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ELECTRONIC DISTRIBUTION OF LIFE ASSURANCE SERIOUS BUSINESS OR JUST A GAME?

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Electronic Distribution of Life Assurance

Serious Business or Just a Game?

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Section

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1. Battleships

1.1 Introduction

The title suggests a strong recreational theme to its contents although we acknowledge that, for the life insurance industry, distribution is a serious issue and not a game. The life insurance industry must prepare itself for further fundamental change if it is to survive and continue to provide a valuable service to the public. Rather like a giant game of battleships, there are hidden dangers lurking for life offices, which could bring about destruction if corrective action is not taken.

This paper covers the UK life insurance industry, although many of the themes are pertinent to other insurance markets as well. We have also adopted more of a marketing stance than strictly actuarial, although we have ventured some actuarial thoughts on pricing. Our intention with this paper is to stimulate discussion about the role of electronic media and the information superhighway in the future of the life industry, which is likely to extend well beyond distribution. Some of the practical examples of electronic distribution, mostly telesales, are drawn from motor insurance, mortgages and investments, as there is, as yet, little practical life insurance experience.

Distribution is a key strategic issue for most UK life offices today, and is likely to continue to be so for the forseeable future. Bancassurers are expected to increase their market share at the expense of the traditional offices, with predictions of an ultimate 30% to 50% market share. The number of companies with a direct salesforce is in decline, with the number of individuals registered to sell insurance falling steadily. Official PIA figures indicate 179,681 representatives in December 1990, which had reduced to 84,606 by April 1995. IFAs are forming larger and stronger groups, benefitting the networks and national IFAs.

Electronic distribution (whether direct, or integrated through branches, IFAs or DSF) is set to grow in importance, as consumers increasingly prefer to be serviced via the phone and over other electronic media such as interactive terminals and videokiosks.

1.2 Rules of the Game

There are almost 100 life insurance companies competing for life business - a considerable number of them will not be players in the next millennium. Will your office be one of them?

Since this game has nothing to do with the National Lottery, we do not have a crystal ball. Consider:

- Is your company battling to write profitable new business?
- Does every new rule and regulation create a corporate headache for your organisation?
- Are expense ratios, in particular acquisition costs, a problem?

If your honest answer is "yes" to even only one of these questions, then your office faces a challenging future, along with the majority of the industry. And why?

Our industry has been accused of being:

- product led
- commission led

where

- profit comes first, customers second
- sharp practice amongst sales agents has been condoned
- product structures are too complex
- total charges are too high ("life insurance is a rip-off").

The instinct for survival will ensure that many life insurance companies do not dwell upon the misdemeanours of the past. They will concentrate upon developing a reputable service to the British public, by abiding by the simple rule of developing processes and products that best suit the needs of the customer. Adapting products, processes and distribution to the changing consumer and technological environment, will be a necessary feature of success in the future.

The rules are simple, although not everyone understands them and not everyone wants to play. But the stakes are high - an incorrect distribution strategy and your ship could be going down!

2. Pictionary

2.1 Painting a Picture of Electronic Distribution Opportunities

We would like to draw attention to a number of factors which are combining to exert great pressure on traditional methods and channels of distribution of financial services.

A key ingredient to being a successful company today is the ability to meet the expectations of consumers, who are becoming increasingly sophisticated in identifying their needs. Being able to provide a premium rate or quote a surrender value over the phone, or providing product information and helplines around the clock, are still only ideas on the drawing board for many life offices. As people become more comfortable with using the phone, home PCs, and other electronic media, access to on-line and on-demand information will increase. With access to this information comes the power of the consumer to identify his or her own needs, and select products which meet these needs.

2.2 The Potential for Telesales

The potential and opportunities for telesales are increasing in the UK, due to a number of inter-related factors:

2.2.1 Customer expectations are growing in sophistication

Traditional barriers and consumer resistence to new technologies are reducing. Over 30% of all personal motor and 10% of household insurance policies are sold over the phone, and this is likely to increase. Telebanking, already accounting for almost 5% of all customers, looks set to reach 30% by the year 2000. (In France, telebanking was in use by 19% of all households last year. Interestingly, direct motor writers in France only have 1% of the French motor market.) Only 5% of all savings and investment transactions are from telesales, but this is growing rapidly, and for equity dealing is perhaps as high as 85% of all deals. The proportion of life insurance products sold over the telephone is currently very small, less than 1%, but this looks set to grow. In America, telesales of life insurance accounts for less than 10% of premium dollars, whilst more than 40% of mutual fund sales are no-load products over the phone.

2.2.2 Technology

Companies are able to establish customer databases which are directly linked to their call centre networks, enabling integrated voice and data transfer. Communication programs can be extended beyond single delivery contacts to scoring multi-hits, including cross-selling, upselling, referrals and information capture.

2.2.3 Competitive developments

Activity in telesales in the financial services marketplace has been spurred on by the likes of Direct Line for personal lines insurance, First Direct for telebanking and Virgin Direct for PEPs.

2.2.4 Companies must deliver what the customer expects

Consumers are driving these changes by responding to organisations which allow consumers to manage and control the interactions and contact. Companies which implement a successful telemarketing culture focus on achieving quality service by:

- carefully managing customer expectations
- intensive training, appropriate recruitment and motivation
- effective processes, and interaction supporting (not limiting) systems. A key requirement here would be a customer database, rather than a policy database. Given the increasing pressure on people's time, ease, speed and convenience are paramount. Customers expect to interact with knowledgeable people who are able to deal with all of their queries, so systems must support the full interaction possibilities.

2.2.5 Pricing advantage

Telesales enable a company to offer a cheaper price or service since the commission component is eliminated. The typical cost of life insurance and pensions advice varies enormously:

Channel	*Typical LAUTRO Indemnity Commission*
IFA	120% - 150%
Bancassurer	100% - 150%
Appointed Representative	150% - 250%
Direct Salesforce	130% - 250%
Telesales	?

Looking at personal motor insurance, Direct Line had the lowest expense ratio : 14.5% in 1993, versus an industry average of 26.3%. Even after allowing for the large advertising spend of Direct Line, it is only costing the company some £50 to add one new motor policy to the books, whilst other insurers can spend £150 - £200 or more. These acquisition costs must be recouped over the expected duration of the policy, so customer retention is vital. (It is estimated that the critical mass for direct motor writers is between 100,000 and 150,000 policies, and some companies are battling to achieve this.) In America, the direct motor writers have consistently enjoyed a 7.9 point expense ratio advantage over the agency writers over the last five years, and American mutual fund groups using telesales have distribution costs of about two-thirds of the market average costs.

2.2.6 Telesales allows flexibility

A company can adjust its pricing daily if necessary, and can also adjust individual quotations to incorporate a wide range of risk or rating factors (see Section 6). Direct motor writers are able to improve the accuracy of their rating through techniques such as "ink spot testing". A particular niche is targetted, eg young female drivers with 4WD vehicles, and the premium for this risk is slashed below market levels. Once enough risks have been accepted, after 500 policies say, the premium reverts to normal levels. The insurer is then able to plot the emerging experience of this closed portfolio over time. Insurers with IFA distribution, even if screen based, do not have as much flexibility.

2.3 Beyond Telesales....

The potential of the phone is probably only the beginning. An incredible array of electronic commerce is opening up new horizons to companies and their customers. The financial services industry may be about to go digital.

Financial cyberspace is here today, and growing. Banks, brokerages, networks of independent intermediaries, credit card companies, building societies and unit trust companies are all experimenting with new, innovative products and services available electronically. Whilst some life offices have entered the fray, their efforts are still small-scale and cautious. Insurance companies have traditionally used information technology in the back office, or to automate an existing front-line distribution channel. The opportunity now exists to introduce innovative new products in ways that exploit the advantages and dynamics of the electronic marketplace, not only over the phone, but also via other media such as interactive terminals, personal computers, videokiosks, interactive TV and the Internet. The following examples illustrate some of these possibilities:

2.3.1 Interactive Terminals

Interactive terminals or kiosks may be used to promote company products and services at any number of remote sites. Examples of the uses of this medium include staff training, interactive advertising, consumer research, customer feedback, promotional content at conferences and exhibitions, as well as transactional capability (eg applying for cover).

BUPA have installed a single interactive terminal situated at Victoria Station, London. Text, pictures and cartoon sequences are employed to involve users in a health and lifestyle questionnaire. The user is encouraged to input name and postcode, and these are used to generate sales leads for BUPA.

2.3.2 Home PCs and Multi-Media

One third of all home PCs are connected via a modem and are used for business purposes. More and more personal finance information and services are becoming available on-line.

