Gen Re | LifeHealth

Risk Matters *Symposium*

The purpose of the Risk Matters Symposium was to bring together senior opinion makers within the life insurance industry to discuss, in an informal atmosphere, a specific issue that the industry is facing.

The topic for the Symposium was Protection 2009/2010. We invited Dr. Rebecca Driver, the Director of Research and Chief Economist, Association of British Insurers, to provide an overview of the economic and regulatory environment that the industry will be facing over the period. We also invited Peter Chadborn, the Principal at CBK Colchester and an IFA, who dealt with how distributors will be gearing up their businesses over the period, the issues they face and what their expectations are of providers. These two short presentations acted as a stimulus for our discussions.

This issue of Risk Matters is the full transcription of Rebecca Driver's and Peter Chadborn's presentations. The presentations can be found at:

http://www.genre.com/page/0,,ref=LifeHealthUKTraining-en,00.html

Gen Re LifeHealth, UK

What's in store for the Protection Industry in 2009

The Risk Matters Symposium was held on 11 March 2009 at the Capital Hotel in London.

Our guests for the evening were:

- Dr. Rebecca Driver, Director of Research and Chief Economist, Association of British Insurers
- Peter Chadborn, Principal, CBK Colchester
- Ross Ainslie, Managing Director, Bright Grey and Scottish Provident
- David Barr, E-Market Manager, Bright Grey
- Steve Payne, Director of BUPA Individual Protection, BUPA
- Clive Allison, Head of Protection, HBOS
- Stuart Bell, Chief Executive, Metropolitan Police Friendly Society
- James Crispin, Head of Product Portfolio, Scottish Widows
- David Lamb, Group Business Development Director, St James's Place
- Peter Hamilton, Protection Management Director, Zurich Assurance
- Peter Temple, Managing Director, Gen Re LifeHealth
- Jules Constantinou, Head of Marketing, Gen Re LifeHealth
- Robert Kerr, Senior Account Executive, Gen Re LifeHealth

The Impact of the Credit Crisis

by Rebecca Driver, Director of Research and Chief Economist, Association of British Insurers

Introductory remarks

First of all, thank you very much for inviting me, Jules. It is a great pleasure to be here, particularly to talk about a subject matter dear to my heart, having spent many years working as an economist and a macroeconomist. It is probably true to say that when I joined the ABI in 2005, there was very little interest in my abilities as a macroeconomist, on the grounds that the economy had become very boring, and monetary policy, in line with Mervyn King's dream, had also become very boring. Unfortunately, that is no longer the case, so the demand to know what is going on in the economy has increased sharply over the last year or so.

Perceptions of the economy

In context

So, to talk about the economy, the first thing to mention is that it is important to remember that we actually started from a relatively strong position. The current regime, as far as managing the macroeconomy was concerned, had been relatively successful. We had enjoyed the second longest, and second biggest, expansion in the history of the UK, so we had seen the economy grow by over 50% between 1992 and 2007. As well as that, we had witnessed a sharp contraction in volatility. If you look at the volatility of output between 1960 and 1992, it was 2.2%. Similarly, inflation was 5.5%. Since 1992, and even including the current period, the volatility of output has been 0.7% and inflation has been 0.8%. We had witnessed a remarkable reduction in volatility. One of the reasons the current period feels so scary is that we are simply not used to the economy bouncing up and down regularly. We have got out of the habit of dealing with it.

It is also important to remember, not only in terms of growth but also in terms of employment and unemployment, the UK has been quite successful in international terms. If you look at output growth over a 15-year period, what you basically see is that the UK's average growth, even including the projected slowdown for this year, is only a touch below that of the United States. You would not expect it to be as strong as the United States because the US has much stronger labour-force growth than the UK does, and that helps it grow more strongly. However, we have been extremely successful, certainly when compared with the main Euro-area economies.

We are in the middle of a crisis, though, and it will feel bad. We are not used to having recessions; we have not had one since the early 1990s. We are going to see higher unemployment. We are clearly seeing higher funding costs coming through. As a result of all this, you have seen a significant policy response, which comes also with costs, certainly if you are thinking about fiscal policy and the fact that there will be a tax bill to follow. We are also going to see quite a big housing-market correction.

Public perceptions

Not only does it feel bad to the economists thinking about what is happening in the economy, but it also feels bad to the general public. In the ABI, we run various YouGov surveys in order to help inform us what is going on in the real world and with the real people out there. I have been slowly inserting into those surveys a set of questions about the economy. You can see that there is a clear perception that the economy has worsened since April last year. One of the big jumps up was over 20 days in September. You did not actually see any big macro news at that time; no big redundancies or scary output figures were announced. What you did see was a series of headlines saying that my bank might go bankrupt, and that is one of the reasons why, for the population at large, the economy feels quite so scary at the moment.

The Bank of England

As far as the Bank of England is concerned – and I should say in the interests of full disclosure, I have borrowed extensively from the Bank's repertoire of slides, as well as from other sources such as Morgan Stanley, on the grounds that we do not do a lot of standalone macro analysis at the ABI – it is expecting a sharp slowdown over the course of 2009, but with growth picking up during 2010, and with growth stabilising at roughly the level where it had stabilised previously. Things will therefore be very bad for a while, but they will get better, and we will get back to where we previously were, or at least we can but hope.

What is true, though, is that you have seen a huge increase in uncertainty surrounding what people think is going to happen to output. Part of the reason for that is the extent of the policy response and particularly, for example, the introduction of the unconventional monetary policy that was announced by the MPC earlier this month. What you have seen is this: When you ask economists for their forecasts, the blue bars there are the forecasts that they produced in November 2008. You can see that they are mostly quite negative or, at least, quite small positive numbers. However, they are quite bunched. What you see if you ask them again in February 2009 is that they are much more widely spread. Some people think that the economy is really going to contract extremely sharply. Others basically think that in a year's time we could be witnessing some quite strong growth. Part of the reason for that is that there is a risk with the extent of easing that has gone on, you may see the economy bouncing off the ceiling, having fallen flat on the floor this year. There is a clear increase in uncertainty as far as people are concerned.

