YOU THE JURY

by Mike Fenwick ACII
Director,
Asset Services (Paisley) Ltd.
and Advance Insurance Design (UK) Ltd.

When subtraction no longer adds up — do we divide to multiply?

When the first dinosaur died, did the remainder pay any special attention? Did they take stock of the changes about them which forecast their own identical fate? When the first man walked erect, did his fellows ponder their position? Did they take stock and consider the inevitable effects of the change?

Taking stock of evolutionary change is a task undertaken best with the benefit of hindsight but it is not an absolute requirement. Within our industry, there are sufficient indications of significant changes taking place which would make it wise for us to take stock, and nowhere more so, perhaps, than on the subject of commissions.

Undoubtedly, a time did exist when the remuneration to be received by the appointed agent of an insurer was best met by a system of commission. It is hard to imagine an insurer, say 100 years ago, enticing many applicants for a new agency appointment by insisting that the agent's only option was to charge all prospective clients a fee — even when a risk was to be declined. Undoubtedly, a time did exist when the most efficient and equitable arbiter between promoting the expansion of an insurer's interests and paying an agent for so doing was a percentage of the premiums transacted.

Such circumstances will continue to exist. During the privatisation of British Telecom, the present Government did not insist that all intermediaries involved must charge a fee to all prospective share purchasers. The Government chose instead to use a system of commission to secure its interests and to reward others for their participation in doing likewise.

CHANGES OCCURRING

We will retain many transactions within our industry where the joint and several interests of an insurer, an intermediary, and a consumer will be best and most efficiently met within a commission system. The recent suggestion by the Institute for Fiscal Studies to ban all commission would not always produce the most favourable position for the consumer.

However, it will prove extremely unwise for us to ignore the changes occurring around us and assume that commission will continue as the only lubricant of our industry's distributive mechanism or indeed that it can be applied universally – to all parts – at all times. Changes have occurred and perspectives have altered.

What are these changes? The following list is not exhaustive, but does suggest changes of significance, particularly when viewed cumulatively:

(1) *The provisions of the Financial Services Bill,* no matter the final outcome, will ensure that, whatever our past, it is clearly no longer our future;

(2) The recent *reductions in general insurance commission,* which may or may not be justifiable, but they certainly confirm changing patterns of behaviour and have served to underline the danger of assumptions in a changing and competitive market;

(3) *Selling insurance direct.* A bank-owned insurer has recently disproved the mainline theory that the premium equation was – "underwriting cost + commission = premium". It has subtracted the last item and estimated that the books will still balance. Indeed, if it is correct and given time, who is to say that intermediary may not provide a better answer, both to his client and himself, by adding his chosen margin to that lower "net" charge than by allowing his present supplier to decide the amount of margin to be subtracted from a higher "gross" charge. Simple arithmetic could replace percentages.

(4) *Plus or minus variations.* When uninsured loss recovery insurance was imported into our market, it too defied the laws of our traditional understanding. Commission simply did not figure in the equation. Instead, the intermediary was free to charge his

YOU THE JURY

margin without any insurer intervention. Indeed, when some intermediaries compared the previous administrative costs borne by them in claims recoveries, it even proved sufficiently profitable to them to absorb the actual premium cost instead. Changed days and changed ways.

ABSENT LOGIC

(5) *Product packages.* Packaging of insurance "products" now abounds. The internal factors which together added up to "the premium" are now dissected, examined and reconstituted with an almost infinite variety of costs and components. Gone are the days of the tariffs and set market disciplines.

(6) *The absence of logic.* The life assurance market is fully on course for banning commission payments which recognise volume production, whilst the general insurance market establishes products and income entirely dependent on the volume to be anticipated. Despite the apparent contradiction, both are seen as plus factors.

(7) *Technology.* The future cross-pollination of computer-based information within our industry and its efficiency can and will yield a harvest vastly different to that enjoyed in the past. Do we expect that our machines will be programmed and controlled as we ourselves are at present – capable only of subtraction, not addition?

