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POINT OF VIEW

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THE SEVEN MISSING INGREDIENTS IN LIFE INSURANCE CUSTOMER RETENTION PROGRAMS

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The Australian life insurance industry has recently experienced its highest lapse rates of the past 20 years. This in itself would be a cause for alarm, but the impact of high lapse rates has been compounded by a spike in claim rates, looming economic uncertainty and falling profitability (34.7% drop in industry profits in the year ended March 2014[1]). Moreover, these pressures come at a time when customer expectations are rapidly evolving and the industry is grappling with enormous regulatory changes.

Even as insurers have been busy fire-fighting these changes, they have had to be selective in picking their battles. As a result, customer retention programs have fallen victim to an over-reliance by insurers on the hope that improving economic conditions and industry-initiated changes will address the issues.

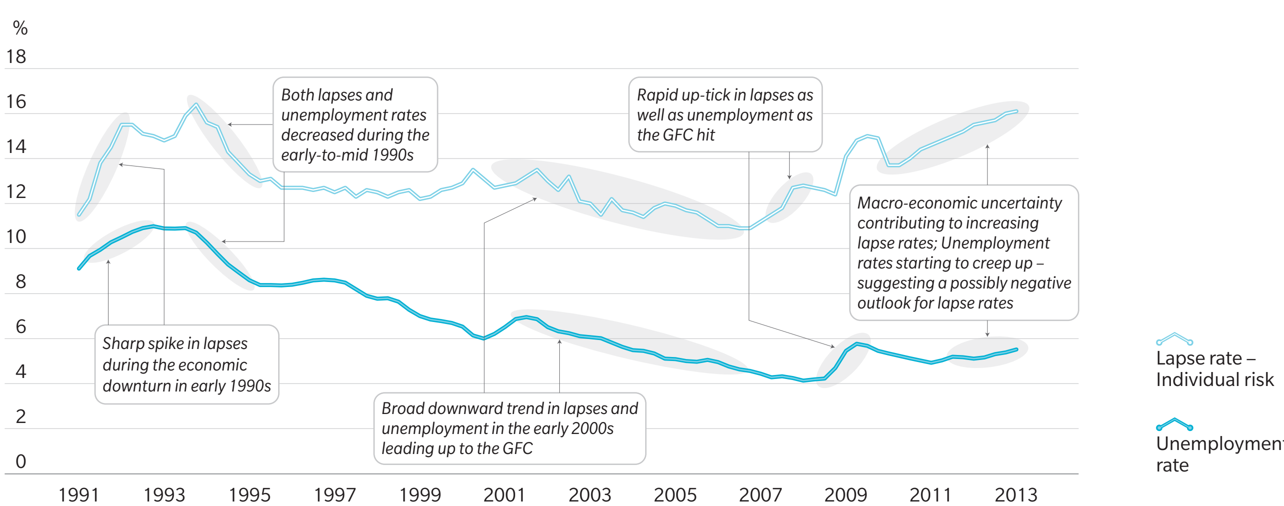
We believe that an improved economic environment will only partly ameliorate the underlying issues and that waiting for an industry-led solution may not leave players with much of a business to save. Sustained success will only come by enacting a significant, proactive program that focuses on seven key ingredients. Together, these can deliver a 3% to 5% improvement in lapse rates within three years, realising hundreds of millions of dollars in value for insurers. Importantly, these ingredients can accelerate an insurer's journey towards a customer-centric organisation by helping it effectively engage with its customers and adapt to their changing needs.

In this report, we briefly explore the drivers behind the lapse problems and then outline what we believe are the seven missing ingredients for institutions still struggling with retention issues.

WHAT ARE THE DRIVERS OF THE RETENTION PROBLEM?

Lapse rates have been increasing rapidly over the past four years. A review of the trends in lapse rates over a longer time period suggests a strong positive correlation with the unemployment rate, which has been trending upwards in recent years (see Exhibit 1).

