Pakistan Insurance Institute
Since 1951

Persistency Issues in Life Insurance Industry

Muhammad Ali Nathani

CASE STUDY

Introduction

In life, we are always faced with uncertainty. The risk is when uncertainty leads us to undesirable outcomes for which we cannot be prepared. Therefore, we 'insure' ourselves by setting aside a sum of money, which can come handy when required the most. Today, professionals do it and surely, in a better way than we could have. We call them 'life insurers', as they manage our risks. As of now, these life insurers have progressed enough to become a worldwide industry.

Life insurance companies base their business models on assuming and diversifying risks. In simple words, they collect money i.e. **premium** from interested buyers and invest it in different alternative assets to earn a substantial return. In an event of any mishap with the buyer, the insurer pays the nominated person by buyer i.e. **beneficiary**, the sizeable amount i.e. **sum assured**. Both; amount of premium and sum assured is pre-decided at the contractual agreement. The amount of premium differs from one person to another, depending on required sum assured and on the basis of assumed risk that is calculated through the process of **underwriting**. The frequency of premium payments is based on the type of product selected by the buyer and his convenience.

Currently, in Pakistan and South East Asia, life insurance industry is mainly sales driven in nature. The seller inspires a buyer to initiate a buying process. Therefore, it is often said that **"life insurance is sold, not bought"**. Insurers are represented by sales agents in the local market.They hire sales force which brings in different customers by thorough persuasion to purchase life insurance policies.

Each year, many buyers of insurance contract join the circle of insurance. Circle of insurance is composed of all policyholders, each paying his share of premium to help circle keep its shape. As long as all policyholders pay their premiums regularly, insurers will have absolute persistency and high profitability. Oppositely, if policyholders discontinue or lapse their policies by not paying premiums, persistency will decline and profitability will be affected. As a result, the circle of insurance will lose its shape.

For the circle of insurance to retain its shape, persistency should be viewed as a very important indicator for the performance of life insurance industry because if it is left unmanaged, there are to be grave consequences. Assessing persistency on other hand is quite challenging because it requires insurers to investigate reasons behind policy lapsation or discontinuation. One must have clarity that persistency does not mean enhancing customers' base; rather it deals in retention and strengthening of customer-company relationship.

Managerial views regarding persistency differ from one organization to another. There are insurers who believe that utility from assessment and analysis of persistency is pointless, because, despite low persistency, insurers in Pakistan are enjoying huge profits; which eventually fulfills owner's motive. So, why to incur a cost at all?

In an interview with one senior actuarial official, we asked that what you think about 'poor persistency'. Do you care that you are losing customers? He replied:

"Yes, we care. But before buying a life insurance policy, the customer is supposed to be sure about his financial goals. He should analyze the industry, read terms and conditions, and understand that it is a long-term contract.We do not force people to sign up. But if they sign up and regret it later, that is entirely their fault. Why insurer has to incur a cost to compensate clients for their poor decisions. Customer, if want to exit, will stop at nothing"

Then we asked, that most of your clientele is not educated. How do you expect them to read terms and conditions?

"We don't expect though we want them to understand it, but it is neither ours nor agents' responsibility to educate them and explain those contractual terms. Agents explain that how a product works. Terms and conditions are more of lawyers work"

Another view proposes the standpoint that emphasis on persistency is not enough unless it can approximate to be 100 percent. Such a view derives from the motive that if persistency issues are addressed adequately, profits shall be much more than what insurers in Pakistan are profiting now.

When the same question was asked from another official in another insurance company with more of similar length of industry experience, we were surprised to see such contradicting comments. He replied that:

"That is what worries us the most because the insurance industry is fragile. We are fighting a war against defamed perception of insurance among the public, which should be changed because it is based on misunderstandings. On other hand, we are continuously working on our services, trying to teach the general public what insurance really is. We also focus on need-based selling. We adhere to regulatory guidelines in true spirit, such as converting our forms, media, and website into bilingual formats. There is much to do. We have setup a complaint center that entertains all complaints regarding agents and their misselling practices which, indeed, is a temporary solution. We are looking for permanent solutions"

Both school of thoughts being at different extremes implies that approaches to identify causes for policy lapsation and discontinuity also differ. Likewise, response strategy towards these problematic reasons varies as well. For now, the point in question is that what are general reasons due to which policyholders discontinue or lapse their policy and exit from the circle of life insurance? Can they be prevented from doing so? In other words, can persistency be 100 percent? Or it can't be maintained at an absolute level, but can definitely be managed?

