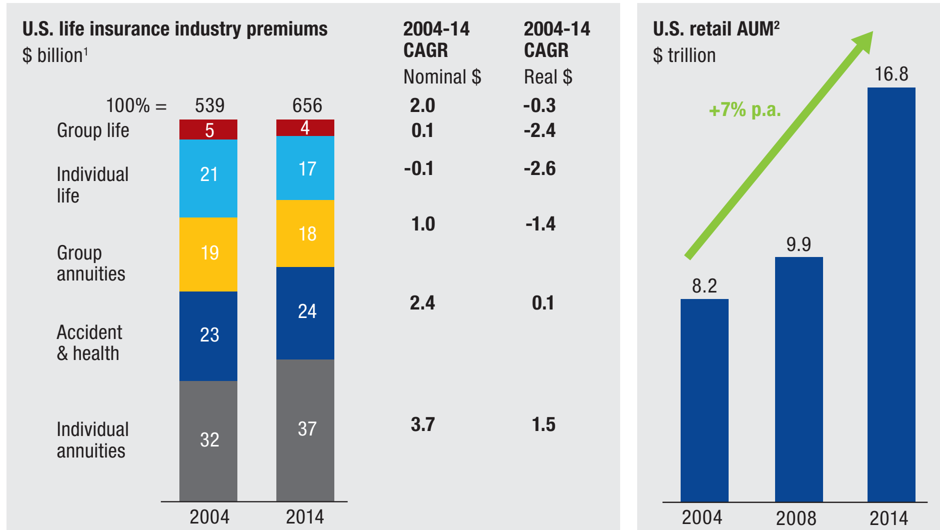
The relatively low penetration of the industry's risk protection products can be explained in part by shifting consumer preferences. Americans today are less interested in leaving nest eggs for their children and more concerned about their standard of living during retirement and the risk of outliving their assets. In other words, people are worrying less about dying too early and more about living too long (Exhibit 2).

Premature mortality remains a serious risk, however. For example, notwithstanding major improvements in medical science, one in five American men who are 20 today will die before reaching age 65.

The life insurance industry dominated the savings and retirement market for decades until 1982, when 401(k) plans were introduced. Since then, defined contribution plans have slowly but steadily eroded the life industry's position in the retirement market. The asset management industry's share of retirement assets under management has grown from 36 percent in 1990 to 70 percent today. Despite some structural advantages of life products, such as tax-deferred growth and smoothing of policyholder returns over time, the asset management industry has prospered at the life industry's expense by offering a wider range of individual and employer-sponsored products with multiple investment options, a higher level of

Exhibit 1

The U.S. life insurance industry has shrunk in real terms over the last decade



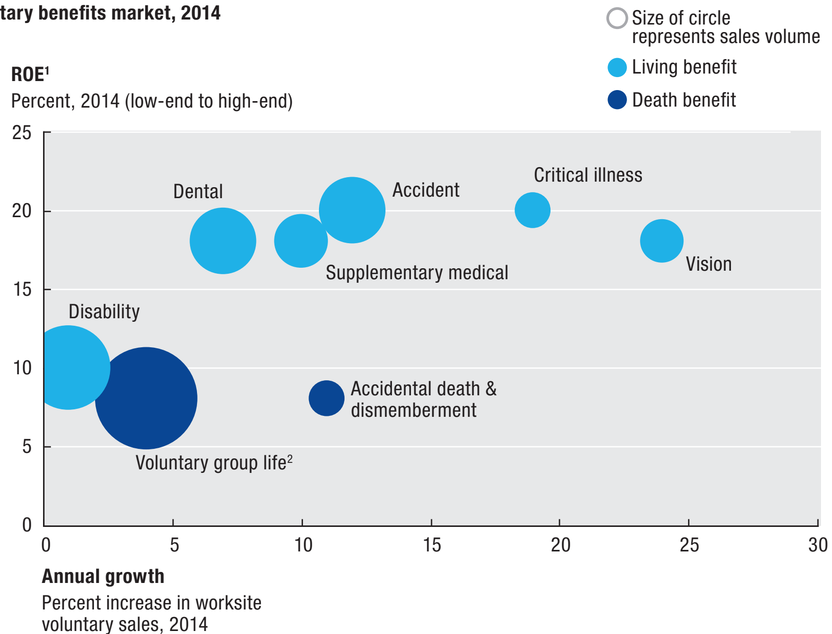
[1] Does not include premiums from credit life or other fraternal business.