Exhibit 1: Historical lapse rates (individual risk) vs. unemployment rate



Sources Plan For Life, ABS, Oliver Wyman analysis.

1 Australian Prudential Regulation Authority (APRA).

Others point to product churn as the main source of the problem, with commission-hungry advisers flipping policyholders into a new product every few years. Our analysis suggests a more nuanced situation, with a number of drivers coming together to create a perfect storm (see Exhibit 2). Specifically, we see a combination of structural, cyclical and organisation-specific components all contributing to recent, significant write-downs and losses from lapses.

Exhibit 2: Summary of key lapse drivers

DRIVER			DESCRIPTION
STRUCTURAL	1	**Customer needs and preferences**	• Customer needs changing over time – e.g. for lower cover at older ages • Customers find current products opaque and complex – demand simple, flexible offerings
	2	**Intermediary ownership of customer relationship**	• Historically, intermediaries have been treated as the insurer's primary customer, with minimal efforts to proactively engage with the real customer • Distance between insurer and customer has contributed to insurers being slow in recognising and responding to changing customer needs
	3	**Stepped premiums**	• Prices increase with age, typically at a faster rate for older ages, pressuring affordability • Lower need for insurance cover at older ages exacerbates problem
	4	**Incentive structures**	• High up-front commissions encourage advisers to churn • Lack of awareness of retention being a key issue amongst advisers and Business Development Managers
CYCLICAL	5	**Worsening macro-economic outlook**	• Positive correlation between unemployment and lapses • Decreasing affordability and perceptions of value forcing customers to shop around for better deals or exit industry
	6	**Worsening claims experience**	• Tough environment for insurers with recent worsening claims experience pressuring insurers to raise prices to restore profits – exacerbating lapse issues for the price sensitive customers
ORGANISATION–SPECIFIC FACTORS	7	**Culture and organisation**	• Strong bias in culture towards sales rather than retention • Typically, no single senior executive ownership of Retention with limited dedicated resources – delay in recognition of and response to retention issues
	8	**Pricing and product competitiveness**	• Uncompetitive pricing with select peers, in aggregate or for select cohorts or products • Products and pricing not updated as frequently as peers resulting in lower ratings from rating houses • Lack of focus on inforce pricing and product suitability relative to new business

Each insurer has felt the impact of these drivers. But the relative materiality of each driver will vary across companies, requiring a comprehensive diagnosis of the individual insurer to understand the impact and develop a tailored response.

THE SEVEN MISSING INGREDIENTS

The complexity of the operating environment and diversity of views on the key drivers of lapses has resulted in a range of responses from insurers. The more successful players detected the key issues early and now have relatively mature programs providing material benefits; however, recent lapse performance across the industry suggests that very few players fall into this category. We believe that most insurers have some form of customer retention program in place but lack one or more of the seven key ingredients for a sustainable solution. Together, these ingredients can help insurers migrate from tactical fire-fighting efforts that barely contain the damage to a sustainable operating model that creates and preserves value.

1. INSIGHTFUL ROOT-CAUSE DIAGNOSIS RATHER THAN COMPLEX STATISTICAL ANALYSIS

Most insurers typically start with a detailed actuarial lapse experience investigation to understand the drivers and causes of poor lapse experience. These investigations can be a valuable source of information and insights, but too often are narrow in their focus and technical in their description. Our experience suggests that a much broader framework should be used for diagnosis and that the results and subsequent discussions should focus more on the "why" and "so what", rather than a description of the findings. In the framework below, we outline some key questions to ask and dimensions to analyse (see Exhibit 3). The list is not exhaustive, but the categories are broad enough to begin providing a holistic and richer set of insights. Furthermore, since these areas span the business, they have the added advantage of increasing awareness and providing an enterprise-wide lens to retention issues.

Exhibit 3: Retention management framework – effective diagnosis tool

Culture

- Is there periodic reporting on retention outcomes for senior management and the Board?
- How material are Retention outcomes in executive compensation?

