FINANCE
101

THIRD-PARTY MARKETERS

ASSESSING RISK

NEGOTIATION

By Daniel M. Isard

Choosing a Preneed Insurer

Consider the many variables that come into play when making this decision for your firm.

Dear Dan,
I have a new funeral home and am ready to decide between two preneed insurers. Each has its own marketing company that will do the local selling for me. One gave me a good pitch that focuses on the strength of its financial assets. The other told me that all insurers are the same but that they have a better marketing plan. So, if it were you, which would you choose – strong financials or the ability to put more business on the books?

Signed,
Preneed Dependent in Portland

Dear PDP,
You have narrowed down your search to two very candid and easily differentiated third-party marketing (TPM) companies. If one is going to focus on more sales, that will help you build your new business. If one is asserting less in sales but a more stable financial institution, that is also a worthwhile concession. I do not concede, however, that all insurers are the same. There are vast differences between them.

To judge them on their terms, obtain the minimum operating production objectives for each. This is the amount of sales each TPM company guarantees. A company that does not use a TPM company can expect, on average, to have 15% to 20% of its annual case count come in as new preneed sales. A 100-call business can expect to write 15 to 20 preneed contracts on its own. If either of these TPM companies quote this amount or less, don't use them. You can do this yourself.

Add your estimates to the contract with the TPM company. Break it down by quarter; the first-quarter estimates will be lower than the other quarters as a pipeline of leads must be started.

THE MOST IMPORTANT POINTS TO NEGOTIATE WITH A THIRD-PARTY MARKETER ARE REVENUE, COSTS AND ESTIMATED RESULTS.

The important points to negotiate with a TPM company are revenue, costs and estimated results. Most TPMs want to have commissions. I understand that. They should also share in some or all of the expenses as well. There are still expenses for programs that benefit the goodwill of the funeral home, which you will bear even though these programs may sell preneed. That is just good sharing. Learn which expenses the company is going to put forth and the amount it will spend in each category. Ultimately, you will have a cost/lead analysis. If this looks too low, beware.

The insurer represented by the TPM company should be examined as well. You will be servicing any business it writes on your behalf. The maturity date on these contracts could be four to 15 years in the future. If the insurer is not a stable financial institution, you are taking a long-term risk.

I look at a number of factors when choosing a preneed life insurance company:

1. Capital and Surplus Ratio to Assets This ratio reveals how much margin for error the insurer has. Capital and surplus are to an insurance company what retained earnings are for a regular business.

The amount of retained earnings doesn't tell us anything. The ratio of retained earnings to assets, however, tells us how much risk there is in investing in this business. As a funeral home owner deciding about an insurer, you are deciding about risk. For example, if capital and surplus are $1 and assets are $10, then C&S is 10% of assets.

In my experience, any C&S-to-assets ratio between 6% and 10% is good; the average is 8%. Too little C&S is usually bad; too much is not necessarily good either. When an insurance company elects to stop selling new business, its profit will start hitting its books on the old business as it is paid off. At that time, C&S will start increasing. That doesn't make an insurer a good risk. You want a company that is continuously putting new business on the books as well (see next point).

2. New Business Compared to Previous Year I prefer an insurance company writing new business equal to or greater than the previous year. This is indicative of a solid marketing system, which gives better security and guarantees that current operations will be supported into the future. A good company sold premiums of $100,000 in 2016 versus $95,000 in 2015 and $90,000 in 2014.

3. Total Return Greater Than Yield Yield is an investment computation. If I buy a $100,000 bond with a $5,000 dividend, that is a 5% yield. That seems good relative to the current market, where the prime rate is much less.

However, I believe total return is more important than yield. Total return takes into consideration the change in the bond principal value as well as the dividend payment. Let's assume that our $100,000 bond with a $5,000 dividend has a drop in principal value to $95,000. The total return would be 0%! We want total return to be greater than yield. If bond prices are dropping, that will adversely affect your investment. It also adversely affects your capital and surplus!

4. Claims to Premiums If a consumer takes out a $5,000 face amount policy and pays $4,000, the insurer has $1,000 at risk. If the company has a large number of first-year claims above actuarial assumptions, it will impact profits negatively. It is unlucky for the board of directors to run an insurance company with claims that exceed premiums.

One factor I do not consider is the A.M. Best rating. A.M. Best is a well-respected rating agency that has rated insurance companies forever. The problem I see is it rates preneed insurers the same as it does regular life insurance companies. I do not believe they are the same. And if they are not the same, then you can't compare them.

I believe the classic life insurer differs from a preneed insurer in the following ways:

1. The classic life insurance company usually has a period of 35 years or longer from policy issue to death claim. The preneed company has about seven years.
2. The average age on a life insurance policy at issue is mid-30s, whereas preneed is above age 75.
3. The mortality rate is far different.
4. The underwriting is totally diverse.
5. The investment strategy is far more conservative for preneed as there is less time to recover from non-performing investments.
6. Almost all preneed life insurers have less than $1 billion in assets.
7. The average preneed policy is less than $10,000 in total face amount.
8. Preneed is almost exclusively whole life insurance; traditional insurance face amounts are more heavily weighted to term policies.

With these differences, how does one compare preneed life insurance coverage with, say, Prudential life insurance coverage? You can't. The A.M. Best rating doesn't look at preneed life insurers differently than normal whole life insurers. It should. However, it is easier for me to take the A.M. Best data and modify it to compare preneed life insurers to other preneed life insurers.

PDP, I have digressed and want to get back to your question of which TPM company I would use. Both have risk. Both have potential. Only you can prioritize your best objective.

All businesses have risks, and you get to decide to which risk you want to be exposed. If yours is a new business, starting from scratch, I think you want case count. Therefore, the company with the better marketing plan might have an advantage. However, if the company does not have minimally acceptable financials, find another marketing company.

> **ALL BUSINESSES HAVE RISKS, AND YOU MUST DECIDE TO WHICH RISK YOU WANT TO BE EXPOSED. IF YOURS IS A NEW BUSINESS, STARTING FROM SCRATCH, I THINK YOU WANT CASE COUNT. HOWEVER, IF THE COMPANY HAS POOR FINANCIALS, FIND ANOTHER COMPANY.**

There are 62 preneed insurers nationally, and I'll bet you can find one to fit your best interests. Or, depending on state law, perhaps a trust would reduce the risk if you can cash-flow the underwriting of new preneed production.

Dear readers, over my four decades in funeral service, I have made some outrageous comments. One from the early 90s was, "Preneed is the crack cocaine of funeral service!" I was speaking in Washington, D.C., when this utterance flew out of my brain, but the profession has indeed become addicted to preneed. It's a great marketing tool, but we tend to look at all of the wrong things. We look at commission while looking away from financials and operating results. We rely on relationships and pay no attention to results. I guess if I would have to restate my comment today, I would say, "Preneed – can't live with it and can't live without it!"

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