As I mentioned, one thing you are going to see is a sharp increase in unemployment. Unemployment is a lagging indicator, and so this will occur for some time to come. What you see, however, from this chart (and this is one of the reasons I like this chart) is that it is actually happening from a very low level of unemployment. Although there have been some very scary numbers announced around redundancies and high levels of unemployment (we have not seen this many people made unemployed in a quarter since 1990), in terms of the level of unemployment, we are still in relatively positive territory. That is something to bear in mind when thinking about what it feels like for the majority of people.

Companies

What it feels like from a company's perspective, or at least from a funding perspective, is probably quite scary. This chart shows credit-default swap premia for banks and insurers in Europe. It shows that there has been a sharp increase in the credit-default swap premia, which is effectively a measure of counterparty risk, if you are going to lend money to these institutions. October felt extremely scary with the possibility of several large UK banks going bust as well as similar problems in Europe. What you have seen since then, though, is that, we have not just reached that level, but come to a level much higher. People are really worried about the financial system. The government is throwing large amounts of money at it, governments overseas are throwing large amounts of money at the financial system, but it seems to be disappearing and nothing seems to be happening. There is clearly, within the financial markets, a hugely negative sentiment about what will happen to the financial system. That has implications for funding for banks and also obviously for insurers.

Part of what you are seeing is an increase in illiquidity premium: people just do not want to trade the stuff. However, there is also obviously not just an increase in the default risk associated with these numbers, but also an increase in the uncertainty associated with the default losses. Basically, all three components of corporate bond spreads have increased in recent months.

Volatility

You have also seen a huge increase in volatility across the board. This is a chart which I have taken from the Bank of England's Quarterly Bulletin. It shows the implied volatilities at two different points in time (one in the middle of last year, and one towards the end of last year). You see that it has increased across the board: absolutely everything has seen an increase in volatility. That does mean that, if you are advising clients about financial issues, it is going to be quite important to have a strategy about how you deal with volatility. If you are thinking from the point of view of an insurer, and that funding, volatility is going to be important. It is going to be important to understand whether volatility is going to remain this high, or whether it will reduce to the levels associated with the great stability that we saw, at least at macro level, between 1992 and 2007.

Inflation and quantitative easing

This is the Bank of England's famous "rivers of blood": it is a chart of its inflation projections. It shows, quite nicely, that it is projecting that inflation will remain below target. Indeed, it looks almost stabilised below target for most of the forecast period. This does give the bank quite a lot of room to manoeuvre when it comes to adding additional easing into the macroeconomy. On the back of that, the bank has persuaded the Chancellor to allow it to do quantitative easing: in fact, GBP75 billion worth of quantitative easing. The bank is aiming to do several things with this. Firstly, because at least half of the money is going to be used to buy long-dated gilts, it will bring gilt yields down because they are going to be purchasing these instruments directly, causing the price of them to go up. In fact, since these measures were introduced, the yield on 10-year gilts is roughly 50 basis points below its average for the year so far. Even before they have done anything, we are seeing a reduction in gilt yields on the back of this policy.

The other thing that the bank may well do is intervene to buy corporate bonds, which could have the same impact on corporate bonds and so reduce the costs of corporate borrowing more directly. One of the reasons for doing this is because, if they are going to concentrate on gilts, they need to think about who will be selling them these gilts. The banking system, as a whole, are actually net lenders of gilts; as net lenders, they do not have much that they can sell to the Bank of England in order to receive this money. The hope is that the banks will use the money from what they do sell to increase their capital base or, preferably I suspect, to increase their lending. However, if the government is buying these instruments from other players within the system (such as insurance companies or foreign organisations), they will hope that the money changes their behaviour and in some way helps boost the economy. It is also true – at least if you ask economists what they expect, and I would be the first to admit that economists are not always the best forecasters in the world – that there is a clear expectation that bank rate will remain at very low levels really until 2012. Even in 2012, you will not see bank rate back at the levels that it was when we went into this crisis. There will still be some tightening to come within the system after that.

Savings and investment

What is the outlook for savings and investment? Well, it is probably not really news to anyone in the room that you are seeing very low levels of savings, and have been for a long time. You have seen recently falling equity markets, hugely reduced trust in banks, and a clear perception that the benefits of savings have fallen. Somewhat surprisingly, given one of the slides that I am going to come to, property is still seen as the best form of investment by retail clients. Savings have been falling for a while. Part of that is probably a reaction to the reduced volatility in the system; if you have less volatility, there is less of a need for rainy day saving. However, there is still a clear perception that savings levels have undershot. The good news is, at least if you look at the contraction in the early 90s, you did see savings increase over that time, so it is possible that we will see similar increases in savings in the current recession.

As I said, there is a clear perception by people that the benefits of savings have fallen and that perception is getting worse. If you asked them in September, they felt that the benefits of savings had gone down, compared to a year earlier. If you asked them in December, there is a very clear perception that they had gone down compared to a year earlier. One of the reasons for that is obviously the fall in equity indices. If you have any savings tied up in equity, you are going to have seen the value of those fall quite sharply. Anyone who monitors their savings – which is not everybody within the population – will have seen them go down and will therefore be asking "why did I bother?" There is also a clear perception that the risk of losing money if you put money in your bank, has gone up compared to a year ago. Although that has moderated slightly between September and December, compared to June, it is clearly seen as much, much riskier. Unfortunately, we never thought to ask this question before the crisis, but I am guessing that, if I had, there would have been almost nothing for "gone up" and everything would have either stayed the same or gone down.

