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a reinsurer's experience

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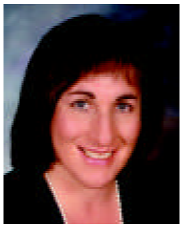

Dolan

CUSTOMER RELATIONSHIP MANAGEMENT: A REINSURER'S EXPERIENCE

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Executive Summary: When life reinsurers follow a customer relationship management paradigm and strategy, they look closely at their clients' behavior, value and needs. Customers who are loyal and add value to their relationship with a reinsurer are the best clients to have, and should experience reciprocal treatment by the reinsurer. In this article, the customer relationship management strategy as practiced by Hannover Life Re in the U.S. will be reviewed as a case study.

In a presentation at the Second International Underwriting Conference in London, 1999, Wolf Becke, PhD, Member of the Executive Board at Hannover Re, described what was then a relatively new paradigm in insurer-reinsurer relationships.[1] "In the context of relationship (management), a new view is taken on what constitutes the net value of a corporation: actual and potential relationships are the only real assets of the enterprise, not the physical or software systems that make the products, the products themselves, or the know-how reflected in the people making the products."

In the years since Dr. Becke's presentation was given, Hannover Re has oriented its management stance to reflect customer relationship management (CRM) principles. As part of this effort, a department reporting directly to Dr. Becke was established four years ago to oversee the transition among all Hannover Re life and non-life business units worldwide. Leading this department is Axel Heinemann, who has over 30 years' experience in international reinsurance.

According to Dr. Becke, CRM has made Hannover Life Re (HLR) "the third largest life reinsurer in the world, according to the 2004 edition of the World Insurance Report. By applying CRM principles in a consistent manner, we have avoided most of the recent, well-known disasters in life reinsurance."

Principles of CRM

The paradigm of loyalty as the ultimate litmus test of corporate performance was widely promoted in the mid-1990s by many management consultants, including Frederick Reichheld, a director of Bain & Company. Mr. Reichheld indicated that customer relationship management strategies were the means to achieve loyalty from a company's best customers.[2]

According to Mr. Reichheld, "The current approach (practiced by many companies) might be called the profit theory. All business skills and competencies stand or fall on their capacity to contribute to profits. The new (loyalty) theory sees the fundamental mission of a business not as profit, but value creation. It sees profit as a vital consequence of value creation – a means rather than an end, a result as opposed to a purpose.

"The new theory also makes loyalty a truer litmus test of corporate performance than profits ever were or could be. Profits alone are an unreliable measure because it is possible to raise reported short-term earnings by liquidating human capital. Pay cuts and price increases can boost earnings, but they have a negative effect on employee and customer loyalty, and so, shorten the duration and worth of those assets. Since the only way a business can retain customer and employee loyalty is by delivering superior value, high loyalty is a certain sign of solid value creation.

"It may sound as if loyalty and profits are in conflict. If business were a zero-sum game, that would be true; any given pay increase or price reduction would be a tradeoff against increased profits. But business is not a zero-sum game, and the putative conflict is a misunderstanding. To resolve it, we have to break out of the snapshot mentality and recognize that there are two kinds of profit.

"Call the first kind of profit *virtuous*: it's the result of creating value, sharing it and building the assets of the business. The word for the other kind of profit is *destructive*. Destructive profit does not come from value creation and value sharing; it comes from exploiting assets, from selling off a business's true balance sheet.

"When profit is a company's goal and purpose, virtuous and destructive profits serve equally well. But once you see profit as a means to, and a consequence of, the sustained creation of value, then only virtuous profit will do. Unfortunately, it's not always easy to tell them apart. For example, accounting reports will not help, because on a profit-and-loss statement, the two look identical.

"The best way to differentiate between good profits and bad is by measuring the loyalty of your most valuable assets: your customers, employees and investors. If defection rates are low and decreasing, then profits are virtuous. If not, you are probably liquidating your balance sheet – and destroying long-term value."

Goals of CRM

From an interview with Axel Heinemann and Curt Hagelman, senior vice president and chief marketing officer at Hannover Life Re U.S.:

Mr. Hagelman: We implement CRM through procedures and systems from the philosophy that is instilled in Germany. We have had the CRM principles for a long time; they have been expanded and improved. They are easy to adopt, because they encourage us to get close and know the clients. We make a conscious effort to get together with our clients' management once each year for strategic planning sessions.

