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Some Assembly Required

Pre-structuring a life policy's death benefit could pay off in a big way for consumers, agents and your bottom line.

By Jeff Shaw

Why is it that in a culture addicted to shopping, people still hate to shop for life insurance? Personally, you can count me among the declining minority who equate a trip to the mall with a trip to the dentist—I measure success by how quickly I can get it over with. Nevertheless, it's curious to me that people find the life insurance buying process so uncomfortable when it's really such a personal expression of love and commitment.

An interesting parallel comes from Fleet Feet, a retail chain of running and walking footwear with more than 80 stores nationwide and a notable exception to my shopping skittishness. Fleet Feet has created a unique shoe buying experience that bears an uncanny resemblance to the life insurance buying process, but works much more effectively. The moment I enter a Fleet Feet store, I am greeted by an athletic looking person who is obviously an avid runner and who asks a series of questions regarding my running habits: How far do you run? What type of surface do you run on? How fast do you run? What are your running goals? What types of problems have you had running? It's both refreshing and flattering to have someone so interested in knowing all about my feeble efforts to stay healthy.

The Fleet Feet experience, however, doesn't consist solely of idle chitchat. The salesperson also puts me on a treadmill to videotape my stride and plays the tape back in slow motion to analyze my physiology and running style in order to select just the right shoe. After trying on a few pairs and taking some laps around the store to test for comfort, it's back on the treadmill to make sure that the shoes are doing their job effectively. As I'm walking to the cash register with credit card in hand, I realize that I never asked how much the shoes cost. By that time, it's so obvious these are exactly the right shoes for me, I don't even care—and I had fun buying them!

The life insurance process is very similar except instead of an athletic looking salesman, the insurance agent conveys an aura of professionalism and financial health. Instead of a treadmill and a video camera, the insurance agent uses a computer and specialized software. And instead of inquiring about running habits, the insurance agent wants to discuss financial goals and dreams. Why then are people so enthusiastic about one process and so reticent about the other?

Big Hurdles

One reason might be the motivation behind the evaluative process. For example, imagine if after completing an analysis of my videotape, the Fleet Feet salesperson told me they had the perfect pair of shoes for me, which were extremely well made and on sale for half price. Unfortunately, they were available only to people capable of running six-minute miles or faster. Instead, Fleet Feet could put me in a more expensive pair that weren't nearly as well made, but would be sufficient for the plodding runner profile that I fit perfectly. Chances are, I would either storm out of the store without making a purchase or exaggerate my running prowess to get the better shoes.

Unfortunately, this is exactly the sort of scenario we've created with our innumerable ultra-preferred and super-standard underwriting classes of insurance. Now, I'm not arguing against pricing by underwriting class. Healthy individuals should pay less for their insurance than those who aren't as robust. However, we need to finesse the message this sends to the consumer. In this instance, I would argue that the Fleet Feet salesperson wants to know about my running habits to select the right shoe, but the life insurance agent wants to know about my health to see if I'm worthy of a policy. There's an element of judgment and distrust that is inherent in a life insurance transaction that can understand-ably undermine the pleasure of the process.

Now imagine that instead of leaving Fleet Feet wearing my new shoes and carrying a box containing my old ones, I had to wait for my shoes to be shipped. And then imagine that once they arrived, I would have to assemble them myself, cutting them to size and painstakingly gluing and sewing the various parts together. This is akin to what we expect our life insurance policyholders to endure, and I would argue that the delayed gratification—both in terms of getting a policy approved and in realizing any immediate benefits—combined with "some assembly required" death benefit proceeds represent the biggest hurdles that separate the life insurance buying process from most other consumer purchases.