Product and pricing

- Which products/portfolios (lump sum vs. income protection, group vs. standalone, other)
- Product competitiveness
- Pricing strategy – relative to market
- Pricing strategy – new business vs. inforce
- Product design
- What do customers tell us about product and pricing?
- What do advisers tell us?

Distribution

- Profile of intermediaries contributing materially to lapses (owned vs. aligned vs. IFA, tenure, sales and size of inforce book etc.)
- Are intermediaries aware of retention issues?
- Are BDMs aware?
- Does performance management pay adequate attention to retention?
- Importance of good/bad retention outcomes in incentives
- Advisers views on proposed solutions

Customer operations and servicing

- Is there a dedicated "save team"?
- Size of "save team"
- Training and incentive structures of save team?
- Do save teams have "save offers" readily available?
- Is the save team empowered to use judgement within boundaries?
- Is the list of lapse triggers comprehensive?
- How effective is the proactive engagement process?

Customer data and analytics

- What is the profile of customers that are lapsing? Age? Tenure? Number of products they hold?
- Is there adequate data and understanding of why customers are lapsing? Affordability? Lack of need? Product suitability? Other?
- How frequently is this captured?

Organisation and governance

- Is there senior executive ownership of retention?
- Are there adequate number of resources dedicated to retention?
- Is there a strong PMO function?

This framework should also form the basis of the overall solution design. In the centre panel, we have provided some concrete examples of how this framework can be applied in developing comprehensive solutions. The success factors and supporting representative exhibits have been compiled based on our collective local and global experience in delivering transformational impact with the design and implementation of retention programs.

BRINGING THE RETENTION MANAGEMENT FRAMEWORK TO LIFE

EXHIBIT A: CUSTOMER DASHBOARD (ILLUSTRATIVE EXAMPLE)

