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Are direct channels helping life insurers and consumers to address underinsurance?

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Abstract

The paper considers the experience of direct channels (e.g. telephone, mail) and indirect non advice channels (e.g. consumer credit, over the counter) in distributing life insurance.

The paper considers the issue from both the consumer and manufacturers point of view. Consumer perspectives include sales volumes as a measure of demand being met, value for money and whether or not the products meet the insurance needs of the consumer. Manufacturer perspectives include sales volumes and profitability.

Keywords: direct channels, underinsurance, indirect non advice channels, internet, debt insurance

1. Introduction

Not really. But there's a lot of untapped potential. This is the conclusion that we have drawn, after much discussion with industry participants both in Australia and overseas and some first hand consumer research.

Direct channels increase the number of ways consumers can access life insurance, and importantly vice versa. But the market share of direct channels remains small. Also, direct products tend to be simplified, which in combination with the absence of advice may lead to consumers using these channels being under protected.

Direct channels are a small but important part of the life insurance industry in Australia. Important, because they provide access to insurance for the 72% of Australian's who do not have a relationship with a financial adviser[i]. Particularly when for many of these 72%, most financial advisers do not even want to have a relationship with them due to their low levels of accumulated wealth. Of those Australians earning $75,000 or less, only 13% have an adviser.

However, the relatively small amount of life insurance sold by direct channels indicates that, as yet, they have not had a large impact on the level of life insurance in Australia. International comparisons indicate that this situation is repeated in all other developed life insurance industries. Nowhere have direct channels yet grown to anywhere near the size of the "traditional" distribution channels, whatever the traditional channels are in that region. In many places though, including Australia, growth in direct channels is greater than the industry overall and the rate of development of new products and new direct distribution methods indicates significant anticipated growth in at least the short to medium term.

This paper:
- outlines the current state of direct life insurance in Australia and selected overseas markets,
- discusses the current impact of direct channels for life insurers, in the context of addressing underinsurance, and
- discusses the current impact of direct channels for consumer to address underinsurance

2. Environment

2.1. Underinsurance

The problem of underinsurance of the Australian population is an accepted and well defined issue, at least among participants in the insurance industry. In the context of life insurance and for the purpose of this paper we have adopted the definition used by Credit Suisse which uses total premiums as percentage of GDP per country as a measure of the level of insurance penetration in that country (or underinsurance, if this penetration rate is considered low).

In a study completed by Swiss Re Sigma[ii] in 2008, it showed that Australia has one of the lowest life insurance penetration rates relative to other developed countries, ranking 20th in insurance penetration with premium as % of GDP of 3.8%. This compares to penetration rates of between 9% and 13% for the top 5 ranked countries (Taiwan, UK, South Africa, Hong Kong and Ireland).

IFSA research[iii] has shown that the percentage of the population with some form of life cover (however inadequate) is approximately 55%, while the portion of the population with income protection/disability cover is much lower at around 30% or less. The majority of this cover is purchased through super funds and is often at standard and generally inadequate levels of cover.

Important in assessing insurance gap, however, is not so much just the number of persons covered but also the adequacy of that cover. IFSA commissioned research[iv] has found that only 4% of Australian families with dependent children have adequate levels of insurance cover (that is 10 times earnings as recommended by Rice Warner Actuaries), meaning that Australian families were critically underinsured in life cover by

$1.37trillion. For income protection insurance, IFSA states (through its Lifewise initiative) that 75% of your gross income is typically enough to cover the essential costs of living.

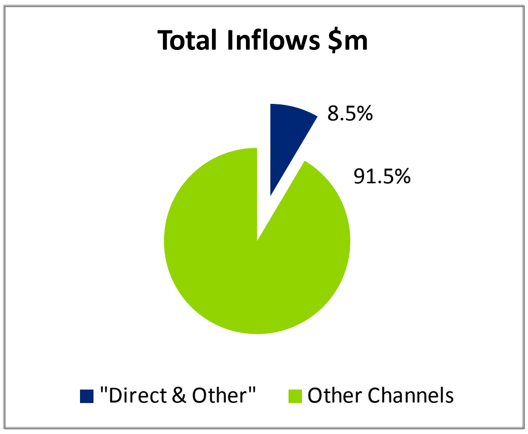
There is a counter argument that, while there is currently a significant level of under-insurance in Australia, some market segments are over-insured. Examples of this include younger people with little or no debt and no dependents who possess significant levels of death cover. Also, the industry's efforts to increase awareness of under-insurance could result in a situation of over-insurance in a rush to solve this problem. While we acknowledge these points, we consider them out of scope of this discussion.

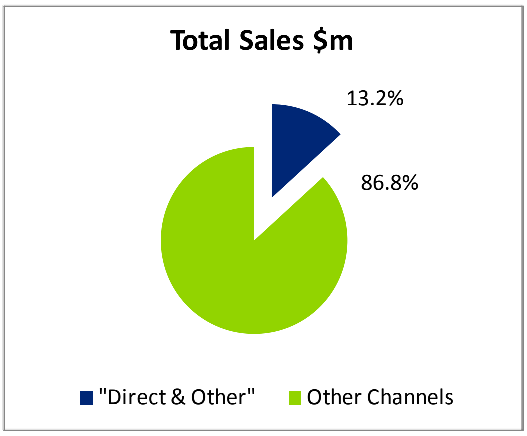
2.2. Introduction to Direct Channels

For the purposes of this paper we have segmented the distribution of life insurance in to 3 categories:

1. **Intermediated**. This includes individual policies distributed by an intermediary financial adviser or planner that is accredited to offer "full" advice.
2. **Group**. This includes bulk policies distributed via not-for-profit superannuation funds, employers and retail master trusts.
3. **Direct**. This includes individual policies sold without the involvement of a financial adviser or other intermediary, though often an intermediary is involved in referring the insurer to the customer. Typically these are designed to be sold without the involvement of a financial adviser or planner and in the absence of any financial advice or assessment of the insurance needs of the customer. There are a variety of distribution methods adopted including outbound telephone calls, direct mail, internet, advertisements in print or electronic (television, radio, internet) media, by lenders and their sales representatives to insure finance obligations and directly in bank branches and shop fronts.

The exact market share of direct channels in Australia is near impossible to define, however it is likely to be less than 15% of both sales and in force premiums. Plan for Life data indicates that "direct and other" channels accounted for 13.2% of "Sales" (i.e. new regular premiums and all single premiums) received in the 12 months to September 2009, and for 8.5% of all inflows. By any measure, it appears to be only a small part of the market. These sales figures are analysed in more detail in section 3.1.