Every life insurance professional knows that you sell solutions rather than products. People don't want to own a drill; they want to make half inch holes. For my personal insurance, I performed my own financial needs analysis and evaluated the present value of paying off my mortgage, funding my kids' education, and providing survivorship income for my wife. I assumed a range of inflation and investment scenarios and arrived at a reasonable median amount of capital required to meet my goals. However, there still remains a distinct disconnect between executing my ambitions and giving my wife a huge check in the event of my untimely death. Will a million dollars be sufficient? Maybe, but there's definitely some assembly required in order to make it happen, and I won't be here to make sure that everything fits together the way I intended.

My family is fortunate because they can turn to a number of financial advisors we consider to be trusted friends. But my wife has made it abundantly clear that she doesn't consider "the problem" of my untimely death to be solved at all. In fact, from her perspective, all I've done is created a new problem for her to inherit. She doesn't want to have to make decisions about whether to pay off the mortgage or to invade principal in order to meet temporarily higher income needs. She doesn't want to have to evaluate her risk tolerance or asset allocation profile or make assumptions about inflation. And she definitely doesn't want to have to make those decisions shortly after my funeral. Frankly, she'd rather not have to deal with the problems associated with investing money at all, but she's astute enough to know that it's irresponsible for her to abdicate all responsibility for those decisions, even to a friendly professional or a trust. She also recognizes that even with the best intentions, the best advice,
and the most stringent guarantees, things don't always work out as planned—and merely throwing more money at a problem doesn't usually fix it. So much for leaving my family with peace of mind.

Selling Solutions

For example, with tele-underwriting and electronic applications, it's now possible for a company to accept and underwrite applications via a phone call while the agent is still in the prospect's house. This solves the "delayed gratification" problem and provides instantaneous approval of the coverage upon electronic transfer of the first payment.

Simplified issue underwriting also reduces the stigma of judging the worthiness of an applicant's health since there are fewer underwriting classes and less health questions. The rare "elite athletes" of the small face life prospect pool would probably be better served to pursue a fully underwritten contract that was priced to reward their superior health rather than a simplified issued contract that reflected the mortality of the masses.

Pre-need insurance provides a noteworthy exception to the life insurance death benefit "assembly required" issue. With pre-need, the consumer enters into a specific contract with a funeral director for the future delivery of goods and services. The life insurance becomes the funding vehicle for that contract and provides a valuable inflation hedge for the funeral director. However, unlike a typical final expense sale, the death benefit isn't paid to the insured's beneficiaries with some vague intent that it be used for some undefined but estimated "final expenses". With pre-need, the consumer has arranged to purchase a half inch hole—in this case, we should call it a six foot hole—and the insurance finances the contractual obligation for the funeral director to drill it. There is such a clear relationship between the problem and the solution that the consumer is indifferent to whether the funeral director funds the obligation with a trust or an insurance product; from their perspective they are merely paying for a funeral. Unfortunately, for nearly all other small face life sales, the death benefit and the specific purpose for the insurance aren't as directly connected. For example, assume a 30 year old married modest income prospect with two young children. Both spouses work full time and they don't currently have any life insurance. One approach would be to recommend a couple of term insurance policies in order to maximize the death benefit while their kids are still young. Another approach would be to recommend a modest sized whole life or other permanent policy to pay final expenses with a bit left over to help out with the kids. Or the agent could recommend any number of combinations of the two.

Another Solution

What if the agent had another solution to offer? What if during the course of the conversation the prospects acknowledged that they needed more life insurance than they were willing (or able) to afford, but as a compromise, they both agreed that out of all of their financial needs, it was most important that there be at least enough money to help provide for their children while they're young. How much is enough money? Well, maybe enough to put food on the table and a roof over their heads while the kids are growing up. OK, I can sell you a policy that guarantees to pay $2,000/month for the next 20 years if either of you dies. That should cover your monthly rent with

something left over for food for the kids. If one of you dies 10 years from now, you get $2,000/month for ten years. If the unthinkable happens 15 years from now, you only get five years of payments. And if you live for another 20 years and don't need the insurance, we'll give you some of your money back so that you can buy another policy.
If you're concerned about inflation, we can add a rider to increase your potential payments by three percent a year. And we can also tack on an immediate death benefit of $10,000 to pay funeral expenses if you'd like.