Multi-media applications designed for CD-ROM can be used to deliver interactive products and corporate financial information to users, covering areas such as self-assessment needs analysis, explanations of an individual's protection needs and financial projections. These can be put together in imaginative ways, using graphics, video clips, extracts from TV advertisements and testimonials from clients, although the development costs of such packages are not cheap, currently ranging from £400,000. The growing availability of CD-ROM will enable companies to package personal financial services software, which will allow the customer access to presentations and updates which would be cumbersome to attempt on-line.

2.3.3 Videokiosks

In the USA, some insurance companies (including two of the five largest companies) are currently experimenting with the use of videokiosks to sell life insurance. Customers link up to a centralised call centre from one of many videokiosks located in a shopping mall, and via a two-way video link, a remotely located customer representative is able to assist with an insurance purchase. A typical call centre would involve a small team (around a dozen people) of licensed insurance agents, remunerated on a salary only or salary plus bonus basis, who work in shifts. (Sundays are one of the busiest times.) The sales process might begin with a simplified Factfind which would only take about five minutes. This Factfind would not meet UK PIA standards. The customer is taken through quotation and application, with signature via an electronic signature pad. Where underwriting is required - and some companies are selling Term Assurances and Universal Life policies for up to $500,000 - this is arranged separately through an underwriting service provider. For Deferred Annuity products, similar to UK investment bonds, immediate acceptance can be given. Some insurance companies have quoted initial take up rates as high as 70%, with at least 80% of those sales leading to the sale of at least one additional product or service.

In the UK, a number of banks and building societies are testing such technology in pilot branches, which are entirely automated and are not manned by any staff. Bank and building society branches have been closing at the rate of one a day - from 21,500 branches in 1989, the UK was down to 18,500 branches in 1993. This process is expected to continue, although self-service banking does not have to be impersonal. As a result of the growth of self-service and telebanking, there has been a corresponding reduction in the opportunity to cross-sell financial products to branch traffic. This is of particular concern to the bancassurers, who have seen a reduction in sales productivity over the past two years. Videokiosks enable financial institutions to overcome this issue by maintaining face-to-face interaction in a self-service environment.

A number of UK insurers are currently looking to move beyond the phone, by installing videokiosks in key sites such as retail stores, shopping centres and work-sites.

2.3.4 Interactive TV

BT is gearing up to provide information, entertainment and home shopping services over its existing phone network, and is currently trialling Interactive TV amongst 2,500 selected households in the UK. The existing regulator, Oftel, has ruled that allowing BT access to its own network amounts to unfair competition against the cable channel operators, who are digging up every street in Britain to lay their fibre cable network, in order to pump yet more interactive services into each household. The new Minister for National Heritage has recently announced that 20 new digital television channels will be available from 1997. It seems that the great British public cannot get enough TV to watch.

2.3.5 The Internet

Mortgages, share dealing, banking and insurance are already available over the Internet. An example of the sort of products and services available is Cyberhome, provided through the

Insurance Club, which users can access to call up live quotations for home contents and buildings cover, complete a proposal form and use credit card details to pay for the cover.

A Nevada based broker has launched Quickquote, which allows users free on-line comparisons of Term Life and Annuity products from more than 200 companies, plus the ability to begin the application process electronically. The user answers a few questions about product needs, and then receives a list of the five best quotations in the database. Customers then download an application form, which is electronically transferred to a paramedic company, in the case of a life policy, for the blood and urine testing procedures to be arranged.

Actuaries Online is the electronic bulletin board of the Society of Actuaries, launched last year, and accessible via Compuserve for $5 per month for unlimited usage. There are 11 message sections, 14 libraries and over 500 files which may be either downloaded or viewed on-line.

Delayed stock-market indices (updated every 30 minutes) can be downloaded from the Financial Times Web site. MoneyWorld's site includes comprehensive articles and advice on school fees, investments, mortgages, reviews of personal finance books, a list of fund managers, current savers' and borrowers' rates, an A to Z of financial terms and a guide to other British personal finance sites. Money Management's Web site is currently under construction. LIMRA Online is now accessible through the Internet, allowing users to directly contact researchers and consultants. Access to LIMRA's research, marketing insights, industry news and other vital information can now be downloaded to the user's PC.

Microsoft has launched a Home Banking Network, which offers bill payment, home banking and securities trading on-line, and has expressed interest in expanding into the financial services industry. (Microsoft was recently blocked by the US Department of Justice from acquiring Intuit, the personal finance software specialist whose home banking application Quicken, is the market leader in America.) The application of the Internet is forever being extended - Microsoft's Windows 95 will have an icon which will allow users to click into the Microsoft Network, which has been described as Microsoft's version of the Internet. In addition, users will have a full browser to look at the full Internet service. On the recent announcement that MAID, an on-line database services company, had been signed up to provide its services on-line through the Microsoft Network, MAID's share price was pushed upwards in a trading spiral based on optimistic expectations of future streams of revenue.

The Internet can be used to extend a telemarketing service. Every major mutual fund group in America offers a phone service, with inevitable waits on hold and longer waits for literature sent through the mail. Mutual fund groups now offer user-friendly forums on America Online, where users can browse and download investment advice, which provides instantaneous response.

We understand that there are still many people who do not regularly surf the Internet, but who nevertheless manage to lead fairly interesting lives. For those intrepid surfers amongst you, Appendix 1 shows a list of insurance and financial services related Internet addresses.

In more and more areas of work and play, consumers will expect to be able to quickly and efficiently browse available market information, using modern technology, and reach their own decision. IFA networks are well placed to compete in such an environment, with the ability to store large databases of product and market information.

2.4 New Market Players

Consumer expectations are not being set by existing financial service competitors, but by video game developers, movie producers and multi-media software programmers. Perhaps these organisations will be your future competition?

- The Ford motor company currently derives 19% of its revenue from financial services.
- Volvo in Sweden derives 12% of its revenue from financial services, Marks and Spencer 5%.
- AT&T, the US phone company, has launched a credit card under its brand.
- Virgin has plans to offer insurance products in the UK, extending beyond its current PEP products.

The success of some of the new entrants to the financial services market is influenced by the following factors:

- The customer is the most important person in their organisation.
- Processes are consumer led - not company led.
- They provide simple, sensitive service and strive to get things right the first time.
- Mechanisms exist for customer feedback and response to these are an important facet to their overall marketing strategy.

Customer service and value for money are their differentiators and not necessarily price. It is not only because they are amongst the cheapest that they have gained their excellent reputation - although this obviously helps! Building a business where processes are flexible, new technology is exploited and structures are flat, are all ingredients to reduce acquisition costs. The biggest driver in cutting expenses though has to be in customer retention, where direct writers in the personal lines boast figures in excess of 85%, compared to the industry average of 60%. It is too early to speculate how this might translate for the life insurance market but similar comparisons can be reasonably expected. Customer retention is a critical success factor and Section 6.3 has an analysis of the relationship between retention and profitability for a direct financial services operation.

2.5 Summary of Electronic Distribution Opportunities

Future electronic means of distribution might seem like the latest fad in the insurance games industry, and it may well be a number of years before such media gain widespread acceptance and use.

We believe that Electronic Distribution will bring great benefits to the financial services industry and its consumers, by:

- increasing the speed and efficiency of delivery of products
- improving service to customers
- decreasing distribution costs
- removing barriers of distance and time.

More and more business will be conducted over the phone and other electronic media in the future, and many insurance companies are already exploring these channels. How quick on the draw will your organisation be in this game?

3. Monopoly on Customers?

3.1 Consumer Research on Telemarketing of Life and Health Insurance

Do life insurance companies believe that because their protection products are long term, customer loyalty exists until the expiry of the contract? Proceeds of savings plans are generally 'spent' by the customer years before the contract matures - targeting the policyholder to reinvest three months before the maturity date is rarely a successful campaign for retaining customers.

Total quality management and customer service programmes have featured high on strategic agendas for some years. A number of offices would claim they already operate as totally customer focused organisations, yet products are created for competitive positioning in the market and processes are developed for the convenience of the insurer. In their paper presented to the Staple Inn Actuarial Society, Keith Abercromby and Joanna Hall examined the product development process and whether it is focused on the customer. We are grateful to their findings which support our view that the reasons for launching a new product are rarely customer led.

There are signs already that companies are launching their direct telesales operations for reasons that are internally focused - keeping up with the competition, increasing market share ("me too" knee jerk responses) - without understanding the changing dynamics of the market. Some companies have indeed understood the changes occurring in the marketplace, and will be successful at utilising the new technologies. However, we believe that others will spend a lot of time and money on these new channels which will result in dismal failure.

"Go directly to jail. Do not pass GO."