At our annual meetings, both the client and we share knowledge to accompany the strategies so that the strategic goals can be accomplished. I don't think other reinsurers do that. CRM is applied broadly throughout HLR, including the actuarial and underwriting divisions, so that everyone knows what is going on.

HLR wants to offer reinsurance on more than a commodity basis. We believe that our services as assisted by CRM are a work in progress; they are always under development for improvement. We use a CRM software system that is tailored to the reinsurance business, which includes the collection, storage and ready retrieval of financial information, projects, written and verbal information. This information is available not only to the people who contribute to the system, but to everyone directly in contact with any client.

Mr. Heinemann: We started our CRM process several years ago when we asked ourselves, "How do we get closer to our clients?" We wanted to achieve this on a worldwide basis, and thus share a common language about CRM throughout HLR. For example, the same story about CRM should be told, whether in Australia, Germany or the U.S. The philosophy should be realized throughout the corporation using the same approach.

Mr. Hagelman: I joined HLR in the first quarter of 2001, and saw CRM at that time already being driven on a worldwide basis. Corporate headquarters was instilling CRM in all of its subsidiaries, even when the regional markets were different from each other. I have not seen activities anywhere at variance with the CRM path to improve workflow.

Mr. Heinemann: Of course there had been a great deal of resistance, for we are human beings and human beings sometimes resist change. One of the biggest objections that we heard was, "We are already doing CRM. We don't need to do anything different." My response had been, "Yes, but exactly *what* are you doing?" Everyone was doing something that appeared like CRM, but it was not systematic or consistent across the company. Different processes were being implemented in different countries.

Another objection was, "I cannot afford to treat different clients differently." The key to realizing a consistent, effective CRM effort is to have a champion of the process at the very top of the organization. Dr. Wolf Becke has been the quintessential champion of CRM from the beginning to today, and will be well into the future.

Mr. Hagelman: From an external standpoint, some large direct companies perceive that reinsurance is a commodity. Reinsurers have created and supported that image. Many reinsurers in the U.S. market deal with hundreds of clients. They often have to be everything for everybody, as well as provide services to insurers who are competitors in the same niche.

HLR is very selective about the clients we handle; we are not widely based, nor do we provide everything for everybody. We take care to support limited clients within any particular market niche, so that we can develop trust between each client and ourselves. Our clients can be assured that the information that is shared with us will be kept highly confidential, and not used in any way to benefit their competitors.

Our approach is evolving constantly, but what I have seen since I arrived at HLR has been extremely positive.

Mr. Heinemann: We call this "vertical marketing," which is narrowly but intensely based, as opposed to "horizontal marketing," which is widely based. We would rather concentrate on doing better with fewer clients, than doing less well with many clients.

HLR has already passed all the objections and hurdles that must be passed within the company. We are now speaking the common CRM language worldwide. We purposely introduced the software late in the process, because we wanted to be assured of a complete buy-in first from all of our staff.

When we first introduced the CRM concept, we worried that the implementation of the concept would be onerous or vague to many people. Naturally, business people think that understanding theory takes too long, and they want practical, "real world" results quickly. We knew that if HLR started practicing CRM immediately, within one month it would completely fail.

Many companies think that CRM can be instituted as easily as buying a $2 million software system. They don't realize that to encompass CRM properly there must be a long learning curve. They might think they have it right, but the critical backlash will appear after one year. After this crisis, it will be time to redo and rethink CRM throughout the organization, and start from the bottom again.

The second time around, the consistent acceptance of CRM will be achieved slowly, but it will be achieved. It may take between two and three years since the start of the CRM effort to have it accomplished to where it is done right, but it is worth all of the effort.

Mr. Hagelman: The practice of CRM cuts broadly across the company, involving many components. The adoption of the philosophy is important, and applying it daily is very novel and difficult, especially across different countries.

Some countries do put limits on information that can be kept by vendors about their customers. For example, England has regulations about the amount of information that can be kept about a customer without that customer's permission. We did get almost all of our clients' permission to maintain this data about them. Only one individual in one company objected.

