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Session 20PD
Design and Pricing of Products for Internet Distribution

Track: Nontraditional Marketing

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Summary: The Internet has potential to significantly supplant existing methods of distribution for life insurance. What makes it unique? And how has this been reflected in product design and pricing, to date?

MR. W. HOWELL PUGH: This session is sponsored by the Nontraditional Marketing Section and co-sponsored by the Product Development Section. We're here to talk about the Internet as a distribution method. And I want to distinguish upfront the type of company that I'll be talking about and the type of company that my panelist, Gary Thomas, will be talking about. I'm going to be talking about companies that exist, traditional-type insurance companies that are using the Internet as a distribution arm and working within that environment as a marketing arm. Gary Thomas works for a company that is an Internet-based company, with both products and processes completely Internet-based. So there's a distinction between those two.

First, let me introduce myself. I'm Howell Pugh, and I am with my own consulting group, Howell Pugh, LLC. Prior to that, my experience was with Lincoln Financial Group, both at First Penn-Pacific Life Ins Co. and then Lincoln Reinsurance. At First Penn-Pacific I worked on universal life, long-term care, equity-index annuities and bank annuities. At Lincoln Reinsurance, I headed their product-development area for client companies. I have an extensive background in individual-life product development and have dealt with various distribution arms in that company. The last project that I had at Lincoln Reinsurance was working for a large wholesaler-based retailer, designing a term product to be sold in warehouse retail.

Gary Thomas is Chief Actuary at Inviva, a recent technologically based insurance company start-up. Prior to that, he was a consultant at Mercer Human Resource Consulting, specializing in design and finance of executive benefits, as well as the corporate uses of life insurance, including split dollar, group universal life, and key-man coverage. In the early part of his career, he was a software developer for the insurance and financial services industries. And he maintains a strong interest in technology.

I'm now going to talk about Internet distribution for traditional companies. With something as ever-changing as the Internet , the Society gives you deadlines for your presentation that seem too far in advance, so I want to share some recent headline information regarding what's happened to Internet companies recently. And then I'm going to talk about the Internet as a distribution arm. I'm going to talk about some underwriting techniques involved. And finally, I'll talk about pricing assumptions that are unique to Internet distribution and similar for both Internet and agent distribution.

Recent headlines: In the May 6 *Wall Street Journal,* Barry Diller was announced as having purchased LendingTree.com, which creates mortgages on the Internet. Barry Diller is a media mogul. His company owns, among other things, the Home Shopping Network, Expedia.com and Hotel.com. And he plans to purchase other financial-services industry businesses.

Barry Diller listed three criteria for the kinds of Internet sites that he wants to go after. One, he wants to find sites that are in a fragmented industry, where it's easy to be a big player. Second, he looks for businesses that can provide better service on-line than off-line. And third, he wants to seek the benefits of scale, so when a business doubles, you don't have to double your staff. But Barry Diller has always been someone who has been closely watched in terms of what he's planning to do. And he's planning to make a total of $9 billion in acquisitions in the financial services Internet marketplace.

On May 12, *BusinessWeek* announced in a cover article the return of e-business and then quoted several facts that I want to share. In the year 2002, business-to-business commerce on the Internet was at $2.4 trillion dollars. There are now companies that make all of their purchases through the Internet. In 1999, Forrester Research predicted that consumer retail in 2003 would be at $108 billion dollars. It's now projected that, in 2003, it's going to be $95 billion dollars, which is pretty close, considering the timeline. Furthermore, *BusinessWeek* said that for those companies that are selling on the Internet (public Internet companies), 40 percent of them were profitable in the fourth quarter of 2002. And that's a vastly distinct difference from what we think of in this third year of the downturn for Internet commerce. According to *BusinessWeek,* e-commerce still has problems with abandoned shopping carts. Over 50 percent of people who go out on retail sites abandon their shopping carts before they complete the sale.

And finally, the May 15 *Wall Street Journal* reported the most recent Forrester dot-com research study. This is an annual study that's supported by an organization called Shopping.org. They are able to collect Internet-only commerce information on a confidential basis from over 130 large Internet retail sites. Based on that information, they now project that on-line sales are 4.5 percent of all retail sales. (Don't you imagine that a lot of states wish they had sales tax on 4.5 percent of all sales?) But in certain industries, it's an even higher percentage: for computer hardware, 32 percent is sold over the Internet; airline tickets, 17 percent are sold over the Internet. In the year 2002, on-line sales were up by 48 percent to $76 billion, and the study also repeated the fact that retail on-line sales are expected to reach $95 billion this year. According to this study, 70 percent of retailers are making money on the Internet. As another final indication of growth of this area, the study reported that catalog sales took 100 years to reach 5 percent of all retail stores. The Internet has done it in six years.

The Economist is able to throw some cold water onto that. They reported that, despite the second resurgence of Internet companies and Internet sales, you have to hark back to the railroad era of the late 1800s for a similar example of growth. And the railroads went through three booms before they finally were able to be viable businesses and investments. So take everything that I said previously with *The Economist's* grain of salt.

I want to talk first about the Internet as a distribution arm and where we are with the kinds of things that are out there. First of all, what Web sites are available? I did a recent study (basically Google) on what sites are available for term insurance. I found 175 term quote Web sites. Almost 63 of these were joint ventures by 20 or more companies. Another 46 included 10 to 20 companies. And the largest proportion included less than 10 companies. In general, what you're seeing is that most of these sites are still very much agent-driven. Agents or agencies will put up Web sites, list companies or company information, and ask you to call them. So there still is vast proliferation out there, and there's not been a lot of consolidation in the numbers that we see.