Life insurance is an intangible product and is not high on the consumers list of priorities. Will the success of other telebusiness, and indeed of direct general insurance operations, be exportable to life assurance?

3.2 Perceptions of Buying Over the Telephone

Recent consumer research has been conducted into the viability of selling life and health insurance products over the telephone. It ignores investment products, since the consumer attitudes to buying are perceived to be different.

Interviewees were presented with a collection of attitude statements and were asked whether they agreed or disagreed with them and how strongly. The results shown below indicate the feelings that consumers have about life insurers:

Telemarketing Consumer Research

Perceptions of buying life and health insurance over the telephone

	Disagree Strongly %	Disagree Slightly %	Neutral %	Agree Slightly %	Agree Strongly %
Telesales Means....					
More direct mail/calls	6	11	5	30	48
Info used by other cos	10	17	17	23	33
Less pressure to buy	17	25	5	37	16
Have more control	34	26	3	24	13
Cheaper policies	28	26	18	24	4

Source: Gordon Simmons Research

3.3 Consumer Expectations

In the same research, people were asked to prioritise their expectations on service issues when buying life protection products over the phone.

Telemarketing Consumer Research

- Written policy details before going ahead
- Guarantee of confidentiality
- Deal with the same operator if calling again
- A quote on the first call
- Arrange to meet an advisor if necessary

Source: Gordon Simmons Research

Consumers are demanding a number of comfort factors in dealing with life offices over the phone by asking for:

- something in writing before agreeing to proceed
- confidentiality in the provision of sensitive information (ie income, savings etc.)
- face-to-face discussions, if required.

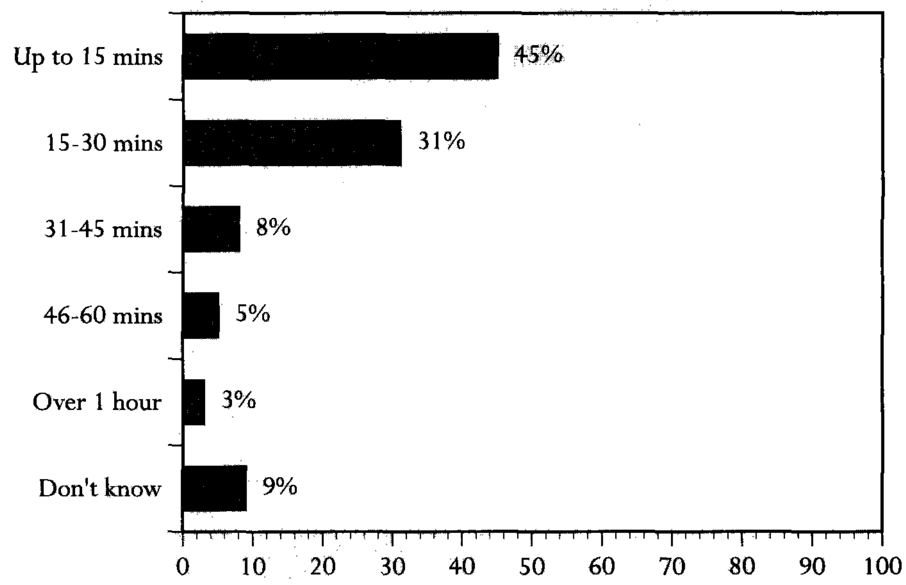
What changes the rules of the telemarketing game when applied to life insurance is regulation and the need to undertake Factfinds if providing advice for regulated products. Companies are experimenting with telesales of non-regulated contracts such as Term Assurances; or with the provision of regulated products on an execution only basis (including pensions!). The majority of potential customers, however, are not fully aware of their life protection needs and the types of products that exist to meet them. Execution only processes can therefore expose the ordinary customer to buying cover that is not appropriate.

3.4 Consumer Feedback on Call Duration

Can Factfinds be conducted over the telephone? In theory, there is no reason why they should not but in practice, are customers willing to spend up to an hour on the telephone for this service - even if it is a freephone number? Some organisations who are already piloting Factfinds over the telephone would argue that the duration of the phone call is not an issue. It is, however, worthwhile considering some consumer feedback on this:

Telemarketing Consumer Research

Expected time that a telephone call should last



Source: Gordon Simmons Research

These results indicate that performing a Factfind over the telephone may not be viable.

3.5 What Customers Want Most From Customer Service

Arthur Andersen & Co. conducted a programme assessing what customers want most from customer service. In 1970, the second most important element was frequency and speed of delivery, and the first was contact with a capable outside salesperson. In 1990, frequency and speed of delivery was still second most important, but outside contact had fallen to last place. The most important thing now is a capable inside salesperson.

What Business Customers Want Most From Customer Service

Rank by Customers

	1970	1980	1985	1990
Contact with outside salesperson	1	3	5	5
Frequency and speed of delivery	2	1	1	2
Price	3	2	3	4
Range of available products	4	5	4	3
Capable inside salesperson	5	4	2	1

Source: Arthur Andersen & Co.

3.6 Summary of Consumer Research

Selling life and health insurance over the phone is not any easy proposition. Only a small minority of people are likely to buy over the phone, although no less than 70% of the respondents in the above survey agreed that buying over the phone is the way of the future and will become more common. People are unwilling to spend a lot of time on the phone in connection with buying life and health insurance. However, telesales of motor and household cover has grown from small beginnings, and with exposure and education, people become more favourably disposed towards the use of the phone.

What the telephone does offer is the opportunity for life offices to build and demonstrate exemplary service processes direct to the customer. The speed of response, longer opening hours and the transfer of knowledge are prime factors in the expectations of our customers.

"Advance to GO. Collect £200."

4. Pinball Wizards

"He's a Pinball Wizard, there has to be a twist,

A Pinball Wizard's got such a supple wrist."

The Who

4.1 Types of Electronic Distribution Media

4.1.1 Tried and tested methods of direct distribution

Direct distribution has always been a part of the insurance industry, although for life insurance products the total market share of direct distribution has remained fairly constant, at about 2% of all sales. These direct marketing techniques included direct mail, newspapers, magazines, TV and radio.

4.1.2 New distribution techniques - electronic media

The traditional insurance industry has preferred to invest heavily in expensive active distribution channels, with many companies preferring to hunt out a totally new customer, rather than pro-actively seek to satisfy the insurance needs of its existing customers. There are indications that this mentality is changing, as companies realise that their existing list of policyholders may be the best list of future prospects. Direct interaction with these customers may offer the best route to maximising revenues, and many companies are investing heavily in sophisticated customer databases and new technology to support these initiatives.

In addition to enhancing a company's relationship (and sales) with existing policyholders, direct distribution can be used to actively recruit new customers. Many of today's customers are too busy for a personal consultation with an insurance salesman. Today's customer wants a means of transacting business which is available at a time and place convenient to him or her, with an organisation which he or she trusts in. The types of electronic media which are becoming available, include:

- telemarketing
- interactive terminals
- personal computers
- videokiosks
- interactive TV
- the Internet.

4.2 Telemarketing

Many companies have established separate, centralised call centres to handle their telemarketing activities.

If the call centre is equipped with a computerised workstation linked to a customer database, then the tele-operator dealing with the call is able to access all relevant information held about the customer. There may even be links with other databases, for example socioeconomic and geodemographic profiling from postal codes. A requirement for live real time customer data may indicate an in-house or dedicated facilities managed contract would be best, whilst if big volume or avalanche response from TV advertisements is involved then a third party bureau may be appropriate. Software packages are available to help organisations better exploit customer data in their communications with existing customers.

A call centre may be inbound, outbound, or able to handle both types of calls, depending on the company objectives. For an inbound call centre, a crucial aspect is the driving force behind the calls, and the type of advertising media campaign used. This will affect the pattern of the inbound calls by volume, timing, call duration, cyclical variations (eg tax year end), and service answering standards.

An outbound call centre is arranged around a universe of calling names and available telephone numbers, and is usually customer event driven - eg change of address, change of direct debit instructions, birthdays and anniversaries. The company needs to consider the objective of the campaign, when the calls should be made, the proportion of calls which should be successful, and whether investment in automated dialling technology is financially justifiable.

Simple products and information requests, where only a short, structured reply is needed (eg unit price values) may be provided via 24 hour automated digital voice response systems, without the need for tele-operators. Voice response systems have significantly lower ongoing operational costs than human assisted - in America, a mutual fund group has voice response calls costing less than $1 per call, whilst assisted calls cost in excess of $10 per call once all salary costs have been taken into account, due partly to the different type of transactions routed to the different systems. Systems are available which allow consumers to interact with the computer, or switch to a human helpline if required.

