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Financial Services Practice

The Future of Group Life Insurance in the U.S.

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The group benefits business in the U.S. has been pivoting in the past five years toward voluntary benefits and away from end-of-life benefits, as employers seek to reduce costs and manage the impact of the Patient Protection and Affordable Care Act (PPACA) and employees make more of their own decisions about benefits. In response to the PPACA, new distribution platforms, such as private exchanges, are emerging, and brokers are consolidating, putting pressure on carrier distribution and economics.

Some employers, aiming to shift benefit expense to employees, are offering supplementary products that provide employees with greater choice regarding how they spend their benefit dollars.

Carriers can respond to these trends in two primary ways. First, to drive voluntary take-up, carriers should develop direct-to-consumer marketing and distribution capabilities, supported by advanced analytics. Second, to build scale and loyalty with key brokers and expand the number of plans sold, carriers should develop digital tools to help brokers with self-service quoting, real-time compensation data, and visibility into the overall book of business.

Momentum in the voluntary benefits market

For generations, tens of millions of Americans turned to their employers for life insurance coverage, but the PPACA has spurred employers to reconsider the benefits they offer. This reappraisal is likely to accelerate the longer-term structural trend of employers shifting financial and decision-making responsibility for benefits to employees. Close to half of the employers McKinsey interviewed in late 2014 said that the PPACA was leading them to reconsider their choice of insurance carrier and benefits broker.

The group voluntary benefits market—that is, benefits purchased at the worksite—has grown rapidly. New annualized voluntary benefits premiums grew 9 percent in 2013 and 5 percent in 2014 to $4.5 billion, while sales of term and whole life insurance lagged. Benefits that improve quality of life have grown fastest, with sale of vision insurance up 24 percent and critical illness insurance up 19 percent in 2014 (Exhibit 1, page 2).

Voluntary life insurance has grown for a number of reasons. Some employers, aiming to shift benefit expense to employees, are offering supplementary products that provide employees with greater choice regarding how they spend their benefit dollars. Group life brokers, in turn, are looking to expand their revenue base by distributing more supplementary products to meet shifting employer needs. In addition, the advent of the private exchange has also created a platform for introducing more voluntary and ancillary products to consumers.

As employers determine how best to respond to healthcare reform, minimize costs, and attract scarce talent with superior benefits packages, sales of voluntary insurance benefits should grow rapidly. In a recent LIMRA employer survey, 40 percent of respondents said they were likely to add a new voluntary benefit over the next couple of years, as they strive to provider greater transparency and choice for employees.

Brokers and non-traditional competitors are gaining strength

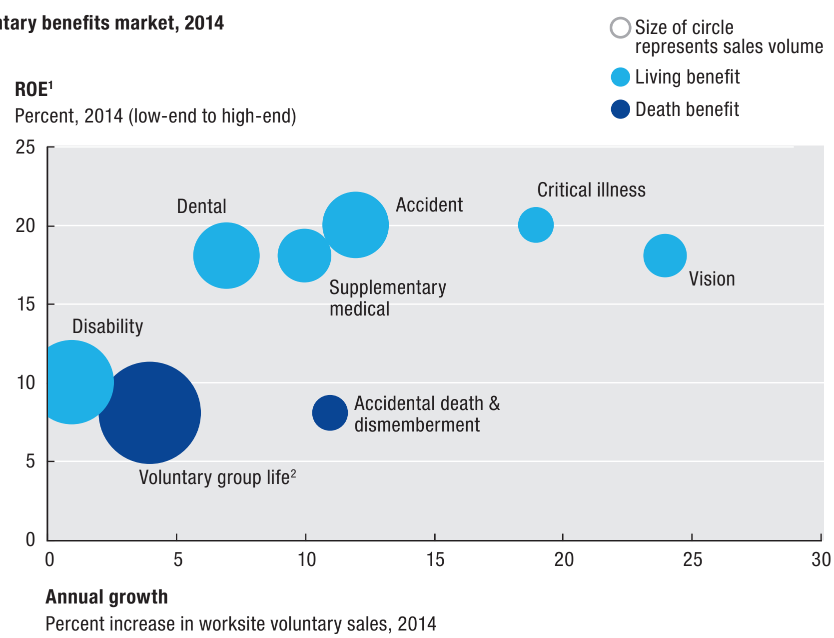
To gain scale and improve efficiency, insurance brokerages are consolidating at a record pace, with 321 acquisitions in 2014 across property and casualty and life and health insurance. McKinsey expects this trend to continue for several years, further increasing brokers' power in the market.

Consolidation is delivering value for U.S. insurance brokerages, often at the expense of carriers. In 2014, the average

Exhibit 1

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

Worksite voluntary benefits market, 2014



[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 revenue of the 10 largest brokers increased by 9.2 percent, compared to 4.9 percent for the top 100 brokers, and these top 10 delivered average organic growth of 5.6 percent. Private equity has played a key role in the consolidation. As recently as 2000, only 12 percent of broker revenue was controlled by a private equity-backed company, while in 2014, that figure exceeded 25 percent.