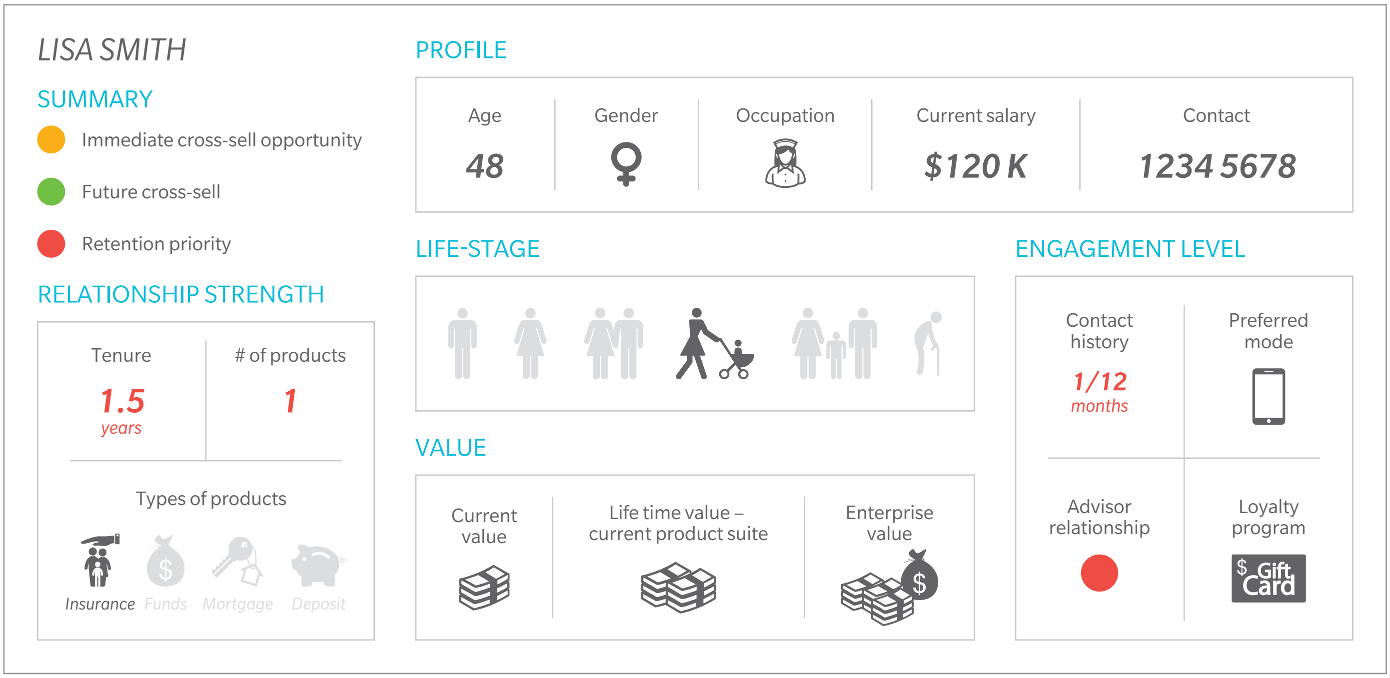
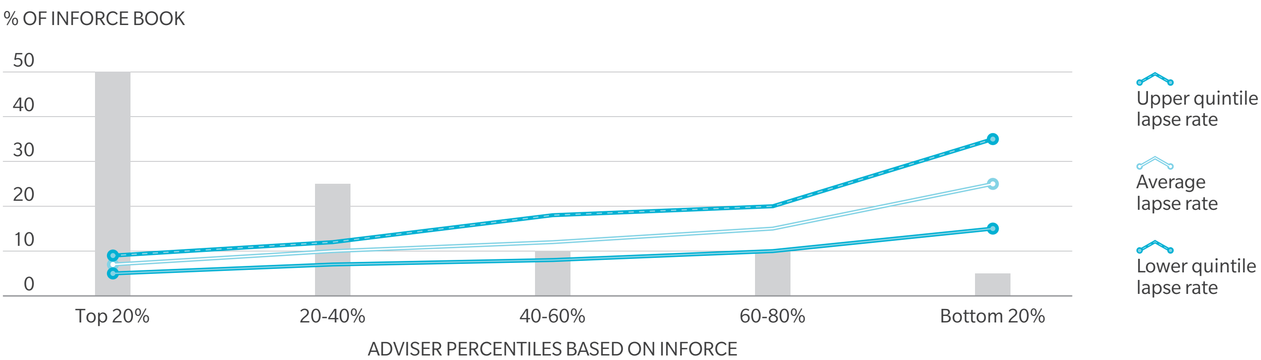


EXHIBIT B: ADVISER LAPSE PERFORMANCE BASED ON SIZE OF INFORCE BOOK



Note Granular analysis of adviser retention performance can provide valuable insights – performance management approach can be customised for each segment of advisers.

KEY SUCCESS FACTORS ACROSS THE RETENTION MANAGEMENT FRAMEWORK

PRODUCT AND PRICING

- Comprehensive diagnosis and market intelligence
- Analytic capabilities and broad stakeholder input critical for inforce pricing strategy
- Re-assessment of whether product design is truly customer centric – no silver bullet but valuable thought exercise

DISTRIBUTION

- Performance dashboards that include retention metrics
- Retention performance a key part of communication
- “League tables”
- Don’t forget about BDMs
- Use incentives to reward and penalise retention performance

CUSTOMER OPERATIONS AND SERVICING

- Granular data and insights into sources of leakages and improvement levers
- Real-time “save offers”
- Pro-active engagement program
- Strong focus on “test and learn”

Target save rates of 70%-80%+ are achievable for inbound calls

EXHIBIT C: APPROACH FOR DEVELOPING AN INFORCE PRICING STRATEGY

DIAGNOSIS AND FACT-FIND

External views
- Customers
- Advisers (Aligned and non-aligned)
- Competitor research
- Regulators...

Internal views
- BDMs
- Finance
- Risk
- Marketing...

STRATEGY HYPOTHESES

Strategic hypotheses long-list
- Lower prices
- Lower cover
- Which customer segments?
- Offer loyalty discount
- Premium holidays
- Level premiums
- Other...

