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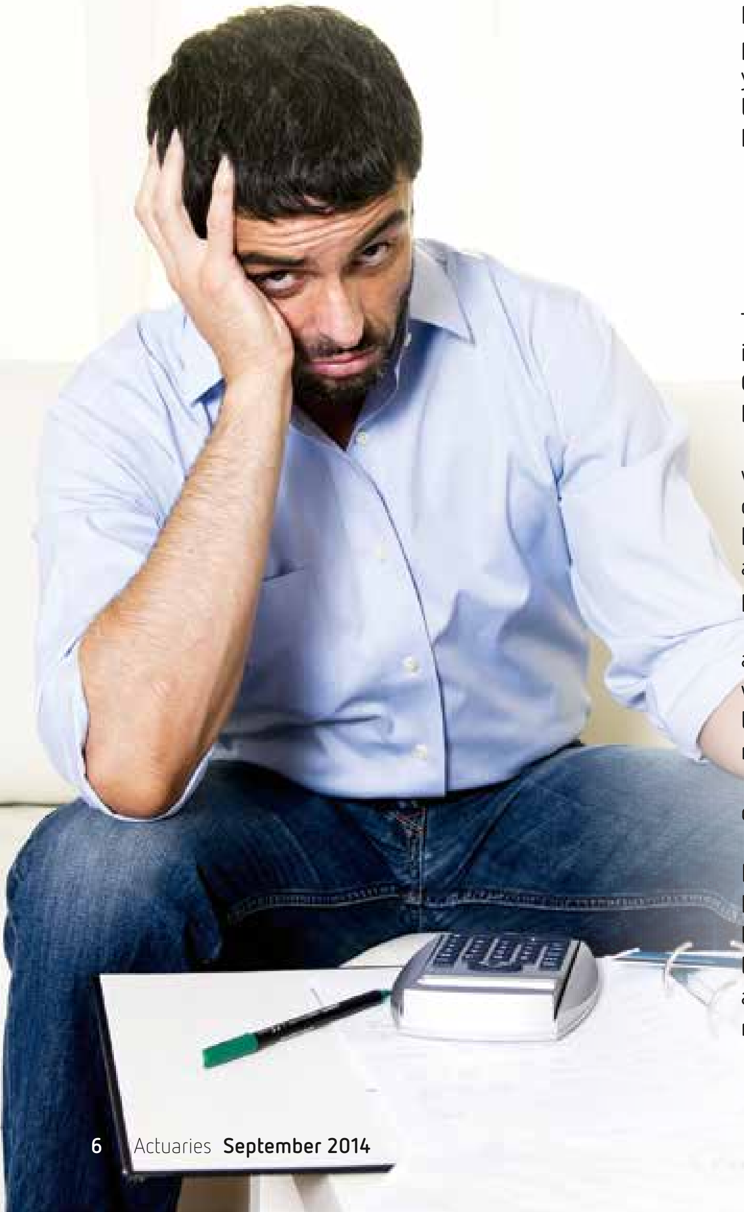
Life Insurance Lapses – Responding to the Challenge



Policy holder lapses are an expected part of life insurance. Naturally, customers go through different stages of life and their need for insurance changes over time. However, the life insurance industry has experienced a clear deterioration in lapse rates in the last few years. Due to the payment of upfront commissions and other acquisition costs, higher than expected lapses are impacting on insurers' bottom line profitability.

The question of "how to fix the lapse issue?" cannot be answered without first fully understanding "why is this happening?".

CAN WE BLAME THE ECONOMY?

Many are pointing the blame of deteriorating lapses to affordability pressures. But what really is different about these last five years from prior years? Yes, we've had the GFC, but when you look at economic indicators, there is surprisingly little evidence to suggest that affordability at a macro level has deteriorated to such an extent as to directly impact lapses:

- the unemployment rate remains low by historical standards;
- consumer confidence is volatile but there is no clear downward trend; and
- saving levels are actually increasing.

The trends in saving and spending behaviour also suggest that the recent increase in lapses is more likely due to a shift in consumer priorities. Customers may have a low perception of the value of life insurance and just be exercising their ability to shop around.

Similarly, affordability issues are often attributed to stepped premiums, which increase with age. However, stepped premiums have been commonplace in Australian life insurance since long before the recent poor lapse experience. In any case, why should premium affordability really be an issue when most products offer customers the flexibility to control their premiums to suit their budget?

'Premiums freeze' options, premium waivers, level premium structures, and the option to decline CPI increases can all help to provide customers with this control. However, these options are rarely exercised; suggesting that they are not easily understood by policyholders, or else the process to make changes is difficult.