There have been consolidations among the primary players, namely Quotesmith.com, InsWeb, Insurance.com, QuickQuote.com, Select Quote Insurance Services, and ReliaQuote, Inc. Quotesmith.com and InsWeb are public companies, and the rest are just major carriers. There's been consolidation among these and recent changes. Quotesmith, for example, has beefed up its shopping capability for substandard insurance. One can go in now with a diabetes condition, and the Web site will shop through the preferred criteria for the best rate for their diabetes condition. So it uses an interesting technique of anti-selection, ongoing by computer.

Since Quotesmith.com and InsWeb are publicly quoted, we can actually track sales and other information from their 10(K), 10(Q) and press releases. And Quotesmith, in the year 2002, had their second-best sales year ever. It was a growth from 2001 of 4.2 percent, slightly behind the industry. I think the industry is larger in terms of growth in number of policies. There was a big change from 2000. The change from 2000 to 2001 was that Quotesmith stopped their advertising budget to staunch some of the red ink involved. But we still have seen, from 1996 to 2002, fairly impressive growth and stability.

InsWeb uses a different technique. Quotesmith is basically a super agency, a managing general agency (MGA), if you will. They actually manage and sell the policies. So they are tracking policy sales. InsWeb is more of an aggregator site, that's a lead generator. So they are going to be focusing on the lead fees that they generate. When the Web site finds somebody who is interested in purchasing and goes through the quotation process, they will pass that information along to carriers. That's their lead that they've provided.

For InsWeb, their drop-off in leads has been from 2001 to 2002. The first six months of 2002 were roughly equal to 2001. The difference was in the last six months. And they certainly saw a declining trend in the last quarter of 2002. There is no real explanation here. But even though InsWeb is a leader in the term insurance industry, it now has an emphasis on auto sales. And indeed, they have turned into the agent model on auto insurance.

I want to talk a little bit about what kinds of products are available on the Internet. We're still not seeing much universal life or variable universal life. And it still is felt that it's too important that you have an agent assisting in the complexity involved in that sale. And I think that there's reluctance on the part of carriers to incur some of that liability involved.

Annuities, both fixed and variable: the interesting thing there is that the originator of insurance sales and annuity sales on the Internet is now moving into a sponsored environment, more or less a TPA type of environment, because the first attempt on the Internet had very mixed results. The first round of funding for InsWeb for the annuity seller was $10 million. The second round of funding was $12 million. And the actual sales results over two-and–a-half years were on the order of 67 policies. So it was one of those sites for which it was assumed, "If we build it, people will come." And it was a clear example of some of the failures in Internet designs.

I want to turn now to underwriting techniques. Most products that are sold out on the Internet are term insurance. There are at least three different kinds of underwriting models out there for term insurance. One is the fully underwritten, involving your grid of age and amount, paramedical examinations, blood tests—doing all of those things that you would do in a regular agent-distribution environment. That's the most common.

The second one is what I call the "underwrite first" model. And it's not seen in the United States. It is available in Canada. The initial quote is given in terms of a price band. The Web site visitor puts in their information—what their weight is, whether or not they are a citizen of the U.S. or Canada, what their driving record is, what their parents' ages of death due to cardiovascular were, etc. And based on that, they assign a preliminary band of preferred underwriting criteria. So there's a low-premium quote and a high-premium quote. Then, they go out and get their paramedical test, or other tests involved. And as the various carriers process that underwriting information, they will narrow their price band. So some carriers may have complete underwriting information, and therefore can quote. Others may require additional tests. So they will narrow the band. At any point during this auction process, the policy of the applicant can elect to take the quoted policy that they have.

It's interesting to think about in terms of an auction process, but it has not yet been proven to be viable information. We haven't yet seen implementation in the United States.

The third area to consider is simplified issue—price versus convenience when trying to do things on Internet time. And this is what marketers have said is the way to sell on the Internet. Most people are trying to maintain that within certain affinity lists. You're going to work through bank customers. You're going to work through worksite arrangements. And they're also trying to use new underwriting tools—prescription databases or other tools that might be out there.

In general, it's quite unproven. The Nontraditional Marketing Section Council arose out of a direct-mail environment. And there we have our six questions or three questions, with response rates, etc. A lot of the simplified-issue underwriting on the Internet works in the same fashion as the direct-mail model. But you no longer are working from a known mailing list, if you will. And so, that adds some extra complications. Also, some of the tools that are supposed to be on-line have not yet come on-line. The prescription database, as of the beginning of this year, was only about 30 percent populated. So you're only going to get information for all the people who quote on that basis. There is only a 30 percent hit rate on the prescription database.

Now I will talk about underwriting models and pricing assumptions. I want to compare and contrast the Internet to agent distribution, because there are a lot of similarities and there are some key differences.

Because you're using a different distribution, one of the key areas that's different is distribution cost. For a lot of these Web sites that I've talked about, in order to get on them, you're going to have to pay an upfront fee—either an initiation fee or annual expense cost. A lot of that covers the Web site's overhead. They have to build your product's preferred criteria, your application, etc., into the Web site. So they have some valid IT costs that they have to cover through that. But you're obviously going to have to look at the cost and make a trade-off with the number of applications that you are going to get on that Web site. If you compare your policy to the policies that are out there from other companies, what expected sales rate might you have? So how can you amortize this upfront cost or cover that $100,000 per year in annual fees?