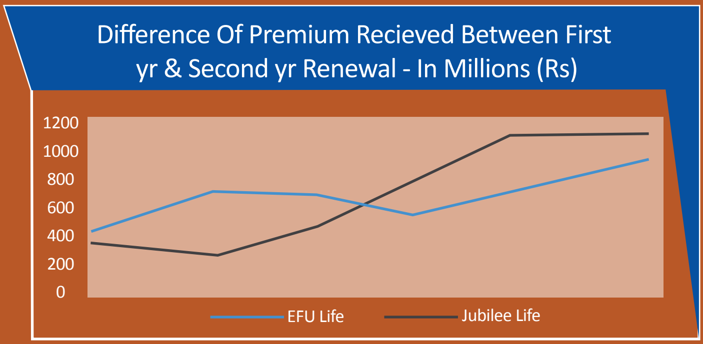
Background

To understand implications for both school of thoughts, we must carefully examine different dimensions of 'poor persistency'. Careful assessment of low persistency initially requires insurers to diagnose its existence, and measure its extent. Its existence can be diagnosed from figures reported in financial statements each year. Life insurance companies can also analyze improvements or decline in persistency over the years by comparing financial figures. For example, in a single year, company forms insurance contracts with different policyholders and simultaneously many policyholders quit such contracts by simply not paying the required premium. *This behavior can be explained with help of the following table for 2nd -year renewal:*

Values in US $	2015	2014	2013	2012	2011
First Year Payments	35,543,705	34,179,362	30,188,581	26,528,476	27,012,610
Second Year Renewal	26,029,295	23,404,895	21,583,371	20,794,086	17,057,076

In 2011, all newly issued policies brought a premium of $27.01 million to the company. After exact one year, the same amount was supposed to be collected by the insurer. However, as we see that in the next year 2012, collected premium for second-year renewal amounts to be $20.794 million. Approximately, $7 million is not received by the insurer next year, because clients discontinued their insurance policy contracts. *The table below shows the increasing trend of loss in value (premium not received for policies in the second year that were collected in the first year) in million rupees for two mega companies dominating life insurance industry in Pakistan.*

Difference of premiums between first & second year (Millions Rs)	2010	2011	2012	2013	2014	2015
EFU Life	440	660	650	520	710	850
Jubilee Life	360	280	440	730	1000	1010



Persistency can also be diagnosed by carefully studying the change in customer base each year; by separating increase in customers against lost customers for a given year. It is also important to note that when customers exit, implications for policy lapsation in initial years are different in contrast to policy lapsation in years closer to maturity; therefore timing of customers' exit for both scenarios call for different response strategies.

Once the diagnosis is complete and extent of persistency is measured, investigation of factors causing poor persistency becomes easier and comprehensive. In theory, an extent of persistency; either substantial or negligible determines that whether the insurer should dig out causes for 'poor persistency' for his company or not. However, in the real world of insurance, persistency is the most feared terminology for all insurers merely because it is not up to the mark and very poor for each of them. There could be a rare instance, in which insurers' persistency is worth praising mainly because they target a specific class of people; preferably their own community members, and do not open their doors to the general public. Such community-based insurers do not need to study and investigate causes for poor persistency, because it is indeed meaningless for them.

Investigation of causes of 'Poor Persistency

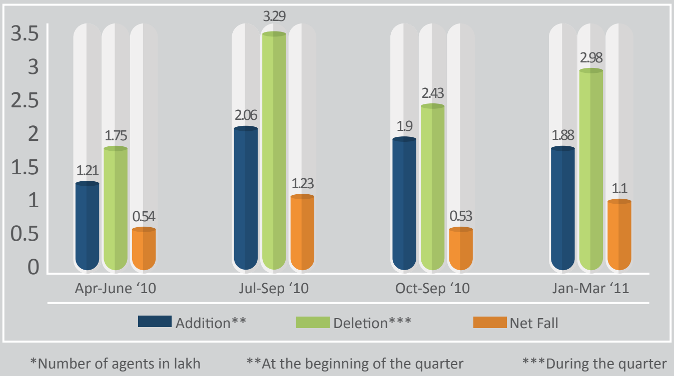
Reasons for 'poor persistency' could be many. These causes differ from one part of the world to another. At times, these causes are country specific, could be company specific, or may vary because of different region or demographics. However, it is essential to understand the characteristics of life insurance contracts and agents who sell them, after sales services, external environment, and circumstances which originate these causes, particularly for life insurance industry in Pakistan.