[2] U.S. retail asset management includes all discretionary, professionally managed assets under management owned by households, outside of defined benefit pensions, including mutual funds (open-end investment companies), variable annuities, fixed annuities, separately managed accounts, limited partnership vehicles (e.g., most hedge funds), unit investment trusts, closed-end funds, other collective/commingled investment vehicles and discretionary (managed) personal trust accounts.

Source: AM Best; McKinsey Asset Management Growth Cube

Exhibit 2

Living benefits represent a majority of voluntary sales and are growing faster and delivering higher ROE than death benefits



[1] Using health/supplemental ROE estimates for dental, vision and supplementary medical

[2] Universal life sales increased 14%; whole life 2%; and term life 1% in 2014

Source: LIMRA Worksite Sales 2014, Fourth Quarter Review; Benefits Pro; Eastbridge Consulting

consumer engagement, easier-to-understand product performance and robust financial planning and advice. Meanwhile, regulations have restricted the use of annuities in qualified plans—even though policymakers see the need for guaranteed lifetime income to protect against increasing longevity. Annuity companies have struggled to communicate the value of guaranteed income for life; many consumers now over-value lump-sum payouts.

The irony is that despite the life industry's focus on death benefits, savings and retirement products generate well over 75 percent of insurers' operating earnings. If risk protection were repositioned as a vehicle to enable families to meet their financial goals despite the premature death, disability or serious illness or injury of the breadwinner, the appeal of life insurance would increase. It can take a skilled agent to explain this kind of protection, however, and those agents tend to focus on the most affluent customers, not the middle market.

Multiple "pain points" in the customer experience

Consumers say that researching, buying and owning individual life and retirement products can be unpleasant. They cite four primary pain points:

- **Complex products that are difficult to understand.** Life insurers tend to design products for professional salespeople, not consumers. But companies that do not incorporate the voice of the customer in product design risk losing consumer interest.
- **Complex, time-consuming applications and demanding underwriting processes.** Buying a fully underwritten term life policy can take six to eight weeks—leading to applicant drop-out rates of up to 20 percent across carriers.
- **A distribution system geared to "push" products** rather than provide objective advice and timely educational support on and off line.
- **Inadequate service and advice after a sale.** Customer satisfaction is at all-time lows in part because of agent attrition; four out of five agents leave a carrier within four years, creating millions of "orphan" policyholders without a personal connection to the insurer—many of whom are less likely to renew their policies.

Low customer engagement

Many of these pain points have challenged the industry for decades, limiting its growth opportunities. Now, however, customer expectations are increasing. Companies such as Amazon and Uber now use digital technology to deliver goods and services quickly and seamlessly at a reasonable cost, raising the bar for companies in virtually every other consumer-facing industry, including insurance.

Engaging consumers on the topic of life insurance will always be a challenge. They see the products as highly complex, and few enjoy contemplating illness, disability or death. Carriers and agents rarely engage with a customer beyond the purchase process and policy administration, and so have few opportunities to gain share of mind or build brand equity. This stands in sharp contrast to

other companies in financial services, such as mutual fund providers, banks and credit card companies, that offer simpler products and are associated with more positive activities such as saving and spending. Other providers may continue to engage with customers more deeply than life insurers, but agents and carriers can close the gap by adapting to consumers' changing expectations.