And generally, this is not a problem area. I mean, you work it through once to see if your answers work. And then you work through it again and again, if need be. Because it is an ongoing process, you are going to find that your market share is going to change over time. Particularly as your product erodes in competitiveness, your market share will go down.

The other main distribution cost involved is either per application or per lead. And $80 is kind of a low-ball rate. They actually can range much higher, depending upon the level of service that the Web site might give you. I caution people that the main thing to worry about is what your pull-through rate is. Some people call this a conversion rate. Some people call it other things, but it's the percentage of applications or leads that turn into policies. And it turns out that this is probably, for Internet term, one of the most critical pricing assumptions that you can make.

It has to do with the fact that we're dealing with an unknown distribution. We're dealing with really unknown processes. And the other element involved is the fact that you have to look at an unknown process and bring it to a conclusion. In trying to manage this, you might try asking the Web site for a guaranteed minimum, so that you know that they will guarantee you a certain percentage of pull-through rate. Or you might try to negotiate to see if you can stop paying once your leads exceed twice what your sold policies are from that Web site. And so, you know, those are perhaps ways that you can control some of that cost upfront. But again, it's going to be a type of variable that's very critical in terms of pricing.

Just to reiterate the third point on distribution costs, essentially what we've done is replace percentage commissions—agent percentage commissions, percentage of premium commissions—with a flat commission per policy or lead. By the time you add these upfront costs and lead fees, you really have a flat per-policy commission. And so, it also will help you to get very good information about average sizes, age distributions. And another way to control this, to some extent, is to have the Web site filter out applications that are too small in policy size, or too much of a younger issue age. Because those are the ones that really get killed by a flat commission. If you have got total cost per policy at $200 to $300, you can have some severe negative pricing sales at age 25 or $100,000 or something like that.

So the Web sites can use their own information to actually shut your company off from showing up if the person says, "I want a $100,000 policy" or "I'm age 25." Your policy won't even appear on the list available. And so that's one way of managing the risk. You also can do it based on a plan type. If your 10-year policy is ineffective at certain ages because of this huge flat commission, but your 20-year will work, they can *not* display your company on the 10-year plan, but show it up for the 20-year plan or the 30-year plan. So you're able to further amortize those costs out.

The other way of helping to control distribution costs is through the company Web site. You can use banner ads to drive people to your company Web site. Or you can have a link from a company's home page to your quoting engine. Obviously, the more control you have over something like this, the better your profit. The problem with company Web sites is that you have to have a brand name involved. So a large brand name company can better use that strategy than a smaller company.

The second key element in Internet distribution is your call center. Again, I'm talking about a traditional company that's now selling on the Internet and bypassing its agent distribution. You've got to have something that manages people through the process. And the call center seems to work best. Obviously, they can be internal or external. You can manage those hassles yourself or pay somebody to manage them for you. But it turns out to be a key weapon to help that pull-through rate .

One company that I am aware of looked at their processes when they set about starting their Internet term, and counted the number of times that they invited people to say, "No, I don't want this policy." And they ended up with a huge number. "No, I don't want to give you time to go set up a paramedical exam." "No, I don't want to go through with that paramedical exam." "No, I don't want to sign away my rights to allow you to do a Medical Information Bureau (MIB) check." "No, I don't want to send you a check." "No, I don't want you to use a credit card." There are nine different opportunities that we give people in the insurance buying process to say "No," and walk away. And the call center can be trained to deal effectively with each of those stages of no's. It's a key weapon in your process. And I think that companies are not aware of how well agents do in this area in particular.

Other underwriting and issue costs—I generally recommend that you have exam requirements that are similar to agent term, because you're directly comparing products in that respect, and so you want to have as much mortality advantage as they do. So you're going to have paramedical exams, you're going to have blood tests, you're going to have X-rays when you need to, and that kind of thing. And some companies are trying to use technology to cover some of these costs. There are various ways of getting electronic inspection reports or things like that.

Finally, some good news from lapse assumptions—even though it's not as important for term insurance as it is for other products—early experience has shown that Internet products have about half the lapse rates of agent distribution. Now I don't really know if that's going to hold up over time. Again, early Internet adopters may be more gung ho in this kind of environment, or something like that. But what I surmise are two things. One, the buyer is in control. The buyer has gone through shopping, comparison, picking the company, picking the features that they want. They feel like they have done a good job on their own and are happy with their purchase. So they don't need to go out and do that again next year. They don't need to shop again. The more cynical answer is that you don't have an agent involved; there's no agent there to push for a new term commission, years down the road. But whichever explanation is true (and probably both are to some extent) we are seeing some incredible early lapse rates. And it really does credit to the companies that do a good job of communicating with their customers and contacting their customers.

Mortality: For the fully underwritten, same-as-agent term, you can get the same mortality on the Internet without having the benefit of field underwriting, as you do with agent distribution. And it does require careful underwriting. It does require all of the kinds of underwriting-exam testing that you might normally get. You obviously cannot expect this with a simplified underwriting condition. The other thing to be careful of is—and this can happen just because of the way the Web sites construct their charts and preferred criteria—if you have an underwriting hole, you're really going to stand out fast. And word can spread through the Internet in a very quick fashion. We don't necessarily fully understand what all of this instantaneous communication (interest groups, etc.) that the Internet enables communication on. So the problem arises because Web sites are trying to handle more and more substandard conditions. And you need to be careful in setting up those tables and checking the results.