There are quite wide variances in front line call centre remuneration, driven by geographical location (north is generally cheaper although there are some notable exceptions) and industry sector (financial services pay more handsomely than travel and mail order!). Most call centre staff are remunerated on a salary plus bonus basis rather than commission. Typically, the starting pay for a full time agent would be £10,000 - £13,000pa with team leader roles around £13,000 - £16,000pa. A good team is essential, since a few seconds on the phone can negate the vast sums spent on advertising, product development and brand.

The productivity of the call centre depends on a host of factors - the strength of the brand, the products and services offered, the success of the targetting of the advertising campaign, good interactive systems and good staff training. It is important to monitor conversion rates and the reasons for rejections. It may take less than five minutes to sell a motor policy or sell a PEP on an excecution only basis, but selling a life or pensions policy may take considerably more than half an hour, and may need to be constructed as a multi-stage process, involving more than one phone call, and possibly including a personal appointment if required. Experience in America suggests it is possible to achieve life policy sales of 1.5 policies per hour per teleoperator, whilst in Canada some companies have achieved three sales per hour. In the UK, it would be optimistic to expect more than one sale per hour, and many have questioned the viability of selling life and health insurance over the phone.

4.3 Interactive Terminals

An interactive terminal may be either touchscreen or keyboard - the customer is presented with a menu of financial services options which he or she may select by indicating the appropriate place on the screen (by touching) or by pressing the appropriate keys on the keyboard.

The Automated Teller Machines (ATMs), or hole in the wall machines, used by banks and building societies to automate payment and receipt transactions, are examples of interactive terminals, albeit with a very limited range of capability. When ATMs were first introduced, banks expected only a very small proportion of consumers to use them. Their acceptance and use is now widespread, and 1993 was the first year when transactions via ATMs exceeded in-branch transactions.

The cost per transaction via such terminals depends on the number of transactions which the terminals may be expected to handle each day. A bank or building society may upgrade its ATMs to include a wider range of financial services, including insurance. The cost of the machines and supporting software would be spread over a much wider number of transactions than if such machines were installed solely for selling insurance.

4.4 Personal Computers

The PC is becoming more widely accepted amongst consumers as a source of entertainment and information, and increasingly as a means of transacting business. Currently some 25% of UK households have a PC and this is projected to reach about 50% by the year 2000. Information about insurance products and services can be offered via this channel, either via financial services software packages (eg advertisements and offers on CD-ROM), or on-line via services such as the Internet or Compuserve. Users may access such on-line services from as little as £10 subscription charges per month, plus the cost of the phone call. It will cost insurers very little to provide products and services using this method, although the PC may initially be more suited to an educational and awareness role rather than actual selling of life and health insurance. PCs allow personal access into the home and can be used for one-to-one personal targetting of products and information.

4.5 Videokiosks

A videokiosk is an integration of voice, videoconferencing and data transmission, which is capable of being transmitted across an existing phone line network. The customer is able to carry out a vast range of financial transactions by engaging a customer service representative located in a centralised call centre. To begin a transaction, the customer picks up a telephone and is automatically connected, verbally and visually, to a remote customer service representative. The consumer does not have to touch any buttons, keyboard or touchscreen. All products, proposals, Factfinds, illustrations and quotations may be viewed on the screen and printed out if required.

Videokiosks and interactive terminals can be located in existing bank branches, supermarkets and shops, work-sites, airports, malls, universities and virtually any other site, enabling the customer to choose the time of access. The videokiosks themselves may be permanently positioned, or used as mobile lead and sale generating centres, as they can be easily dismantled, transported and re-assembled.

The cost of one videokiosk is around £25,000 and in addition there is the cost of setting up the centralised call centre with its computer system and videos, plus the salaries of the operators, who would be paid similar salaries to tele-operators. The link between the videokiosk location and the call centre is via ISDN or switched 56 lines, which makes the technology more cost-effective than it would be with dedicated links. In addition, local graphical presentation software is required, and around-the-site advertisements and attract videos for customers are used to generate interest.

4.6 Interactive TV

Interactive TV involves the delivery of video-on-demand and other on-line services down the existing phone line network to the TV in the customer's living room. The customer is able to select a video from a wide range of entertainment providers, indulge in some home shopping, view information from selected databases (eg flight or travel information), or perform home banking or insurance transactions, all from the comfort of his or her living room. It is expected that the widespread availability of interactive TV services in the UK is still five years or so away.

4.7 The Internet

The Internet is a global network of computers, to which over 30 million computer terminals have access. It is a dynamic and interactive multi-media environment, which already has many banks and insurance companies offering a range of product information and other services. On-line shopping and financial transactions have been initiated, via the use of encryption technology which allows users to transmit credit card and banking details in a secure environment on the Internet. There are a number of on-line services available which may also provide easy access to the Internet, such as America Online, Compuserve, Delphi, Demon and Prodigy. The core Internet applications remain e-mail, bulletin board services, remote access and file transfer.

It does not cost anything for a company to set up an Internet site, apart from the design and software programming resources needed to create the right message and interactive screens. At present, the Internet is a free resource for companies to use. If the Internet site is used to generate leads or sales, then it is important for the insurer to have back-up resources available to follow through on these enquiries. One of the advantages of this medium is the ability to accurately monitor the number and type of users who access your site, allowing better targetting.

4.8 The Regulatory Environment

Within the rapidly evolving environment of telemarketing and other forms of electronic commerce, the regulatory authorities have to move fast to keep pace with the new methods of distribution and transaction. There are further guidelines on telemarketing due out this Autumn from the PIA, but this is probably an area of legislation which will change rapidly over time (as in other areas of legislation!).

4.8.1 Regulating telesales

The direct distribution of financial products over the phone falls under the broad jurisdiction of two main industry regulators, namely the PIA and Oftel. Further, the Direct Marketing Assocation has published a Code of Practice which sets standards of ethical conduct and best practice for all of its members. All of these bodies have the power to apply disciplinary measures if these rules are breached.

Most insurance companies have set up their telemarketing channels on an "execution only" basis - although this would only be strictly true if all calls were completely unsolicited. If the company had recently advertised a particular product and invited customers to phone in for a quote, then the call would be in response to this Category B advertisement. (Category A is general and non-product specific, Category B identifies and promotes specific products, whilst a Category C advertisement makes or invites an offer.) Responses to Category B advertisements do not require completion of a Factfind, unless actual advice is given.

Status disclosure is another particular issue, as this must be done before any advice is given, and usually involves giving a business card. If wordings such as "call this number to discuss your requirements with our representative" are used in advertisements, then Status Disclosure over the phone would be superfluous as callers responding expect to speak to a company representative.

Once the sale is made, it is likely that a package could be posted to the client for confirmation and completion of the relevant documents, containing:

- the agent's business card and the terms of business
- copy of the Factfind and application form for signature
- client specific key features with own charge projections
- commission disclosure and policy details.

4.8.2 Regulating other electronic media

There are no specific regulations yet which are aimed at these new electronic channels. For global applications, such as the Internet, this is likely to cause problems for the regulatory authorities in the future. The PIA has announced in its First Year Regulatory Plan that it will consider the investor implications of new developments in the direct and excecution only selling of financial services products. The brief also includes looking at the implications of selling financial products on the Internet.

Oftel has issued a consultative document, "Beyond the Telephone, the Television and the PC", aimed at soliciting industry views on the regulation of the information superhighway. Oftel is still insisting that the ban on BT providing content services should remain. This prevention of telecommunication companies from providing service and running networks is at odds with the latest telecommunications reforms in the US.

4.9 Summary

A number of new electronic distribution media are becoming available. Whilst it may take a number of years for widespread acceptance and use of these media, it does appear as if the future of distribution of insurance will not be the same:

- The speed of delivery is becoming faster and faster.
- The volume of content which can be accomodated is growing.
- The diversity of content is expanding.
- The interactive nature of the media allows data capture directly from the consumer.
- The reducing cost of this technology and user control over it suit today's consumers.
- There is growing user acceptance of a different future.

However, using such channels will require a different approach to the traditional marketing of life insurance. Companies will need to focus their products and services better on targetted market segments. Products may become unbundled, and shopping around for protection may become a feature, with more emphasis on price competition than historically.

The new technology will allow the consumer a greater say in the products provided, leading the direct life revolution into new directions. In the new marketplace, the customer will select the point of sale where they live, work and relax. Lifestyle issues - convenience, speed and service - will direct the buying decision. Immediate access to information on products and services streamlines the transaction. Personal contact will still be important, but needs to be integrated into the new technologies. Traditional channels will lose ground to diverse electronic markets.

"He's a Pinball Wizard, there has to be a twist,

A Pinball Wizard's got such a supple wrist.