Life insurance contracts are high-end expensive products. They are complex in nature and difficult to understand for a layman[1]. Such contracts are not bought once; rather they are maintained regularly by paying the premium amount each year which adds a hassle on policyholder's 'to do list'. Plus, any change initiated by a policyholder in terms and conditions on which insurance contract is formed, it requires investigation, medical tests, or approval through documented formalities. Since amount paid as a premium is invested elsewhere, it deeply concerns the potential policyholder that insurer may bear a loss on his money. These are few main reasons because of which people are reluctant to buy life insurance. Therefore, it is quite rare that buyers approach the seller. In contrast, most agents are keen to pursue the buyers with sheer determination. To accomplish the sale and commission, they highlight promising value, unrealized need of insurance, overall benefits etc.; in short to make most of the potential buyer. With such a strong pitch, many people easily give in without analyzing the very need for life insurance. 'Poor persistency' kicks in when customers regret their decision; also known as **buyer's remorse**[2]. What choice do they have now? Hold the policy until maturity; unwillingly, with a heavy heart or exit now!

1. *The image below shows many inherent causes of post purchase dissonance.*

As it is mentioned before, the life insurance is sales driven industry. An intermediary; hired by the insurer is involved in the process of making sales. Due to huge reliance on an intermediary, qualifying criteria to become a sales agent is not very stringent. Standards such as education and experience are usually set at low levels, resulting in low barriers to entry. As an outcome, 'sales agent' becomes the easiest job title to get. As a result, anyone can qualify to become an agent, whether he or she possesses selling skills or not. Therefore, both, entry and exit of agents in sales force is quite random in nature[3]. The profession of a sale agent is a target oriented job in which requirement to do a certain business within specified time has to be met. The objective of insurers is to increase its customer base each year, by adding more life policyholders in the circle of life insurance. Which obviously means that more the number of agents, better chances of tapping more clients and eventually policy sales. In return, the sales force is entitled to keep 30 to 60 percent of the first premium received by the life insurance company as a commission. Subsequently each year, sales force keeps its cut from premiums but the rate of commission declines drastically. Higher commission in initial years which reduces with the passage of time motivates sales agents to sell high premium policies. With such one-sided, self-beneficial intention of both the insurer and the agent, there are strong incentives for agents to cheat, manipulate or collude with customers[4]. Whatever may be the case, relationships based on lies, deception and treacheries do not continue for long.

2. *South Asian countries have the similar trend in this regard. Given below image reflects inflows and outflows of agents for a single year in India.*



3. *A questionnaire survey exhibits different types of frauds prevalent in insurance industry pertaining to malpractices.*

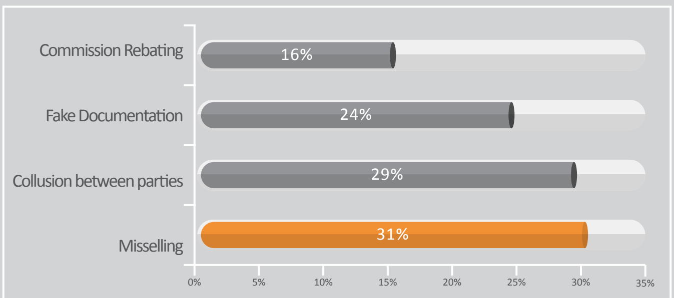


Figure: Different types of fraud of affecting insurance companies.
Source: Ernst &Young Report on Frauds in Insurance.

To facilitate clients after policy issuance, insurers setup a 'client services department' to ensure that policyholders are serviced well in many different aspects. These different aspects involve changes to be made in a policy whether financial or non-financial, renewal of contract at each year, inquiry about status, value, and balance of the policy etc. Since the above-mentioned procedures are operational to the core and involve documentation and paperwork, therefore **TAT (Turn Around Time)** differs from one policy to another. Even if **TAT** is managed well, customer services can be poor due to a shortage of staff. Big insurance companies have huge customers base, but telephonic calls and written applications; pertaining to inquiry or request, are not only received by policyholders, but also general public who are potential clients. Customer services also largely depend on the ability of a client to convey his queries and to comprehend the guidelines provided by staff members. Any negligence such as delayed response,call waiting, failure to resolve complaints timely etc. can lead to dissatisfaction of customers[5].