Source: Plan For Life (Sep 2009), based on sales and inflows over previous 12 months.

This data should be used only as an indication of the size of the direct market as:

- It is based upon the "Direct and other" category
- We understand that the category excludes some consumer credit and related debt protection insurance
- The data excludes business written by general insurers – e.g. accidental death or some elements of jointly written debt protection insurances
- We understand that many insurers have difficulty splitting their sales accurately by channel for this data and not all participants will apply the same logic in defining which is direct and which is not.

2.3. Who's Who

Are direct channels helping life insurers and consumers to address underinsurance?

Perhaps not surprisingly, it is our experience that direct channels in the open market seem to have generally been adopted most enthusiastically by those insurers without large in force books sold by advisers and without their own adviser networks. The insurers that we have observed as being most active in the segment include Allianz, Tower (via InsuranceLine), Zurich, AIA, MetLife, Hallmark, St Andrew's and CUNA Mutual. Plan for Life data indicates that other established insurers, such as MLC, CommInsure, BT Westpac and AMP also write significant amounts of “Direct & Other” business, perhaps mostly through channels that are not in the open market such as debt insurance and so not competing directly with their adviser force.

In direct segments there is also scope for companies to specialise in distribution and administration of insurance products, while leaving the issuing of the insurance to a third party life insurer or reinsurer. Real Life Insurance is a good example of this, distributing and administering policies issued by Hollard, with an in force book including policies issued by AIA and St Andrew's. Also, Australian Life Insurance Group (ALI Group) design and distribute insurance policies but where the life risk is passed to Tower, then 100% reinsured with Swiss Re.

A note on the identification of the “most active” industry participants. The authors have used a variety of methods to identify the participants in each segment including researching the industry as a hypothetical consumer, discussion with industry participants, analysis of previous research and our own experience working in the segment. This however is not an exhaustive process and we offer our apologies to any reader who feels that their employer or business has been under represented. We note particular difficulty in identifying the participants in segments where the distribution is targeted to individual consumers, for example direct mail distribution. In these instances it is not possible to identify the participants by internet research, yellow pages or even an analysis of media advertising, you simply need sit back and wait to be targeted yourself!

2.4. Description of Direct Channels

Direct Mail

This is one of the most common direct distribution methods. Typically it involves mailing a letter of introduction, an application form and a Product Disclosure Statement to customers with whom the organisation has an existing relationship. This is often followed up by a reminder letter, post card or simply a repeat of the first mail pack a few weeks later. This may allow for a variety of application methods, such as returning a written application form in a pre-paid envelope, telephoning a call centre or on-line.

For example, a bank may send an offer of term life insurance issued by the bank's own life insurer to a selection of the bank's customers. The offer could be more closely linked to the existing product relationship, for example an offer of credit card protection insurance to credit card customers. Many insurers in this space specialise in distributing to independent customers bases such as those of smaller banks, building societies, health insurers and automobile clubs. These offers are often white labelled and use the branding with which the customer is familiar, rather than that of the insurer.

Critical success factors for this method include:

- Targeting and segmentation. It can be very expensive to simply send the offer to every name and address you can get your hands on. As the cost of distribution is relatively fixed per thousand people mailed, profitable distribution requires the minimisation of costs per policy by the maximisation of "strike rates". In this context strike rate would be the number of policies or number of lives insured divided by the number of offers sent. Sustainable use of this method requires the use of customer data to identify those more likely to successfully apply for the life insurance. This data can also be used to tailor the marketing pitch to the customers’ likely insurance needs.
- Strength of relationship and breadth of brand. If the popular media is to be believed, the general population don't like banks. So would they buy insurance offered to them by the bank? On the other hand organisations such as credit unions and health insurers are often considered to have high brand loyalty and their customers may be more likely to take up a related insurance offer. Breadth of brand is also important. A customer may have the same degree of loyalty to their bank and their airline rewards program, but that doesn't mean that the rewards program brand could extend to offering life

insurance. Customers may think that the rewards program is simply not related to their financial needs.
- Getting priority among other direct mail offers. When most banks measure the number of products per customers as a KPI, it can be difficult to fit the insurance offer in the marketing schedule alongside the credit card, saving account and wine club offers. Customers can also suffer from direct mailing fatigue and there is a need to limit the number of offers being made, especially via specific communications (e.g. not as an insert with credit card statement).

Direct Mail with outbound Call

This is a variation on the direct mail method described above. The mail pack may be simpler and may alert the customer that a customer service representative will call in the coming weeks. After allowing time for the customer to have received and contemplated the offer, a sales call is made to enable the customer to apply for the insurance on the phone right now. The sales call varies, however "best practice" seems to involve:
- Positioning the call as a service call, yet using a script and conversation approach which generates a high strike rate
- Accepting "clean skins" and nearly standard lives over the phone, issuing the policy on the spot.

Compared to the simple direct mail approach this generates significantly higher strike rates, but also significantly higher and still fixed costs. It is a truism that "life insurance is sold not bought" and it is logical that a targeted forewarned well organised sales call should generate significantly higher sales per offer than a simple mail pack.

Critical success factors for this method include:
- The quality of the call centre staff and training. Selling and underwriting life insurance over the phone is a sophisticated sale and is done within a complex compliance regime. This can not be done by a generic call centre with a high turnover of largely untrained staff. The authors' observation is that considerable effort needs to be put in to selecting and continual training of the call centre staff. Measuring either strike rate or compliance measures as KPIs, considerable variance can be observed from week to week during a sub-optimal sales campaign. There are a number of call centre operators that specialise in providing this service to insurers and other financial services companies.
- Whether systems allow for underwriting and issuing a policy on the spot.
- Telemarketing concepts such as calling at the right time of day, taking in to account the target demographic and less obvious factors such as the time of year and the weather.
- As for simpler direct mail offers, targeting and segmentation and the strength and breadth of the brand.

Advertised Call to Direct Action

This method involves fundamental advertising of a specific service offering. For example, "What would happen if you died and your funeral expenses had not been provided for? Did you know that even simple funerals cost many thousands of dollars? Protect your loved ones from this unnecessary burden in their time of grief by purchasing *XYZ* funeral cover. Cover is available immediately with no medical tests for less than the price of a cup of coffee per week. Call *XYZ* now on 13 *abcd* to be immediately covered."