How do you think he does it? - I don't know.

What makes him so good?"

The Who

5. Snakes and Ladders

5.1 Strategic Issues Regarding Electronic Distribution

Financial services companies need to consider their distribution channels from a total market, customer lifetime perspective. Companies which adopt ad hoc tactical distribution capabilities are less likely to be successful.

The following strategic issues need to be addressed:

5.1.1 Integrated or separate channels?

Whether the new electronic channels will be an extension of the existing distribution channels, or stand separately, and ultimately in competition with, the existing channels. For a company with a strong DSF or with a high IFA profile, establishing alternative channels may cause serious political disruption within the organisation, as the following case study shows.

In September 1994, the Prudential Insurance Company of America, the largest life and health insurer in the USA, began selling Term Assurance directly to consumers via a freephone number, under the name Pru Direct. The policies were priced about 20% lower than those available through the company's large DSF. The mission was to offer banking, investment and insurance products direct. A $2 million database contract was approved, and 12 to 15 targetting models built. The first direct campaign, offering cover of $25,000 - $75,000 was traditional direct mail activity and passed almost unnoticed by the agents. The next campaign was to be a telesales offer and advertised a freephone number in a personal finance magazine in October 1994. It offered cover between $100,000 - $1,000,000, and included phrases such as "hassle free" and "on your terms". The agents reacted extremely negatively to such an aggressive campaign and immediately began lobbying senior management. In January 1995, Pru Direct issued a memo stating that for the forseeable future it would not compete with agents by offering insurance products. Thus, one of the most ambitious life insurance telesales campaigns ever mounted was ended due to a conflict with existing distribution. Whilst Pru Direct has ceased insurance sales, it still does a significant amount of other direct marketing - health policies sold to The American Association of Retired Persons, and household cover to its large mortgage customer portfolio - but these do not compete directly with existing channels.

5.1.2 The products and services

The company could offer its existing range of products, or new and different products could be marketed - simpler products are better suited to direct distribution than more complex ones. The ultimate choices here depend on the objectives which the company is setting out to achieve.

5.1.3 Product design and product pricing

A company would generally want a channel to be self-supporting, without any cross subsidies between channels. If direct distribution of products can be delivered substantially more cheaply (due to reduced or nil commission), then agents and brokers find it increasingly difficult to justify their added value to consumers. Differential pricing between channels raises serious conflicts for a company. This is perhaps most visible for the simple, price-driven personal lines such as motor and household. If simple life and health protection products were available cheaply via the phone or electronically, then such comparisons would begin to be made - this has already happened in the case of PEPs.

5.1.4 Resources required

A new range of resources may be needed - technological, human, whether in-house or outsourced, appropriate monitoring, control mechanisms, and management information.

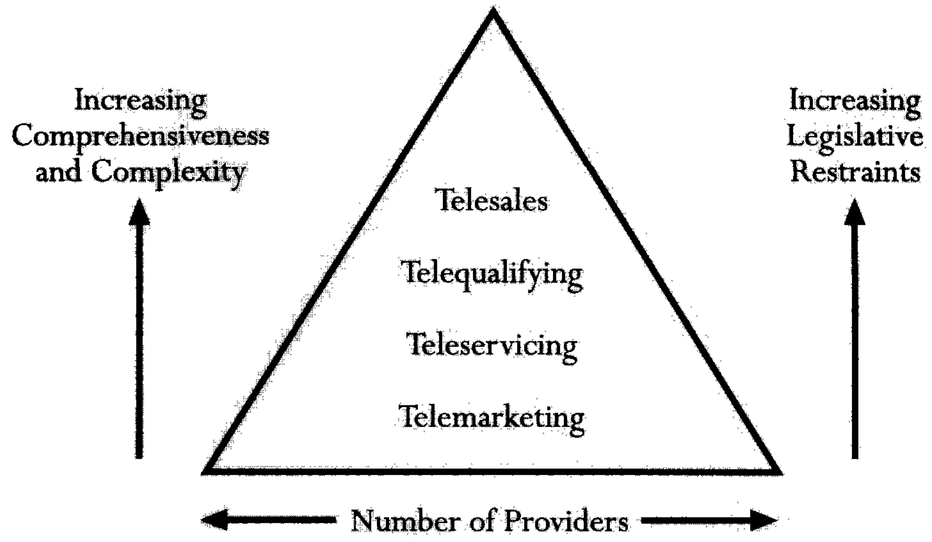
As an example of the issues involved, let us venture up the ladder involved in establishing a telemarketing channel.

5.2 A Telemarketing Channel

Although many life insurers have established a telemarketing channel, very few companies indeed are realising the real benefits reported by the more advanced users - increased customer loyalty, revenue maximisation and competitive edge. It is important to consider the type of services intended to be delivered via the phone:

- Telemarketing, the most basic provision of service, is done by almost all financial services groups. An example is the ordering of product literature. No transactions over the phone are allowed.
- Teleservicing incorporates helplines, hotlines and service departments to provide assistance and advice, for example arranging benefits before entering hospital.
- Telequalifying brings the customer through the necessary data collection and verification process, and may even include the provision of a quotation for the requested or recommended product, but stops short of the actual sale.
- Telesales occur when the whole transaction can be made over the telephone.

Telephone Distribution Mechanisms



Source: Datamonitor

In setting up their telemarketing operations, companies should have a clearly formulated set of objectives, which could include:

- development of a new client base (use of brand)
- cross-selling to existing client base or warm database
- cross-selling to clients of other companies within the group (extension of brand)
- reduction of acquisition costs
- reduction of operation costs
- lead generation
- customer service
- lapse prevention.

5.3 Macro Telebusiness Development

There are three identifiable stages of telebusiness development:

5.3.1 Complementary service

The phone is used in a complementary manner to existing business processes and distribution channels, without fundamental change to the business. Telephone numbers are added to communications material and product literature, without further re-engineering. This is becoming prevalent in the UK now..

5.3.2 Business transformation around the phone

Here the business transforms its operation to fully utilise the power of direct telemarketing distribution, with its systems and processes designed to support this channel. An example of this is First Direct, which offers a full range of banking services with no bank branches.

5.3.3 Business as usual?

This stage is customer imposed - the phone becomes the expected and accepted way of transacting business. This is emerging in the USA, but is not yet visible in the UK. This stage would be reached once the traditional intermediary became even further disintermediated, perhaps even fully excluded from the personal lines insurance market. At this point, the traditional direct salesforce for life insurance companies may well be a dinosaur, existing only as a fond recollection of how life assurance was sold in the good old days. Such an outcome however requires fundamental change, which may well be foisted on companies by the consumer!

There is currently a real opportunity for companies to deliver financial services direct, in a way that will create a genuine market advantage. Traditional insurance companies may be too hamstrung by their existing culture, their paper-bound processes and inefficient yet politically powerful existing distribution channels. Companies should be thinking in terms of relationship building and strategic realignment of their telephone channels. Consumer expectations and anticipations are certainly ahead of most business practices. The current approach to telemarketing in the UK falls short of the potential to create new markets, opportunities and competitive advantages.

5.4 Telesales Options

A company choosing to develop a telesales channel has a series of critical and inter-related decisions to make with regard to:

- product range, eg investment, protection, or both
- the regulatory framework within which it will operate, ie products regulated by the FSA, SIB, or PIA, or non-regulated products
- whether it will take business on an execution only basis, or an advice basis (which must involve a Factfind), or both.

Telesales Options

Unregulated Business		Regulated Business		
General	**Life**	**Life**	**Pensions**	**Investment**
Short Term Protection	Protection Only - No SV	Protection with SV	Pensions & Savings	Savings
(Medical Expenses Accident, Sickness & Unemployment)	(Term Assurances, PHI, Critical Illness)	(Whole Life, Endowment)	(Single Premium Bonds, Personal Pensions)	(PEPs, TESSAs, Unit Trusts)

Under the PIA rules, sales by phone must be treated in the same way as any other distribution channel; business can be either execution only or involve the provision of advice. If advice is given then there must be a Factfind and all suitable products from the marketing group's range must be considered. This distinction applies to all products sold by the life insurance industry except purely protection products, such as Term Assurance, Critical Illness and PHI, which have no investment element in the form of a surrender value. At present these products are, like general insurance, not subject to the SIB or PIA regulations. However the OFT recently announced that it would investigate the sale of health and travel insurance. The OFT said there is scope for misselling because consumers are sometimes not given all the information they need, exclusions are not made clear and policies can be difficult to understand.

5.4.1 Cost of advice

Companies attempting to minimise costs and compete on price will be tempted:

- to follow the execution only route
- to offer non-regulated products, eg general insurance (which can include short term but renewable life and PHI), pure term, with appropriate guaranteed insurability options. Of course, there is always the possibility that regulations will be extended to cover these areas.