Slow adaptation to consumer and technology trends

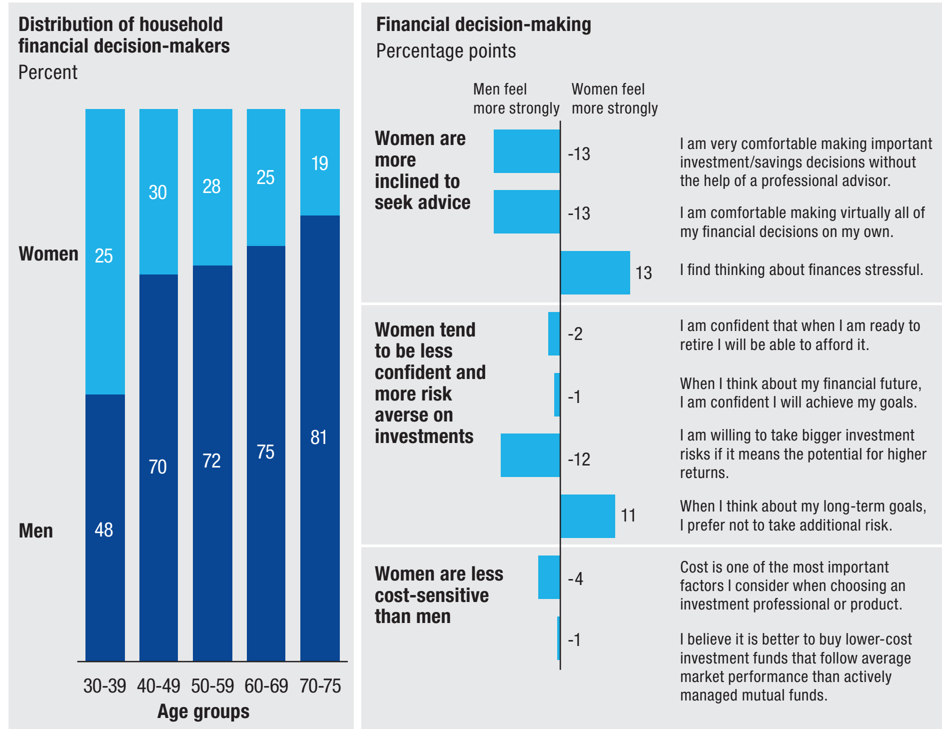
The life and annuity industry has been slower than other consumer-oriented industries, including banking, to use technology to meet the rising demand for user-friendly, personalized experiences.

Although few traditional life agents are equipped to serve the needs of a changing population, they have retained their "ownership" of the customer relationship and are protective of customer information. This is one reason so few life insurers understand their consumers well enough to respond to their shifting needs.

Today, consumers research products and services and make purchasing decisions in new ways. In addition, new demographic groups are making those decisions. For example, women are becoming

Exhibit 3

Women are playing a more significant role in financial decisions and differ attitudinally from men



[1] N=10,114; all respondents

Source: McKinsey Affluent Consumer Insights Survey (ACIS) 2014

the primary decision-makers in families headed by adults under the age of 40 (Exhibit 3, page 7), but few life insurers are adjusting their marketing or distribution efforts accordingly.

Technology is opening startling new opportunities for innovation, but life carriers have been slow to embrace them. The boom in mobile computing, for example, is unveiling enormous amounts of data on consumers that is available from biosensors, wristbands and other lifestyle measurement devices that could eventually revolutionize life underwriting and monitoring processes.

In short, the life industry's growth challenges seem to arise more from its sluggish response to change than from lack of consumer demand. According to LIMRA research, about 30 percent of American adults say they need some or more life insurance, but fewer than half of them are likely to purchase any in the next year, in part because they do not know where to start.

The life insurers who respond quickly and effectively to the aforementioned challenges will outperform their competitors in the years ahead.

The Way Forward for Life Insurers

To achieve superior growth, life insurers must meet consumers' needs by offering living benefits, retirement income and a friendlier, simpler, seamless experience.

The opportunity is significant: as millions of baby boomers finish their careers, the U.S. retirement market will experience robust growth over the next decade. The major challenge for life insurers is to reposition themselves to compete more directly and aggressively with firms (e.g., asset managers) that are providing the kinds of products and experiences that consumers are demanding.

The objective should not be to displace asset managers, but to better position life and annuity products as important components of a family's retirement plan.

