LIFE INSURANCE DISTRIBUTION NOW AND IN THE FUTURE

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Before anything else I would like to thank the Actuarial Society of the Philippines (ASP) for the privilege of being invited to your annual convention. I will do my best to fulfill my assignment, which is to discuss the topic, "Life Insurance Distribution Now and in the Future."

Before I begin, please allow me to make a disclaimer. I don't consider myself an authority on life insurance distribution. Rather, I can only claim to be a firsthand witness and practitioner. What I will present today comes from my own experiences, observations and reflections from nearly four decades in the business, augmented by a little reading and research. In preparing for this talk, I asked for guidance from your incoming President, Candy Suarez, as to what may be of particular interest and relevance to the Society. Five points were enumerated, namely:

1. The future of agency distribution
2. How the agency model has developed through the years
3. Agency versus alternative distribution models
4. Changes in the distribution landscape
5. What does it take for local companies to compete with multinationals, especially in the light of ASEAN integration?

Before I address these points, I believe it is first necessary to establish a few preliminary facts about life insurance and agency distribution.

The Origins of Insurance

By some accounts insurance has been around since the dawn of ancient civilization. According to several historians, the origins of insurance can be traced to Babylonian times (around 2100 BC) in what was known as the "Hammurabi Code", one of the earliest sets of written law. Traders were required to take out loans to guarantee the safe arrival of their goods by caravan. If a catastrophe occurred, debtors would not have to pay back their loans *(source: righttruth.typepad.com History of Insurance)*.

The concept of life insurance, however, probably took root during ancient Greek and Roman times with the creation of guilds called "benevolent societies" which cared for the families of deceased members as well as paid for their funeral expenses (*source: Wikipedia)*. In the United States it was Benjamin Franklin who got the first life insurance company, the Presbyterian Ministers' Fund, off the ground. Initially religious leaders expressed outrage at the practice of putting a monetary value on human life, but the sentiment cooled down when they saw how insurance was protecting widows and orphans *(source: www.investopedia.com The History of Insurance in America)*.

It is not my intention to make historians out of us, but it is necessary to recall the origins of our business for a better appreciation of the role and value of the agency distribution system. Life insurance came into existence out of a noble purpose to provide assistance to widows, orphans and other financially distressed persons. It is this personal nature of life insurance that likely led to the establishment of an agent distribution model because who else can better explain the merits of life insurance than people who are trained and dedicated to the advocacy of financial security? From the outset, therefore, this was how our business operated. Insurance companies manufacture the products and the sales force finds, qualifies, and closes the customers. Such division of labor continues to this day.

The Agency System

When we talk of the agency system we are essentially referring to a distribution model composed of exclusively contracted (tied) agents affiliated with a sales office and receiving variable compensation, incentives and recognition for selling life insurance products. Sales offices typically have two management layers. They are called "direct agencies" because they are directly managed and logistically sponsored by the company. Another version of the agency model is the General Agent (GA) whose main difference is that it is a third party legal entity contracted to sell the company's products but manages its own organization and logistics. In other countries where the insurance sales practice has already matured, there are independent agents who source or broker business for different companies, but this is not a prevalent practice in the Philippine life insurance industry.

Nothing much has appreciably changed in the agency distribution model over the decades. What has occupied much of the attention of companies that distribute products through a sales force is how to expand it, in particular how to increase the number of agencies. Many companies have provided additional layers of management such as Associate Unit Managers and Associate Agency Managers. For the more tenured sales managers, another level - the "Senior Manager" – was added to encourage them to promote new managers from their own agencies and eventually spin them off after a certain period of royalty compensation. All these have tended to lengthen the period of time for internally incubated agents to one day run their own sales agencies.

There has been no lack of efforts to gear up the agency model for greater productivity and efficiency. Some innovations I have seen include providing direct agencies with overhead expense allowances for them to operate more autonomously and have all the impetus to grow larger. Another intervention was in assisting sales agencies organize their administrative staff. Jointly managed agencies where two managers partner to run the business were likewise rolled out. These are just some examples I am personally aware of at enhancing the agency model. Many other interventions emanate from the corporate side in such areas as training, sales management, agency development and marketing, all for the purpose of trying to make sales agencies more productive. When this entire ecosystem is taken into account, building and maintaining the agency distribution channel is a resource-intensive undertaking, but while companies worry or even labor under the cost burden of operating an agency distribution channel, they still continue with it for a number of reasons.