4. *With help of Likert scale with a range from 1 (strongly disagree) to 5 (strongly agree), below table exhibits that out of 67 respondents, many think that poor complaint handling influences perception of life insurance organization.*

Factors	5	4	3	2	1
Poor comlaint handling	16	26	23	2	0
	(23.9%)	(38.8%)	(34.3%)	(3%)	(0%)
Mis-selling by sales agents	4	16	26	11	10
	(6%)	(23.9%)	(38.8%)	(16.4%)	(14.9%)

Reasons for 'poor persistency' include many external factors that are not under control of the organization. For example, demographic factors such as age, gender, background, region, marital status, the value of insurance (Sum assured and premium), payment mode and financial literacy influence one's determination to continue life insurance contracts[6]. Other external factors may include macroeconomic conditions that vary from time to time, weakening the financial ability of the insured[7]. Alternative investment choices available can also sway customers away from the insurer. It largely depends on who provides better returns, more control of own funds, lesser hassle and trust like characteristics that other investment alternatives may not offer. Therefore, movement of clientele from one insurer to another or towards non-insurer is reasonably possible.

5. *The table below illustrates that most of the lapse/surrender cases occur in combined 18-40 age group.*

Age Bracket (in proportions)	Lapsed	Surrendered	Grand Total
18-25	24.17%	4.83%	29.00%
26-40	43.56%	8.27%	51.83%
41-60	15.51%	3.10%	18.61%
above 60	0.45%	0.10%	0.56%
Grand Total	83.70%	16.30%	100.00%

6. *As shown in the table below that lapsation/surrender cases from rural areas are more in number when compared with urban cities. Such a difference can be attributable to lack of communication & access to service etc.*

Geographic Dimension	Lapsed	Surrendered	Grand Total
Urban	15,292	1,401	16,693
Sub - Urban	41,815	5,816	47,631
Rural	47,327	9,081	56,408
Grand Total (in numbers)	104,434	16,298	120,732
Urban	12.67%	1.16%	13.83%
Sub - Urban	34.63%	4.82%	39.45%
Rural	39.20%	7.52%	46.72%
Grand Total (in proportion)	86.50%	13.50%	100.00%

7. *Tables below illustrate an indirect relationship betweenan amount of sum assured or premium and lapsation occurrence.*

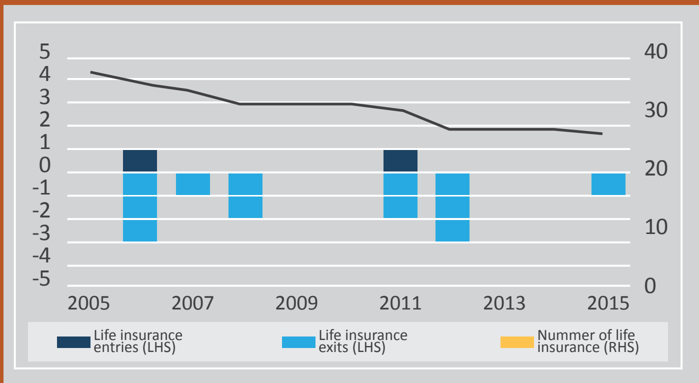
Sum Assured groups (in proportions)	Lapsed	Surrendered	Grand Total
0-$5000	51.81%	7.56%	59.37%
$5000 - $10,000	22.73%	3.39%	26.11%
$10,000-$20,000	9.27%	1.33%	10.60%
$20,000-$40,000	2.62%	0.36%	2.98%
above $40,000	0.79%	0.16%	0.94%
Grand Total	87.20%	12.80%	100.00%

Annualized Premium groups (in proportion)	Lapsed	Surrendered	Grand Total
0-$500	68.56%	9.88%	78.44%
$501 - $1,000	12.87%	1.87%	14.74%
$1001-$2,000	4.07%	0.72%	4.79%
$2,001-$4,000	1.23%	0.22%	1.45%
above $4,000	0.47%	0.11%	0.59%
Grand Total	87.20%	12.80%	100.00%

8. *The table displayed below evidently proves that only 38 percent of issued monthly mode policies complete their tenure.*

Mode (in proportions)	Completed the contract till maturity	Lapsed/Surrendered: Discontinued policies	Grand Total
Annual	60.11%	39.89%	100.00%
Half yearly	56.70%	43.30%	100.00%
Monthly	38.76%	61.24%	100.00%
Quarterly	52.63%	47.37%	100.00%
Single Premium	82.08%	17.92% - surrendered	100.00%
Grand Total	58.97%	41.03%	100.00%