For example, one company had an error in their Web site programming on their criteria for mental and nervous conditions. Every other company rated such people standard or maybe substandard. And this company ended up with quote rates that were one-half to one-third of what everybody else on the Web site was showing. So unless you want to add a lot of psychiatrists to your underwriting staff, you better watch all of those little pieces involved.

Riders—waiver, accidental death benefits (ADB), child rider, spouse rider—generally it's not easy to compare all of that information on the Internet. Some Web sites do have the ability to compare both with and without waiver, for example. Your pricing for these riders may give you some advantage.

And then conversion: to me, it's really the same dilemma that you have with regular term. Does the public perceive the value of conversions? And I think the answer often is "no." So, you really have to deal with that in your own fashion. And that's more of a company-philosophy decision than it is a pricing decision, as to how you want to treat conversions.

I want to mention a couple of things. I assumed that average sizes would be similar to agent term. And they are. What you find is that Internet distribution is tapping the same pool of buyers and getting the same sort of average size. And if you use Web sites to turn off the $100,000 and $150,000 cases and the age-25s, you can drive that average size up remarkably quickly.

One company reported that their sales by amount—28 percent of all their policy volume—was at $1 million and above. And to me, this was so staggering. It's amazing to think of people going out and buying million-dollar policies without benefit of an agent. I still think that's a big decision. You need an agent there to help you through it. But they actually are seeing a very large percentage of volume at $1 million and above.

Age distribution is another key assumption. In general, you're seeing the same age distribution as agent term. And this is despite the fact that three or four years ago, Internet demographics were very much skewed toward younger ages than the regular insurance-buying population. So, for example, for Internet users, you had more 25- to 35-year-olds than you do in the insurance-buying population. But age distribution seems to work well. So those 45- and 55-year-olds who need term insurance can go out on the Internet just as much as they can through an agent.

Reinsurance is just as important for Internet term, obviously, because of reserve strain on XXX. And some reinsurers are able to give product-development assistance. It would be helpful if the reinsurer can help design allowances to mitigate some direct-side risk, because you, again, have these per-policy distribution costs that are hard to swallow. And they're going to be very mismatched if the reinsurer stays with their normal percentage of payment allowances. So it might behoove you to work with the reinsurer and say, "How about taking on some of that upfront per-policy cost risk involved?

In conclusion, I want to list three elements to think about. One is, I think that Internet distribution continues to be a viable thing. It is struggling, to some extent, right now, but it is also growing. And the important thing is that a company can make a decision to use Internet distribution in conjunction with regular distribution. And there are ways of using these Web sites—aggregator sites or agent sites—that can help you to get into this distribution process. And as far as pricing assumptions, it's important that you take advantage of the similarities to regular agent term, but also be aware of the distinctions on the pull-through rate and the distribution costs involved.

MR. GARY THOMAS: I'd like to talk a little about Inviva; it's a relatively new company. I have been there for less than a year. As you may have guessed, technology is quite central to the way the company was set up, the way it operates, and the way it tries to sell products. I'll finish off by talking about some of the products that we offer and what some of the challenges have been. And hopefully, you'll get a feel for how that differs from the traditional way of selling insurance.

Inviva was founded four years ago by two dot-com entrepreneurs. One of them was the founder of TeleBank, which was, I believe, either the first or the premier Internet bank. Once that was sold, they tried to see whether or not they could do the same thing with insurance. And the goal was to develop a technology-oriented insurer, and that goes beyond just selling on the Internet. The idea was—as far as possible—to use electronic issuance and administration of policies, electronic documents, and electronic signatures. This was a start-up initially. They basically went into business by buying American Life of New York, which was a fairly small company with a rather dormant block of business. It did have a term product, and that was used as the basis for Inviva's first foray into the Internet.

Several products were rolled out, including a no-load, no-surrender-charge variable annuity. Late last year, the company purchased Conseco Variable Insurance Company (CVIC), and that was renamed Jefferson National Life. And now we have history going back to 1937, so we are a real insurance company.

There are several aspects to our technology platform. We have a fully automated underwriting system. And a little later, I'm going to make some statements that may seem all-encompassing. As I get a little further into this, I'll talk about some of the exceptions and how we complement some of these technological solutions. We do have an underlying administration system that is based on relational databases, which are rather commonplace. I'm assuming that most of you have familiarity with Access and Oracle, and such.

We much prefer to have everything administered electronically, although for policyholders that wish it, we can administer on a paper basis, also. As I said, we have Web access in a number of different areas. You can buy and apply for policies from us using the Internet. We use the Internet to do certain real-time checks against MIB. We have a fraud check service that we use. And we can also use the Web to retrieve a copy of your prospectus, if you're a variable annuity customer and you have the policyholder ID. We maintain on-line electronic copies of all correspondence. So in theory, if you don't want us to hold five copies of letters that we sent you, it's all stored on the databases. You have your own ID that you can use to retrieve that information any time you want. Obviously, we have policy information, but that can be retrieved electronically, via the Internet, also.

What are some of the consequences of the technology platform? Well, again, we're still fairly small. We're growing quickly, so we don't have a full handle on our costs, certainly in terms of what the costs are going to be if we continue to expand. But we do believe that most costs are scalable. The technology that was originally developed for term products has been expanded to handle fixed and variable annuities. And then again, with the Conseco purchase, we basically had expansion in both the in-force policies and a new portfolio of products with the usual variations on a lot of these products.