Aside from what I already mentioned, other qualities that make this distribution model attractive are its capacity for expansion as well as mobility. In the right leadership hands a sales agency can rapidly grow into an organization of hundreds, if not thousands of entrepreneurial men and women dedicated to aggressively selling life insurance. This is particularly relevant in the Philippines because of our low insurance penetration as well as geography. Coupled with this is the agent's ability to go where the action is because, unlike a physical office, he is not constrained by location, thus raising the likelihood of more sales being made. Another very important consideration is that, by and large, the market still prefers face-to-face transactions because the complexities of life insurance can best be simplified, explained and managed by well-trained agents/financial planners.

On the other hand, there are also some serious concerns. Foremost among these is the high cost of agency distribution. The agency model is compensation and incentive driven. If not operated well, agency sales can easily become a cost center adversely impacting the financial performance of the company. At the core of this issue is finding the right blend of science and art for managing this channel.

Another very much related concern is the efficiency of the model. Large numbers of agents may be good for covering the field, but only if the sales force is consistently and sufficiently productive. In reality, however, actual sales performance ranges from marginal to highly prolific. Obviously the prolific producers are the most desired, but what about the rest of the force? How can they be made more consistently productive? Short term interventions like sales contests and incentives have produced positive results, but then again these entailed added costs, thus not exactly leading to better expense efficiencies. More troubling, however, is that the behavior change may not be permanent and may lapse back to less productive habits when the intervention is over. Activity management programs, if properly implemented, can direct the agents' use of time along the sales process cycle, but it will only be effective if strictly monitored by the leadership to exact better performance. Forward-looking agencies should break away from inefficient sales practices and develop their associates to be more disciplined and process-oriented by inculcating and reinforcing the right work habits early.

A third point of perceived weakness in the agency system is market conduct. Because sales people are so diverse in their backgrounds, economic classes and lifestyles, upholding a high level of ethical and professional market conduct is never certain. All it takes for the good image of the organization to be tainted is for one agent to seriously misbehave. Needless to say, such situations must be resolved swiftly and decisively, but it doesn't guarantee that the company's reputation will be unaffected. Ensuring sound sales conduct in the marketplace entails commitment of resources as well as sufficient hands-on management time devoted to the effort.

Summing up, there are pros and cons for maintaining the agency distribution model, but the prevailing view is that the agency system will continue to operate well into the future, notwithstanding the emergence of other distribution platforms. However, agency must continuously evolve into a more reliable channel. In my view, successful sales agencies of the future will not depend so much on numbers as in quality of performers. There are indicators that this “flight to quality” is happening already - for example, the more career-minded agents are getting certified as registered financial consultants or planners. On the part of insurers, they are beefing up marketing capability to extend their reach, to provide more leads to the sales force, to develop stronger communication tools and customized products. All these have to be done with better cost efficiencies, stricter market disclosures and compliance.

It is also conceivable that, in the near future, the most progressive sales agencies will transform themselves into comprehensive financial practitioners offering the full range of wealth management advisory services to their clients. This development will see a formalization of alliances among agents and other professionals such as tax planning lawyers, investment fund managers and the like.

The death knell on traditional agency distribution has not sounded in our country; nor is it going to happen in the foreseeable future. Nevertheless, insurance companies must continue to wrestle with today's business challenges: a prolonged low interest environment that threatens long-term profitability as well as dampens the development of traditional insurance products, rising distribution expenses, the need for a bigger and sustainable revenue scale while keeping the organization lean, stricter regulatory compliance and corporate governance mandates, and a continuing convergence of financial industries.

Bancassurance Distribution

Next in prominence and performance is bancassurance distribution. Bancassurance first came to the Philippines only a little over a decade ago, but today it is already a major engine for premium generation. The bancassurance model consists of financial sales associates who, unlike traditional agents, are salaried employees who also receive incentives. The insurance partner taps into the bank's customer base and branch network, earning the bank fee income from every sale. FSAs are assigned to specific branches and work in unison with the bank's personnel to identify and pursue prospects from their depositor base. In addition to fee income, the bank is also paid a lucrative lump sum amount for exclusive access into its network.

