Product Development News

July 2003 – Issue 56

Pricing for Internet Distribution

by W. Howell Pugh

What does Internet distribution look like three years into the downturn? There is some indication of stability in the marketing groups after they suffered sharp drops in sales. A recent survey that I performed found 175 sites that sold life insurance on the Internet. Over 100 of those were multi-company sites that sold at least 10 companies' products.

The most prominent sites probably account for the majority of sales, although I do not know of any measurements of the total market. Two of the main sites are publicly quoted companies and thus have published their own results.

QuoteSmith had its second best sales year in 2002. Their reported term sales (number of policies) are showing stability over last year's sales and overall appear to parallel the industry pattern. (See table on top of page 23).

InsWeb reports the fee income it gets for providing term leads to companies. Their drop in sales occurred in 2002. The second half of the year is down by one-third from the previous year (See table on bottom of page 23).

Term still remains the most common product sold on the Internet. The belief is that it is less complicated and can be more readily self-bought by the consumer. There are several attempts to sell annuity products on several sites. Almost no one is attempting to sell universal life.

Underwriting Techniques

The biggest area of innovation is on the underwriting front. Attempts to bring new underwriting tools to replace full underwriting are coming from new directions on a frequent basis. In general, the idea is to supplement simplified issue questions with nonconventional underwriting tools such as credit reports and prescription databases. The goal is to have the trade-off between price and convenience at an acceptable level to minimize anti-selection. The Internet also allows easier access to some affinity groups, which will help mitigate anti-selection.

Pricing Assumptions

Distribution costs have a very different profile for Internet sites than for other direct or agent distribution. Many of the sites have up-front fees to handle setup of your policy and rates on their system. They also will charge an annual fee to carry your product on the site. These costs must be spread across the expected sales. You can compare your product to those on the site and estimate your expected traffic.

In addition to the bulk charges for the Web site, there are often per-lead or application fees. They typically range from $80 to $125. Thus, a key pricing assumption is the pull-through rate—the percentage of applications that turn into policies. Sometimes companies have requested a guaranteed minimum on the pull-through rate or even have negotiated to not pay for leads above twice the number who close. This is a critical item to manage the cost, in order to achieve overall profitability.

Internet distribution is more likely to have a flat commission per policy or lead. Such an arrangement is not typical for agent distribution. This means that there is a need for good information on average size or age. However, the Web site may be able to filter out applications for small amounts or young ages and reduce the less profitable cases to a very small percent of your product's sales.

Internet distribution is also common using company-owned Web sites or affinity sites. The sites are accessed by a click through button on a general company home page. Sometimes a banner ad is used to bring customers into the Web site. The main advantages that the sole company Web site

QuotesSmith 2002 Reported Term Sales (number of policies)	
Year	Quantity Sold
2002	17,622
2001	16,915
2000	33,491
1999	17,039
1998	10,920
1997	8,755
1996	6,649

InsWeb Quarterly Reports (fee income $1000s)			
	2002	2001	2000
4th Quarter	$733	$1,202	$642
3rd Quarter	938	1,411	544
2nd Quarter	1,100	1,142	422
1st Quarter	1,000	970	511
Total	$3,814	$4,677	$2,119

brings are that the prospects are more uniform and costs can be better controlled.

Underwriting and issue costs are similar to direct marketing costs. The use of a call center to manage the application process is recommended. This can also be a key weapon to manage the pull-through rate. Exam requirements generally are similar to agent-sold products. Some companies are attempting to use technology to control these costs.

Lapse experience for some of the earlier companies is about half the rate of agent sold business. The buyers are in control. They feel good about their choice of product and the shopping process to obtain it. There is not a need to repeat the shopping experience. There is no agent to push for new application.

Mortality for fully underwritten Internet distribution is the same as for agent distribution. However, because of the Internet, if you have an "underwriting hole," word can spread quickly. Since Web sites now have flexibility to handle substandard conditions, it is important to monitor your own underwriting rules and how the Web sites have constructed their rule set to make sure that you have not created an outlier.

Reinsurance is used for Internet term to mitigate the XXX reserve strain. Sometimes the reinsurance allowances can help mitigate the risk on the direct side. Using a normal allowance structure would mean that per-policy distribution costs would be mismatched by percent of premium allowances. See if the reinsurer will share some of the policy issue risk.

Internet term is a product for a new distribution. Some of the pricing assumptions are unique, while other assumptions are familiar to those who price agent-sold term. □

W. Howell Pugh, FSA, MAAA, is president of Howell Pugh Consulting in Indianapolis, Ind. He can be reached at howellp@comcast.net.