The authors have observed ads in magazines, in newspapers, on post it notes on the front of newspapers, the internet, radio and television. Anecdotally, we understand that the greatest successes have been achieved by television advertising, known as Direct Response Television or DRTV. The key players in this channel seem to be InsuranceLine and Real Life Insurance, though we note that Real Life Insurance have also white labelled products and television advertising for other brands such as Aussie Home Loans.

The advertising in this method should be distinguished from brand advertising or advertising where the call to action is to contact a financial adviser and ask them about a particular product or insurer. The call to action here is to call now and be protected immediately. While the television advertising directs the customer to an inbound call centre, this method could also direct them to a website, a mail response or to a branch or store for the application process.

Critical success factors for this method include:

- Effective advertising, targeted at an appropriate audience. Does the call to action hit home?
- Systems and application process. Do the systems allow for underwriting and issuing the policy on the spot in the case of an inbound call centre? Otherwise is it easy for the customer to engage with the application process? Are the call centre staff skilled in converting these warm leads, as opposed to "cold calling" outbound sales calls.
- Brand. Interestingly perceptions of “quality” or the strength of the institution may not be important here. For example the DRTV advertisers of InsuranceLine and Real Life Insurance are not relying upon established “blue chip” brands. Instead they are building their own brands through the advertising and leaving the actual insurers relatively anonymous.

Internet

Internet sales of life insurance have disappointed many people. While writing this paper we spoke to one actuary who explained that they had personally designed and promoted an on-line insurance sales, application and underwriting process around a decade ago. Our correspondent explained that he had always understood the life insurance is sold not bought truism, but hadn't realised how strong it was until this venture.

Internet sales do not seem to constitute a significant part of the overall industry, though its importance is expected to increase as consumers become ever more familiar with making purchases over the internet, and those generations that are already comfortable with this take out life insurance. Probably. Eventually. Or maybe it will only ever be a niche, but worthwhile as it is a very low distribution cost once the website is developed and if you already have an automated underwriting process. And you are prepared to spend money to ensure that people find you on common internet search engines such as google.

To research this segment the authors typed "term life insurance" and "life insurance" in to the google search engine, with a setting to show Australian websites only. We figure that this is what the majority of potential customers would do. We then only looked at websites on the first page of results, again believing that if a customer could find what they were looking for on the first page they wouldn't look further.

What we found was:

- Insurer's own websites. Prominent insurers included Allianz, Tower (as InsuranceLine), ING, Suncorp and Hannover Re. Most but not all of these offered on-line application processes for the subset of products that were marketed via the search engine. These are typically simple lump sum risk products with maximum sums insured under $500,000. Where application could not be completed on-line the methods offered included requesting to be called within 15 minutes, requesting to have an application form mailed or downloading an application form and mailing it in.
- White labelled offers. These are where the website and insurance offer uses a brand other than the insurer’s. Zurich is a key player here and does not distribute products on its own website, but on the website of a large range of third parties.
- Broker comparisons. This category involved websites developed by adviser or broker groups. Typically the website collected some basic details about the customer and their insurance needs, with the aim to sell a selected product from a panel of insurers. In most cases this service was not on-line and resulted in an adviser contacting you later with a quote or a quote being emailed to you later. An exception was InsuranceWatch which provided the quotation instantaneously and linked through to the application process for the selected product. If the product was available by on-line application then the appropriate links were provided for this to occur.

The products available on-line are typically simplified versions of lump sum risk products, with maximum sums insured of up to $500,000. These products include term life, sometimes with TPD or trauma riders, accidental death and funeral insurance. Standalone trauma, accidental injury and income protection products were less widely available. Where income protection is available it too was typically simplified, for example with maximum monthly benefits of $5,000 and maximum benefit periods of two years.

The authors are unclear on the critical success factors for this method, as we have not spoken to anybody during the course of our prior experience or research that claimed to have been successful. Nevertheless some of the likely success factors are clear:

- Ability to generate web traffic. There is no point in having an attractive, easy to use website, with good products and an automated underwriting engine if nobody can find your website. Methods for increasing web traffic to your website include "optimising" the website to have it included in common internet searches for the product and advertising whether by web banner, sidebars, sponsored search engine responses or other advertising (e.g. print). OnceOnline is in the opinion of the authors an example of a very good website, which makes it very easy to take out term life insurance on-line. However it is currently largely invisible by its absence from search engine results and on-line advertising.
- Ability to establish the need for insurance on-line. Once someone is looking, are there sufficient materials on the website to confirm and reiterate their insurance needs, for example an insurance needs calculator?
- Brand. It is likely that a trusted "off-line" presence would be required to convince many potential on-line customers. Many consumers are still cautious about using the internet to make even routine purchases. How do you convince them to make a long-term financial commitment on-line?

Debt Insurance

Debt insurance refers to an insurance product designed specifically to insure a customer's ability to meet their debt obligations. Typically it is sold at the same time as the debt facility is established by the lender, although it may also be offered in the following months or as a direct mail campaign to existing borrowers. The products are often tailored to the debt facility. For example a mortgage insurance policy might have a package of benefits:

- Death and TPD benefits with sum insured of the amount outstanding on the mortgage at the time of death or TPD
- Accident & sickness benefits with the sum insured of the monthly repayments, with waiting periods and maximum benefit periods, if the policyholder can not work due to injury or illness
- Involuntary unemployment benefits on similar terms to the accident & sickness benefits, payable if the policyholder becomes unemployed for reasons defined as involuntary (e.g. redundancy).

All repayments are typically made directly to the lender with no money passing through the hands of the claimant.

Debt insurance can be arguably the easiest sale in direct life insurance as it is easy to establish a connection in the customer's mind between the debt being taken and an insurance need to protect their ability to repay it.

Common features include:

- Debt insurance is often written as consumer credit insurance and in this case legislation imposes a commission cap of 20% of premium. If sold as consumer credit insurance then the policy lapses if the loan discontinues (e.g. is refinanced).
- Single or monthly premiums. Single premiums would typically be financed in to the amount borrowed and paid for as part of the regular loan repayments. To reduce the impact of insurance premiums on mortgage repayments the insurance term is typically less than the original loan term, though longer than the average life of a mortgage.
- A pre-existing conditions clause in place of any detailed underwriting. Broadly this clause means that the applicant can not make a claim at any time if the reason for the claim existed at the time of taking out the policy. The definition would include conditions of which the applicant was aware, that a reasonable person in their position could have been expected to be aware of or that they had consulted a doctor for in the previous 12 months. For example a policyholder with a history of heart problems would be likely to be denied a claim in the event of a heart attack. It is effectively underwriting at the time of claim.