ANALYTICAL ENGINE

Build propensity model
- Start simple
- Increase granularity, coverage and sophistication over time
- Continue to back-test and improve

TEST AND PILOT

Cost-benefit analysis and testing
- Quantify the impact of hypotheses
- Test with advisers and refine
- Test with selected customers and refine

ROLL-OUT

Implementation
- Translate actions into policy
- Phase implementation over time, gradually increasing scope
- Periodically refresh

EXHIBIT D: DEEP UNDERSTANDING OF LAPSE DRIVERS AND LINK TO RETENTION PROGRAM RESPONSE LEVERS

LAPSE REASON	1 MM AVG.	3 MM AVG.	RESPONSE LEVER
Affordability – cancelling cover	30%	35%	• Premium holiday
Cheaper price	30%	20%	• Discount
Better product	10%	10%	• Switch product
No insurance need/life-stage	20%	30%	• Refer to retirement business
Job change	5%	5%	• Save insurance
Other	5%	0%	• ...

CULTURE

- Strong awareness of retention at the senior executive level
- Periodic internal communication campaign to reinforce importance of retention

CUSTOMER DATA AND ANALYTICS

- Systematic capture of customer data, including reasons for lapsing
- Structured process to feedback customer data to initiatives
- Suitable value metric to distinguish between high-value and low-value customers
- Dedicated resources focused on modelling and analytics

ORGANISATION AND GOVERNANCE

- Senior executive ownership of retention
- Clearly defined roles and responsibilities
- Periodic reporting to senior management and Board on retention outcomes
- Dedicated PMO

1%-3% of FTEs dedicated to retention activities

2. EMBED “VALUE” IN DECISIONING

Far too often, there is a disconnect between the findings from the diagnosis, the program in place and the value drivers of the business. Effective retention programs bridge this gap and are designed to have initiatives that illustrate a clear linkage to the core value drivers of the business, with the impact measured by a set of agreed-upon value metrics. In practice, organisations need to find the balance between:

- Simple value metrics that are easy to understand and communicate (e.g. net cash-flows, DAC[2]-at-risk, etc.) vs.
- Complex value metrics that may better capture the long-term nature of the business and its value drivers (e.g. embedded value, customer lifetime value across lines of business, etc.), but may be challenging to calculate as well as to communicate

Often, it is better to start with simple metrics that can be quickly calculated, easily communicated and that have the benefit of increasing business awareness of retention. As capabilities progress, a migration to sophisticated measures of value that better capture the business characteristics is recommended.

The sophistication of the value metric is important but secondary to ensuring that the retention activities that drive value are clearly understood. For example, it is important for the call-centre staff to understand the impact on value of alternative save-offers (e.g. premium holiday vs. discounting vs. lower cover). The more informed the staff, the better it will be able to target offers and, hence, preserve value. This typically requires a strong focus on education and staff training, and is critical to success.

2 DAC = Deferred Acquisition Cost, an accounting measure that spreads the up-front cost of acquiring business (e.g. initial commissions) over the expected lifetime of the insurance policy. Increased lapses can lead to write-downs of DAC, which in turn reduces reported profits.

3. CULTURE THAT APPRECIATES THE IMPORTANCE OF RETENTION

Most insurance companies have been guilty at some stage of placing a greater focus on new sales and implicitly setting a lower priority on retention. Over time, this has become ingrained in the culture of organisations and has helped glorify sales, often at the expense of retention. The importance of retention in a culture is difficult to measure; however, in our experience, a few simple indicators can provide a helpful health-check (see Exhibit 4).

Exhibit 4: Retention culture health-check dashboard

Measurement can help enable change by highlighting the areas in need of improvement. However, in practice, changing organisational culture is extremely challenging and should be phased in over time. We see three sequential pillars in developing and embedding a retention-centric culture (see Exhibit 5).