I guess one consequence of having a well-organized database is that the data is accessible to senior management. That means that we have real-time access to data. It can be customized. Our company president is a master of pivot tables. I don't know whether people use those. I'm still trying to figure out how they work. That's all a consequence of having a database that's designed the way you'd like it to be. Internet distribution is still a new area. There are a lot of unknowns. We certainly are far from having answers in a lot of areas, but we do a great deal of experimenting. We try to sell, using a number of different marketing methods. We have e-mail campaigns. For some of them, we send a link to a page where buyers can actually purchase a simple-issue term policy.

We're a little nervous with some of these experiments. We don't quite know what we're going to get in some cases. We monitor sales and we monitor most applications almost every step of the way to see what kinds of people we're getting, how long it's taking, where people are abandoning, etc. There are a number of different places where people can abandon an application, and we obviously want to know that.

As I said, the products, initially, were pretty simple, and we started out with a fully underwritten term policy. The idea is that you can apply online, and we will issue you a 90-day preliminary policy, while we go through the blood work and the attending physician's statements (APSs). At that point, assuming that everything is okay, we will issue you a permanent term policy

From that fully underwritten term policy, we've built a couple of different variations on simplified-issue terms, which I'll get into a little later. And we also developed a direct annuity. One thing that we are finding is that you can certainly sell over the Internet, but there are certain types of products that are hard to sell. And I think that a variable annuity is an example of something that one can buy cheaply on a Web site, but generally speaking, these things are often sold by brokers who make good commissions. And they get those good commissions for a reason. They are there to deliver customers. So we have some experiments going on with that. These initial products were developed specifically to take advantage of the platform. Instant issue wouldn't be possible if you didn't have additional signatures and real-time electronic links to third-party data. We have a number of services that we use. I mentioned MIB. We are also testing other approaches. And I think that one thing that will come through in my remarks is that we're doing an awful lot of experimenting. Some of these things work, and some of them don't. In a lot of cases, it's still a little too early to tell. We're pretty close, in the next few months, to rolling out a third-party product for another insurer. In other words, that insurer is filing a term product, and it's totally administered on our system, using our technology. And using Web technology, we can reinsure a piece of that. So it's something that uses our technology, with a few small tweaks. And they were able to adapt it for a completely different way of operating. That's certainly not something that we ever anticipated at the beginning.

Obviously, we have very close working relationships with our reinsurers. For a lot of the marketing methods that we're using, the groups that we market to are new. We certainly don't have a lot of expertise in some of these areas. We're getting a lot of hand holding from our reinsurers, and they're sharing fully in some of these risks.

I'd like to give a few highlights from several different products and talk about how they work. The first one is the fully underwritten term that I mentioned. You can buy this directly from our Web site. You can buy it from one of the number of marketing partners that we work with. Again, if those marketing partners would use the same kind of Web screens that the direct purchaser would use, it's fairly adaptable with small changes.

The application form is Web-based. One advantage of a Web-based application form is that it allows for easy reflexive questioning. You can ask the basic question, and then based on the answer to that question, if need be, you can have follow-up questions to narrow it down and determine the nature of the particular risk.

We also use an automated underwriting system. We don't use it in all cases. Right now, we reject substandard applicants. It's used for standard, preferred and super-preferred. We actually do have manual underwriting of rejects. We are thinking of having manual underwriting of people that would get rebated—for example, people that we would give a preliminary quote to and then the labs come back with another number. Again, I think this is all part of the process. We have an automated underwriting system, but we want to make sure that it's really working the way that we want it to.

We do use a digital signature to commit the purchaser. I have absolutely no idea how these things work. I've seen the digital signature. It's just a page full of unprincipled characters. I don't know how it gets generated, but somehow it enables people to have access to their data. It's fully private and it commits them. Our lawyers have told us that these things are valid signatures. It's part of the magic of technology.

I mentioned earlier that we offer a 90-day policy that is then followed up, once we've done the paramedical, the lab work and full check that goes on behind the scenes. Obviously, that's not technology-related. You can't get around that. There are a number of ways in which you allow people to say "no." I think that the goal with our fully underwritten product was to get something in their hands as quickly and easily as possible and to let the follow-up work happen later.

I talked a little about the underwriting and the premium class being refined, based on lab results. Again, I think it is important that you know that we have this automated underwriting engine. We think it's pretty good. But because we can, we want to continually test to make sure that the kind of risk that gets through the system is the kind of risk that we want to have.

Simplified issue: This is a fairly straightforward product, and we offer 10-, 15-, 20-year term, up to 65, up to $150,000 of coverage. It's offered through a variety of marketing channels. It can be sold through agents, financial institutions, or affinity groups. It's also available through direct e-mail campaigns. We do have it on some

Web sites of certain types of affinity groups. Obviously, we're nervous about the idea of putting it on Yahoo.com, for example, where people can more easily do side-by-side comparisons with fully underwritten products. We tried to have a fairly short series of questions. We have internal debates all the time over how important it is to have three questions versus four questions versus six questions. But anyway, that's something that we experiment with. It's a fairly simple accept/reject process. If we don't get the answers we like, we don't try to steer them to another product, although that's something that we might want to think about in the future.

On the simplified issue of products, we validate data in real-time. We have a fraud check, which is fairly rudimentary. And we do check against the MIB database. We're currently testing the idea of going against pharmacy databases. And I don't know whether those databases have enough coverage for you to feel fully sure, but it's certainly something that is there and is growing. And it's something that we're eager to try out.

I mentioned immediate issuance of policy. We actually we have this experimental program. We request APSs from people, not because we're looking to do any underwriting or follow-up underwriting or anything like that. We like to look at the risk criteria and make sure that we feel comfortably that if we were to underwrite these people they would stack up against the profession set they're apparently asking.