As I mentioned, property is still seen as the best form of investment, although it has fallen sharply compared to August 2007. There are lots of "don't knows" out there. There is therefore a clear perception of "I probably need help to decide what to do". Given the preference for property, what is the outlook for housing and household debt? Firstly, secured debt levels are extremely high. Income gearing is also high, at least compared to the early 90s. You are seeing a rise in repossessions. There has been a reduction in lending, and that obviously has implications for the protection business, where a lot of protection policies are sold off the back of mortgage transactions. You are seeing a sharp fall in housing transactions. As an economist, I would say that some correction in house prices was needed: so some of this is good news, at least as far as rebalancing the economy is concerned. Clearly it is not if you actually own a house. There are questions there.

As I said, there are very high levels of debt, though that level has been coming down in the very recent past. However, there has been a huge increase, with predominantly secured debt levels going up. That is partly what has been fuelling the house price boom. As I mentioned, income gearing has gone up. The green bars are the levels recorded in 1991; the oranges ones are the levels recorded in 2008. Basically, what you have seen is this shift to the right: there are more people, in other words, with higher income gearing.

You are starting to see, and have been seeing since 2005, increasing numbers of people reporting payment problems on mortgages. The chart for repossessions shows a very similar pattern. If you were to ask the Council of Mortgage Lenders, extremely scarily, they would tell you that the repossessions for 2009 are likely to be the same level as those in 1991. Now, I guess there are a couple of things to say there. One is that unemployment has not reached anything like the levels seen in 1991: there is a long way to go before that level of pain is felt by people. The other thing to say is that interest rates have actually been falling. The base rate is currently at 0.5%; during the early 1990s recession, the base rate averaged at 12.2%. We are in a very different world from the world then. Although it is almost certainly going to be the case that repossessions will rise this year, whether or not we reach quite the Armageddon scenario that the Council of Mortgage Lenders is predicting, I am not sure.

What you have seen, though, is a reduction in lending to households, and this is mainly reflected in other lenders (i.e., mostly overseas banks) moving out of this market. However, you have also seen major UK banks reducing their lending to the household sector. The housing market activity indicators as a whole are predominantly extremely depressing, all going down. One exception, which may be a suggestion of brighter things to come, is (the pink line) new-buyer enquiries. It is possible, then, given the falls that we have seen in housing, that actually new buyers are going to come into the market, and this will help. Of course, the problem is that a lot of people are now in negative-equity territory. Particularly with Gordon Brown saying that what he does not want to see is any more 100% loan to value mortgages, it is going to be very difficult to facilitate these people moving. You are likely to see much lower levels of housing transactions for some time to come because you will have many people locked in and unable to move.

This is why I said that some house-price correction was necessary. The pink line shows the ratio of house price to earnings. It increased massively: it almost doubled between 1996 and 2007. I do not know of a single economist who can account for that entire rise. On average, probably, most people will get to about 50% of that increase. This is put down to increased household formation, either because you are seeing more single-person households, or an increase in longevity meaning that fewer people are dying early, and therefore creating a greater demand for the housing stock from the elderly. You have also seen very low levels of housing-supply increases within the UK over that period. You can account for some of that increase, but probably only 50%. Assuming that 50% is the level that you can account for, that would imply a 30% fall in house prices, of which we have now seen just over half. That would suggest there is more to come. Of course, with any asset-price bubble, there is a risk that it will undershoot; it is quite rare for a bubble to burst and to end up on (what most people would see as) the equilibrium.

Protection

What are the implications for protection from the current environment? There is no surprise here: life insurance is currently seen as the most popular protection product, but its popularity is falling. One of the issues that people cite when they talk about why they have stopped buying protection products is expense. I guess there is also some sense that the intermediaries may see an opportunity to start selling protection, given, for example, that savings are not seen as a good bet at

the moment. It is difficult to sell savings products at the moment, and mortgage products are also quite difficult to place at the moment given the low levels of housing transactions.

In terms of protection products held, there are no real surprises here if you ask people what sort of products they have. There is a slight decline in life insurance, critical illness and indeed most of products across the board, but only very slight. What you have seen is, if you ask people which products they might want to buy in future, a sharp fall in the popularity of life insurance. I am not quite sure that I understand why that is, so that is something we probably need to do more digging around. It does mean that private medical insurance is now more popular than life insurance as a product that people might actually want to buy.

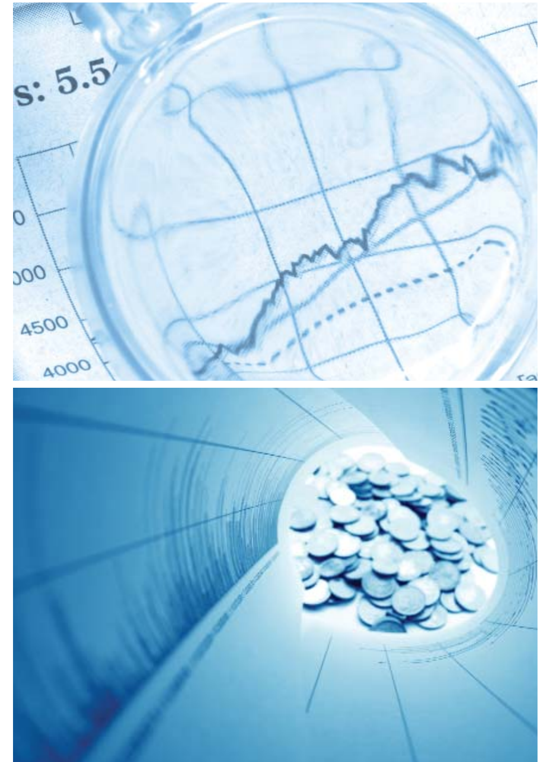
If you look at what products they no longer hold, this is an indication of products that people have let go. There are probably no real surprises there. Part of this will be driven by how many people had these products in the first place. Why do they no longer hold them? The two pink bars there are related to payment protection insurance, either refinancing of debt or paying down of debt. If you ignore those issues, you see that the product becoming too expensive is by far the most popular reason for why they no longer hold the product, followed by "I no longer felt it was a risk I needed to insure against".