Consumers want simple products they can understand and easy self-directed access to make any desired changes.

ENGAGE THE CUSTOMER

Life insurance can often be one of those things that a customer will buy then rarely think too much about. And why would customers think about their insurance, if they never hear from their insurer again (unless they are being sent a bill or a renewal notice)? There has long been a lack of meaningful engagement between life insurers and their customers.

There has recently been some improvement among life insurers on engaging customers – but at the same time, the bar is rising. Rewards and loyalty benefits are ubiquitous: from phone companies, to supermarkets, to hotels. The expectations of modern consumers are ever increasing. Just to keep up, insurers need to add value in a way that builds customer relationships.

Building relationships can start by sending emails to keep in touch, by offering something to customers like free movie tickets or a magazine, or by partnering with others to provide discounted products and services.

Setting up a 'wellbeing' program can engage the customer more, by considering important topics affecting their quality of life. Wellbeing programs can not only support physical health, but financial and mental wellbeing too. More insurers are turning towards implementing such programs. It is another way of demonstrating that the insurer is interested in the customer, and providing further value to the customer/insurer relationship.

EY's recent Global Insurance Consumer Survey found 63% of those customers who had left their insurer said that the insurer had made 'little or no effort to keep them'. This was an area where Australia really lagged behind other countries in the Asia Pacific region. Insurers can influence lapse rates – customers want their insurer to give them a reason to stay.

USE THAT DATA

When tackling lapses, insurers need to identify and act on lapse predictors. It is important to understand what the drivers of lapses are for your company, so that you know how to best respond. Therefore, gathering and analysing the underlying data is the first step. This may mean integrating standard policyholder and product details with multiple data-sets which give further insight into a customer's behaviour, and their financial and family situation.

All of this can be used to better understand their risk of lapsing. This in turn allows insurers to personalise efforts to proactively intervene before a lapse occurs, or to tilt sales efforts and pricing to favour lower lapse segments.

CAN WE BLAME IT ON CHURN?

Another target of the blame game is advisers churning customers to different products. 'Churn' can be defined in terms of product recommendations made in the adviser's interests (i.e. another upfront commission payment), rather than the customer's interests. However, the motives of an adviser are rarely so clearly identifiable.

As an adviser's preferred insurer/s changes, reflecting their view of service quality and product features, then they may encourage their customers to change with them. A survey of advisers by Investment Trends suggests 35% of advisers stopped supporting an insurer in the last 12 months, and 64% of business is written through an adviser's most-used insurance provider.

The customer benefits of switching providers are sometimes quite minor. However, it is not always appropriate to label such cases as 'churn'.

BE DIFFERENT FROM THE PACK

It is often very easy for advisers to recommend a different product to a customer based on marginally better features or price. This is assisted by the use of comparisons made by research house software.

It is up to insurers to think about their product design and break the research house cycle through more meaningful product differentiation. This may mean departing from the existing product and pricing structures currently used in the market.

DO WE NEED MORE REGULATION?

The ongoing saga of the Future of Financial Advice (FoFA) regulation has been aimed at improving trust in the financial advice sector. At this stage though, little has been suggested that is likely to directly impact on reducing retail life insurance churn.

The threat of FoFA regulating against commissions for risk business may have even led to a short-term spike in current churn levels.

Also, the changes around investments business (meaning that there is decreasing scope to profit from churn) may have led some advisers towards churning risk products instead. This may be an ongoing challenge whilst risk commissions remain structured as they are.

MANAGING INCENTIVES

Sales staff and advisers can play a vital role in addressing the lapse problem, but the incentives to do so must be there. This may involve encouraging the use of hybrid or level commission terms, or increasing adviser responsibility periods. However, insurers also need to consider:

- incorporating customer retention outcomes into sales staff bonuses;
- changing commission scales to incentivise sales in 'low-lapse' segments; and
- restricting business from advisers who demonstrate poor behaviour.

The ability to appropriately devise the right 'carrot' and 'stick' is dependent on underlying data analysis.

CONCLUSION

The more losses that life insurers incur from lapses, the more it makes sense to stop the bleeding. Some are tackling the issue head-on right now. But all life insurers have room to make positive changes.

There are many facets to the current lapse issues affecting the life insurance industry – perhaps some are getting more attention than they deserve. At the end of the day, just like any other business, the customer is always right. So, the focus should be on the customer: adding value for them, engaging with them, and adjusting to meet their needs and preferences. 🅰

> **Some companies are already tackling the issue of insurance lapses head-on, but all life insurers have room to make positive changes.**