Many life companies have already built or acquired asset management businesses, but the industry could do much more to communicate the attractive after-tax returns and disciplined savings model of permanent life insurance and annuities' unique ability to provide guaranteed lifetime income—addressing consumers' rising concerns about outliving their savings. The objective should not be to displace asset managers, but to better position life and annuity products as important components of a family's retirement plan. This positioning could include:

- *Compare the performance of retirement products not just among life insurers but across the entire financial services industry.* Life insurers should be able to leverage insights from other companies building share in the retirement market.
- *Make the case for legislative or regulatory changes* based on the fact that only life insurers, by pooling longevity risks, can offer annuity products that provide lifetime guaranteed income—a compelling consumer need.
- *Help consumers understand the financial risks of retirement.* Life carriers could promote a "retirement readiness index" that includes mortality, morbidity and longevity scoring in addition to asset accumulation goals.
- *Match the level of consumer engagement that wealth managers have delivered* in the form of financial planning,

multichannel advice delivery, and transparency on products and performance. The bar should be what the best asset and wealth managers are doing rather than what other life insurers are offering.

- *Reposition life and annuity products as vehicles to serve a broad family retirement plan.* Life companies are uniquely positioned to protect American families in the event of premature death or disability by preserving income during retirement regardless of longevity and by protecting against long-term care and uncovered post-retirement medical costs.
- *Rethink sales force models,* moving away from a product-push mode to provide customers with more unbiased advice, education and ongoing engagement.

Core Capabilities for Superior Growth

To shift the life industry's value proposition to lifestyle and income preservation in retirement and engage consumers, insurers will need to build six core capabilities.

Develop deep customer insights and engagement and a stronger brand.

Few life insurers have effective consumer marketing. Most have implicitly delegated this responsibility to distribution intermediaries. To connect more deeply with customers, insurers need to invest in four areas:

- *Customer information.* Due to the explosion in big data and analytical capabilities, insurers can quickly enrich their consumer databases to update policyholder and household demographics and gain valuable attitudinal and behavioral insights.
- *Customer insights and segmentation.* McKinsey's research on more than 10,000 mass affluent consumers in 2015 explored a wide range of behavioral and attitudinal dimensions in addition to demographics. The research showed that segmenting based on attitudes and behaviors is far more effective in tailoring value propositions and customer decision journeys than purely demographic variables. Perhaps the biggest challenge is attracting the analytic talent that can mine the data for actionable insights. Senior management support is crucial in ensuring the focus on talent.
- *Consumer education, financial planning and overall engagement*. McKinsey research shows that consumers who have attended financial education programs, whether online or through their employers or universities, are far more likely to purchase life and annuity products. Financial planning and education represent major opportunities to deepen customer engagement. Firms such as Ameriprise have baked ongoing financial planning directly into their business models. The future of financial planning will also include robo-advice tools—like those offered by Betterment or Personal Capital—that can be effective both at the moment of sale and in rebalancing asset allocations over time.
- *Powerful branding.* Life insurers must strengthen their marketing skills to build consumer awareness and affinity with the brand and its attributes—not just financial strength. This will become even more important as companies sharpen their focus on target market segments. Digital and social media allow for faster, more economical testing and delivery of tailored brand messages.

Invest in the distribution models of the future

The most successful life insurers in the years ahead will build customer engagement and sales productivity on two pillars:

- *A seamless omnichannel experience.* Consumers already use multiple channels on their decision journeys, from consideration to evaluation to purchase. They are also increasingly asking for holistic financial and retirement advice (although many, especially the younger generation, do not insist on face-to-face conversations). The bar is rising as carriers improve their digital platforms and integrate them more closely with other channels. Two new channels are also gaining traction: mobile apps and remote advice centers. While the omnichannel model applies more directly to tied agent distribution, it also offers life insurers working through third-party distribution the opportunity to partner with distributors to integrate their activities and provide consumers with experiences that fully meet their needs.
- *Advanced analytics.* Data and analytics are improving decision-making in nearly every industry. Search engine data, for example, can illuminate consumer buying intentions. Analysis of huge amounts of consumer data can yield predictive models to generate warm leads, and social media can reveal individual consumers' life events, such as marriage, parenthood and promotions at work, that can trigger the need for insurance. Advanced analytics can also help carriers identify the wholesalers or individual producers who are most likely to be productive.