As I said earlier, the current climate does mean that from an IFA perspective, or an intermediary perspective, there is an opportunity to think that protection products are a good thing to concentrate on. It does come at a risk, though. This chart shows what is happening if you add up mortgage-related term assurance, other term assurance and whole-life assurance, and split the pie between them. What has happened in the very recent past is that other term assurance has gone up at the expense of mortgage-related term assurance. Jules is quite right that for Q3 and Q4 2008, you did see a reduction in the overall level of protection sales. However, other term-insurance sales actually increased in that time. What you may be seeing is intermediaries, who had provided mortgage-related term assurance, going to their clients and saying "I know you will not want a new mortgage in the current climate, but how about a new term assurance product?" Therefore, we see that switch between mortgage-related term and other term. This is just speculation on my part, but it would make sense of these numbers, and it may have implications for the persistency associated with different parts of your protection book.

Concluding remarks

In terms of conclusions, we are seeing an economic downturn and it is a very scary economic downturn, not least because it is global. However, we did start from a very strong starting point, and we have seen a very determined policy response. Interest rates have come down, which is, surprisingly enough, not typical within most recessions. The outlook you are seeing is increasingly uncertain, so it is very difficult for commentators now to form a consensus around the outlook. You see very split views over what could happen. You are seeing a correction in the housing market, and most economists would argue that that was necessary. We are not a particularly popular profession, I have to say! In terms of the position of consumer finance, you are seeing very low levels of savings and high debt levels, which is something that you have seen for a long time. You are likely to see more emphasis on paying down debt than you are on increasing savings, given the huge scepticisms about the benefits of savings and worries about the health of the banking sector. People will need strategies to deal with volatility, particularly for the high level of volatility we are currently seeing persist. You are seeing a shifting pattern of protection sales, away from mortgage-related type protection sales and towards other protection sales.

Thank you.



IFA Perspective

by Peter Chadborn, Principal, CBK Colchester

Introductory remarks

Good evening, everybody. As Jules said, the main themes I want to cover tonight are the issues that are facing us as distributors in the market today: what we are doing about it, how we are gearing up our business, and (one of my favourite subjects, and one I never tire of talking about) what we want from providers.

Jules gave you a little background there about me and about us, but I do not want to give you only my views tonight. I am as opinionated as the next IFA, though you do not want to hear all about that! I speak regularly to other similar firms, ranging from one-man bands to those with three to five advisers, which is the category we fall into. I think it is important to get a broader view than just the one we have, and what we think and how we position ourselves. What we all have in common is that we have a mixed range of admin support. We all operate across the whole of the market, in terms of the providers that we use. We also advise on all areas, not only protection. What is very relevant is to say that our volumes are very low, because the people I speak to are either one-man bands or small firms. So, we fly under the radar for most providers and are bordering on insignificant. However, we are therefore perhaps very representative of the industry as a whole. That is why I am happy to do things like this: it gives a voice to what is likely the majority of the intermediary industry, who perhaps would never otherwise get a voice.

Downfalls in businesses

What is it like out there? Well, it is very tough. I was chatting to a few people earlier, who were saying that, for the first time ever, we cannot rest on our laurels, and sit back and shout "next" for the next customer who comes in wanting some advice. Things have changed quite drastically.

It is interesting talking to different firms. For the first time ever, different IFA business models are coming under the spotlight. Those that have been perhaps cruising, without putting contingency plans in place, are now very apparent.

No re-occurring income

One of the most obvious downfalls of businesses that I have seen is that there is no re-occurring income. That does not just mean funds under management; it means non-indemnity and income streams from protection. It also means repeat business from existing clients. I have never quite understood the mortgage brokers who have said they do not have time to do protection, as there is a long queue of people waiting to do mortgages. That has been the reality, and that has now stopped. Insufficient capital is definitely a problem for several businesses. A lot of small businesses run their business just like some individuals run their household budget and live to their means. A high cost base, with golf club, golf membership, subscriptions, flashy cars: all that is having to go. Limited servicing activity: thinking back to what I just said about the mortgage brokers (who did just the mortgages and nothing else), a lot of firms would boast massive numbers of clients who were not clients, as much as people they had done business with once. I certainly know that to be true from my time at the bank. Without that servicing activity, without those people knocking on the door, it is very difficult to go back to their client base.

Selling and not advising

Selling and not advising: "we are financial planners, don't you know, we are not salespeople". It is seen as a dirty word in some of the IFA community; we do not like to be called salespeople, though that is what we do most of the time. It is a bit of a cliché, but there is a difference between selling and advising in the eyes of our customers (and I will touch on this a little more later on). Essentially, those who are selling are perhaps not adding value, as opposed to those who are advising.

Despair and exit versus the resilient IFA

In terms of the sentiment out there from the firms that I speak to, views are definitely polarised. On the one hand, there is complete despair, Armageddon already, and "get me out of here". There are an increasing number of firms looking to consolidate, and it is not just what we previously saw, which was older IFAs trying to retire and get out of the business as they could not keep pace. There are lots of firms and advisers that I quite admire who are questioning their future in the industry. On the other hand, there is the resilient IFA we hear so much about, who are saying "here is another challenge. We have lived through one recession; we can live and work through another". There is more determination there.