Bancassurance distribution has several strong suits. First, the market is already known and "captive". Unlike agents who have to hunt for prospective clients in the open market, Financial Sales Associates are already provided qualified leads. Second, the bank branch network is already in place and operates immediately to produce insurance business. The insurer thus avoids the cost and, more importantly, the time needed to build the sales office infrastructure. Third, bancassurance distribution is a strong partnership between the sales associates and bank management. This is further ensured by hard-wiring activity and productivity parameters into the performance DNAs of both parties. On the part of the FSAs, activity standards are prescribed and measured daily. As for the bank manager and staff, they are mandated to provide leads, to engage customers, and even to identify needs for insurance. Fourth, when it comes to financial advice, depositors are greatly influenced by their bankers. It is also most convenient for a customer to deal with his bank for multiple financial services, including insurance.

Notwithstanding these advantages, there are, however, some areas of concern. One is the product array. For now the bancassurance environment appears to be more conducive to investment-linked insurance products where the primary choice is a single pay policy that does not generate recurring premiums for the insurer. However, production of regular pay variable life insurance is starting to gain ground. On the other hand, life insurance for financial risk protection is still scarce. Another issue is sales personnel retention. By and large, longevity in the profession is still uncertain among Financial Sales Associates. Feedback from former FSAs who migrated to agency distribution elicited two reasons. First, the career path of an FSA is more limited. A fortunate few are able to climb up the corporate ladder and become team leaders or area heads, but what's beyond that is unclear and, in any case, there are simply not enough higher positions available to accommodate many. Second, a salary-plus compensation is attractive when FSAs are starting out in the business, but once they make enough sales to bolster their confidence, they begin to entertain the notion of making more money if they were to go into this business for themselves. They are drawn to the variable compensation of agents because it is more lucrative for consistent producers. Finally, they can continue to build an entrepreneurial career leading to organizing and earning from their own sales agencies one day. Another potential area of weakness in bancassurance is mobility. While FSAs are able to transact with clients in the bank's premises, because of their go-anywhere disposition, aggressive insurance agents can always intercept the bank customer. Finally, bancassurance distribution may not be possible for all insurers. For one thing, there is a finite number of banks with significant branch networks and almost all of them are already partnered with insurance companies. Second, the "up front" cost of sealing a formal bancassurance agreement is expensive, and recent deals for exclusivity of global banking networks have raised that expense bar to prohibitive levels. Hence, the notion that bancassurance distribution is less costly than an agency channel may not always hold true.

Given its impact in significantly changing the competitive landscape in our industry, bancassurance distribution appears here to stay and will continue to have a sizable share of the market space that agency distribution once monopolized.

Online Distribution

Let's examine another emerging development in life insurance - online selling. The pervasiveness of the Internet and its power to reshape consumer buying behavior is indisputable; many marketers, in fact, are convinced that online selling is the new distribution method for the millennium generation. To what extent will this apply to life insurance as well?

Hundreds of thousands of businesses all over the world have joined the dotcom bandwagon. In the field of insurance, certain products have already been commoditized for online distribution such as travel, fire and car insurance. Cyberspace links the product manufacturer directly to the buyer, and by cutting down on intermediation costs, by expanding market reach, by pinpointing and profiling target customer segments, and by communicating the company's services economically, it becomes a very attractive channel for distribution.

In the Philippines using the Web as a distribution arm for life insurance is not yet that evident. Existing digital marketing platforms are mainly used for establishing presence, for growing a following, and for referring "netizens" to agents. End-to-end online distribution of life insurance is still an incomplete process, but with technology becoming more and more affordable, with relevant applications already available, and with E-Commerce transcending trade borders, it is only a matter of time before online distribution becomes another significant delivery channel for life insurance. But for now, it is best to say that digital marketing is a "combination play" where online signals, if done well, can lead to offline transactions with agents.

Other Distribution Channels

In my view, agency, bancassurance and online selling are the three major channels for life insurance distribution now and in the future. There are, of course, other distribution systems currently utilized here or elsewhere in the world, depending on the level of maturity or complexity of the insurance practice. There's the broker channel typically used for Group Insurance marketing. There is also Direct Mail (DM) marketing as a distribution arm primarily for simple, coverage-capped insurance products. In fact, DM can be redirected to the Internet and may, in fact, be the prototype for full online distribution. Affinity marketing, another source of insurance sales, distributes insurance to specific interest groups. Other modes of distribution employed are kiosk or mall-based marketing, E-commerce through mobile devices, corporate unit agents, worksite or seminar selling, and retail assurance.

