

## Tomorrow's Group Insurance Business

*What impact will demutualization have on group insurance providers? Get ready for a greater emphasis on profitability and less choice for national employers.*

The former Mutual Life of Canada (now Clarica Life Insurance Company) may have been the first out of the blocks, but by the time the firm put its demutualization plan to a vote by policyholders last June, it was clear others were close behind. The insurance Business in Canada would never be the same.

First came the cheques. Demutualization, which turns firms like Clarica into stock companies rather than mutual companies, meant an unexpected payday for thousands of individual (and some group participatory) policyholders across the country. But the real change is still in the development stage. The impact of demutualization is only now beginning to take shape. Part of that change will mean significant challenges for the group insurance business.

The Canadian group insurance marketplace has four public stock companies currently: Great-West Life Assurance, Clarica, Canada Life and Manulife Financial. The latter three demutualized in 1999. This year, Sun Life of Canada and Industrial-Alliance Life Insurance Company will also become public stock companies subject to policyholder agreement.

These carriers represent over 61% of the Canadian group insurance market according to BENEFITS CANADA'S 23<sup>rd</sup> Annual Survey of Group Insurance Providers (see "Major players," below). As the carriers change in response to demutualization, the landscape for the advisers' marketplace (including agents, brokers and consultants) will also change. And it will be dramatic.

Canadian group insurance carriers have embraced the bigger is better ideal. The first wave of mergers, acquisitions and collapses made for extraordinary headlines.

An increase in size provides a quick escalation in market-share. It also affords the opportunity for lower overhead when spread over a large and wide base. This, theoretically, would make the bigger carriers

substantially more competitive—from a policyholder expense perspective—when compared to the surviving smaller carriers. In turn, this suggests that the smaller carriers will have to consider either merging for joint survival or courting an attractive purchaser. The status quo is just not an alternative for the smaller carriers unless they are niche players.

### DEMUTUALIZATION'S EFFECT

The emerging ramifications of demutualization on a group insurance policyholders, most all of which were predicted, are now coming to fruition. Retentions are up on insured and uninsured accounts. User charges for specified core services are either up or are being introduced. And carriers are starting to assess realistic user charges for policyholders' consumption of non-core services.

There is an underlying theme emerging from demutualization—an expected return on investment of at least 15%. It is not surprising then to see a move toward conservatism. When we consider the potential for additional charges to policyholders as a result of demutualization, the real question becomes: What isn't going to rise?

With required profitability hanging over their heads, it is increasingly evident that group insurance carriers are becoming selective about which policyholders they include in the bidding process. In fact, certain newly demutualized carriers are quite public about the type of policyholder with which they will partner.

These carriers are looking at the policyholder's attitude, their group insurance sophistication, as well as that of their adviser, and the intensity of work required to provide appropriate service to plan members. It would appear that carriers are prepared to undertake a never before seen due diligence of potential policyholders in advance of insuring a policyholder's risk. Risk acceptance is becoming more

conservative as evidenced by high pool charges and the inclusion of new margins.

Employers who used the 1989-to-1992 recession as a starting point, and who acquired more and more services from their carriers to the exclusion of advisers (particularly fee-for-service advisers), will find that demutualized carriers require them to pay the difference when requested services are higher than the carrier's original fee structure assumption. Carriers will redefine core and non-core services and establish pricing levels for these services.

Ultimately, policyholders will pay for the level of service they desire. With this pricing action, the carriers are reaffirming their commitment to the traditional balanced role that advisers play in the group insurance industry. Carriers anticipate a certain amount of servicing by advisers in their regular pricing, and they will price certain services in such a way as to drive some business back to the advisers.

#### **MORE CONSOLIDATION**

The marketing of employer plans—to find lower rates—should reduce significantly. Carriers are going to start saying no more frequently. This will be widespread by 2001, when the federal government will allow the newly demutualized public stock carriers to buy the shares of each other. This could include further carrier consolidation.

In his Aug. 25, 1999 column, *The Globe and Mail's* Andrew Willis predicted that the group insurance carrier market will shrink further, by a least two national carriers once the federal government's moratorium is lifted. For national employers, it is possible the marketplace could shrink to under five carriers. Compare that to 1972 when there were over 15 carriers from which national employers could choose.

This leads to an important question. What are the Blue Crosses and other not-for-profit organizations going to do as the for-profit group carriers get larger and leverage their economics of scale? If there is no consolidation among these not-for-

profit carriers, then the major national carriers will be in a position to dictate to policyholders and advisers. National employers simply won't have much to choose from in such a small marketplace. The power pendulum will belong to the major national carriers.

Marketing projects will be reduced, which will affect the adviser's sales representative at the carrier. Demutualization will see carriers switch from an acquisition focus to a persistency focus. That will mean a change of status for the sales representative—making him an account executive with future compensation based on the profitability of the book of business under his responsibility. For some sales representatives, demutualization could be the end of their group insurance career.

#### **EMPLOYER CHALLENGES**

Employers will find that they have to live with the consequences of their plan design and administration systems, their approach to disability management and the claim fallout cost of staff rightsizing projects. They will not be able to leave their debts behind as easily by switching to another carrier—carriers' due diligence of prospective policyholders should see to that.

One of the great concerns among advisers is the extent to which carriers choose to compete with the services currently rendered by some advisers. Should that happen, advisers will either have to provide more for the same price (in order to show value), or undercut the costs charged by the carrier. Such competition will have dire consequences for rate-focused advisers. They will not be able to compete if they lack the skill sets to perform the services required by their clients.

Carriers and advisers used to work as partners. Soon, carriers will compete with advisers in some areas. Clearly, the variety of technical services provided by the advisers will become paramount.

The response to carrier consolidation and demutualization has been somewhat

limited among smaller advisers to date. This because many of the advisers have yet to put a succession plan in place.

It is quite likely that many of these businesses will close. Consider Turnbull & Turnbull Consultants Ltd. In Winnipeg last year—its clients were pirated away. This will happen within the next decade, as many of the partners in these firms retire.

The surviving firms will choose not to buy those retiring businesses. They will simply go after their clients. As a result, there will

be substantially fewer adviser firms specializing a group insurance by the end of this decade. The survivors will have skills and services needed by employers as their core strength. They will not be rate arbiters.

The message to advisers is clear. Throw out your old rulebook. Business will be conducted much differently in this new millennium. That is a direct result of carrier consolidation, demutualization and the publicly stated profitability requirements of carriers.

*Fred Holmes is national practice leader, group health and welfare, with Buck Consultants in Toronto*

#### MAJOR PLAYERS

Group insurance providers that have either already demutualized, or that have demutualized plans in the works, represent 61.4% of the Canadian industry. Here are their rankings in the industry, and the total business as of De. 31, 1998 (in \$ millions)

1.	Great-West Life Assurance Co.	\$3,719.4
2.	Sun Life of Canada	\$3,150.6
3.	Manulife Financial	\$2,193.2
4.	Mutual Life of Canada (now Clarica)	\$2,141.0
5.	Canada Life	\$1,664.4
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