ReMark InSights

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History Does Not Repeat Itself – But It Rhymes

Boiler room distribution operations employing aggressive sales and marketing tactics, massive new business volumes, high commissions, opaque disclosure and products are designed more with the needs of the distributor in mind than that of the consumer.

Widespread use of insurance telesales has revolutionised the volume of business that insurers can expect to write via their alternative distribution channels or partnerships

For those of us who have been engaged in financial services for any length of time, any of the above would be recognised as systemic risk factors to be managed (avoided) when accepting business from traditional channels such as agents.

It has long been an axiom of agency management that the compensation employed for agents is essentially a compact of mutual obligation and benefit. The agent/intermediary is, in various degrees, expected to prospect for new business, make sales and provide some sort of ongoing service.

In return the agent is afforded a variety of financial compensations, the quantum and structure of which typically reflects a combination of the following:

Criteria	Measure
Volume	Premium Written
Productivity	Policy Count & Spread
Quality	Persistency & Claims

This system of compensation is designed to encourage volume (and spread) of sales, while providing incentives to maintain the quality of business written and ensure the lifespan of the portfolio. While the precise mechanisms may vary between companies and markets the principles are near universal.

We know that that failure to insist upon the trinity inevitably produces the potential for distortions such as those mentioned in the opening paragraph.

But What About Other Forms of Distribution?

Historically, non-traditional distribution has remained somewhat immune to this type of scrutiny as it has typically represented a small proportion of most company portfolios. Furthermore, direct marketing techniques such as direct mail required no form of intermediary. As such consumers would be mailed offers, time could be taken to contemplate the suitability of that offer and the onus to respond would still lie with the consumer. This was a very passive form of marketing.

A Step Change In Third Party Marketing

However the past decade, in particular the past five years has seen an explosion in third party marketing throughout Asia, Europe and North America regions, fuelled in the main by the extensive use of telemarketing.
The widespread use of insurance telesales has revolutionised the volume of business that insurers can expect to write via their alternative distribution channels or partnerships. This has meant a "step change" for the business as telemarketing allows you to actually talk to the prospect, persuade and cajole, and perhaps most importantly demand an immediate impulsive response.

With the advent of well-equipped call centres, in the hands of professional marketers, incentivised by high commissions, very large databases can be contacted in a very timely and cost efficient manner.

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Compared to the mail, response rates and subsequent premium volumes rose dramatically – and such growth in production can be achieved with the use of a scaleable "shake and bake" sales force. Recruits to this type of sales force require, and inevitably receive, less sales and product training than their traditional agency counterparts. The rationale for this is that the products sold are overwhelmingly simple, guaranteed issue personal accident (or derivative) plans.

The Model

The model is quite simple – and its basic architecture will be familiar to most readers of this article. In the first place all you need is a list, preferably banks and credit card customers, but everything from home shopping viewers to telecom subscribers are currently in vogue. These "list owners" make available lists of their customers for the sale of insurance products. This may be done via exclusive arrangements or an "open" distribution agreement – where any insurer willing to provide a product and pay commissions of list fees can have access. Those commissions are mostly an agreed percentage of premium; understandably the higher the better from the list owner perspective.

The biggest single indicator that there might be something wrong with the current model is in the prime measure of quality – persistency

The insurer is engaged to "design" and manufacture a product. These are almost certainly (but not always) very simple personal accident or personal accident derivative products that require little or no underwriting, but contain a high mortality/morbidity margin.

An agent/third party marketing company is contracted (by either party) to provide program enablers, such as marketing strategy, creative development, data modelling, call centre management and, crucially in many cases, finance. The marketing company is usually paid a marketing allowance by the insurer or reinsurer on an NPV basis. They may also be on risk for a proportion of marketing expenses.

You only need to own a valid telephone number to understand how the rest works.

Calls are made on behalf of the list owner and offers of insurance are made to you – little or no underwriting is necessary. Your premium can be automatically deducted from your credit card or bank account & a policy should arrive a week or two later. A few months later you might begin to receive offers for upgrades and cross sells.

Is It Working?

In the main the model has been highly effective and there is a clear role for it. It enables list owners and insurers to reach customers in a timely and efficient manner and alert customers to offers they may otherwise miss.

It provides customers with an easy and flexible way in which to purchase some insurance and, in the final analysis, some cover is always better than no cover.

For list owners and insurers the use of third party marketers often brings skills and resources, including capital, that may not be readily available, thereby increasing the success of the programs. It provides handsome first year returns (commissions) to the list owner and marketing company and provides the insurer (and reinsurers) with the potential for large downstream surpluses so long as the business stays on the books in line with assumptions.

If we measure by volume and productivity the model is working as it was designed to do.

But there may be a very significant problem with the model when assessing the third dimension of quality.

A Question of Quality

The biggest single indicator that there might be something wrong with the current model is in the prime measure of quality – persistency.