Companies selling business both with advice and execution only will be tempted to move towards differential pricing or offering discounts to execution only customers. There could be different products depending on the distribution method. Those sold via IFAs and Direct Sales Forces and involving advice could include extra features and options, in order to allow additional deductions to be made to pay for the advice.

5.4.2 Transaction only and education not advice

It is important to distinguish between "advice" and "education". The execution only rules do not preclude giving factual information to the customer, eg information on the tax rules which apply to self-employed people, provided that no actual advice is given.

Under "transaction only" the insurer simply provides an application form and standard literature and processes a proposal.

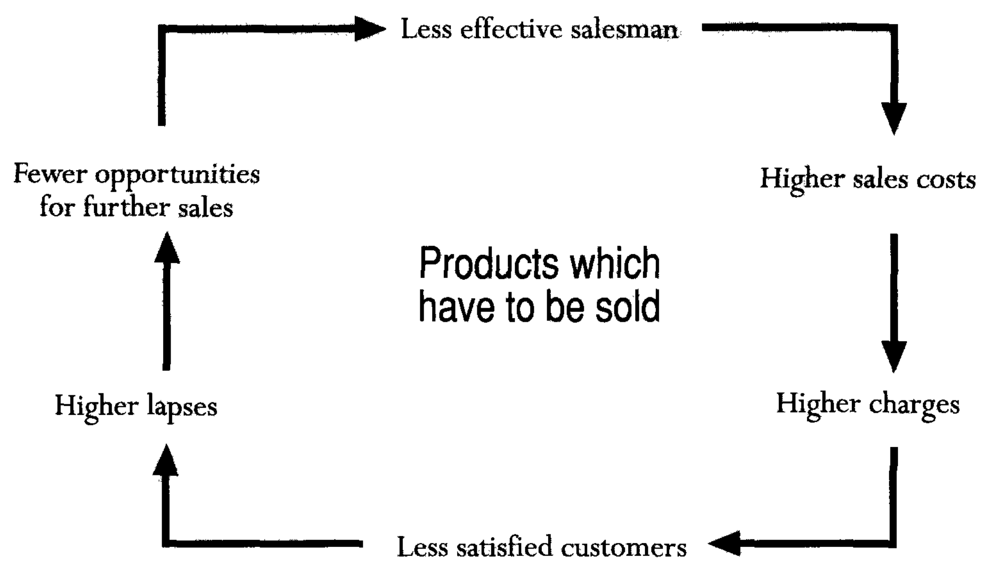
Under "education not advice", in addition to the above, the insurer answers technical questions, eg by providing the sort of material which is routinely provided to IFAs and DSF and appears in the trade press. For example, a reasonably intelligent self-employed person could work out if he could make good use of the carry back and carry forward rules for pension contributions given a ready reckoner and appropriate tax tables. No advice would be given. Should it be needed then the case would come into the advice category. (Advice involves tailoring information and recommendations based on the individual's circumstances.)

It could be argued that "education not advice" cases incur greater costs than "transaction only", but in practice this may not be significant, especially if the education consists of a brief telephone explanation plus the posting of standard technical notes.

It has been suggested that the regulatory authorities will frown on any company which writes more than 15% of its business on an execution-only basis. However, this guidance would not apply to an operation set up specifically to write direct business, eg through telesales.

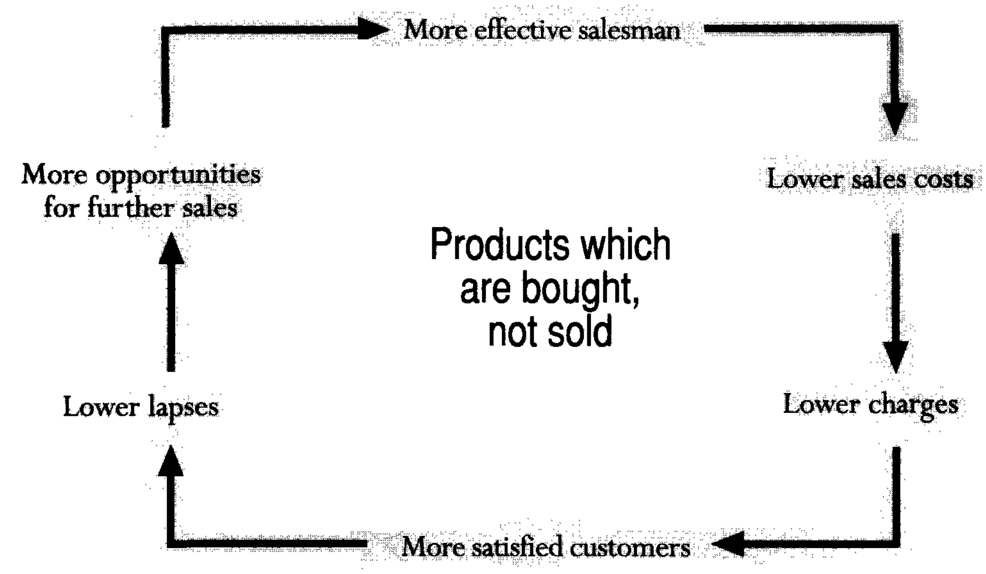
5.5 Product Design for Electronic Distribution

The traditional insurance industry is structured around products which have been designed to cater for the demands of the salesperson, rather than to meet the needs of the consumer:



Source: Abercromby & Hall

There is a good chance that some organisations, (from outside the financial services industry?), will set up to provide customers with what they want:



Source: Abercromby & Hall

5.6 Teleunderwriting

5.6.1 Traditional underwriting procedures

Companies choosing telesales for protection products will need to carefully define their underwriting procedures. This creates opportunities for new approaches to be tested and adopted. An extra benefit is that the "teleunderwriter" may be able to learn more about the applicant than would be gleaned from just reading a proposal form.

Traditionally, life underwriting in the UK is based on a series of standard questions plus various criteria with regard to:

- age
- sex
- smoker/non-smoker
- occupation/hobbies
- sum assured
- premium
- product type.

For non-standard lives and large sums assured there are further investigations,eg.

- MAR
- ME
- Specific Condition Questionnaires
- Financial Questionnaires.

5.6.2 Teleunderwriting procedures

Assuming that telemarketed products will be designed to meet normal protection requirements initially, teleunderwriting can be streamlined and various new techniques and concepts used, for example:

- Guaranteeing certain levels of cover.
- Use of preferred rates or individually priced premiums.
- Free cover periods until necessary underwriting is completed.
- Greater use of guaranteed insurability options to encourage future premium increases.
- Use of paramedics to visit applicants and carry out medical tests.
- Integration of underwriting with health checks.
- No claims bonuses.

5.7 Teleunderwriting - Expert Systems

It is possible for a company to install a computerised expert underwriting system, which is integrated with the system prompts used by its call centre operators, in order to guide the customer through the underwriting process. Such a system could significantly reduce a company's underwriting expenses and increase its competitive advantage.

The process of teleunderwriting involves linking a trained underwriter (who has access to a computerised, intelligent underwriting system), directly with the insurance applicant. The customer deals directly with the underwriter, who asks appropriate questions only as required. The customer then chooses a medical examination appointment at a time and place convenient to him or her.

Expert systems may be used when mortgage applicants are being underwritten by phone. Telemortgages are relatively new in the market, but are becoming very popular. One of the potential drawbacks is that applicants are able to misrepresent themselves more easily over the phone than during a face-to-face interview. Data being collected on telemortgages versus branch-issued mortgages suggests that the arrears on telemortgages are significantly higher - no data is yet available on repossessions. A similar experience has emerged in America on household cover, where direct writers have suffered higher claims costs than agent companies.

5.8 Summary of Strategic Issues

Telemarketing will become more important for the life industry, affecting not only the way in which our products are distributed, but altering even the products and services we provide, and the way in which our organisations relate to their customers. Telemarketing may change our underwriting process and product design.

Those companies with existing direct distribution capabilities for general insurance products may be better placed to extend their product range into life and health products. Traditional life companies may be hampered by their legacy systems and perhaps cultural resistance to a new distribution channel.

Customer service and the value of brand image will be more important for those products where price is easily compared. More traditional offices may, however, fight back on the issue of service, by utilising the phone to build on existing customer relationships, and improving salesforce productivity by referrals and warm leads.

Those companies that do commit to telemarketing will need to ensure that it is adequately resourced. Management information may be used to refine the marketing process and product design. Companies will need to monitor activity to ensure quality and performance targets are met.

Will telemarketing lead your company up a ladder to reach new heights, or send it snaking down deeper into problem areas?