Some variations are less directly tied to an individual debt and may be sold alongside the debt as intended to meet their needs with regard to the debt. For example a product could have a reducing death sum insured designed to reflect the amount outstanding, but not matching it. These variations may exhibit lower cancellation rates as they may not need to be cancelled if the loan is refinanced with a different lender.

Critical success factors for this method include:

- Sales process & training. Consistent sales processes are essential not just for sales volumes, but also to reduce early cancellations and avoid misunderstandings regarding the pre-existing conditions clause arising at claim time. The support of the lending institution to embed the insurance offer in the sales process for the debt is essential, as is the personal and corporate relationships between lender and insurer. The highest strike rates will be achieved where the insurance application is offered at the same time as the debt application and where the lender's sales staff truly believe in the value of the insurance product.
- Clear lead and sales process. This channel succeeds on the premise of meeting an immediate and apparent insurance need, with a product customised to meet the need. It works when it is clear and simple. It is less successful when the lender also has a strong in branch financial advice presence as this creates firstly confusion as to the appropriate referral channel for any lead and secondly competition between channels.
- A product that clearly meets the need. This channel involves a sale made to a captive audience. It is more important that the benefits of the policy are clear than to be price competitive.

Bank branches and shop fronts

A number of bank-aligned insurers offer simple products over the counter in bank branches. Internationally these over the counter sales may also be made in supermarkets or various kiosk locations (as detailed in section 2.6). However in Australia it is largely restricted to financial services outlets (e.g. bank branches) and shop fronts of member based organisations such as health insurers or automobile clubs.

We understand that generally this kind of approach does not generate significant sales volumes directly. Competing priorities in the store, the relative complexity of the products and a regulatory regime that essentially limits the store staff to providing factual advice only constrain sales. This channel has been more successful in other environments such as the United Kingdom where branch staff can actively sell the product.

In Australia, it is probably best used to build awareness of the products or brand as part of a multi-channel approach. For example a branch may feature posters for a life insurance offer and stand with PDS and application forms, at the same time that a Direct Mail with Outbound call campaign is being conducted with customers in that area.

2.5. Direct Products

The types of insurance products available through direct channels are similar in many ways to those available through advice channels. However, there is a much greater focus on keeping the products simple, with straight-forward benefits and premium rate structure and minimal or no underwriting.

Acquisition costs with direct products may be lower, mainly because there is no intermediary to receive commission, however the price can still end up higher than similar products sold through intermediaries. This is because direct products tend to be priced for an 'average' person, so that the insurer can accept or decline an individual at standard rates after asking relatively few underwriting questions. Adviser-sold insurance products are typically fully underwritten, priced for a 'healthy' person then applying premium loadings or exclusions for individuals who may be considered a higher risk.

While most direct products are designed to ultimately accept or decline an applicant at a reasonable price, some have gone further than this, and have added more advanced underwriting engines to the application process and will aim to provide cover for higher risk individuals for an additional premium (or alternatively, to accept an exclusion and maintain standard rates).

It is not uncommon for some Consumer Credit Insurance (CCI) and Funeral Cover products to provide automatic acceptance to applicants, relying mainly on a pre-existing conditions exclusion and age limits at entry to manage the anti-selection risk. CCI policies have the additional protection that you need to qualify to borrow before you are can apply for insurance cover on the borrowed amount.

The most popular products sold directly are listed below:

- Term Life Insurance
  - This can be offered with varying degrees of underwriting, from no underwriting to fully underwritten policies.
  - Premium rates can vary by year of age, can be split into age bands (e.g. Increase every 5 years) or can be held constant for the term of the policy.
- Trauma cover
  - Can be offered with full range of features, but more commonly covers only 4-5 specific risks.
- Mortgage cover, Loan cover and Credit Card cover
  - Usually offered as Consumer Credit Insurance (CCI)
  - Products tend to be tailored to meet the needs of a borrower (i.e. repay the loan in the event of death or TPD, or cover the loan repayments in the event of accident, sickness or unemployment).
- Funeral Cover
  - Often sold with no underwriting, for low sums insured and small premiums.
  - Target market tends to be retirees
- Accidental Death or Accidental Injury
  - Providing payout of the sum insured in the event of accidental death.
  - Accidental Injury cover extends this to cover a number of prescribed injuries (e.g. Loss of limbs or sight, etc.) and sometimes the benefit payout can vary depending on extent of injury (i.e. one vs. two limbs lost)
- Income Protection

2.6. International Experience

Our research has not found any markets where direct channels are the dominant source of life insurance business, and intermediated channels remain as the main channel in all of the overseas markets we have researched. However, a number of markets are experiencing significant growth in this area and competitors are being increasingly innovative in the way that they reach their target market.

Kiosk sales

Some insurers in Asia are using electronic kiosks to reach a wider customer base and tailoring their product offering to the kiosk locations. The customer can enter their basic details (name, gender, policy type, sum insured) and the system generates a quote. The customer then has the option to approve the terms and make a payment. These kiosks allow the insurer to provide customers with the opportunity to buy insurance when the associated risk is on their mind. Examples include:

- Travel insurance terminals placed at airports, bus stations, seaports.
- Motor insurance terminals placed at petrol stations or service stations, allowing customers to renew their car insurance or get a new quote while on the road.
- Health insurance terminals placed at hospitals.
- Kiosks in shopping malls offering multiple life/non-life products.
- Banks selling insurance products through ATMs.

Historically, these have been very popular in countries where customers are not well connected to financial services. However, the kiosk distribution channel is also likely to work in countries with technology-knowledgeable populations.

SMS

Mobile marketing has proven to be of value in increasing brand awareness as it allows an instant response. Compared to offline advertising, it provides an immediately quantifiable measure of the success of the campaign.

Generally, a text message is sent to a customer informing them about a product and they are provided with the option to purchase complete insurance coverage direct from the phone or send a text message to request more information and special offers. They can also request a call back for assistance with queries and premium purchases.

Internet

The internet is also emerging as a distribution channel with significant potential for growth. While it is unlikely to become the primary insurance distribution channel, it is used very successfully to distribute simple and easy to understand products. In South Korea, online car insurance operators are winning increasing market share from traditional insurers, because they are able to easily get in touch with a large proportion of the market and offer reduced premiums online. Like South Korea, Australia also has a high population of internet users. The planned roll out of the National Broadband Network combined with Generation X and Y's expectation to fulfil all of their needs online means that there will continue to be significant growth opportunities with web based insurance sales.