While it is not the remit of this article to quote company names, and generalisations are inevitable, it is an open secret in the industry that many insurers are grappling with horrendous lapse rates on business written via telesales through third party lists – banks, cards and affinity partners included. There is more than just anecdotal evidence that points to first year lapse rates ranging from 25% all the way up to 70% plus. These stories can be found in most markets and in almost any regulatory environment. In many cases this is creating average product lifespans of two to three years.

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This would be unthinkable in a traditional distribution context.

Even more alarming is that there has been a steady decline in response rates in mature markets coupled with low rates of genuine product innovation. This suggests that it will be increasingly difficult to write business at a rate that replaces business that may currently be in free fall.

What Can Be Done?

From our examination of different scenarios around the region there are four major causes contributing to the persistency crisis.

1. External factors (adverse economic conditions, credit crisis etc)
2. Lack of product value
3. Aggressive selling or mis-selling
4. Opportunity for the "churn"

While the first may be beyond the control of the players mentioned, the rest are not.

Product Value

The issue of providing "value in product" is a matter that should concern all. List owners have a responsibility to provide products to customers that meet a need and contain some kind of genuine benefit and value for money. In addition provision should be made for some kind of servicing component.

Insurers and marketing companies must invest more heavily in finding effective ways to distribute higher value products (on lower margins) to consumers who prefer to purchase via direct channels

Even in a commoditised environment it is sophistry to suggest that continually loading up customers with general purpose PA products is meeting anything but the most rudimentary kind of need. Insurers and marketing companies must invest more heavily in finding effective ways to distribute higher value products (on lower margins) to consumers who prefer to purchase this way. And that is the salient point here. Consumers who prefer to transact this way will buy more sophisticated products – it is up to us to give them the chance.

Mis-selling and Churn

As with any mis-selling or churning of business the real issues lies in the area of compensation and control. The standard control mechanisms that are involved in traditional forms of distribution such as commission holdbacks/writebacks, agency termination for poor persistency and servicing requirements are simply not applied to this form of business.

Does it make sense to pay upfront new business commissions of between 100%-150% where absolutely no servicing component is required of the agent writing the business? Does this create the right kind of incentives? Whether you agree with this or not, lapsation is a prime indicator that the consumer is voting with their feet.

What Are The Remedies?

If you accept the diagnosis in part or full, correcting these problems begins with insurers insisting upon:

- Sales and product training that is of the highest standards – quality assurance is paramount.
- Remuneration and reward structures that reflect the points at which value is created for the insurer – volume, productivity and quality.
- Retention and retrieval strategies that have been determined in advance and embedded as part of the new business program and product.
- Maintenance of control over the distribution process – even if another party "owns" it.
- Clarity of roles for third parties – a clear definition of accountabilities and in whose interest are they acting (contractually).
- Disclosure of all financial interests that exist between the different parties.
- Capitation of marketing expenses charged by external infrastructure providers.
- Enforcing servicing standards to be provided to policyholders.

But commitment to all of these factors should be demonstrable, quantifiable links in the process – not merely punch lines in a powerpoint presentation.

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To What End?

Before we receive an avalanche of criticism from practitioners involved in the business let us restate the obvious. Firstly, this is not some Luddite response to new technology, nor is it a pining for some form of insurance Valhalla. There are good examples of how this model can be made to work in the interests of all stakeholders. This is evidenced by some very successful exponents of this form of distribution, who offer their customers a broad range of product solutions, at a reasonable price via a professional tightly managed sales channel.

The Minority

Secondly, it is understood that negotiating these arrangements can be difficult, especially when others are lining up behind you to do the deal regardless. Self interest often demands that we follow suit.

But finally, we know from experience what happens when short-term self interest becomes the governing paradigm in self regulation – the real regulators step in and impose requirements that in many cases are an overreaction to the excesses.

Professionals are Treated in the Same Way as Cowboys

Overt disclosures of commission, mandated commission tariffs and product pricing are the typical weapons used by regulators to bring distribution practices to heal. We've seen it before many times in the traditional distribution sphere. If we are too slow to make changes ourselves we risk standing by and watching others make them for us.

Hopefully history is not repeating itself here, but it is beginning to sound like a familiar rhyme.

ReMark

Maximum Value Creation

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For over two decades, ReMark has been providing end-to-end insurance marketing and technology solutions to Insurers, Financial Institutions and Affinity partners worldwide. The company specialises in the design and implementation of results-driven direct marketing programmes utilising proven acquisition, growth and retention strategies on behalf of hundreds of world-leading clients in the bancassurance, insurance and affinity markets.

Headquartered in Amsterdam, The Netherlands, and with 12 offices worldwide, ReMark focuses on maximum value creation for its global client base.

For more information on how ReMark can maximise the value of your existing portfolio contact us at generalqueries@remarkgroup.com or visit us online at www.remarkgroup.com

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