Making the Choice

With a rapidly-evolving market environment, increasing regulatory and cost pressures, shortened product life cycles and squeezed profitability, how will life insurance companies rationalize their distribution strategy? I believe it will boil down to making decisions along the following strategic options:

1. Singular or Multiple?
2. High Touch or High Tech?
3. Direct or Indirect?
4. Retail or Wholesale?

Singular or Multiple

First, will a life insurance company be better off having only one dominant distribution arm or should it pursue a multiple distribution channel strategy? This can only be answered by the size of the production appetite. If the entire top line revenue requirement can be borne cost effectively on the shoulders of one channel, there would be little or no need to employ additional methods of sourcing sales. On the other hand, the argument can also be made that it is better to have several distribution platforms to augment the current channel. Alternative distribution can buttress the company's performance during times of production shortages from the main source. But even if the principal line is doing well, having a multiple distribution capability extends the company's market reach enabling it to compete more aggressively. A crucial point to be stressed here, however, is that employing a multiple distribution channel strategy requires the company to be very adept at maintaining harmony among and across its distributor lines. Channel conflict is the greatest threat to this type of operation, negating the gains of multiple distribution. If an insurance company does not have the expertise or the commitment to build and sustain different sales platforms, it should not undertake to do so.

The research on whether to be a one distribution or a many distribution type of insurance company favors developing multiple sales channels, largely because of the view that the market is becoming more segmented as to generations, lifestyles, and buying behavior.

High Touch or High Tech

The second strategic option is high touch or high tech. This specifically concerns choosing between people or technology. Where should distribution focus and resources be more concentrated? If management believes that interpersonal relationships between the institution and its customers is the most critical factor for sales, then it must concentrate on people-driven distribution. If, on the other hand, the viewpoint is that the market will be increasingly served by technology-driven business, then the company will have to leverage on technology-led distribution. A company can actually invest in both, but if it can only afford one predominant distribution, then it must decide which side of the bread is more heavily buttered. If the bulk of the resources will be used to enhance agency distribution by sharpening relationship and communication skills augmented by a little technology assistance, the belief would be that winning races is not about the vehicle but about who is behind the wheel. On the other hand, if technology is seen as the principal platform for driving sales, then the race car is chosen over the driver. In the world of competitive business it is not always an easy or clear-cut choice to make.

Another food for thought is this. If a company favors high touch over high tech, then technology is essentially a tool to enhance the agent's productivity and professional image. On the other hand, if life insurance selling is to be leveraged primarily on technology, the agent may then be relegated to a secondary role, possibly to that of an order taker. If it is the latter, should agency compensation be re-examined and revised? Remember the historical basis for agency compensation is the concept and distribution of labor between the company and its sales force. The company concentrates on manufacturing the product and the agent finds, qualifies, and closes the customer, does after-sales servicing, and nurtures the relationship further. But what if the company builds and operates a technology platform that could take on the prospecting function, could engage a potential customer meaningfully, could present the product and even do a financial needs analysis, and could help nurture the relationship? The insurer is then able to provide value-added functionalities that significantly reduce the work load of the agent. If so, should the company monetize those functionalities to rationalize its distribution expenses further? It's something that may be worth thinking about.

Summing up, there are compelling arguments for and against each side of the high touch vs. high tech spectrum, but the more pragmatic insight may be that it is really not a choice of one over the other, but either (a) having one or both as stand-alone systems, or (b) developing a blended distribution model combining the best elements of these two channels. If a "hybrid" approach is favored, to my mind it would strongly suggest a reassessment of sales compensation to rationalize distribution costs as well as to maintain parity in the company-agent partnership.

Direct or Indirect

Let us now consider the proposition, “direct or indirect”. Is it better to directly manage distribution channels or to outsource them? Many companies see merit in building and maintaining their own distribution, believing they can better influence the sales production of directly commanded channels. Proprietary channels do result in personal loyalties that usually make it difficult and costly to poach sales people. The tied agency system is the most significant of all direct distribution models, but other kinds would be direct mail marketing, salaried sales associates as in bancassurance, corporate unit agents, and in-house telemarketing units, among others.