Under the heading of despair and exit, while there are some good guys looking to get out of the business, you can also separate those that have always followed the path of least resistance – and just want the quick hits and easy, transactional business, which has now stopped, leaving them struggling – from the ones which have provided more of a holistic planning approach. I cannot do a presentation without using the word "holistic", and I make no apologies for it! I think the two scenarios by and large go hand-in-hand.

We have mentioned declining sales, and it is no surprise to anyone to know that protection sales have been declining. One obvious reason for that is, certainly for ourselves, approximately 75% of our protection business is written off the back of mortgages. In Q2 last year, mortgage enquiries were significantly slowing down, or even if there were still enquiries, the business could not be placed. By the end of the year, it was virtually non-existent.

What Rebecca said earlier on about enquiries from first-time buyers going up was interesting; we are noticing more enquiries. As yet, however, that business cannot be placed. If the protection is written off the back of it, there is still no solution there.

Should protection be under the RDR?

I will try to keep my section on the RDR brief. We have not really got long enough; we could have a session on this alone. I am often asked whether protection should form part of the RDR, and everyone you speak to, with different agendas, has a different opinion. I am kind of on the fence with it. I do not like the RDR in its current format. However, I do feel that there is a danger that protection is seen as the poor relation in financial planning by many people, and not just advisers. We all believe that protection should be the cornerstone of all financial planning (we certainly give it that sort of priority) but it seems to operate so differently from the rest of the industry in terms of regulation and – dare I say – quality standards. I think that if protection does not want to be seen as the poor relation, then in many ways it needs to up its game: certainly the advisory process does. I am thinking of things like transparency of remuneration, remuneration reflecting the work that has been done, and all these things which the FSA are driving for.

On the one hand, I think it is great and protection should be included because we operate that basis with our investment work: the remuneration reflects the work that we have done and is transparent. Certainly, we do all our protection business under COB and disclose commission, although we do not have to. So, on that basis, perhaps it should be in. However, we know that fees do not work in protection, and never will: maybe in certain business protection cases, but other than that, they do not. Perhaps that means it should not be included. If we want to raise standards, perhaps for that reason it should be included. An example might be the amount of critical illness rebroking that goes on with very little consideration, I am afraid to say; the definitions are being lost, it is all about the price, and I know this happens. Yet that does not seem to get any headlines or attention from the regulator, whereas the FSA has just conducted a review on pension transfers and highlighted bad practices and where standards need to be improved. Arguably, the consequences of giving bad advice when rebroking critical illness can be as bad as bad advice about someone's pension that has been transferred and then does not perform as well. Perhaps that is an example where standards are not the same.

On the other hand, we all want protection to be made easier to sell, and bringing it under the RDR will probably make it more difficult to sell. I am on the fence about that. There are lots of ways in which I think the advice process needs to be improved, but I am not convinced that applying the full process of the RDR is actually going to do it. I think that in many ways doing so might be a hindrance.

Most of the factors driving protection sales will come as no surprise to anyone. Mortgage-related business, of course, is having a negative effect. As we mentioned earlier, more advisers are focusing on protection and concluding that, as they are losing revenue on mortgage business and on investment business, they need to go out there and look at protection business again. That is hopefully going to have a positive effect.

I always refer to rebroking as "rebroking/churning", because I think there is a very fine line between the two. It is very easy to justify a replace sale that could be churning as rebroking. I think that actually has a neutral effect. One thing that always amazes me is how much new business, and new sales, reported with industry is actually new cover being taken out and how much is just recycled cover being moved around. If a provider is increasing market share, are they doing that to the detriment of other providers, or are we actually closing the protection gap? I think a lot of new business that is actually rebroking is not really growing the market.

The price war

The price war is still there, and again I think that has a neutral effect. My personal belief is that that commoditises protection, and I think that so much protection is sold on price that consumers then think that price is the most important factor. If it is a quick and easy decision to

make that purchase, I think it is just as quick and easy a decision to discard it when times get hard. Rebecca mentioned earlier the reasons why protection is cancelled, and I think, very often, they are not the real reasons. However, I think the continued focus on price, and providers telling us that "we have some great news for you – we have cut our rates", is not really that exciting.

Factors causing lapses

Budgetary constraints

Some of the factors causing lapses will be no surprise, of course: budgetary constraints, for example. It kind of goes without saying that if the breadwinner or one of the breadwinners in the family has been made redundant, then automatically the budget is going to be scrutinised.

No perceived value

I think there being no perceived value by clients comes back to the adviser adding value. If something is sold on price, it will be discarded quite easily when it is not needed. If the adviser has not really understood what is motivating the client to consider protection issues and has not sold it on that basis, then the client ultimately will not think there is a great intrinsic value. That could be a reason for lapses.

Richard Verdin has a great saying, to which I often refer: "A lot of mortgage brokers will try and slip a little protection in the client's pocket as they are leaving the mortgage sale". Unfortunately, that has happened a lot and there is going to be no perceived value as a result of that.

The price war

The price war we have already mentioned, and commoditisation. We, as Jules mentioned, are not just looking at price, but at the features and flexibility of the policy and contract. With these changing times, many people's circumstances and objectives are changing and, if the policy cannot be adapted to reflect those needs, it has to be cancelled. Some contracts are very flexible: you can reduce the term, extend the term, reduce the cover, and so on. Yet if the policy is inflexible, and often the cheaper ones are the most inflexible, then the customer has no option but to cancel it. It comes back to the churning/recycling, really, but that is of course a lapse to somebody.