Exhibit 5: Building a retention culture

EDUCATE BOARDS AND SENIOR MANAGEMENT

- Sustained and periodic education sessions to increase Board and senior management awareness
- Focus communication on business impact
- Link clearly to business strategy

COMMUNICATE DOWNWARDS

- Periodic, top-down driven communication campaigns to increase business awareness
- Measure effectiveness through "corridor pulse" surveys and refine approach

ALIGN INCENTIVES

- Use this to accelerate impact rather than to force change
- Strong change management process needed to support implementation
- Start at the top (Board and senior management) and embed downwards

Liberty Holdings, a South African financial services provider whose life insurance business is widely acknowledged as having established a best-practice retention program, recognised the importance of building a retention culture early on in its program. Its retention problems surfaced in 2008 and early 2009, yet the 2009 annual report already disclosed efforts towards shifting the sales culture towards retention.

Change management is ongoing and includes extensive face-to-face engagement by our executive team with the distribution force to emphasize the need to balance a sales culture with policy retention.

Liberty annual report 2009

The success of the shift in Liberty's culture toward appreciating the importance of retention is epitomised by the fact that four years after its troubles, the company's annual reports still acknowledge retention as a key strategic priority and discuss the issue in detail.

#1 – 2012 achievement

The Customer retention team continued to improve defence processes with record monthly retentions achieved. Knowledge gained has been embedded in processes and procedures and is being used to inform the emerging consumer market acquisition strategy.

#1 – Objective for 2013

Manage persistency levels within assumption.

Liberty annual report 2012

4. GRANULAR DATA, FOCUSED APPLICATION

Hampered by intermediaries which act as gatekeepers to the customer, multiple legacy systems and a mindset that treats data as part of an administrative process rather than a strategic asset, insurers have suffered from both poor-quality customer data and ineffective use of that information. To address those shortcomings, many insurers have focused on short-term tactical data initiatives, while others have embarked on longer-term transformational "Big Data" programs. The challenge for organisations in each of these camps is delivering material and sustainable impact from their efforts. While this challenge is relevant in a broader context, it is particularly important for customer-centric initiatives such as retention, where granular data is needed to develop targeted solutions for customers as well as intermediaries. Below are three key data and analytics principles we find in successful organisations (see Exhibit 6).

Exhibit 6: Data and analytics guiding principles

	PRINCIPLE	DESCRIPTION	RETENTION EXAMPLES
1	**Focus on high-priority gaps**	• Identify most pressing/high impact data gaps	• Incorporating retention metrics in adviser and BDM dashboards • Developing adviser league-tables
2	**Tap into non-traditional data sources**	• Periodic interviews with key staff and external stakeholders • Crowdsourcing internally to fill data gaps	• Underwriters can often quickly identify advisers with poor retention records • Interviews with advisers to understand market views on product and pricing competitiveness • Designing customer-centric products using crowd-sourcing
3	**Build structured feedback loop**	• Disciplined process to feedback data and insights to improve initiatives	• Capture customer data on reasons for lapse and feed back into retention program to improve save offers and propensity modelling

Finally, it is challenging and time-consuming to fundamentally re-tool underlying systems to provide relevant retention data directly from the source. Rather, successful organisations develop dedicated enterprise layers that sit on top of the multiple existing systems and draw information as required. This also allows for the rapid inclusion of new data sources, which in turn can allow new information to be deployed in "Internet time" rather than the much slower timeframes from existing core systems.

