



Cookson Walker Consulting

# The Changing Face of Financial Service Distribution

***“Will integration work or fail? The jury is still out.”***

More than ever property and casualty insurance brokers are embracing the concept of providing integrated financial services to their clients. For at least twelve years the idea of providing financial services such as property and casualty, life, group life and health, funds, GICs/deposits and mortgage loans to a single or combined client base has been talked about and kicked around, and has been implemented in a few cases, as a successful approach to the sale of multi-line financial services. In spite of the length of time described, this model of doing business is still not the norm. Further, whether or not it will be the norm in the future is not certain. There are signs in the marketplace that suggest there are a growing number of integrated financial service brokers. The question is, are these brokers providing multi-line services successfully. This article discusses some of the benefits, critical success factors and approaches to establishing a fully integrated financial service brokerage.

## **Market Conditions**

A number of conditions are now present in the Canadian marketplace, which have not been present at the same time in the recent past, that may foster growth in brokerages that offer multi-line financial services. These conditions include; (i) a large group of Canadians who are aged between 35 to 49, with the financial needs and resources to purchase the various financial services described; (ii) the emergence, in a post consolidation era of larger brokerages with larger client bases to which other non-property and casualty financial services could be profitably provided, and; (iii) the emergence of property and casualty carriers that have designed and packaged programs that support and enable their brokerage distribution force to sell non-property and casualty lines of business.

## **The Benefits**

Everyone has long believed that the customer list of a property and casualty insurance broker provides an excellent base of existing clients who would buy financial products because a business relationship has already been established. The successful sale of these products to existing clients over the long term should result in increased profits and a corresponding increase in the value of the brokerage. In addition, an increase in profits and in value should result from the positive effect on account retention for multi-line clients. As a business concept, it sounds simple but, it may not be simple to accomplish.

In respect of non-property and casualty business, pre-tax profit margins, expressed as a percentage of revenue, tend to have a wide range, on average between 10% and 25%.

The margin is primarily dependent on volume and mix of business, with, for example, group life and health business at the high end of the range.

Similar to property and casualty business, average values on the sale of other financial service businesses are expressed in terms of multiples of commission income (but determined based on many factors including profitability) in a range of 1.0 to 1.5 times revenue.

### **Critical Success Factors**

If you are considering redefining your brokerage to provide comprehensive financial services, a number of key critical success factors should be considered in the planning process.

#### **Formulate a Strategy**

Reorganizing your brokerage from selling primarily property and casualty lines of business to also selling life, group life and health, funds, GICs/deposits, and mortgage loans requires long term strategic planning and a commitment on an annual basis to implementing the strategy. Such an endeavour carries risks and real costs. In effect, to be successful it requires changing the nature of how your brokerage operates (“its Mission”) from providing property and casualty insurance solutions to providing comprehensive financial service solutions to meet your clients’ needs. This is not minor tinkering to achieve operational efficiencies; it represents a major change in the manner in which you do business.

Before any brokerage embarks on a change in strategy, senior management must assess whether the brokerage has or can get the management and sales skills required to produce a significant volume of other financial service business. In this process, management must obtain an answer to the hard question of whether or not it is worth the effort (time, money, training, etc.) to commence selling a complex range of financial services, or is it more profitable in the long run to concentrate on what the brokerage knows best, property and casualty insurance.

#### **Set out action plans to achieve strategy**

Design and operate the reorganized brokerage with systems and procedures in place to support the strategy to sell integrated financial services.

- **Invest in growth**

Understand the profitability relating to the products available and choose to invest in and sell those that achieve target profit margins.

Many non-property and casualty products attract low commission revenue. For these types of products, volume growth and retention is important combined with the resources to invest in growth until volume levels are achieved that result in targeted profit margins.

The chart set out below highlights average commission rates for typical financial service products.

Funds	% Premium	
	New	Renewal
Front Load (i)	0 – 5%	0.5 – 1%
Rear Load	5%	0.5%
No Load	1%	1%
GICs/Deposits	0.2%	0.2%
Term Life	75.0%	5.0%
Universal Life	100.0%	10.0%
Group Life & Health	10.0%	10.0%

*(i) Front load and renewal (trailer) are inversely related.*

- **Control Costs**

Any action plan should be reflected in an annual operating budget in terms of its effect on revenue and expenses and monitored by key management. Variances from budget should be reviewed monthly and corrective action should be taken if appropriate.

Most expenses relating to financial service products are incurred on the initial sale with minimal expense occurring in the renewal periods.

It is therefore, critical to control costs in the renewal periods if target profit margins are to be achieved.

- **Sales**

Identify and sell products that are appropriate to the needs of your clients. For example, if you have large commercial and association accounts it may make more sense to sell group life and health products. If you deal with owner-operators who have succession issues, the sale of life products may be more relevant.