Our experience is that we have not seen that many lapses – there has been an increase – but generally our persistency levels are quite high anyway. We are nonetheless monitoring it very carefully, as you can imagine. I think the reason that policies are lapsed (and that is why I am interested in what Rebecca had to tell us about the reasons that people give) is a very good indication in the way in which the product was advised in the first place. I think there is a danger of a delay. I think if people are worried about affordability, they will perhaps think about it for a while, and it could therefore be a while before they actually cancel the policy. Some companies are very good, and we get notified straight away; others, we do not get notified until a policy is about to come off the books, which of course is a couple of months down the line. We are tentatively expecting that it is going to get worse, and we are trying not to be too complacent in saying we are okay so far.

Remuneration

Undeniably, remuneration does influence behaviour. You might find it strange that an IFA is talking about high indemnity commission. If this were a room full of IFAs, of course, I would not be saying indemnity commission – it is too high! As I mentioned earlier about the remuneration reflecting the work that is done: it does not automatically follow that a GBP100 term assurance is ten times as much work as a GBP10 term assurance, yet the remuneration is often ten times as much. I think of sales targets from an adviser's but also from a broker/consultant's (remember that an IFA's interaction with the industry is only with brokers/consultants) point of view. They clearly have sales targets and, unless I am mistaken, I do not believe many of them are targeted for persistency: it is all new business. For that reason, I can say without fear of contradiction that if there is a case where the client has missed a month or two's premiums, and we are considering the options (do we reinstate, or rewrite it?) the advice from the broker/consultant is nearly always that it would be easier to rewrite it, you may as well do it again. There is perhaps someone within the life office actually causing problems for the life office themselves. Maybe I am being cynical, but they have obviously got sales targets and they are perhaps rewarded on sale. If we are talking to a broker/consultant about a client who needs to top up a policy, of course, if it is their own one, the impression is that it is better to rewrite the policy than to do a top-up policy. There is an influence there.

Persistency

I find persistency quite a fascinating subject, because in all the conversations I have with life offices, we have never been asked about the quality of business that we write. I would like to think that is because our quality of business is very good. It has always been about volume, and we cannot play the volume game because we are a very small distributor. Clearly the way indemnity commission works, there is absolutely no incentive for me to keep a policy on the books beyond two or four years. No wonder so many mortgage brokers like the providers who offer two-year indemnity, as it ties in nicely with the mortgage every two years. I do not quite understand why that system has not changed – perhaps because the intermediary market will not be receptive to it – but I would like to see some sort of dialogue about rewarding firms, or different remuneration structures (call it profit sharing or call it what you like), but some kind of incentive to keep the business on the books. If I am reviewing a policy that is more than four years old, I am doing it for nothing. If I am helping the client adapt the policy or change their menu plans, unless I rebroke or churn it, I am not getting paid for what I am doing.

Peter Hamilton: Does that imply a willingness to take less up front? The level of profitability for my company on those plans is actually very, very small. In practice, there is not much more cake to give away; would that imply a reshaping? I think you are right in terms of the logic of doing it, but the reaction to any discussion I have had has been "would you like it spread over a longer period?" That might suit us very nicely, but it does not tend to suit the cash level of a lot of people in your position.

Peter Chadborn: I think it comes down to the business model, Peter. If you speak to certain firms and certain types of IFAs, absolutely not. I do not know how many firms think like we do but, as you know, we take a lot of our indemnity commission on non-indemnity for protection. Probably half of our protection business is on non-indemnified basis. We are already thinking in that way, and there are lots of reasons why we do that. But if there are more firms that think like us, then is it possible for providers to offer different remuneration to different firms, or does it have to be one size which fits all? I do not know. We are also part of a network and that causes problems itself. It is interesting that we have never been asked that question. Again, we fly under people's radars, and so why would anyone talk to us? I am, however, always intrigued to know why, or even if, there is more consideration for trying to incentivise persistency.

Peter Chadborn: I think that is partly because we are part of a network. We have spoken in the past about commission. Well, our commission levels are based upon whatever is given to the network, regardless of the volume or the quality of the business we write.

Peter Chadborn: Dare I say it, I think there is a real danger that businesses suffering from cashflow have a real incentive to make more money by selling protection. If that means new cover, fantastic. Perhaps one of the dangers of inexperienced advisers

getting back into, or entering for the first time, the protection market, will see it as an opportunity to rebroke business, and not always for the right reasons. Again, this big chunk of indemnity commission is seen as a good way of helping their cashflow situation.

Opportunities for IFAs

There are opportunities for IFAs out there. Consumers are feeling vulnerable. There is a paradox with the perception of vulnerability in which people, who are worried as a household about the "what ifs', feel they need to get some protection sorted out but cannot afford it as they are worrying about losing their jobs in the short term. There are pros and cons there. I call it seeking "proper advice" because most people who come to us have a mixed bag of policies that they have acquired over the years. The first question is "what motivated you to take it out?", and the second is "when was it last reviewed?" The answer to the second question is nearly always that it has not been reviewed since it was taken out. It comes back to this salesperson (dirty word) or adviser. I think there is a perception among consumers that they want to get some sort of proper advice, and a proper relationship with someone they can turn to.

People are definitely questioning the value of what they have. Whether the customer sees the policy as important or not comes back to how the policy was positioned, and the need for it, in the first place. There are great servicing opportunities – I know a lot of mortgage brokers will buy in client banks to get mortgage leads, and I have noticed that there are an increasing number of these firms offering leads for protection, too. I think that is a bit of a mug's game, and I think that there is an awful lot of mileage to be had in servicing existing client banks.

Threats IFAs face

Internal threats

One internal threat we face is over-promising service levels: what about a GBP10 term assurance I sold five years ago and promised an annual review every year? It has not happened, and I am now a victim of the earlier slide's example: saying something will be reviewed every year and then not reviewing it.