Simplify products and messages

The risk of anti-selection will always require some level of complexity in life insurance products and underwriting, but insurers should dramatically simplify how they describe their products' value propositions. Oscar, a health insurance start-up with backing from Google, is using data and technology to make the business work more like an internet service. To compete in the retirement space against attackers and asset managers, life insurers need simpler ways to communicate protection, investment and longevity features.

Digitize the company

Leaders in the life insurance industry are already using digital advances to cut costs and boost efficiency along the entire value chain. Examples include:

- *Automating and simplifying processes* to reduce operating costs and improve the customer experience. The task seems daunting considering the burden of legacy IT systems, but a practical approach and clear prioritization—"two-speed IT"—can save time and money. Insurers can digitize just a few consumer-facing core processes and make meaningful gains without revamping the underlying infrastructure. Digitization can also dramatically speed the application process by tapping into external sources of data.
- *Offer digitally based products.* Insurers around the world have developed apps to distribute simplified accident, health and warranty products. Other apps allow consumers to calibrate how prepared they are to deal with a wide range of financial risks.

- *Enable new and innovative business models, such as digital platforms and private exchanges.* As consumers think about their benefits holistically, rather than in silos, there is a broad shift away from death benefits toward quality-of-life benefits. Life carriers can counter this trend by educating consumers about how life policies can fit into their investment portfolios.

Maximize the value of in-force portfolios

Given the long-term nature of life insurance portfolios, in-force policies represent over 80 percent of a typical insurer's profit, but tend to capture less than 20 percent of management attention. Carriers can boost revenue by cross-selling new riders and improving re-pricing and lapse management, cut costs by optimizing service levels or run-off blocks, and improve capital positions with reinsurance or closed-block transactions and asset liability management and investment strategy. What these levers have in common is that the insurer, and not distribution, "owns" most customer relationships and determines the optimal in-force management strategy for each policyholder cohort. Carriers may worry about alienating distribution, but the reality is that few producers manage in-force policies except for those of their most affluent customers. Some advisors would be willing to accept reduced compensation on sales made by the company centrally, aligning the economic interest of the carriers to invest in direct and remote advice capabilities to serve the in-force book.

Pursue partnerships

The new digital economy will require insurance companies—particularly those serving the middle market—to become active members of a broader ecosystem that includes banks, retailers and employers (through worksite marketing). Partnerships can increase access to customers and drive productivity through advanced analytics.

Despite the challenges, many life insurers have healthy balance sheets and positive economics. Therefore the important question for most carriers is how to transition to a new model without disrupting earnings.

Managing Transformational Change

Many industry executives agree that transformation is necessary, but differ on how quickly and aggressively their companies need to change. The more cautious executives make a number of points:

- *Consumer behavior has a great deal of inertia.* "Yes, smart phones, digital media and online shopping are here to stay, but life insurance is profoundly different from books, music and shoes."
- *Distribution channels resist change.* "It will be years before the 'new breed' of agents and advisors dominate the business."
- *A digital, more consumer-centric approach may indeed drive growth,* "but do we want to grow faster in a period of low interest rates and anemic returns?"
- *The industry has been product-centric for decades.* "Shifting to a consumer-centric approach will be costly, difficult and time-consuming. Most insurers have trouble attracting first-rate consumer marketing talent, so they will need to train marketing leaders while overcoming cultural resistance among other executives."
- *Change will require huge investments now but deliver returns slowly,* putting further pressure the bottom line in a time of low interest rates.

While some of these concerns may be valid, insurers that take a wait-and-see attitude risk being left too far behind to catch up. The marketplace tends to be hard on companies that put off necessary transformations, from Kodak and Sony to Tower Records and Blockbuster.

With consumers adopting digital technologies at an accelerating rate, life insurers need to decide now whether an incremental or transformational approach is best. To align with stakeholders, especially in distribution, insurers need to be explicit about which path they intend to take, the pace of change they are targeting, and the rationale for those choices.

While the life insurance industry's challenges are not new, consumer behavior is changing faster than ever, challenging the industry to reimagine the future and deliver greater benefits for shareholders and policyholders alike.

Further insights

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March 2015

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Financial Services Practice
March 2016
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