Supermarket Sales

In Ireland and the UK, a large supermarket chain (Tesco) has been successfully selling life insurance for a many years. Shoppers are provided with information on life products from pamphlets at the checkout and are able to buy the insurance over the phone, or by completing and returning an application form.

Direct mail and Affinity Groups

In the US, the companies that are most successful at direct mail marketing campaigns are those with strong ties with affinity groups. They are using data analytics to help identify their target market, and can test market any offering and have a good understanding of how they will fare before they commit to larger campaigns.

In the UK, where car insurance is compulsory, where the products are simple to understand and easy to compare, direct channels now account for over 50% of new car insurance business. Given that basic term life insurance in its essence is relatively straightforward and easy to compare, and increasingly viewed as a commodity, it is somewhat surprising that life insurance sales in Australia have not (yet) fully utilised opportunities from direct channels.

3. Are direct channels helping life insurers to address underinsurance

In this section we attempt to answer the question of whether direct channels are helping life insurers to address underinsurance by:

- Considering the size and market share of the direct life insurance market
- Considering anecdotal evidence on strike rates
- Considering anecdotal evidence on the profitability of direct business

Ultimately this section of the paper is concerned with determining whether or not direct channels allow life insurers to profitably access consumers that they would not otherwise access, or to profitably increase customers' levels of insurance beyond what they would otherwise hold.

3.1. Size of the Direct Market

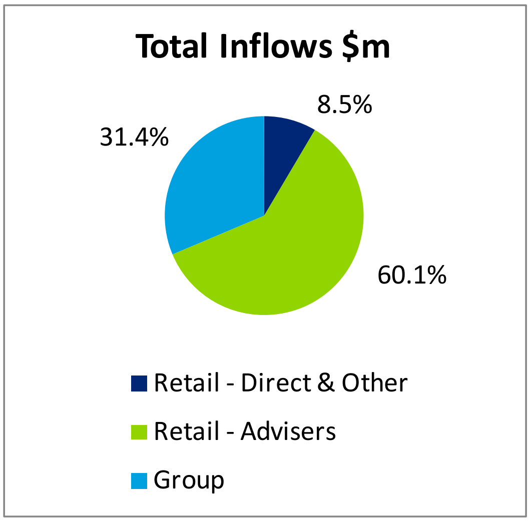
Because there is no clear data source available showing business written through direct channels only, it is difficult to quantify the size of the direct market. However, data sourced from Plan for Life provides details of in-force and new business split by broad distribution channels, including "Direct and Other". This essentially includes all business that is not sourced from dealer groups or brokers, and we have used this to get an idea of the size of the Direct Market.

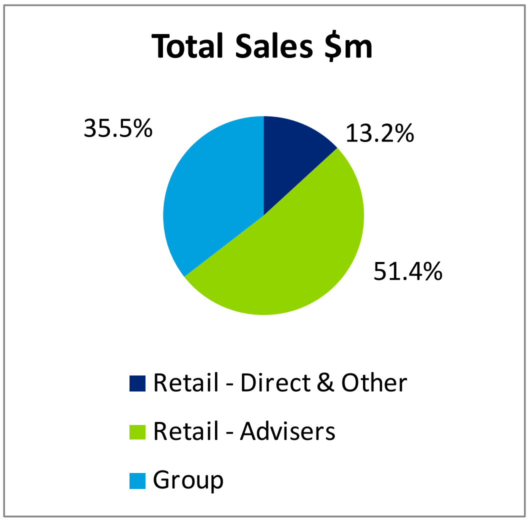
The tables below summarise the Total Sales and Total Inflows for the 12 months to Sep 2009 from the Plan for Life data. Sales include new regular premium and all single premiums.

Total Sales YE $M	Direct & Other	Direct & Other	Direct & Other	All Channels	Direct & Other	Direct & Other
Group	Lump Sum	Income	Total	Total	Market Share	% of Total Sales
TOWER Group	79.433	4.171	83.604	212.136	28.6%	39.4%
CommInsure Group	56.005	0.773	56.778	327.467	19.4%	17.3%
BT / Westpac Group	17.566	18.476	36.042	116.921	12.3%	30.8%
Hallmark Life	31.628	-	31.628	31.628	10.8%	100.0%
Allianz Global Investors Group	17.908	-	17.908	18.179	6.1%	98.5%
AMP Group	12.104	2.920	15.024	259.609	5.1%	5.8%
Macquarie Group	9.323	1.886	11.209	23.147	3.8%	48.4%
ING Australia Group	10.974	-	10.974	268.429	3.8%	4.1%
Cuna Mutual	7.808	-	7.808	10.410	2.7%	75.0%
Suncorp Group	5.887	0.272	6.159	67.672	2.1%	9.1%
National Australia / MLC Group	2.041	2.159	4.200	264.421	1.4%	1.6%
HCF Life Group	2.577	0.136	2.713	2.941	0.9%	92.2%
AXA Australia Group	1.138	1.332	2.470	139.690	0.8%	1.8%
Aviva Group	-	1.905	1.905	88.540	0.7%	2.2%
AIA Australia	1.716	-	1.716	333.567	0.6%	0.5%
Zurich Australia	0.860	0.696	1.556	27.084	0.5%	5.7%
MBF Group	0.573	0.020	0.593	2.169	0.2%	27.4%
MetLife Insurance	0.063	-	0.063	25.897	0.0%	0.2%
Group Total	**257.604**	**34.746**	**292.350**	**2,219.907**	**100.0%**	**13.2%**