The results will be very different for the various players in the market, but will be decided by management and their response to changing opportunities, not the throw of dice.

6. Chess

6.1 Moves on Pricing for Electronic Distribution

Pricing products for direct distribution is both similar to and dis-similar from the pricing of traditional insurance products. Actuarial assumptions about mortality, morbidity, persistency, expenses, investment returns and target profit objectives still have to be made. However a direct operation has no commission component.

6.2 Direct Mail Pricing

Considering traditional direct mail first, the greatest difference is that we are not solving for a premium rate, given all of our other assumptions, as with traditionally distributed insurance products. Rather, the answer which is required is the marketing allowance - how much can be spent to acquire business? (With direct mail, the premium is ususally a given, for example, £9.95 per month for a set level of cover.) This is expressed as the ratio of the total annualised premium needed to the marketing cost:

$$\text{TAP} : \text{MC}$$

where MC, the marketing cost, is fairly easily identifiable and quantifiable. The required response rate is:

$$\text{Response rate} = \frac{(\text{TAP} : \text{MC x Mailing cost per piece})}{\text{Average annual premium}}$$

6.3 Electronic Distribution

In theory, this may be extended to cover electronic distribution. Where equipment such as an interactive terminal or videokiosk is also used to support other products (banking or sharedealing, say) then costs need to be appropriately apportioned. The profitability of electronic distribution will be critically dependent on volumes of business generated via the medium, and customer retention levels.

6.3.1 An example - lump sum PEPs by phone

This is a simple product, used as a simple illustration. Each new investment sold generates a future stream of annual management charges, which grows each year by the rate of growth of the investment fund. On withdrawal, future management charges are forfeited.

So, the expected present value of the income stream from each £ of new investment is:

$$m * \int_0^\infty e^{-((i - j + w)t)}\, dt = \frac{m}{(i - j + w)}$$

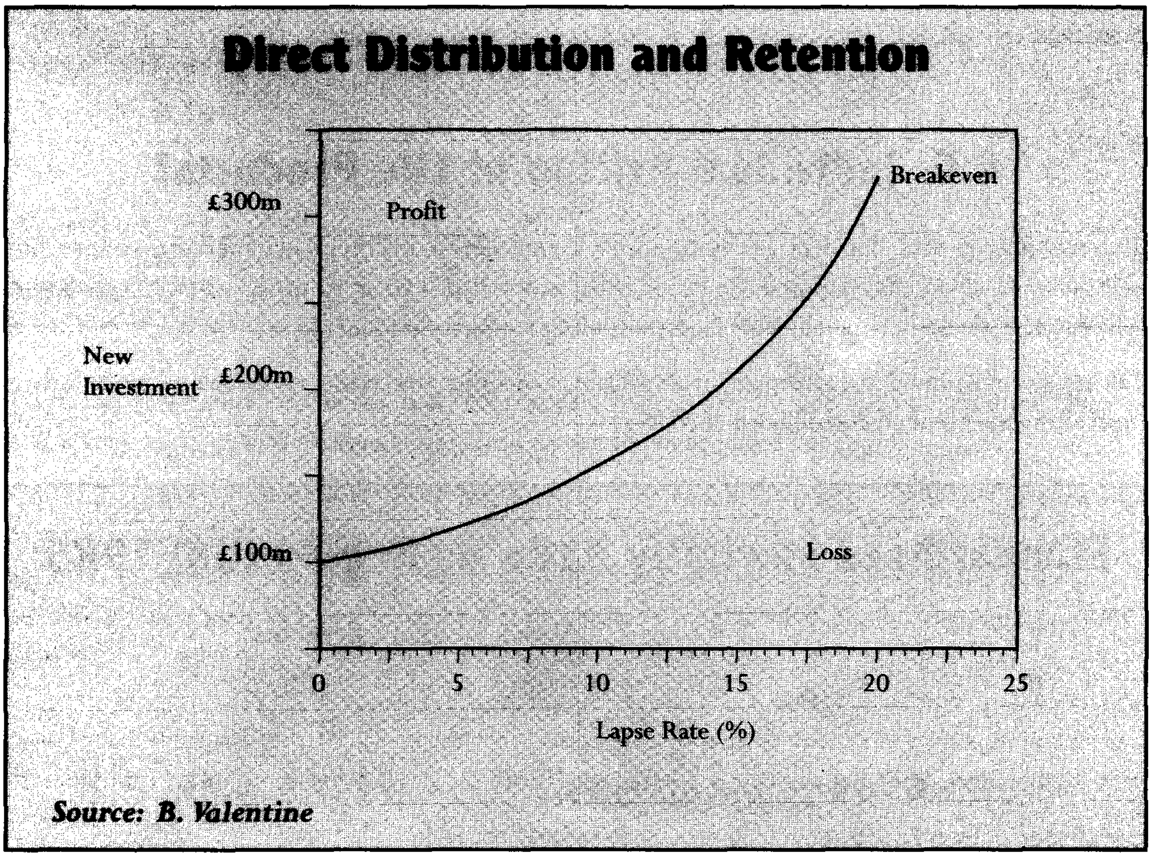
where m = annual management charge (net of investment expenses)

i = risk discount rate

j = investment growth rate of fund

w = withdrawal rate.

Equating this value to the total expenses of the direct operation allows us to plot the breakeven volumes of business which must be written against the breakeven retention rate.



For any given level of expenses, the higher the volumes of business and the higher the customer retention rate (or the lower the lapse rate), the better will be the profitability. Indeed, it may well be more worthwhile focusing on retaining existing business rather than concentrating on new business generation - a message which surely has wider application beyond PEPs. The unit trust industry has a lapse rate of around 25%, although PEPs should experience lower lapse rates than this due to their tax advantages.

6.4 Rating Factors - Life Products

Traditional actuarial product pricing for life assurance products uses age, sex and smoking status as the basis for subdividing the total potential universe of policyholders. Medical underwriting is then used to adjust the standard premium rate if necessary, although 95%

or more of all risks are accepted at the standard premium rate. There is thus a wide variation of actual mortality experience within the standard class of policyholders, which has led some companies to further refine their pricing approach by introducing a preferred lives category. A preferred life satisfies a more stringent set of underwriting criteria, thereby qualifying for a discounted premium rate.

6.5 Rating Factors - General Insurance Products

The fairly standard approach of life companies is in contrast with the fairly detailed rating structure employed for general insurance products. For household products for example, postcode, occupation and remuneration are also used to price a risk.

6.6 Individual Pricing of Life Products?

The technology and the data exists to adopt a completely different pricing approach to life and pensions products. Companies could offer individual pricing to prospective clients based on a further assessment of the risk factors relating to the individual client.

Taking geographical location as an example, consider the wide variation in population mortality experienced throughout the UK:

Standardised Mortality Ratio by Region (UK) 1985

	Males	Females
UK	100	100
Northern England	111	109
South East England	92	94
South West England	89	91
Wales	104	101
Scotland	112	110
Northern Ireland	110	107

Source: OPCS

Taking occupation as another example:

Regional Standardised Mortality Ratio by Occupation Group

Males aged 15-64 (Great Britain) 1979-83

	Managerial	Clerical	Salesman	Painter
Northern Region	107	103	120	122
South East	89	80	102	105
South West	83	76	93	103
Scotland	107	106	129	132
Wales	103	82	115	102

Source: OPCS

From the above data we can see that, even after allowing for age, sex, and occupation, there is still a very wide variation in mortality experience between different regions.

Could such information be used to price life and pensions products? It is conceivable that insurance could be costed more specifically than perhaps it has been up until now, through application of one of the many geodemographic packages available. One of the issues which would need to be addressed would be policyholders who moved out of one category into another.

6.5 Use of Financial Geodemographic Analysis Systems

LIMRA International have used a financial geodemographic analysis system to classify the observed financial behaviour of UK households in their annual Buyer Study. This enables companies to obtain a detailed demographic breakdown of their purchasers (based on a random sample of their new business cases), profiled against the rest of the industry. The results allow companies to target markets for their products more accurately.

LIMRA have also extended this analysis to cover persistency, with the aim of identifying those groups of policyholders that have the highest lapse rates. Using a particular financial classification system (which classifies people into one of ten groups of financial consumer based on their residential postcodes), an analysis of those new policies sold in 1993, which lapsed in 1994, showed the following:

Lapse Rates by Financial Mosaic Classification

All Regular Premium Buyers	100
Adventurous Spenders	95
Burdened Borrowers	95
Capital Accumulators	75
Discerning Investors	60
Equityholding Elders	75
Farm Owners and Traders	60
Good Paying Realists	70
Hardened Cash Payers	110
Indebted Strugglers	205
Just About Surviving	180

Source: LIMRA

Not surprisingly, those groups of the population which show a low propensity to lapse are either the wealthiest, such as the "Capital Accumulators", or those in stable financial situations, such as the "Good Paying Realists". However, at the bottom end of the social scale, the two poorest groups, the "Indebted Strugglers" and those who are "Just About Surviving" are about twice as likely to lapse their policies as insurance buyers on the whole.

