Insurance Operations - Marketing

Marketing

We begin with marketing despite the fact that it is not the first step in starting a business. From a consumer's point of view, it is the first glimpse into the operations of an insurer. Insurance may be bought through agents, brokers, or (in some cases) directly from the insurer (via personal contact or on the Internet). An agent legally represents the company, whereas a broker represents the buyer and, in half of the states, also represents the insurer because of state regulations. [1] Both agents and brokers are compensated by the insurer. The compensation issue was brought to the limelight in 2004 when New York State Attorney General Eliot Spitzer opened an investigation of contingent commissions that brokers received from insurers; these contingent commissions were regarded as bid rigging. Contingent commissions are paid to brokers for bringing in better business and can be regarded as profit sharing. As a result of this investigation, regulators look for more transparency in the compensation disclosure of agents and brokers, and major brokerage houses stopped the practice of accepting contingency commission in the belief that clients view the practice negatively. [2]

In many states, **producer** is another name for both agents and brokers. This new name has been given to create some uniformity among the types of distribution systems. Because life/health insurance and property/casualty insurance developed separately in the United States, somewhat different marketing systems evolved. Therefore, we will discuss these systems separately.

Life/Health Insurance Marketing

Most life/health insurance is sold through agents, brokers, or (the newest term) producers, who are compensated by commissions. These commissions are added to the price of the policy. Some insurance is sold directly to the public without sales commissions. Fee-only financial planners often recommend such no-load insurance to their clients. Instead of paying an agent's commission, the client pays the planner a fee for advice and counseling and then buys directly from the no-load insurer. Unlike the agent, the planner has no incentive to recommend a high-commission product. Whether your total cost is lower depends on whether the savings on commissions offsets the planner's fee.

Some companies insist that their agents represent them exclusively, or at least that agents not submit applications to another insurer unless they themselves have refused to issue insurance at standard premium rates. Others permit their agents to sell for other companies, though these agents usually have a primary affiliation with one company and devote most of their efforts to selling its policies.

The two dominant types of life/health marketing systems are the general agency and the managerial (branch office) system.

General Agency System

A **general agent** is an independent businessperson rather than an employee of the insurance company and is authorized by contract with the insurer to sell insurance in a specified territory. Another major responsibility is the recruitment and training of subagents. Subagents usually are given the title of *agent* or *special agent*. Typically, subagents are agents of the insurer rather than of the general agent. The insurer pays commissions (a percentage of premiums) to the agents on both new and renewal business. The general agent receives an override commission (a percentage of agents' commissions) on all business generated or serviced by the agency, pays most of it to the subagents, and keeps the balance for expenses and profit. Agent compensation agreements are normally determined by the insurer.

In most cases, the general agent has an exclusive franchise for his or her territory. The primary responsibilities of the general agent are to select, train, and supervise subagents. In addition, general agents provide office space and have administrative responsibilities for some customer service activities.

A large number of life/health insurers use personal producing general agents. **A personal producing general agent** sells for one or more insurers, often with a higher-than-normal agent's commission and seldom hires other agents. The extra commission helps cover office expenses. The trend is toward an agent representing several different insurers. This is desirable for consumers because a single insurer cannot have the best products for all needs. To meet a client's insurance needs more completely, the agent needs to have the flexibility to serve as a broker or a personal producing general agent for the insurer with the most desirable policy.

Managerial (Branch Office) System

A branch office is an extension of the home office headed by a branch manager. The **branch manager** is a company employee who is compensated by a combination of salary, bonus, and commissions related to the productivity of the office to which he or she is assigned. The manager also employs and trains agents for the company but cannot employ an agent without the consent of the company. Compensation plans for agents are determined by the company. All expenses of maintaining the office are paid by the company, which has complete control over the details of its operation.

Group and Supplemental Insurance Marketing

Group life, health, and retirement plans are sold to employers by agents in one of the systems described above or by brokers. An agent may be assisted in this specialized field by a group sales representative. Large volumes of group business are also placed through direct negotiations between employers and insurers. A brokerage firm or an employee benefits consulting firm may be hired on a fee-only basis by the employer who wishes to negotiate directly with insurers, thus avoiding commissions to the agent/broker. In these direct negotiations, the insurer typically is represented by a salaried group sales representative.

Supplemental insurance plans that provide life, health, and other benefits to employees through employer sponsorship and payroll deduction have become common. These plans are marketed by agents, brokers, and exclusive agents. The latter usually work on commissions; some receive salaries plus bonuses.

Property/Casualty Insurance Marketing

Like life/health insurance, most property/casualty insurance is sold through agents or brokers who are compensated on a commission basis, but some is sold by salaried representatives or by direct methods. The independent (American) agency system and the exclusive agency system account for the bulk of insurance sales.

Independent (American) Agency System

The distinguishing characteristics of the independent (American) agency system are the independence of the agent, the agent's bargaining position with the insurers he or she represents, and the fact that those who purchase insurance through the agent are considered by both insurers and agents to be the agent's customers rather than the insurer's. The **independent agent** usually represents several companies, pays all agency expenses, is compensated on a commission plus bonus basis, and makes all decisions concerning how the agency operates. Using insurer forms, the agent binds an insurer, sends underwriting information to the insurer, and later delivers a policy to the insured. The agent may or may not have the responsibility of collecting premiums. Legally, these agents represent the insurer, but as a practical matter they also represent the customer.