Total Inflows YE $M	Direct & Other	Direct & Other	Direct & Other	All Channels	Direct & Other	Direct & Other
Group	Lump Sum	Income	Total	Total	Market Share	% of Total Sales
TOWER Group	166.979	2.481	169.460	783.780	58.0%	21.6%
CommInsure Group	144.851	13.203	158.054	1,230.964	54.1%	12.8%
AMP Group	58.786	9.936	68.723	738.163	23.5%	9.3%
BT / Westpac Group	32.340	34.694	67.034	408.242	22.9%	16.4%
Hallmark Life	35.028	-	35.028	35.028	12.0%	100.0%
ING Australia Group	33.272	-	33.272	1,010.197	11.4%	3.3%
Suncorp Group	23.701	2.256	25.957	642.843	8.9%	4.0%
Allianz Global Investors Group	21.288	-	21.288	27.937	7.3%	76.2%
HCF Life Group	16.693	0.457	17.150	19.156	5.9%	89.5%
National Australia / MLC Group	7.883	8.677	16.560	968.882	5.7%	1.7%
Macquarie Group	13.000	2.315	15.315	39.266	5.2%	39.0%
AXA Australia Group	5.024	8.537	13.561	663.065	4.6%	2.0%
Zurich Australia	7.699	3.945	11.644	189.628	4.0%	6.1%
MBF Group	9.515	0.171	9.686	39.730	3.3%	24.4%
Cuna Mutual	8.669	-	8.669	15.243	3.0%	56.9%
Aviva Group	-	8.101	8.101	294.015	2.8%	2.8%
AIA Australia	4.503	-	4.503	682.503	1.5%	0.7%
MetLife Insurance	0.911	-	0.911	256.186	0.3%	0.4%
IOOF Group	0.341	-	0.341	0.811	0.1%	42.1%
Group Total	**590.483**	**94.774**	**685.257**	**8,045.639**	**234.4%**	**8.5%**

The split of business sold by "Direct & Other" compared to Other Channels (Life Office Aligned Dealer Groups, Non-Aligned Dealer Groups, Stock Brokers, Bank Aligned Dealer Groups, Group Risk Wholesale and Group Risk Master Funds) is shown in the charts below:





Source: Plan For Life (Sep 2009), based on sales and inflows over previous 12 months.

In addition to the "Lump Sum" and "Income" classifications, the Plan for Life data includes a small amount of Direct & Other premium which is classed as "Group". The authors are not aware of any forms of group risk business that are sold using channels we classify in this paper as direct so have, with a reasonable amount of confidence, classed all of these premiums as "other" rather than "direct" in our analysis of the direct market.

The tables above indicate that direct business accounted for $685m of in-force annual and single premium income over the 12 months to Sep 2009, representing 12.4% of in-force retail risk life premiums received, or 8.5% of overall in-force risk premiums (i.e. including group risk business).

It is also worth noting that the average annual growth in premium inflows over the last 3 years for direct & other business (16.6%) is greater than the growth across the industry overall (13.8%), indicating that the direct market has gained market share over this period.

As noted in the opening paragraph of this section, there are a number of issues with relying completely on this data. We are confident that this data provides a reasonable indication of the size of the market, but for completeness, have noted the issues below.

- “Other” business is included with direct business in the Plan for Life classifications.
- Some insurers write components of direct business under general insurance (e.g. Involuntary Unemployment cover, Accidental Death and/or Injury, Child cover, etc.) which would not have been included in the Plan for Life study.
- Not all insurers will account for or classify similar policies in the same way. This might arise either because of the convenience of grouping large numbers of products into a single distribution channel, or because of difficulty with correctly splitting out the data by channel.

3.2. Strike Rates – What can be achieved?

The following anecdotal evidence on strike rates provides an interesting perspective on direct sales. The precise definition of strike rate would vary by channel and product but broadly

Strike rate = Number of insured lives ÷ Number of offers made

For example for mortgage protection business the strike rate could be the number of policies issued divided by the number of loans sold. Some companies would count lives insured rather than policies issued, hence counting twice for joint policies. Others would use the number of loans where the borrower was eligible for the cover as the denominator.

Strike rates from the consumer credit insurance sector provide an interesting and probably controversial measure to consider. The authors have observed the following as achievable target strike rates.

Mortgages	40%
Personal Loans	60%
Credit Cards	30%

In this context the measure is the number of lives insured divided by the number of debt products sold, with no adjustment for eligibility. In other words, in some channels we have observed six loan protection insurance policies being sold for every ten personal loans. If nothing else **this indicates that a large proportion of borrowers taking out these personal loans, at the time of application and with the aid of suitably trained sales staff, perceive an otherwise unmet insurance need**. Such products are sometimes criticised for not meeting a customers’ needs more holistically, for perceptions of poor value for money or for unfavourable terms and conditions, but there is clearly a demand that they are meeting. Moreover their success is greatest in customer segments that otherwise have little insurance. For example a typical personal loan insurance customer is under 35.

Strike rates observed elsewhere tend to be lower. For simple direct mail campaigns a “shotgun approach” of making the offer to all eligible names without any targeting typically results in a strike rate of less than 1%. However, due to the low distribution costs this channel can be still profitable on such low strike rates. It is perhaps not sustainable however as with strike rates that low you tend to send the offer to every name that you have access to in order to achieve volume and you can quickly run out of leads who are interested in the offer. A more efficient use of the mailing lists is to use demographic and other customer information to identify those more likely to purchase (propensity modelling) and tailor the product offer or marketing to different customer groups. This should result in higher strike rates and more efficient use of customer lists as a resource. In practice the success of propensity modelling has been widely variable, from highly successful to little or no improvement.

Strike rates for Direct Mail with a follow up outbound phone call are higher, as they would need to be given the additional expense. The authors were involved in some trials of this method and observed strike rates of 5-6% in initial testing. We understand that insurers that have put more time and effort in to this channel have achieved considerably higher strike rates, particularly when the initial lead generation is supported by propensity modelling.

It should be noted in closing that a discussion of strike rates necessarily measures sales successes in the active selling environments. Strike rate is essentially the proportion of opportunities converted to a sale. We have not discussed sales conversions in more passive channels such as Internet, point of sale and direct response television where the number of opportunities is less tangible.

3.3. Profitability

The authors spoke to representatives of a number of insurers and not surprisingly nobody would directly provide details of profitability. A few things can be inferred however:

- If distribution methods have been sustained over a long period of time then it is reasonable to assume that they are sustainable. At worst they are profitable and meeting performance hurdles once optimised. The authors understand that the following channels can be categorised as profitable in this way
  - Direct Mail
  - Direct Mail with outbound Call
  - Advertised Call to Direct Action
- Debt insurance is strongly profitable. This is no trade secret. An indication of the profitability can be taken from APRA’s Half Yearly General Insurance Bulletin Statistics. These showed that for the 6 months to June 2009 the total loss ratio for consumer credit insurance policies issued by general insurers was 22%. In other words 22 cent in every dollar of premium was meeting claims. Given that commissions are capped by legislation at 20%, this leaves 58% of premium to fund non-commission expenses, net cost of capital, taxes and profit margins. By comparison the total loss ratio for the general insurance industry across all classes of business was 76% for the same period. Not all debt protection insurance is written as consumer credit and not all is written by general insurers, however this data can be used to reasonably infer the overall profitability of insurance sold by this channel.
- The authors can claim little knowledge of the profitability of distribution by internet. It would seem logical however that this is a scale game. The costs of developing the application & underwriting platform and a functional and attractive website are significant, but a sunk cost once set up. Recovery of these sunk set up costs and ultimate profitability is then dependent on sufficient expenditure on effective advertising, whether on line or elsewhere, to direct traffic to the internet site. The marginal cost of actually processing an application on-line should then be low or at least no greater than via traditional methods, depending upon how automated the application process is.
- The authors understand that the profitability of sales through bank branches or shop fronts is marginal, if the cost of acquisition is fully accounted for in the margins of the insurance company. Often however this is not the case. For example the insurance company within a banking group may pay the bank a commercial rate of commission for sales in branch. However given the relatively poor strike rates often achieved by this method this commission is unlikely to adequately reflect the cost to the retail banking division of these sales in terms of time, floor and promotional space, training, etc.