9. *Life insurance industry is hurt most when an economy is engulfed in recession. During financial turmoil 2008, the ability of policyholders to pay regular premium diminishes widely. As a result, insurers do not collect as much premium as they forecast, causing detrimental effects on insurer's profitability. The picture below illustrates that three big life insurers exited life insurance industry from 2007 till 2009.*



Optimally, life insurance policies are bought as per the need of insured. With ever-changing situations, it is a possibility that insured need may change from what it was at the time of purchase. Since, life insurance contracts are mostly long and very long term in nature, there are acute chances that need may have totally changed, satisfied already or it is irrational to fulfill. For example, a father purchases a product "education plan" for his only kid who God forbid expires. Availability of upgraded products with improved characteristics and higher returns can also motivate a policyholder to lapse his current policy and replace it with a new product with the same insurer or may be in some cases with another insurer.

Effects of 'poor persistency'

Up till now, we kept mentioning that failure of insurers to hold their customers is 'poor persistency'. Then it should not be a problem for life insurance companies because if it is all about often 'customer loss', then insurers can always add up more customers by increasing their sales force, in fact, which they are doing now in Pakistan. So, why 'declining persistency' is feared so much? Should not this case study be more about "how to retain customers" and should have more of marketing element embedded to it?

Of course not! 'Declining persistency' does address the failure of insurers to retain customers, but it emphasizes on the effects that life insurance companies bear due to loss of customers. These effects are two-fold in impact and quite detrimental, and most importantly, newly added customers cannot compensate for the loss of 'lost customers'. That is why; 'poor persistency' is worried the most among insurance industry. These two fold impacts are:

Firstly: in terms of opportunity loss: Insures gain their true profits when a policyholder continues the policy up till maturity. Any lapsation or surrender of a policy leaves the insurer at somewhat above the break-even point. Had lapsation or surrender not have happened, the company could have gained more.

Secondly: in terms of sunk cost: Failure to hold back customers is more like expenditure on something that doesn't exist anymore, and such expenditure turns into 'sunk cost' that can't be recovered. For example; predominantly, the marketing effort carried out by insurers to make its presence felt by the general public is highly expensive. Time devoted, the energy exerted and money spent by agents in pursuit of successful sale cannot be discounted. After sales, operational activities initiated in regard to documentation and paperwork, medical tests, financial inquiries, underwriting, background checks and other important formalities; till the issuance of new insurance contracts arealso highly commendable.

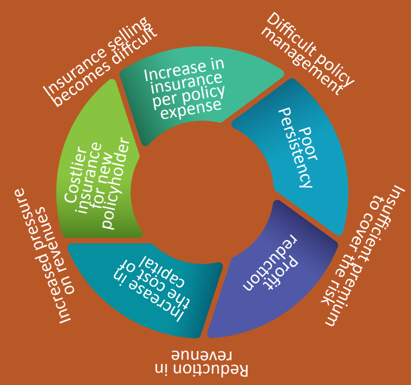
Therefore, it is rightly said that:

"Attracting a new customer can cost as much as 15 times more than retaining an existing customer."
Winning new business in construction - Terry Gillen (2005), p89. Published by Gower Publishing Ltd.

"Conventional business wisdom contends that it costs 10 times as much to obtain a new customer as it does to retain an existing customer."
Pricing for profitability: activity-based pricing for competitive advantage - John L. Daly (2002), p85. Published by John Wiley and Sons

Effects for poor persistency do not end here. With low persistency, the growth of company's portfolio declines, or falls short of the projected or desired level. Any change in projected profits also calls for re-forecasting of capital requirements and strategy. The impact also transcends on credit ratings assigned by rating agencies, which exposes the insurer towards high reputational risk[8].

10. Below image shows that how low persistency affects the insurer in return and its cyclical nature magnifies its impact.



Despite falling persistency, profits for insurers in Pakistan are on increasing trend. Why?

In Pakistan, profits for life insurers are on increasing trend. Plus, all other things being equal, future outlook of life insurance industry is bright. Assurance for a positive progression and prospects of life insurer businesses is entirely based on high profits corresponding to marginally insured population of Pakistan. How is it possible?