Initially take advantage of cross selling. It should be the easiest sale. It should result in improving existing client relationships, corresponding retention, long term profitability and the value of the brokerage.

Sell products that attract renewal commissions. This type of business stabilizes and improves profitability levels over the long term and creates value.

Develop relationships with clients that relate to service. These clients will be loyal if the service is provided and will not move because of price. Again client retention improves profitability and value.

- **Human Resources**

Hire, train and develop a staff that is technically strong and appropriately licensed. Products must be delivered competently.

Reinforce and foster staff adherence to the mission to provide integrated financial service solutions. Ideally, new and existing production staff should be cross-trained and comfortable in selling “the whole deal”.

Develop staff that provide advice-based service in order to attract desirable loyal clientele.

- **Contracts**

Seek out contracts with underwriters that reward success (overrides and bonuses) and by so doing enhance profitability. Sales staff, especially life producers, tend to be highly paid (e.g. 75% of commission income). Integrated financial service brokers may not make a reasonable profit margin on life business unless an MGA contract is in place, which pays override/bonus commission based on volume.

### Approaches

There are four common approaches to establishing an integrated financial service brokerage. The approaches that appear to be succeeding involve careful planning, implementation and investment.

- **Hire experienced life producers** - This is the traditional approach adopted by property and casualty brokers to sell other financial products. Usually, this approach does not entail a change in a brokerage’s business strategy to one focused on selling integrated financial services. Consequently, it has generally met with failure because of a lack of planning and management commitment. The focus is usually on short term sales from working the existing client list. Property and casualty staff tend to guard their client relationships too closely. This inhibits the sales process. A sense of separation develops between the respective staff. Consequently, the property and casualty and life cultures do not merge to one of selling financial services, production is low, producer draws exceed production and finally the brokerage and the producers go their separate ways.
- **Buy an established business** - Some brokers have purchased financial service brokerages that sell life, group life and health, GIC/deposits, funds and mortgage loans. This approach to creating an integrated financial service brokerage has the advantage of instantly creating capacity including revenue, profits, management, experienced staff, and licensing. The difficulty has been in the planning, the subsequent integration of the “two brokerages” into one “financial service brokerage”. This part of the purchase process is key. As these brokers work through these challenges they should realize the profits and value increases resulting from cross-selling and improved retention.
- **Start-up** - Other brokers have created financial service divisions. These brokers started slowly and had large property and casualty client bases. Management was committed to a strategy and these brokerages had the resources to invest in its implementation over the long term. Initially, only group life and health products were selected for sale because of the similarity to property and casualty profit margins, its annuity characteristics and the fit to the property and casualty client base (e.g. association business, critical mass of larger commercial

accounts). After four to five years, these divisions were significant contributors to these brokers' operations.

- **Packaged programs** - Many brokers have been setting up financial service divisions with the help and support of insurers. The insurers, of course, are promoting their own products. Nevertheless, these programs help to reduce the costs of investing in start-up and sales development. The packaged programs offered by the insurers often include planning, budgeting, sales, hiring, training, technology, and licensing assistance. An added benefit from these programs may be the strengthening of the relationship the broker has with one of its key suppliers on the property and casualty side of the business.

### **Summary**

It is not easy for a property and casualty brokerage to sell other financial services. To provide integrated financial services successfully, requires planning and commitment and a fundamental change in the purpose of the business, its mission.

Larger brokerages appear to have significant opportunities to benefit from increasing profits and business value through developing or purchasing financial service brokerages. These brokerages have the resources to invest in developing multi-line business and have the number and types of accounts to achieve the sales volume necessary to attract suitable profit margins.

The risks associated with setting up or buying a financial service business can be reduced by all sizes of brokerages, through obtaining the support from the property and casualty underwriters who are promoting the sale of their non-property and casualty financial service products. This promotion is occurring via assisting brokers in setting up turn-key "packaged" solutions for selling other financial services.

The existence of these trends in the marketplace suggest the concept of property and casualty brokerages reorganizing to provide integrated financial services may be emerging as a significant form of distribution. It is still too soon to tell, but the conditions for change suggest the trend will continue.

<b>Short List of Critical Success Factors</b>
<ol style="list-style-type: none"> <li>1. Redefine business strategy and change mission to sell comprehensive "financial services".</li> <li>2. Complete action plans to implement strategy on an annual basis.</li> <li>3. Be prepared for short term contingencies and set backs associated with investing in long term growth.</li> <li>4. Establish a budget, monitor and control costs.</li> <li>5. Focus initial sales efforts on existing clients.</li> <li>6. Hire, license and train the right people.</li> <li>7. Contract for appropriate financial products accompanied by enhanced override and bonus plans.</li> </ol>