3.4. Conclusion

Are direct channels allowing life insurers to profitably access consumers that they would not otherwise access, or to profitably increase customers’ levels of insurance beyond what they would otherwise hold?

Yes, though perhaps not in volumes sufficient enough to materially solve the underinsurance problem.

- The strike rates indicate that direct channels can be used to access consumers not accessed by traditional channels, or at least to increase the levels of insurance
- The brief discussion of profitability indicates that at least some of these channels are being used to do so profitably
- However, the analysis of the size of the direct market indicates that it is not yet a significant proportion of the overall life insurance market.

In particular if the direct market constitutes 8.5% of the overall life insurance market it is not yet making a large impact on underinsurance.

BankWest research found that 28% of Australians have a financial adviser, however insurance sold by advisers makes up 51% of the life insurance market. Conversely the 72% of Australians who don't have a financial adviser make up only 49% of the life insurance market. Hence those without an adviser have on average 37% of the insurance cover of those with an adviser.

4. Are direct channels helping consumers to address underinsurance?

In this section we attempt to answer the question of whether direct channels are helping consumers to address underinsurance by:

- Considering whether the direct market improves access to life insurance
- Considering whether typical direct products are helpful to this end. Do they meet the insurance needs of the individual?
- Considering the impact of the absence of advice on the ability of consumers to address underinsurance

Ultimately this section of the paper is concerned with determining whether or not direct channels allow the average consumer to meet their life insurance needs.

4.1. Do direct channels improve access to life insurance

With exceptions, yes. It is common sense that the access is improved by increasing the number of different ways in which a product can be purchased. The more methods there are, the greater the proportion of the population who would be comfortable using at least one of them. Moreover many direct channels allow the consumer to purchase insurance without leaving the house, certainly without making multiple appointments to meet a financial adviser, an attractive option in an increasingly time poor society. But is this a material improvement?

Internet distribution improves access to life insurance for those who are internet savvy. However a significant proportion of people remain uncomfortable making any purchases over the internet, a proportion that would logically increase when it comes to complex, relatively expensive and long-term purchases such as life insurance. Perhaps helpfully, younger generations that are more likely to be comfortable using this channel are also those with the lowest levels of life insurance. In time, the internet may become a significant channel for these consumers.

Likewise, bank branch or shop front distribution provides another point of access for proactive applicants who are seeking to purchase life insurance directly. Though only customers of specific banks are likely to realise that life insurance can be purchased in this way.

Advertised calls to direct action also provide an immediate and easy point of access for consumers, whether or not they have been proactively seeking insurance or are simply responding to the advertising. However, access to this channel is arguably limited to those who watch daytime, or simply a lot of, television.

Debt insurance improves access to insurance for applicants at a time when their insurance needs have increased. Moreover it is easy for the consumer to understand the insurance need and to perceive the value in purchasing this cover. The strike rates outlined in section 3.2 demonstrate how effective this channel can be. However this channel does not provide access to a wide variety of products or features, nor does it provide access to consumers who are not current borrowers of a particular institution.

Targeted distribution aids access to life insurance only to those targeted. Hence channels such as direct mail improve access to a reactive applicant but not to proactive applicant.

Ultimately, these channels increase the number of ways in which a potential applicant can access insurance. By increasing the choice and number of access methods, the preferences and needs of a broader range of applicants can be met. They make life insurance easier to buy for some people and improve access to life insurance.

4.2. Do the products sold by direct channels meet the needs of the individual

The previous section concluded that the direct channels as a collective group, improve access to insurance by increasing the number of access points and providing alternative methods to suit a wider variety of consumers. However, does this really *improve* access to life insurance? Do the products meet the needs of the customer? If not, by providing access to products that are in some ways inferior, can direct channels be counterproductive and divert consumers from accessing products that would be more suitable to their needs via a financial adviser?

Meeting the needs of the individual is a function of both:

- providing products that meet the needs
- a sales process that facilitates the consumer purchasing the appropriate products with the appropriate levels of cover

This section considers how effectively direct channels deal with the first matter, while the second is considered in the subsequent section.

As they provide differing products to differing customers, some channels will provide products that better meet the needs of consumer than others.

Debt insurance is particularly effective at meeting *a part of* the needs of the individual. A typical product sold to protect a mortgage may pay a benefit:

- of the amount outstanding on the loan in case of death or TPD
- the repayments on the loan in case of being unable to work through temporary disability, sickness or becoming involuntarily unemployed.

This directly meets the needs of the individual with regard to their mortgage, providing a range of covers, such as the unemployment insurance, not widely available through other distribution methods. It does absolutely nothing for meeting the individuals life insurance needs with regards to their other obligations and expenses though. These products are also often criticised for being expensive, relative to equivalent cover purchased through other channels.

The products sold through other direct channels could be summarised as meeting the basic needs of "mass market" consumers. Typically the products are simplified versions of those sold by financial advisers. They may have lower levels of cover and provide less ancillary benefits. While it would appear to be relatively easy to purchase term life by direct channels, in many cases rider benefits such as trauma and TPD are not offered. Moreover income protection insurance is not widely available in direct channels. Where it is available it is usually simplified, for example with maximum monthly benefits of $5,000 and maximum benefit periods of two years.

Let us consider the needs of a Mr and Mrs A. Mr and Mrs A are average. They are a married couple with two dependent children aged 5 and 8. Mr A works full time earning the national average earnings of $63,600[v] while Mrs A works part-time earning exactly half that. They are both aged 35 and don't smoke and have just taken out a mortgage of $300,000 on their new house valued at the Sydney median of $490,000[vi].