I mentioned the shorter question set. I don't know whether there's that much of a benefit to shortening them beyond a certain point. It's something that our marketers are constantly asking us for. We do pay very close attention to marketing channels. We're nervous about side-by-side comparisons, not just with underwritten parts, but even with other simplified underwritten parts. So you can have one part of that set of questions, with a hole that we don't notice. But an interest group might notice, and they'd drive a truck through it.

There is one thing that we are nervous about, particularly when dealing with Web and e-mail campaigns. I don't know if there is any hard evidence to support this, but we have this nervousness that once you send somebody an e-mail, it can be sent out to a chat room, or it can be sent to all kinds of groups. So one of the things that we've been fairly careful about is that when we put out e-mail campaigns, for example, we link the e-mails into our system, so we know that the person who came into that particular Web page got there through our e-mail. And we track these things day-by-day. And we occasionally have disagreements with marketing partners on how long you should keep these links open. And again, it's something that we don't have expertise in, but by monitoring it and measuring it, we learn things that can improve our next campaign.

We will sell to affinity groups. Obviously, we wouldn't want to sell to Cancer Survivors Anonymous or something. We monitor the types of groups that we allow our partners to go to. And every now and again, we get a question that comes out of left field. We had a situation recently in which one of our partners wanted to do nothing more than put out a press release, saying "We've got this simplified-issue product." They wanted to put it on-line and have a link to our page. And we were a little nervous, because press releases have a habit of being stuck on a Web site where they're open to all. I think that the press release would have gone to all of their agent friends, and that wasn't something that we'd ever thought of before. When we heard it, we became nervous. So there are a lot of different marketing methods that are fairly new to us, and maybe we have to think a little harder than most about them, because we're doing a lot of this for the first time. And that's where reinsurers have been a great help to us.

And briefly, we did develop a direct annuity. It's a variable annuity. There are zero mortality and expense charges, no surrender charges. Basically, all of our costs and profit are covered through the sharing of the investment piece. Again, it was awarded "Product of the Year" by *Annuity Market News*, but we haven't sold a lot. And I think that's shown us that you can't just put something out there and assume that people are going to find it. Maybe if you're Prudential, you can, but certainly we can't do that. So that's part of our growing and learning process.

I mentioned earlier that we have a pretty wide variety of other fixed and variable annuities. We have converted them to our platform. Much of the technology that I mentioned earlier applies. And whether you have a simple annuity or a complicated annuity, if somebody wants to take a loan or series of withdrawals, those types of processes are a little more complicated for us. They still call the customer-service representative, and the customer-service representative has to figure out what to do. But certainly, as far as administering the products, we have those on our platform and, so far, there are no problems.

We periodically redesign our products, and one thing that we're thinking about right now is offering inducements to customers for all electronic service. We have this dilemma. In theory, if you're a customer, you want to have everything done electronically. And we can offer that. But we have tens of thousands of policies that we inherited. All of those people are used to dealing with paper prospectuses and paper letters. We need to figure out a way of inducing them to move over to an all-electronic mode, so that we can realize some of the savings that we anticipated. As you can imagine, printing prospectuses and fund performance and the like is very costly. And we're hoping that some kind of cost inducement and the thought of having everything conveniently available immediately over the Web will be enough of an inducement to people. We'll find out.

Let's talk about general pricing and design differences. We believe that our expenses are low. We have found that the platform is scalable. So we're hoping that over time, that will affect our pricing. As far as mortality is concerned, that's a little difficult for us. I mentioned that our marketing methods are somewhat speculative. There's certainly a lack of industry data on simplified issue, and there are all kinds of opinions on what the effect of certain types of marketing methods and question sets are going to be on the mortality. And I mentioned that we rely heavily on our reinsurer expertise.

Lapse assumptions in the industry, so far, seem to be unusually low. We haven't analyzed our data, so I can't comment one way or another on that. I would say that acceptance rates are a really tricky area, or pull-through rates. The one difficulty we've had with a number of our partners is that they'll look at the number of people that put in an application and actually end up buying a policy, and it looks pretty low. And they say "How can this be any good? We've got a tiny number of people actually buying the policy." If you look closely at the data, you find that a lot of it is due to people just "kicking the tires." It's much easier to do that on-line. You can put in multiple applications and you can change your answers and just see what effect that has on things. We know that we get a lot of bogus and duplicate applications, because we see credit-card numbers like "999999." The way that I would look at it is that it's not so much a low acceptance rate, as the number of applications are probably artificially high, because it's so easy to do.

Conclusions: it is possible to sell insurance products over the Web. I guess what I have learned is, it's not so much about having an intimate interface, but you hope that you're going to get customers on the other end who may buy the product themselves. I think the Internet interface enables you to use a number of different marketing methods and gives you a lot of flexibility in working with different types of partners. I think that the larger advantage of this is more in cost, convenience and liability. Obviously you can have poor software, and that doesn't help you, but I think having something that's consistent, that you can monitor, is probably the most important thing. And I think this is probably true across a number of industries. I think that the Web should be viewed more as a technological enabler, than as a marketing channel. When Web marketing came out years ago, people were all talking about how bricks and mortar would be doomed. And it's turned out that you can't rely just on bricks and mortar; you can't rely just on Internet technology. What seems to have been developing in a number of industries is a combination of the two. The Internet is being used as part of a broader marketing strategy.

FROM THE FLOOR: How important are the ratings to buyers? Do you get asked that question on-line much? Do you post it? How do you handle that?

