

# InSights

## Riding the Wave of Embedded Value: Policyholder Marketing

*For most life insurers, 2008 could be shaping up to be a daunting race to increase top line premium growth and/or bottom line profitability. This is likely to be accompanied by demands from Distribution Channel Managers, Agents and Partners (such as Banks and Credit Card companies) for more innovative products, competitive pricing, increased features and benefits and a more generous remuneration structure.*

Rider benefits can not only increase new business premium, but can also optimise the profitability of new and existing policyholder relationships

With all channels focused on producing increased volumes of high value products to newly acquired customers, each of the above factors may play an important role in assisting distributors to achieve their new business goals.

However their impact on profitability may be more problematic in the short term.

What can be overlooked in this process is the way rider benefits can be used to increase new business premium income and optimise the profitability of new and existing policyholder relationships.

Typical rider benefits such as ADB, Critical Illness, Term Life Conversion & Extension Options, are among the most profitable products in any company's rate book. Yet for many, penetration rates remain low.

This represents a missed opportunity as their impact is both direct and indirect, and at times can be profound – particularly in the following three areas:

### 1. Increasing the Level of Protection Provided to Policyholders

From a consumer perspective, the most significant feature of rider benefits is their ability to provide greater scope for more realistic (higher) levels of genuine "risk protection" than many of the base plans to which they can be attached – at a fraction of the cost. This is particularly the case for the rapidly growing numbers of bank generated policyholders, whose primary motivation has been the purchase of life insurance as a savings and investment vehicle.

At recent Bancassurance Industry Conferences in Europe and Asia, it was near unanimously accepted by all participants that as an industry we are simply not selling anywhere near as much protection business as we should to bank sourced customers.

This is largely due to the reality that for most agents, especially the low productivity/ part timer (or bank officer), including rider benefits in the sales process may be 'complex' and not worth the hassle due to the additional underwriting requirements and/or for what may be relatively 'small change' in terms of commission earned.

This is an understandable perspective as new customer acquisition is the point of greatest distribution value add. However by concentrating on high value base plan sales, considerable value is lost to the customer, insurer and distributor by the failure to utilise rider benefits more effectively as part of their new business process.

While some companies have very effective programmes to encourage greater penetration of rider benefits across the policyholder base, the reality is most do not. While part of the answer is to ensure agents put greater emphasis on including rider benefits in the initial sale, this still overlooks the need and opportunity for existing policyholders.

In this regard the company must engage a different, albeit complementary strategy.

## 2. Increasing the Value To and From Existing Policyholders

We have all heard the axiom that 'your best customer is an existing customer'. And yet the cross sell ratio in the insurance industry remains extremely low. This despite the fact that traditional life portfolios exhibit very healthy cross-sell ratios for rider product offers.

**Our experience shows that this strategy has a multiple effect on the embedded value created for the insurer**

The primary reason for the disconnect is an obvious one. Utilising traditional agency distribution to go back and "re-sell" these benefits is an inefficient use of the agent's time and company resources.

Far better for the insurer to make these offers directly to the consumer via a series of direct co-ordinated cross sell programs, utilising a range of direct marketing channels.

Rather than resist further offerings, the older the Policy the more likely they are to respond to such offers. Policyholders are actually pleased to see they are not being neglected but appreciated, and as a result rider programmes often achieve triple digit returns. This creates the opportunity for innovative life companies to create a highly profitable, yearly renewable, communication cycle with existing customers.

A well designed policyholder programme can further leverage return by adding specific riders which release reserve through risk diversification. For example, the addition of whole of life cover to annuity policyholders.

The more products an individual has, the more satisfied the customer. The more satisfied the customer - the less likely they are to take their business elsewhere. The more "sticky" the customer – the greater value created.

## 3. Higher Customer Satisfaction, Persistency and Embedded Value

While the relationship between persistency (client retention) and the Embedded Value of any Life / Pension Portfolio is axiomatic, there is significant hard data to show that problems and improvements in persistency (and subsequent value) do not arise randomly. Instead they result from the (in)ability of Insurers to meet the service quality expectations of a wide range of disparate customers.

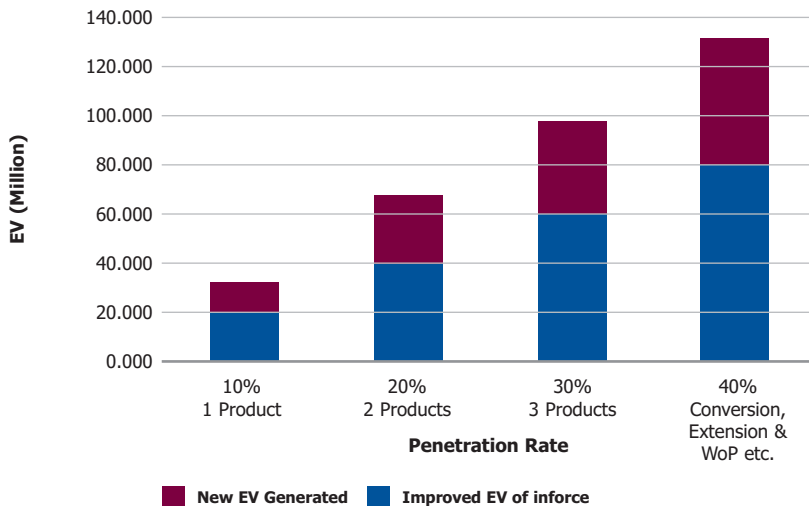
A core component of any quality service strategy involves meeting and measuring customer satisfaction. While there are many ways to measure customer satisfaction, perhaps one of the most robust is the propensity of a customer to (re)purchase additional products or services from the original insurer.