CRM and Life Underwriting

Mr. Heinemann: We find life underwriting to be different than most other lines of business, such as property-casualty, because the effects of life underwriting decisions last for very long time, e.g., there is a long "tail" of risk. At HLR, we do little facultative life reinsurance, next to no catastrophic business, and have specialized in niches like senior citizen markets and financing life reinsurance treaties.

We are solution-driven and a trusted flexible advisor to our clients, which means that in most markets in the world, we are known for not reinsuring the maximum of available life assurance companies, but rather a selected number. Otherwise we could not stay a flexible advisor, let alone trusted.

Since life reinsurance is long tail business, our underwriters will of course consider each and every technical aspect of a potential treaty to make sure that underwriting guidelines are not violated and that our margins are reached. This approach toward products and prices we take for granted, and this approach is not different from what our competitors do.

However, our underwriters and actuaries rank our customers by their long-term worth, and prioritize the allocation of our resources so that different customers will be treated differently.

One of the underlying lessons in order to avoid ambiguity, uncertainty and subjectivity is a checklist based on powerful insights about our clients. To a certain extent, marketing that follows CRM principles has to be organized, otherwise the same old mess remains. As a result, our underwriters and actuaries ask themselves on every step they take in the marketing and treaty negotiation process:

- Do we understand customers and markets as well as possible by keeping, updating and analyzing high quality data, especially for individuals?
- Do we classify customers by their long-term value and ask if the customer will destroy or create value for HLR?
- Do we consider our own resources? HLR has to obtain, keep and grow customers, so we allot our resources by customer type and value in order to maximize the financial return.
- Do we shift from selling products to meeting customer needs? Product lifetimes are getting shorter, and as a consequence customer needs are the name of the game.
- We have to deliver relevant offers in our day-to-day business. This means that high volume campaigns are discarded in favor of direct communication with individuals.
- Do we maintain consistent communication with our clients?
- Is all customer data used in an integrated way among all HLR units?

We do not specifically measure the success of CRM, because I am convinced that this is hardly possible. What we do measure, however, is the customer's lifetime value (estimated as the total profits generated over the business life period of that customer) and the customer's degree of loyalty (the purchasing behavior of that customer). These two factors are vital in any decision we take with our clients.

One Customer's Experience

From an interview with Chuck Scheper, chief operating officer of Great American Financial Resources, Inc. (GAFRI):

"My relationship with HLR at GAFRI started in 1997, but I have had a relationship with them from previous experience since 1992. Our relationship with HLR has always been good, yet it was enhanced within the past four years. We are trusting and open with HLR, as we are with all of our reinsurance partners. Yet we feel as if we are preferred customers with HLR.

“Although I had not noticed much real difference in my interactions with HLR, my colleagues at GAFRI were somewhat skeptical about the reality of what they were seeing. However, within the past year there were some incidents where HLR’s actions and support truly demonstrated that GAFRI was a preferred customer. These actions helped my colleagues to see that HLR was truly sincere in wanting a better relationship than was typical between a reinsurer and its clients.

“We meet quarterly with HLR to review our deals. HLR has indeed identified inconsistencies that were in our favor, even when the treaty language may not have supported those actions. Also, when deals do not turn out as expected, we brainstorm suggestions that can enhance our collective returns. It is this kind of behavior that leads to trust, where keeping one’s word is important. It helps me explain this kind of relationship to others, which in the end enhances the value of the relationship.

“With regard to underwriting, we had some adverse mortality experience several years ago. We invited HLR to audit our experience and give us suggestions. We were able to set up the audit remotely by giving HLR access to our online imaging system. They were willing to perform the audit remotely, which was easier than being on site. The audit was performed and we received good input from HLR.

“With regard to our other business with HLR, it mostly involved the purchase and reinsurance of large blocks of in-force business, and did not involve underwriting new individual cases. In my dealings with HLR, there have been relatively few disagreements – the stronger relationship there is with a business partner, the better we can do more and better business. I wish that other reinsurers would switch to this approach.

“Recently we made a decision to exit a market segment involving a competitive term product in the upper market. Products in that market, for the most part, have become commoditized, and there was not much loyalty to be had there. We could not make our targeted return on investment (ROI), so we asked HLR to make a bid on that business. They took a look at the ROI, and replied that they were not comfortable with that business, either. HLR’s response confirmed our decision not to stay in that market.