MR. THOMAS: We don't get asked it on-line. How important are ratings? Obviously, they're important.

FROM THE FLOOR: They are more important for the annuities, I would imagine.

MR. THOMAS: Yes, they're very important, but it's not something that we get asked on-line. Our partners ask us about it. When you're working with a marketing partner, they're very interested in the kind of company you are and what kind of ratings you have. But as far as the people buying directly are concerned, I don't think we have any evidence one way or another.

FROM THE FLOOR: On your general Web page, do you post your rating?

MR. THOMAS: I don't believe we do.

FROM THE FLOOR: You have instant issue. Do you actually allow the policyholder to print the policy?

MR. THOMAS: Yes.

FROM THE FLOOR: They can print it? Instead of you mailing it?

MR. THOMAS: Yes, they can do it electronically. So if they have a computer and they can view it on the Internet, they can certainly print that.

FROM THE FLOOR: And one other thing, you talk about low costs. But that's a function of volume.

MR. THOMAS: It is.

FROM THE FLOOR: And volume is low, so those costs can be considerably high.

MR. THOMAS: Absolutely, and in our position, we're a small, new company. We had zero employees before we had any sales. We've certainly seen pretty significant benefits of scale from the CVIC acquisition. I don't have numbers that I can throw out, but I feel pretty confident that the number of employees that we had to add to handle certain types of administration and customer-service functions are significantly lower than they were before we made the acquisition. Some of this has to be anecdotal I guess, but I do know that our technology people, for example, don't spend a lot of time writing reports and things like that. We've tried to set it up so that, where possible, people have direct access to data—whether that's management, customers, agents, or marketing partners.

MR. PUGH: I was just going to add to the question of policy form. Actually, Inviva creates a policy jacket, if you will, on-line for each person. And in that jacket goes the variable products prospectus and any fund reports. But for the term policy, they put the policy form out there in an Adobe PostScript file, along with any correspondence and a copy of the application and a secured hash version of the application. And that takes the place of all the paper that insurance companies produce. It's out there on the Internet, available both to the policyholder and the company. So yes, they can go out there and print their own copy, if they want to. Or they can always just access their policy jacket and find it. And that really goes to the heart of what I was talking about in terms of Barry Diller's comments that on-line service is better than off-line service, because you have cut away a whole layer of expense and time involved in delivering the insurance product.

FROM THE FLOOR: That's true if you have the volume.

MR. PUGH: Correct.

FROM THE FLOOR: Is the volume out there? What's the typical of pull-through rate?

MR. PUGH: I think that a good goal would be the same as what retail people are experiencing from their shopping carts. That you get to 50 percent. It has to do with how you measure it. Where do you start measuring it, and where do you end? Ending is simple: with the paid policy. But starting can vary, depending on the Web site that you're using. But you've got to get that rate up.

FROM THE FLOOR: Is anybody looking at radically new products that fundamentally rely on the Internet to exist, that would not have any sort of paper analog?

MR. PUGH: Yes and no. I'll give you a partial answer on that. I've developed and been working with a company that used a product that could not be sold to agents. And yet it's being successfully sold on the Internet.

FROM THE FLOOR: Of course, you have regulatory issues, too, on any new products that must be approved.

FROM THE FLOOR: I guess most of your products are either in term life or annuities. Are all of the term policies simplified-issue policies?

MR. THOMAS: No, we have simplified issues and we also have fully underwritten products.

FROM THE FLOOR: For all fully underwritten policies, applicants never need medical testing?

MR. THOMAS: Oh no, they do.

FROM THE FLOOR: What does immediate acceptance mean?

MR. THOMAS: The question was, with the fully underwritten products, what does fully automated underwriting and immediate acceptance mean? If an applicant were to apply on our Web site for a fully underwritten product, they would fill in an application right there. Without having to put anything on paper and sign it and mail it or have us mail an application for them to sign, they could put in an application. And based on the answers to those questions, we may pop up a second or third or fourth series of questions to get further information.

Based on the answers to those questions, we have a system that would come up with a preliminary rate for them. And we would offer them a policy right there and then that would cover them for 90 days, at a certain rate. While that policy was in effect, we would then commence with the APS, the blood work and labs, and so on. They would still have to go through that process. We couldn't cut that out. Once that process was completed, we get the information back, and it's put into our system, we have logic that then is used to develop a final rating for that person. They may end up being rejected. If they're rejected, we don't tell them, yet. This is what I was talking about earlier, the combination of technology and a non-technology. If, because of the lab results, we determine that we were happy with the class that we had given them in the first place, then we make a permanent term policy available, something that is longer than 90 days. We make the product available to them, and they can purchase it right then and there.

Obviously, if we preliminarily underwrite them as preferred, and as a result of testing, we now think that they're standard, we would offer them a policy at a higher premium. If they are rejected because of the lab results, our software would tell us that we should reject these people, but we don't quite do that yet. We send that information to our primary reinsurer; we basically pay them to take a look at that for us. And in some cases, they confirm that the person should be rejected. In some cases they say that this person should be signed. And in some cases, they actually come out with a better rate than we started with. So it's definitely not all technology, but technology is at the core of most of it.

FROM THE FLOOR: If we compare this kind of term product that is sold through the Internet versus a regular term life product, I guess the only expense savings would be the agent commission, because the underwriting expense is pretty much the same.

MR. THOMAS: Are you talking about our internal expense savings?

FROM THE FLOOR: Right.