For products with profitability which is highly sensitive to lapse rates, such information may be extremely useful. The first and most obvious application would be to better target those prospective clients less likely to lapse. But perhaps such information could also be used to adjust pricing?

6.6 Summary - Pricing

There has been speculation for some time about price competition expected to come from the bancassurers. To date, there has been little movement in this direction in the UK. However, we believe that competition for customers will intensify, with service differentiation and price comparison becoming more of a feature in the life insurance market. This may even be driven by some of the new entrants to financial services, especially those organisations with marketing or retailing expertise.

The data and technology exist for risk products to be priced on a more refined, individual basis. Direct electronic distribution of life products may start a trend towards greater use of geodemographic risk factors in pricing.

Will this lead to an even more competitive endgame, or stalemate?

7. Twenty Questions

7.1 Challenging the Traditional Life Insurance Industry

Questions are often easy to ask but difficult to answer. As an example, take a Building Society's recent poster campaign:

1. Where do flies sleep?
2. Should one paint behind the radiators?
3. Why don't bidets have seats?
4. Why do you never see baby pigeons?

Traditional life products have been accused of being designed more with the distribution channel in mind, than with meeting the needs of the consumer. Perhaps electronic distribution will change this mindset? Consider:

5. Do consumers understand front end charges?
6. Why are investment and protection covers often packaged into one product?
7. Do protection products have to be long term and non-cancellable?
8. Where are new product designs formulated?
9. Why are minimum premium levels so high?

The life and health insurance industry has been accused of allowing an overpaid, inefficient distribution system to persist. The answers to the following questions about our distribution process may well lie in the better integration of new distribution techniques into our industry:

10. Are our industry's distribution costs too high?
11. Has our distribution process become more efficient and customer focused in the last decade?
12. Does our underwiting process serve our customers' best interests?
13. How can we streamline and improve our new business application process?

The image of the life and health insurance industry has suffered over the past few years, and we need to tackle some of the underlying fundamentals before our reputation and standing will be restored to the level it should deserve. The following issues need to be addressed:

14. Do our policies and contracts represent fair value to our customers?
15. Why doesn't the public trust life insurance companies?
16. Why are life insurance products difficult for the consumer to understand?
17. Are the new entrants to our industry better value than the traditional life offices?
18. Do we adequately reward second time buyers and properly service long-standing customers?
19. Will new technologies be used to our customers' benefit?
20. Will life and health insurance be bought and not sold, in the future?

We have not attempted to answer these questions in this paper - rather, some of the possibilities raised here beg even more questions! We look forward to debating these and perhaps working towards solutions for some of these issues.

8. Scrabble to Survive

8.1 Some Conclusions on Future Distribution Issues

Banks and insurance companies have to leave their offices, literally (in the form of expensive branch networks), and figuratively (on the phone, in the mail, and on the information superhighway), to get closer to the customer. Trust is no longer derived from bricks and mortar.

8.1.1 There have been important shifts in the consumer environment within which financial services are sold:

- Consumers are more vulnerable and insecure. The Nervous Nineties typifies the mood.
- Consumers are aware of, and increasingly concerned over the extent to which State benefits are being eroded.
- Solid ground has turned to shifting sands. For example, the belief that house prices should automatically increase each year has been shattered. A career to retirement is no longer automatically expected - many people are having to deal with periods of unemployment, and redundancy precedes retirement.
- The key driver for life and pensions products is becoming a desire for personal control and choice over destiny, rather than duty and responsibility.
- Consumer perception of the integrity and value of professional advice delivered by the traditional distribution channels has hit an all time low (personal pensions misselling, high commissions, high lapse rates). This coincides with heightened concern about future savings and protection needs. Consumers believe that commissions and self interest have driven previous sales, rather than genuine long term commitment to meeting customer needs.
- There is a trend to making one's own decisions, on the basis of press recommendation and free advice from numerous sources. Direct distribution plays into this, in a non-threatening and non-invasive way. If this is combined with a trusted brand name, then there is an even greater feeling of having made the right decision.
- The balance of power and control is moving away from the distribution channel towards the consumer. Winners will be those organisations which are customer responsive. Companies will have to re-engineer their selling process into a buying process.

8.2 Electronic Distribution - The Future?

Electronic distribution is set to become a much more important component of an insurance company's distribution mix, and will have a more central role in the key aspect of customer communication. Electronic distribution should be seen as less of an independent channel capable of delivering only a small proportion of total business, and more of an integrated core part of the overall distribution mix.

There will be more telephone-and-screen-based access to information, such as quotations, product descriptions, past performance figures and market comparisons. Consumers comfortable with using computers and researching their purchases through computer databases will further change the way our industry does business, by telling us exactly what they need and expect from their insurance coverage.

8.3 Life and Pensions Distribution in the Future?

We have gazed into our crystal ball and come up with the following predictions, based on the research we have undertaken, and comments we have received from others:

Predicted Life and Pensions Distribution

	1995	2000	2005
	%	%	%
IFA	40	37	28
Direct Sales Force	35	30	20
Tied Agent	7	3	2
Bancassurer	16	25	35
Direct	2	5	15
Total	100	100	100

8.4 Industry Consolidation

This change is predicted over a period when the total number of life insurers in the UK is expected to more than halve, with probably only 30 or so players left remaining in the market, many of these being new entrants to the market. Insurance companies, building societies, banks and investment managers will consolidate for efficiency. The trend in the marketplace is slowly moving towards direct marketing organisations, with many customers looking for full service and a continuity of relationship that salesmen and brokers have not delivered in the past. Although many consumers may prefer to have an agent available to them, the price tag for the personal touch may be getting too high.

8.5 Consumerism

Almost everything happening may be good for the consumer. Consumers are demanding high-quality, low-cost products with 24 hour accessibility, that are customised to fit their specific needs, and electronic distribution can deliver this. This is a major challenge for the traditional sales channels.

8.6 The Last Word...

The skill of scrabble lies in maximising letter values on premium squares on the board. Only by identifying more efficient distribution methods and being bold enough to break the mould of historic business practices will you become a master of the game.

It's your move...

References

1. "Teleculture 2000", Henley Centre for Forecasting

2. "UK Telephone Financial Services 1995", Datamonitor

3. "UK Insurance Distribution 1995", Datamonitor

4. "The Death of The Salesman?", E. Stevens

5. "Developing Products Which are Bought Not Sold", K. Abercromby and J. Hall, SIAS

6. "Telemarketing in Financial Services", M. Havard, The Journal of Database Marketing

7. "Selling Life and Health Insurance over the Phone", Gordon Simmons Research Group, Mercantile & General Reinsurance

8. 1994 Buyer Study, LIMRA International

9. "The Economics of Virgin Direct", B. Valentine

Appendix 1

Some Internet Addresses Relevant to Insurance and Financial Services:

Companies:

Barclays:http://www.barclays-insurance.barclays.co.uk

Bradford & Bingley BS:http://www.bradford-bingley.co.uk/bbbs

Express UK Mortgages:http://www.demon.co.uk/hadleigh/eukm/eukm.html

First Mortgage Securities:http://www.first-mortgage.co.uk/fms

Legal & General:http://www.cityscape.co.uk/users/dd75/index.html

Mercantile & General Reinsurance:http://www.mgre.com

Nationwide BS:http://www.nationwide.co.uk/nationwide

Norwich Union:http://www.norwich-union.co.uk

Royal Bank of Scotland:http://www.royalbankscot.co.uk

IFAs:

The Exchange:http://www.exchange.co.uk

Gaeia:http://www.u-net.com/~gaeia

IFA Net:http://www.gold.net/users/de37

The Insurance Club:http://www.insuranceclub.co.uk

Moneyweb:http://www.demon.co.uk:80/moneyweb/index.html

Pronoia, of DBS:http://www.vossnet.co.uk/company/pronoia

Quickquote:http://www.quickquote.com

Miscellaneous:

Actuaries Online: type GO ACTUARIES in Compuserve

Electronic Share Information: http://www.esi.co.uk

Financial Times:http://www.ft.com

LIMRA Online:http://www.tccn.com/limra/limra.html

Moneyworld UK:http://www.moneyworld.co.uk

Shopping mall:http://www.londonmall.co.uk