Mr and Mrs A have heard about the industry’s efforts to promote life insurance and have used IFSA’s lifewise.org.au website to assess their insurance needs. The IFSA website suggests that Mr A needs $1.47m of life cover and $3,900 per month of income protection cover, while Mrs A needs $900k of life cover and $1,900 per month of income protection cover. It also suggested that the average cost of this cover should be approximately $9.50 per day. Mr and Mrs A read the fine print and noted that Trauma and TPD cover were excluded from the calculator, did further research and decided to seek TPD cover equivalent to their term cover.

Mr and Mrs A's insurance needs are not well met by the direct market, as the levels of cover they are seeking are not widely available by direct channels. If they continued their search online they would find that many insurers offer term life only up to $500,000 and as previously noted income protection insurance is not widely available. This package of needs could not be met by any single online insurer. For example Allianz, which provides unusually high maximum cover levels on line could accommodate their term cover but would cap the TPD cover at $1.25m and does not offer income protection on-line. InsuranceLine could offer only $1m of Term life and on TPD, but could offer the income protection product. MBF offers term life, TPD and income protection, including a product with adequately high cover levels, however the application process is not actually online but to download the application form and post it to the underwriting department.

Perhaps if they persisted on-line they would end up purchasing insurance via one of the broker comparison websites. These websites source leads on line for adviser groups, then typically sell a more traditional advice style product which may enable Mr and Mrs A to more readily meet their assessed needs.

Remember that this search was on behalf of a financially average couple and assessing their needs with the industry's own on-line needs calculator. If their needs were difficult to fulfil proactively using direct channels then a large proportion of the population cannot meet their needs in this way. This ignores differences in how the needs are met compared to traditional channels, with the direct products often having simpler stricter terms and conditions and sometimes higher premiums.

4.3. What is the impact of the absence of individual advice?

Perhaps the biggest limitation for direct channels is the absence of individual advice. These channels cannot hope to significantly address underinsurance if they do not provide consumers with the means to assess the products and levels of cover needed to meet their needs.

The level of advice and assistance provided varies by channel.

- Most internet distribution includes a simple insurance needs calculator and these provide the applicant with an assessment of needs based upon their responses and a set of generic assumptions. In the absence of providing advice and the current limitations around the provision of advice, this is perhaps the best that can be achieved without significant human intervention in the process.
- Direct mail distributors typically make no attempt to inform or educate regarding insurance needs, sticking simply to factual product information in the mail pack. Again the scope for providing any further advice is argued to be limited by legislation and the inability in this format to provide examples that are likely to be relevant to the individual.
- While it may be practical to provide some assessment of needs during a telephone sales call, as part of Direct Mail with Outbound Call or Advertised Call to Action distribution, it appears to be uncommon. Again concerns around compliance risks in providing information and a concern that it may drag out the call and impact the sales process are limitations. Similar practicalities and concerns apply to branches and shop fronts, though could be overcome by the use of kiosks providing portals to automated application processes.
- Debt insurance as noted earlier directly meets a part of the applicant's insurance needs, while making no attempt to identify or address the remainder.

Generally then, with the exception of on-line, a direct insurance sale involves no attempt to identify or meet the applicants holistic insured needs. This could lead to either over or underinsurance. Judging by the extent of under insurance in both the life and general insurance markets, it is likely that on balance absence of advice would tend to contribute to consumers underestimating their insurance needs and underinsuring.

4.4. Summary

Considering again the questions posed at the commencement of this section:

Q. Do direct channels improve access to life insurance?

A. Yes, they make life insurance easier to buy for many people.

Q. Do the products sold by direct channels meet the needs of the individual?

A. Only partially
Q. What is the impact of the absence of individual advice?
A. On balance people are likely to take out less insurance than they ought to.

Are direct channels helping *consumers* to address underinsurance? Yes though imperfectly. This could be enhanced by:

- Legislative and other changes that would facilitate consumer education in the direct space, to enable consumers to better assess their insurance needs
- Further product development to meet more complex needs

5. Concluding Remarks

This paper sought to consider **whether direct channels are helping life insurers and consumers to address underinsurance.** The authors have sought the opinions and experience of a variety of industry participants, have considered local and international research and spent considerable time contemplating the current state of the industry and the problem of underinsurance.

Repeating our introduction we concluded **"Not really. But there's a lot of untapped potential."**

Direct channels are helping and are important to some life insurance companies. However, they are not yet a significant percentage of life insurance sales (less than 13.2%) or inflows (less than 8.5%) for the industry as a whole. In no developed life insurance industry around the globe are direct channels yet comparable to the size of the traditional channels in that region. Yet in many regions, direct channels are growing faster than the industry as a whole.

Is direct the insurers' solution to underinsurance? It helps. Direct channels allow life insurers to profitably access consumers that they would not otherwise access to, though probably not yet in volumes sufficient enough to materially solve the underinsurance problem. Some direct channels, such as debt insurance, are already highly successful for the insurance industry but by their very nature can only ever provide a partial or niche solution. Others such as Direct Mail with outbound Call and Advertised Call to Direct Action have shown promising signs of both sales and profitability and may provide strong growth in the short to medium term. The internet provides a method of mass access and potentially cheap distribution, but the question of how to **actively sell** life insurance over the internet will likely trouble marketing minds for some time to come.

Is direct the consumers' solution to underinsurance? Overall direct channels improve access to life insurance for consumers, as they make life insurance easier to buy for many people. But the products sold by these channels may only partially meet insurance needs of many consumers, which in combination with the absence of advice may lead to consumers using these channels being under protected. They allow consumers to lessen their underinsurance but are not likely to solve underinsurance on a mass scale.

The authors embarked on this research on the premise that financial advisers could not provide the answer to the underinsurance problem without significant changes to their remuneration models. Most financial advisers are well aware of the implications of living on commissions and many have concluded that people without reasonable accumulated wealth to invest are not profitable potential customers. Financial advisers will not on mass sell insurance to the mass market underinsured because it is not in their financial interests to do so. It will be interesting to see if the changes to financial advice revenue models stemming from the Federal government's proposed ban of commissions on investment products, have any impact on the attractiveness of "insurance only" customers to advisers.

Perhaps Australia's solution to under life insurance, if there is one, lies in insurance purchased through superannuation funds? Premiums from Wholesale life insurance and Master Funds make up 35% of industry sales and thanks to compulsory superannuation (nearly ?) all working Australians would be members of at least one superannuation fund. Many industry funds have taken this thought on board in recent years and default levels of cover are rising.

There is a good topic for future research.

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