In this regard "share of wallet", as measured by the number of products held by an individual customer, is a key quantitative measure of service quality. The cross selling of rider programmes should be a key component of this strategy.

Our experience shows that such a strategy has a multiple effect on the embedded value created for the insurer. In addition to the value created by the rider itself, the neutral – positive impact on persistency provides an additional lift in embedded value across the existing portfolio. In the case of mature portfolios or "closed fund" environments the effect is even more pronounced.

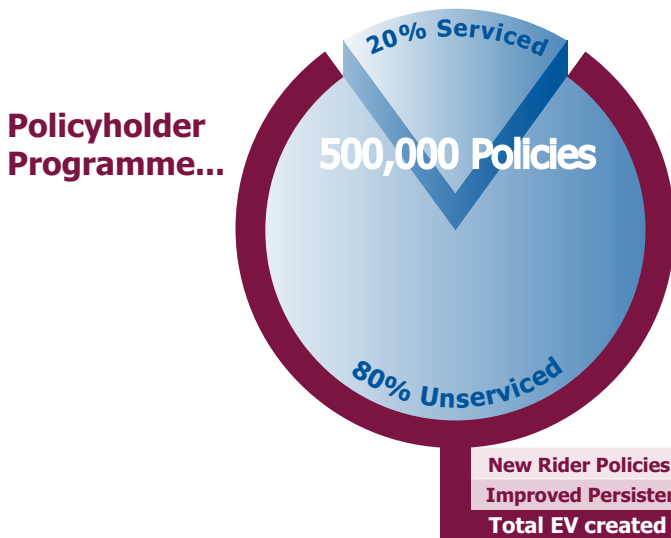
The following example (Charts 1 and 2) highlights the combined embedded value created using a multi product/multi channel strategy to lift rider penetration across a portfolio.

**Chart 1 – Embedded Value Generated by Policyholder Rider Strategy <sup>1</sup>**



<sup>1</sup> Assumptions: Policyholder size: 500,000  
 Percentage of eligible customers for policyholder program: 80%  
 Average Annual Premium per Policy: €150  
 Lapse rate of inforce portfolio: 10%, 9%, 7%, 5%...  
 Lapse rate reduced on inforce policies: 100 basis points each policy year for responded policies  
 Loss ratio: 30% of gross premium  
 Expense ratio: 20% of gross premium  
 Discount rate: 8%

**Chart 2 – The Benefit of Policyholder Marketing Programme <sup>2</sup>**



<sup>2</sup> Assumptions: Penetration rate for rider programme: 40%  
 Average Annual Premium per Policy: €150  
 Lapse rate of inforce portfolio: 10%, 9%, 7%, 5%...  
 Lapse rate reduced on inforce policies: 100 basis points each policy year for responded policies  
 Loss ratio: 30% of gross premium  
 Expense ratio: 20% of gross premium  
 Discount rate: 8%

**... results in Higher Customer Satisfaction**

**Ideal Vehicle for Adding Value To All Stakeholders**

To create an effective strategy, it must be designed to meet the specific needs of the company within the framework of proven products and methods.

For most companies, the new annual premium generated by riders cannot replace that received from the traditional sales channel. However, working alongside and concentrating on complementary cover not frequently sold by agents, increased rider penetration across an existing portfolio can have a disproportionately higher impact on your bottom line (embedded value).

An effective rider marketing programme benefits policyholders, agents and insurers alike.

There's still plenty of time do something about your policyholder growth and retention strategies this year.

# ReMark

## Maximum Value Creation

[generalqueries@remarkgroup.com](mailto:generalqueries@remarkgroup.com)

[www.remarkgroup.com](http://www.remarkgroup.com)

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### Corporate Headquarters

Amsterdam  
Parktoren  
Van Heuven Goedhartlaan 9a  
1181 LE Amstelveen  
The Netherlands  
+31 20 54 55 001

### Regional Offices

#### Africa

Unit B103a  
Cape Quarter  
72 Waterkant Street  
Cape Town 8001  
+27 21 417 28 00

#### Asia

UIC Building  
5 Shenton Way #31-03  
11K Khadye Marg  
Singapore 068808  
+65 6323 3401

#### Canada

2235 Sheppard Avenue East  
Suite 1701  
North York, Ontario  
+1 416 920 0912

#### France

39, rue Godot de Mauroy  
75009 Paris  
+33 1 5822 2323

#### Germany

Elsenheimerstrasse 47a  
80687 Munich  
+49 89 3750 640

#### India

202, 2nd floor  
Konark Shram  
156 Dadaji Jaoji Road  
Tardeo, Mumbai 400 034  
+91 22 3942 9284

#### Japan

Tokyo Tatemono Aoyama  
Building, 4th Floor  
3-3-5 Kita Aoyama  
Minato-ku  
Tokyo 1070061  
+81 3 5413 8050

#### Latin America

Paseo de la Reforma No. 350  
6º Piso  
Edificio Torre del Ángel  
Col. Juárez  
México City CP 06600  
+52 55 5511 9700

#### Korea

10th floor, Hanwha Building  
110 Sogong-Dong, Chung-ku  
Seoul 100-755  
+82 2 728 6200

#### USA

Minneapolis  
301 Carlson Parkway  
Suite 305  
Minnetonka, Minnesota 55305  
+1 952 988 8537

Atlanta  
2859 Paces Ferry Road  
Suite 860  
Atlanta, Georgia 30339  
+1 770 431 1080