(8) *Fees.* How many intermediaries now charge fees? Whether it is the high street broker charging for a replacement certificate of insurance, a multinational broker negotiating a risk management programme, or a unit trust specialist offering an advisory service, the traditional barriers and practices are being breached. The services being provided are no longer solely product based. They can exist independently from the product itself. Can the product therefore remain the only source of expected income?

(9) *Commission rebating.* The rebating of commission to secure income and the antagonistic reactions which this causes may simply mirror the feelings of traders in other areas when faced with the abolition of retail price maintenance and their loss of a previously protected existence. It may not be a simple question of whether the client *needs* the advice which can be offered and *must* therefore pay for it, but whether he *wants* it and is *willing* to pay for it. We must not over-indulge our own sense of importance. Competitive markets allow little room for products which fail to distinguish the purpose for which they are offered or priced.

(10) *New ideas – different calculations.* Over 20 years ago, how many intermediaries or insurers asked questions or, more importantly, found answers in areas such as direct marketing, marketing mixes, segmentation, pre-launch discounts and offers of calculators or first aid kits? How many insurers based their calculations on targeted markets and investment income, as opposed to underwriting profit?

(11) *New services – changing partners.* We have also moved far from the days of simple endowment policies and declared quinquennial bonuses. Unit linking, unit trusts, tax planning, retirement counselling, investment management have created a new dictionary for our industry. We now provide for mortgages, resell mortgages, top them up and pay them off. As financial services blur and providers of services interchange, will yesterday's partner in trade become tomorrow's competitor?

(12) *The consumer.* Last, but by no means least, we have to recognise what has changed in our society itself. Whether it is consumer bodies, The Office of Fair Trading, the popular or financial press, the consumer's interests are now examined, watched over and protected.

GROWN-UP CONSUMERS

It is hard to believe that our industry and its present use of commission will escape closer and closer examination. Can we defend a system on the basis of non-disclosure or even limited disclosure because "they" would not understand how it works, particularly if it is no longer as clear that it does work? Paternalism only works with children, the consumer has long since grown up.

What then of the future – what will it hold? I would suggest a major division from our past. Possibly slowly, possibly quickly, we will go our own individual ways, both insurer and intermediary. The rigidity of agency appointment and agency commission is already under stress and the more it bends to bear the weight of external and internal changes, the more it weakens its original strength.

Commission will and should remain when it is adjudged efficient and is able to be disclosed. The use of "net" rates by underwriters who continue to support intermediary distribution will increase. The "mark up" to these "net" rates will be decided by the intermediary himself and will reflect more closely his own chosen pattern of trade, level of profit and the requirements of his client base. Some intermediaries may sell "the product" at cost price and move instead to a fee basis for "services" rendered. Such a move could directly reflect the time spent on a client's total affairs or be annualised to a set charge per client – the final basis perhaps even being the choice of the client, for the "product" or the "service" he requires.

Some insurers will move from the vagaries and the uncertainties of agency produced business to follow instead the disciplines of internally controlled sales and marketing programmes. Their "name awareness" with the public will be maximised as they broaden their financial trading activities well beyond the narrow confines of "an insurance policy".

It is not clear whether the dinosaurs recognised significant changes in their era or simply failed to adapt to them. It is clear that when man learned to stand on his own two feet, he went forward.

Never can MIBOC be more accurate than in their coining of the phrase "polarisation". There are two Poles – North and South – and I suggest as an industry we are about to take up our respective positions.

Who will eventually multiply – is anyone's guess.

Ladies and Gentlemen

YOU ARE THE JURY

	Yes	No
As an Intermediary I would move to a system which would offer me the choice of commission or fees and would also allow the same choice to my clients	☐	☐
As an Insurer I would support a system which would allow the intermediary and the client to agree their financial relationship without my direct involvement	☐	☐