Finance Fundamentals

Author Profile

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Intermediation in Insurance – The Role of a Broker

In India, insurance is considered a push sale product. This is not good because when an insurer or intermediary pushes a product there is little choice that is given to customers and, quite often, over-commitments are made. The high degree of push sales are evident from the fact that in most cases it is the insurer's employee or agents, who approach the customer to sell the product. A large proportion of urban India would have received cold calls / SMS to sell insurance products to them. As a result of such market practices, more than 80% of all non-life Insurance transactions in India are intermediated by the insurer itself or its agents (the equivalent number in the US is less than 40%). This indicates that in India it is mostly the insurance company that chooses its customers rather than the other way round.

In an ideal situation you would want the intermediary to make the customer aware of the concept of different product lines and then, based on a customer's unique profile and needs, find the most suitable insurer and product. However the focus of many intermediaries today is to convince the customer about the benefits of a particular product of a specific insurer. As a result there are several cases of mis-selling reported. This "push-based" marketing approach has earned the industry a poor reputation.

IRDA has introduced several guidelines to raise the standard of selling. This includes the distance marketing guidelines introduced earlier this year, the minimum performance standards for agents and a revamping of the training curriculum. A requirement such as recording the solicitation conversation over the phone forces the intermediary to adequately train its staff and abstain from malpractices. Despite such prudent initiatives, the industry has a long way to go. Some of the problems are structural. Customers are often not provided the option of choosing the best coverage for themselves because of the prevalent distribution framework in the country. Two examples are discussed below.

Take car insurance. Before you get delivery of the car one must buy insurance. Here is a situation when the customer actively wants to buy a product but runs short on choices. Almost all car dealers have a tie-up with a particular Insurance company – often the key criteria in choosing an Insurance company is the payment to the dealer rather than the customer prices. In any case the insurance cost is a small fraction of the car's purchase price. When the customer completes all the paper formalities, a small portion of the bill gets directed to the insurance sold by the dealer. Since the tariff system was abolished by IRDA, the cost of OD cover in motor has come down significantly. If the customers had access to more than one insurer at the time of purchase, free market competition would have ensured a lower premium for the customer. Unfortunately in a majority of the cases this does not happen.

A similar situation arises in bancassurance. Banks have unparalleled access and trust of the customer. Customers have a huge dependence on banks primarily because of trade credit, which is a key determinant of success of the business. Because of this financial dependence, a large proportion of customers rely on their banker's advice to choose the best insurance. However banks are tied to only one life and one non-life insurance company. This hinders the bank's ability to provide choice and holistic advice to its customers. Banks are restricted to the service and commercial proposition offered by a single insurer. Sometimes banks encourage push marketing. For example, when fire insurance was due for renewal for a small enterprise, a bank just debited an insurance charge against the hypothecated stock and issued a fresh policy in the name of the customer. However, the firm already had a relationship with some other insurance company and did not understand the logic behind bank's actions. On enquiring, the executive would insist that since the firm is taking a loan from the bank, they must give priority to the bank to buy insurance. Though a minor incident, it indicates how customer independence can be curtailed.

Apart from the manner in which insurance is sold, the other challenge in the industry is the type of product sold. Invariably most salaried staff would have some form of insurance. However these are largely investment related products. Consider this statistic: the non-life insurance (which is largely risk cover for health and assets) penetration is as low as 0.6% compared to developed countries which have a penetration of 3-5%. This indicates a lack of focus of the intermediaries on pure risk cover.

The need of the hour is to further develop the independent broking channel. The broker being the representative of a customer would help put the client back on center stage. I recommend a three step approach to help make this happen. Firstly, IRDA should attract high quality talent and capital in the channel. India has been able to attract 9 out of the top 10 global Insurance companies, however not even 3 out of the top 10 global brokers are appropriately invested in the market. The quality of the players will be the foremost determinant of the development of the channel. Secondly, IRDA should incentivize focus on pure protection solutions. The low ticket size of pure protection plans and the current commission structure results in very small absolute earnings for the channel. In the backdrop of low consumer awareness, the cost of acquiring a customer is significantly high, hence the current compensation does not provide an economic rationale for intermediaries to focus on such pure risk products. Finally, in its developmental role, IRDA can educate customers on the advantages, roles and responsibilities of a broker.

We are still in the early years of the industry's growth in India - the industry was opened to private investments only after 2000 – hopefully, as the market matures it would see more depth and robustness in the intermediaries.

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Links to Bondia's articles in previous issues:

http://www.fisme.org.in/newsletters/March15_2012/docs/addressing_the_Issue_Abhishek.pdf