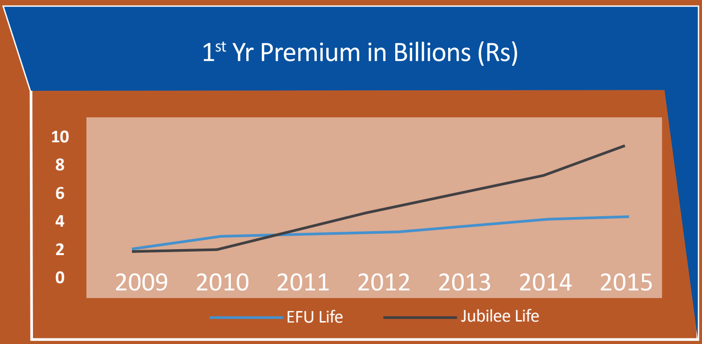
As per reliable estimation from world insurance fact book, 8 percent of Pakistani population is life insured. Among which 5 percent of Pakistani population is life insured through group insurance or employers. The 8 percent life insured Pakistani population is an important statistic because it highlights two major facts:

(1) Remaining 92 percent are vulnerable to life's risk if sudden death of family breadwinner occurs.

(2) There is a great potential for life insurance industry to expand.

Above two facts explain that with such a large untapped population, ceteris peribus; profits for life insurance industry are bound to grow exponentially. *Table and graph below show the increasing trend of first-year premiums for two big competitors in life insurance industry of Pakistan.*

First Year Premium in Billion Rs	2009	2010	2011	2012	2013	2014	2015
EFU Life	1.77	2.45	2.83	2.78	3.16	3.58	3.73
Jubilee Life	1.58	1.77	2.71	4.22	5.33	6.23	7.97



Currently, life insurance companies influx local markets with more sales agents than before to capture market resulting in new customers. The inflow of new customers brings in substantial premium amount as compared to the simultaneous, customer loss on which marketing and operational costs have been incurred, before and at the time of issuance. But since, due to insignificant size of 'sunk cost' in comparison with collected premium, it does not catch attention.

Options and Implications

We started our discussion with a debate between two managerial views each endorsing their own stance towards 'poor persistency'. One school of thought highly recommends that 'poor persistency' is to be well managed and fixed with sincerity and utmost devotion, aiming to achieve greater profits than now. In contrast, other insurers believe that 'poor persistency' is part of life insurance business which we must admit, and should mend superficially whenever possible, but no concrete measures that call for incurring costs must be taken; especially when insurers are already making great profits.

We feel that it is very important to highlight that difference in opinion among both types of insurers is; maybe, an outcome or learning from different experiences they have had in past. Such distinguishable attitude towards a very serious issue i.e. 'poor persistency' cannot be merely attributed to the laziness of one party and industriousness of other. There is definitely more to it that needs to be unearthed.

Factors such as costs to be incurred, reduction in profitability, team availability, organizational culture, owner–management conflict, short run profits versus long run losses, or short run costs versus long run profits, affiliation with groups, effectiveness of such programs, status quo, market structure, favorable conditions and many other aspects; must be thoroughly thought of,before making key decisions regarding persistency.

One must ponder upon, that what motivates one big insurer of Pakistan to neglect poor persistency and other to be very worried and proactive. And what it could be that prevents one insurer to agree with other. While making a decision, the implication of each view for short and long run and the effect on the overall industry must be kept in mind.

Conclusion

Life insurance business deals in assuming the risk of individuals and protecting them against unwanted – uncertain outcomes. Being very lucrative business in nature, it heavily relies on premium collection from all of its customers. Obvious relationship between a number of customers and total premium collection signifies the importance of persistency i.e. for how long each customer maintains and keeps up his/her relationship with the insurer.

This business relationship can only be sustained by making both ends meet and creating such favorable incentives that will result in a win-win situation for both parties. It is customary to highlight that insurers in Pakistan have different opinions about this customer – company bond, each having their own pros and cons, arguments and justifications. Nevertheless, it should not be forgotten that prosperity of insurance industry counts on the general perception of insurance among the public, mainly because customers are real ambassadors of any company.

From the above passage, we conclude that decision for managers to influence persistency boils down to the choice between two viewpoints. Therefore, whatever measures insurers take regarding persistency, it will eventually impact on how insurance is perceived.
We; as insurers, consumers, employees, shareholders, key industry players, regulatory bodies, students, all are interested to know the answers to more important questions for now that:Are we willing to fix 'poor persistency' or not?Will insurers sincerely take up this demanding challenge? Do insurers understand real implications of their respective agenda and its effect on the overall industry? Will insurance industry continue to prosper in future as it is now, especially when market saturates? And lastly, will policyholders ever feel the sigh of relief that they are getting the true value of services against the premiums they pay?