We have deliberately tried to over-communicate with our investment clients, to reassure them, to answer any questions, to discuss what is happening, and to make plans. I think we have definitely under-communicated with protection; it is only when the first few lapses come through that we realise we have missed a trick. That business needs to be protected as much as any other. Marketing ideas for that would be welcome. As a business owner, I need to be wary of remuneration and influencing bad practices. Then, there are the low-value clients, not necessarily a GBP10 term assurance. We have very distinct ways of valuing what we consider to be an important client to us. I think we are going to see more of this segmentation.

External threats

Externally, the DIY approach goes hand-in-hand with selling on price. With advisers selling on price, it is only a matter of time before the client asks why they need the adviser. If you are only finding cheap policies, then the client can do that themselves. On an individual and on a business level, the DIY customer is one that we need to combat.

Online direct providers are making it simple and making it easy. Would we ever offer some sort of direct proposition as a firm? It goes against everything I believe in. If you had asked me before this year, I would have said "over my dead body". However, for the first time, I am starting to wonder whether we should. When our website goes live, and we are thinking about its functionality, should we be offering some sort of direct offering – dare I say, non-advice? It makes me shudder to say it, but maybe it is the case. Times are changing and if we have these low-value clients, perhaps we need to be funnelling those in a different direction. For the first time, I am no longer saying never to that one.

A word of warning to any providers who do have direct offerings or allow their products to be sold through supermarkets: whatever you do, be careful when you are claiming to support the IFA channel, when you then, as we would see it, are standing in direct competition with us. I know more and more firms are thinking about that, but a lot of IFAs take a dim view of it – and why shouldn't they?

Strategies to combat threats

What have we done as a firm to combat this? I thought this would be useful to mention – I do not know whether it could be valuable to feed this back to broker/consultants, and communicate with IFAs. A lot of broker/consultants say they have real challenges talking to IFA practices that do only sell on price, and some of this might therefore be of use. I have mentioned, of course, that promoting quality over price has stood us in good stead. Our persistency levels have – and that is the past tense, I do not know whether it is still the case – been better than most. I believe it is because we promote the quality of the product. We are seen as advising, not selling, and hopefully as adding value to the client relationship, rather than just broking in the traditional sense. We are therefore removing the notion of a commodity purchase. Much of the industry wants to make protection very quick and easy to buy, but we deliberately put gaps in the process, giving people plenty of chances to change their minds before they have signed up. Whilst that makes it a little more convoluted for us, I think people really buy into the advice and the product for which they are applying. Each adviser is a financial project manager, because I do not think any adviser can be an expert in every area. Rather than be a jack-of-all-trades, each adviser would be a point of contact, bringing colleagues in who specialise in certain areas, be that external or internal. 95% of our business comes from recommendations and word of mouth, so we put a lot of energy into building up referral streams, and again that has stood us in good stead. I mentioned earlier that a lot of our protection business is written on a non-indemnified basis, which is protecting our cashflow. About 30% of our revenue is re-occurring, be that non-indemnity or funds under management. Then, there is client segmentation – understanding which

clients we need to be offering what levels of service to, rather than promising everything to everybody, and possibly giving some people a better service than they should have while underperforming in other areas.

Support from providers

Know your client

What can you guys do for us? We have to know our client because the nice people at the FSA tell us to, but of course it makes very good business sense. The more we know about our clients, the better service we can offer them. Clearly, the more a broker/consultant knows about us, the better they can do for us. It kind of goes without saying, but many brokers/consultants I speak to make it apparent that they do not really know the first thing about us or what makes us tick. In fact, you guys will know more about CBK after tonight than your consultants will probably ever have known about us.

I mentioned future planning because there is a possibility of us buying out one of the firms who wants to get out of the business. We would therefore double in size, and that sort of information would surely be useful to broker/consultants. We might be seen as small volumes one day, and perhaps better volumes the next day. Unless they talk to us, they are not going to know that. I have heard it said that some broker/consultants look after up to 1,000 accounts; I do not know whether that is accounts or IFAs. I certainly know that over 500 is not unheard of, which is mind-blowing to me. The 80/20 rule has to apply there: certainly 80% of the accounts are just going to be a number on a screen. It is not my decision, but personally I cannot understand how that might work.

Sharing knowledge across departments

We could have a consultant from one business for investment business, another consultant for protection business; we might use one firm a lot for investment business, but not necessarily for protection business, for whatever reason. I know there is very little communication between the two, which seems crazy, about sharing information. If we are going to merge with someone, surely that information needs to be shared?

Effective communication

Effective communication is probably one of the biggest challenges for you guys and one of the biggest bugbears for us. Clearly, if the consultant has up to 1,000 accounts to look after, it is a real challenge to get messages out to all of the accounts and let us know what is happening. The most effective way is either a bespoke email, or better yet a telephone call, to tell us about something that has happened that they believe might be relevant to us. If I get an email saying "Dear Peter Chadborn", I will probably delete it straight away as it has clearly been some sort of group message. At least if it says "Dear Peter", there is a fighting chance I will read it.

Constant reminders of USPs

A reminder of your USPs: because protection is part of what we do, because we are a small firm and are not going to produce huge volumes (and this is the same for the other firms I speak to) we can forget who is good at what. We need constant reminders. Fortis has been very good at sending out periodic reminders of what they do.

Liaising with the whole team

Very often the consultant will speak to me as the principal, and assume that I will pass that message on across the team. Of course I will do that, but that consultant will then not have a relationship with my two colleagues. When one of my colleagues has three or four companies on their shortlist to choose from, they are much more likely, providing that everything else is equal, to do business with the one with which they have the relationship. I can say "such and such a company is great because...", but if my colleague does not have a relationship with them himself, it will not mean much. Also, in doing so, if the consultant is going to contact each adviser, it is advisable to put a few days between each phone call to each person. It is hilarious when the phone rings for me, and I speak to a consultant, and then, as I put the phone down, the same person rings the phone at the next desk. By the third person, you will ignore that call. It sounds obvious, but it is quite common.