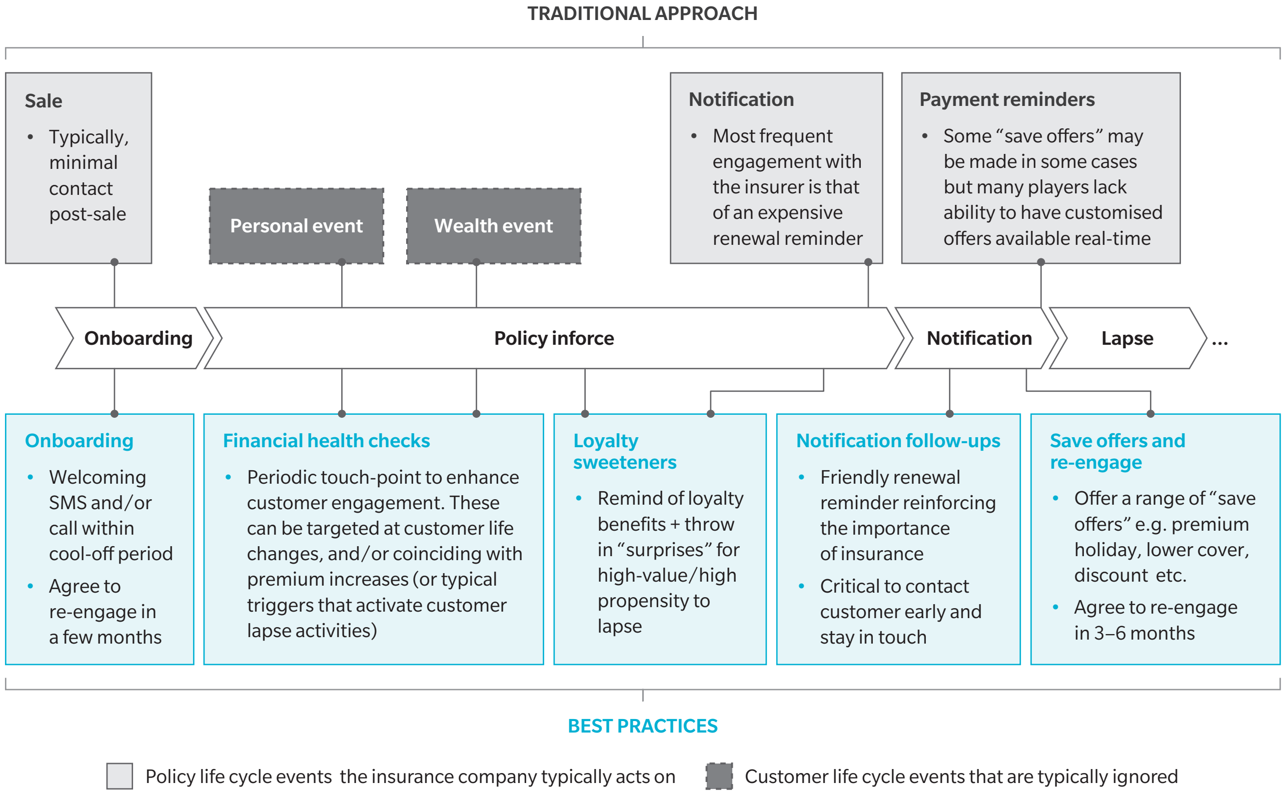
5. ENGAGE EFFECTIVELY

For most insurers, engagement with the customer post sale is confined to renewal notices providing customers with a triage of bad news:

Moreover, when there is an issue with a payment, the engagement mode tends to be threatening (the consequences of not paying) rather than engaging and helpful (what can we do to help?). While the messaging may be toned down by some insurers, and some have fundamentally changed the way they interact with customers, the impact on the customer is the same: a relatively unknown corporation wanting more money every year for a service, the benefits of which are uncertain and intangible.

While to an extent this represents a structural impediment for the insurance industry, we believe it can be overcome via an effective and periodic customer engagement process over the policy life cycle. Exhibit 7 provides an illustrative example.

Exhibit 7: Customer engagement over policy life cycle



In effect, it focuses on more regular engagement with the customer, greater sensitivity to and recognition of their needs, efforts to build and reward loyalty, as well as reinforcing the importance of the insurance cover customers have purchased.

A practical constraint raised by insurers in implementing such processes is a lack of buy-in from advisers to engage with their customers. While this in theory would seem to present a challenge, it is an obstacle that is often easily surmounted in practice. It can be addressed by agreeing on the rules of engagement: reinforcing the benefits for the customer, focusing on engagement initially rather than on untargeted sales, agreeing on which customers the insurer can contact proactively (e.g. those without an active advice relationship, low-engagement customers) versus those where advisers would like to retain an active relationship. The quid-pro-quo is that the both parties should be required to demonstrate how they are managing to act to the long-term benefit of all parties.