To the insurance professional, it's obvious that what we've just offered is a first-to-die decreasing 20 year return of premium term contract that pays an annuitized death benefit rather than a lump sum. The immediate death benefit is equal to the present value of $2,000/month payable for twenty years discounted at a guaranteed rate of three percent—or about $360,000—and decreases monthly according to the remaining present value. The inflation rider merely re-calculates the present value of the additional death benefit compounded at three percent and charges the appropriate additional mortality. Any lump sum payments for final expenses would just be added to the mortality calculations. And the return of premium feature is just wishful thinking from a marketing guy looking for every sales advantage he can get.

One of the key advantages of this type of product design is that we've implemented a variety of features that reduce the potential cost in order to make a larger initial death benefit more accessible for the modest income market. By using a first-to-die structure, we can generally insure two lives less expensively than by writing two separate contracts. By limiting the death benefit to a specified number of years we can reduce the mortality charges since the present value of future benefits is always decreasing. And by requiring that the benefits are annuitized rather than paid in cash, the insurance company can continue earning interest on the proceeds over a longer period of time.

Have we solved all of the prospects insurance problems? No. Are there other equally valid alternatives? Of course. But besides creating a potential administrative nightmare for an insurance company (and possibly a challenge for some state regulators), we've also provided our prospect with a half inch hole rather than all of the parts required to assemble a drill, and in the process we've reduced the components of a very complicated insurance contract into an extremely simple benefit that answers a very specific question: How much income do you want and how long do you want it to be paid?

Larger Foundation

As a financial planner, I've always looked a bit askance at defined benefit plans and structured settlements, preferring instead to position lump sum payouts in my own portfolio. However, as I get closer to retirement—and as the markets become more negatively volatile—I find I have a greater appreciation for building a portfolio upon a much larger foundation of guarantees. In fact, I would gladly accept the inflation risk and survivorship issues associated with a defined benefit pension payout as long as I could supplement it with the liquidity and flexibility from my self-managed 401(k) assets.

I think I would like my life insurance benefits to be structured the same way—and I know that my wife would like that, too. As life insurance professionals, we take pride in walking in the door after someone dies with something tangible that is truly needed at that particular time: a life insurance claim check. Not everyone, however, is fortunate enough to have a long relationship with a trusted insurance agent, nor does everyone respond responsibly when suddenly given a large amount of cash. And in most cases, people aren't emotionally equipped to make significant financial decisions shortly after the death of a loved one.

The concept of "pre-structuring" the death benefit of certain life insurance products certainly can have some disadvantages—no different than defined benefit pension payouts. There's a flexibility trade-off in return for any long term guarantee. However the potential benefit to the consumer in terms of peace of mind, simplicity, and ease of execution suggest that this compromise is worth considering—especially if it can be supplemented with combinations of traditional insurance. But most importantly, this structure provides a direct solution to a prospect's problem and guarantees that some of the more predictable needs will be solved.

Enjoyable Process

I don't know if the life insurance buying process will ever be as enjoyable as purchasing running shoes at Fleet Feet, but I do know that it should be. There's no reason why the process of identifying the things that someone cares most about in life, and then eliminating the potential risks to those things in the event of death, shouldn't be exhilarating and satisfying. But then again, I enjoy math and physics in my spare time! Nevertheless, if the running shoe industry can create an enjoyable evaluative process for its products, which are then used for the purpose of inflicting all sorts of pain and suffering on the user, certainly the life insurance industry can improve its products and processes to engage our customers in the celebration that our products embody. Or at the very least, if we insist on maintaining "some assembly required" with our death benefits, we should provide some better operating manuals with our products.

Next month's article will continue to expand upon this theme and will address some of the challenges we face as an industry in marketing our products, so double knot your shoe laces and don't run off!