MR. THOMAS: Our product is not just sold online. It can be sold through agents. So we would pay commissions to agents. We see savings in a number of different areas. We have an extremely small underwriting staff. We had some upfront expense in putting a system together, with a fair amount of external help. But for a large percentage of applicants, we can offer the 90-day policy without it touching an underwriter's hand. When we get the lab results back, most of the policies that are not rejected get issued automatically. An underwriter is not involved there. So there is savings at the front end. I can't imagine some of the savings at the back end on administration. As the gentleman here was alluding to earlier, it's a little hard to measure some of those savings, when you're not yet at scale. And it certainly remains to be seen whether those savings would be realized.

FROM THE FLOOR: You've only been selling for a year or two at the moment, right? Inviva just really has started out.

MR. THOMAS: Yes.

FROM THE FLOOR: So it's still in the experimental stage?

MR. THOMAS: Absolutely. And the only thing that I think we've proved so far is that the technological platform works. That was the first hurdle. We actually sold some policies, those policies went through the system, and we can see how they work. And then the second thing that's been proven is that when we acquired CVIC, we took on a block of policy and assets that were vastly in excess of our original set of assets. So we've shown that it can be scaled. The question is how much scaling can be done? And if other acquisitions take place, does the aggravation of having all these different types of products outweigh the simple savings of just being able to do certain pieces of your business electronically or technologically?

FROM THE FLOOR: What sort of post-issue transactions can you do with beneficiary changes? My other question is regulatory. What states do you have to file in, if you're selling to people outside of the state of your license?

FROM THE FLOOR: If you're a New York company, it is an important consideration; nothing is easy in New York.

MR. THOMAS: I think that was why they started Met Life of New York. I forget your first question, I'm sorry.

FROM THE FLOOR: My first question was about post-issue transactions.

MR. THOMAS: Certainly, things like changing beneficiaries, that can be done on-line. With the variable annuities, I'm not 100 percent sure what can be done on-line right now. We want to have an awful lot of these functions available on-line. I know that if somebody calls up and asks how much interest they owe on their loan, right now they call a customer-service representative. And that customer-service representative basically is looking it up in a binder. But we're putting some tools together to help them. At some point, we'd love to have as many of these functions available on-line as possible. They're certainly not all there right now.

FROM THE FLOOR: How many policies have you been selling and what have you been selling?

MR. THOMAS: It's below 10,000.

FROM THE FLOOR: Is it more than 1,000?

MR. THOMAS: Yes.

FROM THE FLOOR: How many in a month?

MR. THOMAS: In a month? I don't know.

MR. PUGH: I think the annual report is available in Albany; you can check it there.

FROM THE FLOOR: I notice that you're using MIB checks, as well as Insurance Activity Indexes on simplified issue of $150,000 and below. What kind of protected value do you see at that side versus fully underwritten? For example, I'm guessing that you don't probably get as many hits. I' m curious, when you do get a hit, when do you actually see something alarming?

MR. THOMAS: Actually, I don't know that I've seen that one. I think it's something like 30 percent or so. I don't remember, to be honest with you.

MR. PUGH: My company uses them. They get about one of five.

FROM THE FLOOR: You have a service on there called "fraud check." Would you comment on that?

MR. THOMAS: Well, it does a few things. It confirms things like whether the person has a valid social-security number and that the date of birth that they put in is valid. Basically, it goes against a copy of a social-security database. I'm not 100 percent certain that we're going to keep using that. We're having internal discussions about whether it is doing what we really wanted.

MR. PUGH: On the Internet, everybody looks the same to you. There are no facial characteristics, there's nothing. And so the original goal was to try to distinguish whom you're talking to. The fraud check was to come up with that basic piece of information. It looks at information that's out there in data banks and compares it to what a person tells you on the application.

FROM THE FLOOR: For accept/reject policies, you can't reject the policy based on the information that you got from MIB. So how do you deal with that on the simplified issue term? And if you get information from MIB that leads you to believe that there is something there, what you have to do is investigate it. And you can't easily do that on MIB. Then the follow-up question I would have is, what do you do in the situation in which somebody gets rejected after going through the fully underwritten process and then turns around and tries to buy simplified-issue policy from you, knowing that they should be able to get it issued, because you can't check any information that they tell you? It's like a five-question accept/reject application.

MR. PUGH: The standard technique in any sort of direct-mail, or anything like that, for which you're running MIB checks is—and it's also true on the Internet—you get an MIBhit, and you ask for additional information. Every application form says that you can get additional information. So you ask the person to fill out a questionnaire, ask somebody to get you an attending physician's statement (APS).

And the hope there is that they go away, and you never hear from them again.

FROM THE FLOOR: That's what I was wondering. If it's truly accept/reject, the products that I've seen did not go get an MIB. It's five questions; that's it. The companies know that they don't want to follow up, if they get back information from an MIB that they really should follow up on. And the other way around is, like you said, the APS. What about my second question? What do you do when a potential policyholder applied for fully underwritten policy, and you reject it based on very good information collected, and then they turn around and buy simplified-issue policy?

MR. PUGH: Do you offer the simplified issue directly on-line? Or is that related to affinity groups or partners or something like that, who would opt against a direct person coming on and doing it?

MR. THOMAS: Our simplified-issue product is pretty much offered through partners and marketing campaigns. It's not something that you would buy directly.

FROM THE FLOOR: If they made an MIB report on the first case, they get their own hit back.

MR. THOMAS: Right.

FROM THE FLOOR: But technically they can't do anything with it if it is accept/reject.