6. APPLY AN ENTERPRISE-WIDE LENS

One of the key challenges of retention programs is that the activities involved span many functions (Product, Sales & Distribution, Operations, etc.). Initiatives are often developed in a siloed manner by each of the individual functions to meet their specific goals, and can end up being narrow in focus and limited in impact.

An example that further illustrates this is the development of an in-force pricing strategy. Traditionally, this has been developed by the Pricing team within Product with minimal input from other stakeholders. Better-performing organisations proactively engage a broader set of stakeholders. For example, seeking the input from advisers and BDMs on the perception of price in the market can be valuable, even if it doesn't impact the outcome directly. Similarly, having a structured process to capture customer feedback on pricing can be quite powerful.

Better-performing insurers apply an enterprise-wide lens, seeking input from a broad range of internal (functions, lines of business) and external stakeholders (customers, competitors, regulators, etc.). Such a process leads to a richer, more insightful and ultimately more sustainable solution. For this to be effective, the roles and responsibilities of each function and key individual must be clearly defined. Furthermore, given the large, complex and diverse nature of retention change programs, a dedicated PMO team with strong subject matter and cross-functional expertise and experience is often a critical yet commonly underestimated enabler of success.

As an example, Liberty Holdings Life Insurance business recognised the importance of a strong team with a diverse skill set in effectively tackling retention issues.

Liberty's retention team has been expanded and now consists of over 170 people, including a blend of actuarial and other professional skills.

Liberty annual report 2009

A dedicated team comprising of senior executives with a diverse range of technical skills was established to urgently address the persistency challenges through a dedicated customer management program.

Liberty annual report 2010

7. BE BOLD

There has been plenty of debate on the need to critically reassess the structural drivers of lapses (stepped premiums, high up-front commissions, product design, etc.), but to date, we have seen minimal decisive action taken by any individual insurer. Any change would likely draw criticism from the stakeholders that stand to lose out and potentially also present a first-mover disadvantage, as other incumbents seek to exploit anyone breaking away from the pack.

As an example, an industry-wide shift towards level premiums has been proposed by many as a long-term solution, having empirically exhibited better lapse performance than equivalent stepped premium products. For a number of companies, some 10% to 20% of their books are already on level premium products, yet no major player has announced a greater scale adoption of level premiums. For a select few, this may be because they are confident that the current regime is sound and have granular value-volume analysis to support their stand. For most, there is major concern about the perceived risks that such a move would entail: apparent price disadvantage, large drop in new sales, adviser backlash, potential spike in lapses as advisers move business, BDM turnover, reinsurer concerns, as well as reputational damage.

Similarly, changes to adviser-incentive structures are another talked about solution. Our experience suggests that very few players have engaged in rigorous analysis and internal dialogue to assess the impact of similar bold moves. Most have not prioritised such an exercise or have lacked the decision framework to make a tough call. We believe that conducting such analyses and comparing the outcomes against the status quo and potential adverse scenarios can provide useful insights for management and better equip them to make difficult decisions.

There is no denying that making a bold move similar to those described above is challenging. Given the deteriorating profits of the industry and limited indication of a turnaround in the near term, there is a strong call to action for insurers to revisit their customer-retention business strategy. For many that are disproportionately impacted by lapses, the call for a bold move is growing stronger and may soon be a necessity.

CONCLUDING REMARKS

High lapse rates remain a key issue for the life insurance industry. Most insurers have some form of a retention program in place, but the upward trending nature of lapse rates suggests that these programs have had limited effect, with most of the efforts focused on firefighting and containing the damage. We believe that effective implementation of the seven missing ingredients not only will help repair profits in the short-term but will also guide insurers towards a more sustainable business model over the medium-to-long term: one which effectively engages customers and adapts to their changing needs, and ultimately provides a better outcome for all participants.

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