If a company opts to own the distribution capability it bears all the expenses for operating it. Aside from the costs of agency compensation, there are other support charges like training, sales and marketing, technology, and relationship management. Loyalty and exclusivity therefore come with a commensurate price tag and are susceptible to the practices of other direct distribution operators. Moreover, aside from the financial implications of channel ownership, there are other considerations to take into account as well such as the expertise needed to operate the system, sourcing, attracting and keeping the best talents, coping with the stresses and pressures of delivering desired results, and organizing the administrative infrastructure.

The alternative then is to outsource distribution. Some specialized business lines like group insurance are already into this with their engagement of the broker channel. Other ways for distributing mainstream business would be forming marketing alliances with third party sales organizations, contracting external telemarking outfits, doing affinity tie-ups, or partnering with independent financial planners. While outsourced distribution provides only indirect control, it may be meritorious for insurance companies with limited resources. Their organizations can remain lean but can potentially have a wider business generation footprint. Lastly, dealing with third party sales or marketing organizations cuts down on the time needed to develop distribution capability.

In more mature insurance jurisdictions, tapping third party distributors is prevalent. For example, I know a Filipino-owned organization based in Vancouver that sells for several life insurance companies throughout Canada, and does so very successfully. I asked the owners of this broker-agent channel what it costs for companies they deal with to retain their services and they told me all they want is for those companies to pay them fairly, to process their businesses properly, to resolve their concerns expeditiously, and to maintain good relations with them. They are entirely self-sufficient when it comes to their sales activities. On my own I joined them in one of their incentive trips in Mexico. A Vice President from an insurance company they did business with was also there, and the only cost to that company was their executive's attendance to that activity plus a few token gifts for the producers. Non-owned distribution outfits can thus be cost-effective.

On the flip side of the coin, however, the most evident tradeoff is absence of direct control by the company. An insurer can do everything to lobby for more business, but ultimately only the distributor decides who they will deal with and to what extent. Another thing to consider is that it may actually take greater effort to sustain and enhance the business relationship because the third party operator has other options. Hence, if there are major disagreements in the engagement, they can always favor another provider. Applying an indirect distribution strategy requires constant attentiveness and proficiency to nurture strong relationships. If not, the business patronage may degenerate into a bidding game negating cost efficiencies. From actual experience, however, I can tell you that it is not always about money. The key lies in contributing in other ways to the partnership. For instance, if they need good resource persons for their conventions and the company can provide them with that support, the goodwill and value created will exceed any monetary consideration. Finally, the company must also consider possible reputational risks by associating with independently-operating partners. It may be affected by any impropriety or business failure of the distributor. Therefore, great care must be taken in choosing who to tie up with, and there must be continuing vigilance throughout the partnership.

Once again, the choice is neither simple nor easy. Companies cannot be static. Competitiveness is not just seen in revenue generation. It is also manifested in the strategic decisions made and implemented.

Retail or Wholesale

Let me offer one final dimension on life insurance distribution. Someone from another financial discipline recently exchanged views with me and his perspectives on distribution may either be useful or unfounded. He expressed the opinion that life insurance selling in the volume needed to maintain a company's competitiveness is better achieved if done institutionally rather than individually. He argued that developing proficiency, consistency and reliability in the agency channel is more time-consuming than pursuing institutional alliances that will lead to wholesale distribution of life insurance products. This is not really a new idea. Affinity marketing, for example, already does this. Likewise, this is also the preferred distribution for micro-insurance. The option of retail versus wholesale when it comes to distribution strategy is also part of the consideration. But then again, while most companies would not be opposed to forging institutional tie-ups for selling insurance, the more important question is - can it be a sustainable opportunity for distribution?

The CIFP View

I have endeavored to discuss a decision framework for configuring a company's distribution strategy based on a set of options. I hope it can be useful. Life insurance distribution continues to evolve. While it is not possible to predict the future with 100% certainty, there are a couple of truths that will greatly influence it. First, the agency distribution channel is no longer as overpowering as it was before. The emergence of bancassurance as a significant business generator has prompted insurance companies to reassess their production platforms. As earlier mentioned, the trend appears to favor developing multiple distribution capability. Second, technology is most definitely a game changer even for life insurance and will continue to influence, if not alter, the distribution landscape.