An independent agent **owns the x-date**; that is, he or she has the right to contact the customer when a policy is due for renewal. This means that the insured goes with the agent if the agent no longer sells for the insurance company. This ownership right can be sold to another agent, and when the independent agent decides to retire or leave the agency, the right to contact large numbers of customers creates a substantial market value for the agency. This marketing system is also known as the American agency system. It is best recognized for the Big I advertisements sponsored by the Independent Insurance Agents & Brokers of America. These advertisements usually emphasize the independent agent's ability to choose the best policy and insurer for you. (Formerly known as the Independent Insurance Agents of America, the 106-year-old association recently added the “& Brokers” to more accurately describe its membership. [3])

Direct Writers and Exclusive Agents

Several companies, called **direct writers**, [4] market insurance through exclusive agents. **Exclusive agents** are permitted to represent only their company or a company in an affiliated group of insurance companies. A group is a number of separate companies operating under common ownership and management. This system is used by companies such as Allstate, Nationwide, and State Farm. These insurers compensate the agent through commissions that are lower than those paid to independent agents, partly because the insurer absorbs some expenses that are borne directly by independent agents. The insurer owns the x-date. The customer is considered to be the insurer’s rather than the agent’s, and the agent does not have as much independence as do those who operate under the independent agency system. Average operating expenses and premiums for personal lines of insurance tend to be lower than those in the independent agency system.

Some direct writers place business through **salaried representatives**, who are employees of the company. Compensation for such employees may be a salary and/or a commission plus bonus related to the amount and quality of business they secure. Regardless of the compensation arrangement, they are employees rather than agents.

Brokers

A considerable amount of insurance and reinsurance is placed through brokers. A **broker** solicits business from the insured, as does an agent, but the broker acts as the insured’s legal agent when the business is placed with an insurer. In about half the states, brokers are required to be agents of the insurer. In the other states, brokers do not have ongoing contracts with insurers—their sole obligation is to the client. When it appears desirable, a broker may draft a specially worded policy for a client and then place the policy with an insurer. Some property/casualty brokers merely place insurance with an insurer and then rely on this company to provide whatever engineering and loss-prevention services are needed. Others have a staff of engineers to perform such services for clients. Modern brokerage firms provide a variety of related services, such as risk management surveys, information systems services related to risk management, complete administrative and claim services to self-insurers, and captive insurer management.

Brokers are a more significant part of the marketing mechanism in commercial property, liability, employee benefits, and marine insurance than in personal lines of insurance. Brokers are most active in metropolitan areas and among large insureds, where a broker's knowledge of specialized coverages and the market for them is important. Some brokerage firms operate on a local or regional basis, whereas others are national or international in their operations.

With today's proliferation of lines and services, it is extremely difficult for brokers to understand all the products completely. Brokers are always looking for unique product designs, but gaining access to innovative products and actually putting them into use are two different things. Generally, each broker selects about three favorite insurers. The broker's concern is the underwriting standards of their insurers. For example, a broker would like to be able to place a client who takes Prozac with an insurer that covers such clients.

Internet Marketing

With today's proliferation of **Internet marketing**, one can select an insurance product and compare price and coverage on the Internet. For example, someone interested in purchasing a life insurance policy can click on Insweb.com. If she or he is looking for health insurance, ehealthinsurance or other such Web sites present information and a questionnaire to fill out. The site will respond with quotes from insurers and details about the plans. The customer can then send contact information to selected insurers, who will begin the underwriting process to determine insurability and appropriate rates. The sale is not finalized through the Internet, but the connection with the agent and underwriters is made. Any Internet search engine will lead to many such Web sites.

Most insurance companies, like other businesses, set up their own Web sites to promote their products' features. They set up the sites to provide consumers with the tools to compare products and find the unique characteristics of the insurer. See the box, Note 7.15 "Shopping for Insurance on the Internet" for a description of Internet sites.

Mass Merchandising

Mass merchandising is the selling of insurance by mail, telephone, television, or e-mail. Mass merchandising often involves a sponsoring organization such as an employer, trade association, university, or creditor; however, you are likely to be asked to respond directly to the insurer. Some mass merchandising mixes agents and direct response (mass mailing of information, for example, that includes a card the interested person can fill out and return); an agent handles the initial mailing and subsequently contacts the responding members of the sponsoring organization.

In some cases, you can save money buying insurance by mass merchandising methods. Direct response insurers, however, cannot provide the counseling you may receive from a good agent or financial planner.

Financial Planners

A **financial planner** facilitates some insurance sales by serving as a consultant on financial matters, primarily to high-income clients. An analysis of risk exposures and recommendations on appropriate risk management techniques, including insurance, are major parts of the financial planning process. A fee-only financial planner, knowledgeable in insurance, may direct you to good-quality, no-load insurance products when they are priced lower than comparable products sold through agents. You are already paying a fee for advice from the financial planner. Why also pay a commission to an insurance agent or broker?

In many instances, it is appropriate for the financial planner to send you to an insurance agent. Products available through agents may have a better value than the still limited supply of no-load products. Also, your financial planner is likely to be a generalist with respect to insurance, and you may need advice from a knowledgeable agent. In any event, financial planners are now part of the insurance distribution system.