“The good part about our decision to exit that market is that more capital will be freed to make other deals that will bring in better ROI. HLR’s approach to our needs gives us more confidence that our deals will be better, and will be done well. This allows us to consider deals that can achieve broader strategic objectives.

“For example, HLR enabled us to structure a deal that ended up with HLR maintaining most of the risk on a business that we decided to exit. This freed capital was redeployed to other core businesses. In another deal, HLR provided a great deal of capital to finance an acquisition, which allowed us to leverage our infrastructure. The costs that we saved through HLR’s help allowed us to acquire an additional 100,000 policies that we otherwise could not have accomplished.

“We did not shop these particular deals, because we knew that HLR would be able to work something out with us. They are our reinsurer of choice for doing these bulk purchases and, hopefully, we are their customer of choice. They know our objectives, since we are an open book to them. When we decide to accomplish something, we generally bring it to HLR first to see if they are willing to go along. They will honestly say if they are or are not comfortable with the deal. They will also bring deals to us to see if we have any interest.

“One of the things HLR also does is put a big carrot on the end of their deals. This can involve giving us 50% of the risk return if the block of business performs well after several years, instead of the usual 10%. They are willing to give up a bigger slice of their profit at the end of a treaty to keep the interests of everyone aligned.”

Another Customer’s Experience

From an interview with Dave Smith, senior vice president and chief marketing officer for Fidelity Security Life:

“We have worked with HLR for about six to eight years. HLR’s CRM approach definitely has had positive effects on our business. Involvement has been HLR’s key feature with us. As a small company, we have needed this involvement in order to stay innovative and competitive.

“We have some unique programs with HLR, and their CRM approach affects what we do and how we work in making these programs a success. We have increased our product portfolio over time with HLR and found that we have many attributes in common: flexibility, willingness to do whatever it takes and an attraction to niche marketing. Our ideas have been well received, so our relationship with HLR has worked out well.

"One of our programs involves financial reinsurance. HLR has been wonderful to work with, and helped us out with picking up excess surplus. Another program involves an umbrella treaty on accidental death and disability products that are distributed through different channels. HLR has been good in working with us, as long as we can demonstrate our ability to understand and address any problems that arise.

"Another program involved creating and supporting a product that originally was a veteran distributor's idea. The product was complex and involved a large capital investment, which HLR provided. HLR worked with us closely, and was deeply involved with us during the time-consuming effort of designing and establishing the product. HLR eventually took all of the risk as well as supported an off-premise service that handled the commissions. The product has now been on the market for about five years. We could not have accomplished this without a sound partnership basis.

"A hot issue with reinsurers today is extracontractual obligations (ECOs). ECOs are obligations that can arise when a risk involving a policy occurs outside of the realm addressed by specific policy language. These do not occur frequently, but they do arise and can translate into significant liabilities. ECOs have become an issue among insurance companies that share risk.

"Many reinsurers today have taken a hard stance on interpreting the terminology in treaties so that liability most often ends up belonging to the issuing carrier. When it comes to policyholder obligations, it can be difficult to isolate ECO liabilities from those in the standard policy.

"HLR has been unusual among reinsurers in that we can work and compromise with them on handling ECOs in a reasonable way. They are willing to look at ECOs from a marketer's perspective, and not solely from a pure actuarial or underwriting viewpoint. This is important not just when the risk is shared evenly, but especially when the risk is shared unevenly.

"HLR's ability to avoid a harsh and unyielding attitude toward ECOs is aided by their flat structure, creating ready accessibility to people near the top of the corporation. We are on a first-name basis with everyone, and it is easy to reach the head of HLR's U.S. operations. He reports directly to the head of HLR worldwide, which is extremely convenient when decisions about hard questions are needed quickly.

"I won't say that we haven't had heated discussions with HLR's treaty people; we have certainly enjoyed a number of those. However, HLR stands behind the intent of a treaty, and not necessarily the fine print. We do work with other reinsurers. Diversity is healthy for all, but when we look at new markets we will always ask HLR if they are interested."

References

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