In reading about life insurance distribution, I came across a paper posted online by the Center for Insurance and Financial Planning based in India entitled, "Insurance Distribution Models of the Future". I found it quite interesting and insightful. I've included it as a handout to further stimulate corporate debate on this subject. CIFP enumerates its key observations and conclusions on life insurance distribution as follows:

1. *Changing lifestyles and buying preferences will decide the future models of distribution, while maintaining the equilibrium for the traditional patterns of distribution as well.*
2. *Insurers have to adopt a multi-channel strategy that develops new alternative channel formats and drives out efficiencies in traditional channels.*
3. *Trends prevalent in the insurance industry today run in parallel with the confluence of the financial services as banks, capital markets, and insurance combine distribution channels.*

4. *For insurers to realize the highest value from distribution, they must improve operations and agent-based support for key distribution segments. This includes enhanced operations to support a multi-product, multi-channel distribution model that compliments an insurer's revenue objectives and profit margins.*
5. *The best economic value for insurers is in partnership with distributors that demonstrate a high propensity to drive sales and manage their business with high-tech services and self-service outlets such as the Internet.*
6. *Today, more customers expect to perform most types of transactions either online or using mobile devices. Insurers are slowly pushing greater capabilities onto their Web sites to allow customers a higher degree of control and flexibility.*
7. *The relationship between people and technology is one of the key drivers in empowering the next generation workforce. It is an issue that insurers should consider as they position their organizations to meet the challenges ahead.*

Since there are a number of similarities in the insurance environments of India and the Philippines, the views expressed by CIFP may be instructive.

Being Local, Competing Global

I hope I have managed to address the previous four questions on life insurance distribution that established the agenda for this paper. The last question posed, however, is not about distribution but about competitive strategy, specifically on how to compete with multinationals in the light of ASEAN integration. Representing a local company myself, I ask that very question practically every day.

I would like to give my opinion as someone who started in this industry by working with a multinational insurer, then, after availing of early retirement, accepted employment in a completely local life insurance company. Part of the motivation for that decision was the challenge to apply what I learned to help a Filipino company remain competitive in an industry dominated by many formidable foreign brands. This ongoing experience has taught me that there are indeed ways to hold your own in such an environment.

Let me comment first on ASEAN integration. The most important point not to lose sight of is that this development presents both threats as well as opportunities. Sure, it will allow other ASEAN companies to have a presence in the Philippine market, but that's a two way street because it also enables us, if we wish, to broaden our presence and reach into their markets. In particular, consider the opportunity to market to OFWs working and residing in those countries. They are not being targeted by their host country insurers. We should therefore have an advantage over those companies if given reciprocal access to our ASEAN neighbors, and that is one way we can defend our market shares.

As for competing against each other here in our own industry, it is not nationality that determines performance outcome. All companies have their vulnerabilities. A global competitor, for example, has comparatively more resources than its local counterpart, but its decision-making protocols may make it less agile than a domestic company in deploying its financial muscle. If so, then a local insurer can compete by being the first to act, the first to market. The advantage may be temporary, but nevertheless it still pays off. In other words, the way to play the game competitively is to identify as much comparative advantage as can be utilized, be they large or small, fleeting or permanent. For instance, if we feel we have more insight into the market by virtue of culture, then we should build on this factor to grow our business even more, but always within the bounds of ethical and professional conduct. Business performance is a report card. Just as a student's academic standing is based on his proficiency in a number of subjects, the same is true for every company. It is downright wrong to proclaim a student superior to others on the basis of topping just one subject. Applying this to competing in our industry, let us not mislead ourselves or others into thinking that the gauge of excellent performance is how we rank in any single category. Rather, it should be the overall results in all key business indicators that make for a sound and responsible company. Let the verdict be determined by what our business model requires in the overall; otherwise we would be less than deserving stewards of our companies. Finally, if we truly desire to be world class we certainly can, but our efforts must be commensurate to the size as well as to the demands of that vision.

On this note it is now time for me to end this already long discourse. Thank you once more for the privilege of speaking before you.

Magandang araw sa inyong lahat.