Whether it is reminding us about USPs or, if you do not compete on price and you struggle, remind us about everything because a lot of advisers do not know about these little things. I call them little things, but they are quite important. Unless we are reminded about them, they will be off radar. Many firms are, particularly now, open to ideas about how they might compete more. If I cannot compete on price because people are taking the DIY approach, does that mean I cannot sell protection any more – how do I do it? There are an awful lot of educational opportunities out there. Most firms have something that is an added-value extra. Remind us about it because we probably do not know. Do not assume that we will read about them in the pinks, because not everybody will. If this group email has gone out saying "we have a new initiative coming out", it may just get binned so that no one reads it. Whether it is practical or not, a phone call to the person saying "did you know, we have just decided to do this?" is memorable.

Initiatives could be more prevalent, and certainly are increasingly popular with firms that do not just recommend on price. I love what LV has done with their "three times" critical illness on their IP, because it is not compromising the current plan. It is a true added benefit. For real life cover, Fortis and LifeSearch – it is not something we would sell, but I admire the initiative of it. A simple thing: annual policy reminders. I think Friends Prov and LV are the only companies that do this. LV do it quite well: an annual reminder goes to the client's adviser, just to remind them of the cover that they have. It is so simple but it works. It is what we used to have in the Home Service all the time. It is just a little reminder to review those clients' circumstances.

Peter Hamilton: Zurich sends annual statements each year to all protection clients. I am not sure how many others do that. On the whole, we think it is a very good thing; it reminds people of the value of what they have got and their options. Occasionally, however, we have people suggest that, when you remind them, they might cancel it. We think it is a good thing to do and

it is quite a big investment because there is no direct return from it. The other thing we were thinking about doing was writing out to customers, in this current time, almost a bespoke letter, saying to be careful about cancelling. On the one hand, that could be a very good customer service thing to do right now: presenting the reasons not to cancel. On the other hand, you could potentially be putting the idea of cancelling into their heads. I would be interested in your views on whether that kind of initiative is a good thing or not.

Peter Chadborn: From our point of view, yes. I think any firm that prides themselves on having a good relationship with their client is going to say that that is not a threat, and that it is fantastic. On the other hand, you have IFAs who are very protective about their clients: how dare you communicate with someone who is technically your client, but really our client in the first place! We are thinking of doing that exact same thing, so if you want to do it for us, then fantastic, I would welcome that. It is what I mentioned earlier about over-communicating with investment clients but under-communicating with protection clients. It is something that I think needs to be done. I think you would have to get the opinion – almost the approval – of each firm before doing it. As you say, it could backfire. If it were "would you find it useful if we wrote to your clients", it is a great reason for the consultant to speak to the client.

Peter Chadborn: My advice would be to ask the firm if they are in agreement, rather than just doing it. You will get some who say "that is great", and some who say "how dare you?"

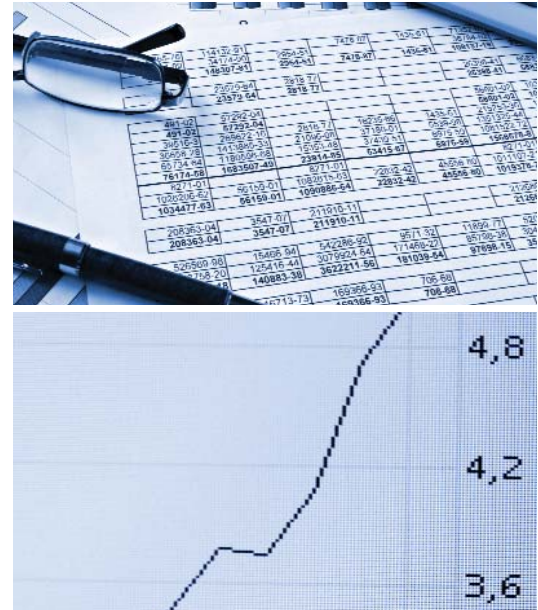
Premium reduction

Premium reduction with CI exclusion: hats off to BUPA, Fortis and AXA. Things like that sit very fairly with IFAs. It is a great TCF initiative. If certain CIs are going to be excluded, then why should the premium not be reduced in line with that? That is a good example of where those companies will get picked above somebody else if there is a potential health issue and the adviser is deciding where to place the business. In terms of cost, everyone, as we know, is much of a muchness. Again, we could talk all night about PruProtect, and what they have done, but I am a big fan. The severity-based approach again sits very well with clients: they like the fairness of it. We can discuss that another time.

E-initiatives

On e-initiatives, it is very important to have a website that is easy to navigate and systems that are very easy to adapt to, whether it be the IFA or the admin. A big tip for firms that want to help with that is to provide some sort of education or training to the people who process the business. I do not do the processing, but our admin team does. If you want firms to engage in terms of processing business online and interacting with your website, providing a bit of training on that would not go amiss – even if it is an online seminar or demonstration. One word of warning about online systems: do not assume that every firm processes business in the same way. A criticism I have had in the past has come where providers do their research with certain business models. These are typically the bigger, high-profile companies: the providers ask them how they want things to work, and set up their system that way. The rest of us are then left scratching our heads because it does not suit the ways we do business. There are a lot of different ways of transacting business which might appeal to everyone; with "one size fits all", you could turn off an awful lot of your audience.

I am a big fan of tele-underwriting, but again, I have gone on the record saying that the difficulty is the fact that everyone operates slightly differently. It is very difficult to manage clients' expectations because we do not know who does what or when they do it. I think getting some sort of uniformity is too big an ask, but again, a little bit of marketing material would be good – perhaps at point of sale – just to say "this is what is going to happen". There we are: a few examples there. Any questions?



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