The strength of brokers and the emergence of powerful non-traditional competitors will force carriers to build new capabilities.

A McKinsey analysis of 140 brokerages showed that the major brokers and independent agents achieved their highest profitability on record in 2014, with EBITDA increasing to about 30 percent of revenue, up from 28 percent in 2013. During the same period, life insurer returns on equity remained steady at 12 percent.

In parallel with the increasing power of brokers, medical insurers are likely to introduce more capacity into the benefits market. With healthcare reform defining minimum medical loss ratios, health insurers are making a big drive to consolidate and enhance economics through scale while expanding the breadth of their product offerings beyond core medical products. Two mergers in 2015 involving four of the five largest health insurers–Aetna-Humana and Anthem-Cigna–demonstrate the push for scale and the potential for increases in the breadth of products and services.

Bold action required

For decades, group life and benefits sales forces targeted their efforts at brokers and benefits consultants, customers that fully understand the products. But as voluntary sales have increased, few carriers are investing in the capabilities they need to educate the millions of consumers who need coverage but do not understand the products. This must change if carriers hope to protect their market position and economics.

The strength of brokers and the emergence of powerful non-traditional competitors will force carriers to build new capabilities to serve their distribution partners better. To grow the number of plans they sell, carriers will need to amass enough scale to invest not only in consumer-facing capabilities, but also in new tools to help brokers identify prospects and maximize the value of their existing book of business.

Consumer-facing capabilities will drive growth in voluntary benefits

As decision-making shifts to individuals with the rise of voluntary benefits, the bar will rise for carriers to deliver seamless and intuitive customer experiences. The retail, hospitality and service industries are setting ever-higher standards for consumer expectations around product comparison, purchase experience and post-purchase service, leaving most insurers far behind.

To deliver a distinctive digital customer experience, supported by advanced analytics, carriers will need to ensure that financial resources are committed to the effort.

McKinsey research on product education shows that two-thirds of consumers prefer to learn about insurance benefits on their own, and about 90 percent would use an online or self-guided digital process. For example, to help customers understand products and coverage and choose the policies best suited to their needs, carriers could create simple tiers of coverage and embed calculators to correct consumers' misperceptions about the cost of products. Digital product guides could make products easier to understand, and testimonial videos, including profiles of similar customers, could help increase shoppers' comfort and deepen their knowledge of products and the enrollment process.

Carriers will also need to use advanced analytics to tailor recommendations to employees across a spectrum of products and translate internal and external data into insights that help consumers make informed benefit decisions. Many of these capabilities can be deployed independently or in coordination with the efforts of enrollment firms that work on behalf of either the client or broker.

To deliver a distinctive digital customer experience, supported by advanced analytics, carriers will need to ensure that financial resources are committed to the effort. In McKinsey interviews with 12 carriers, only three reported spending more than 10 percent of their IT development budget on digital customer experiences. And in McKinsey's work with clients, CEOs frequently report that organizational structure and capabilities to support their digital strategies fall short of what is needed.

Improving the balance of power with brokers

Carrier scale will be an important differentiator as brokers look to increase their leverage as intermediaries. Scale can also dramatically improve the business case for the investments required to provide the breadth of services and benefits to serve both brokers and clients effectively. Over the next 10 years, only the largest carriers are likely to have the scale to fund these transformational investments.

For carriers with the scale to invest in and adapt their businesses, broker- and enroller-facing tools can deliver sustainable gains in market share and lower the risk of carrier products becoming commoditized. Carriers will need to develop digitally enabled tools to reduce pain points for brokers and increase the speed of business. Recent interviews with employee benefits brokers reveal three areas, in particular, where digital tools can deliver significant value: self-service plan design, real-time data on compensation, and identification of opportunities within a broker's overall book of business.

In addition to digital tools, brokers also value in-person or remote advisory services to help train and educate their professionals, solve enrollment challenges, and resolve issues related to quoting or managing in-force clients.

In select cases, carriers may develop direct-to-employer distribution for middle-market or small-market clients, where their distribution partners are less concentrated. This will require targeting specific employer segments based on growth, profitability, industry, demographics and geographic concentration. In going directly to clients, insurers can leverage many of the same capabilities described above, including seamless online enrollment tools and analytics to provide tailored product recommendations.

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The combination of growth in the consumer-driven benefits market, the increasing power of brokers and new entrants, and shifting customer expectations will significantly change what it will take for group life insurers to be successful in the next decade. To solidify their position (and economics) in the marketplace, they will need to focus on delivering a distinctive consumer-facing experience and value-adding broker tools.

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Financial Services Practice
January 2016

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