Industry Will Experience Zippy Growth Through Zip Processing

by Maria N Thomson

The number of insurance companies has been shrinking in the United States from a peak of 2,343 life insurers in 1988 to less than half that today.[1] The current recession will accelerate this shrinkage. In the year 2000, an analysis of Best's Insurance Reports premium written data showed that 30 life insurance families out of about 1,400 were writing 70 percent of all premium—which explains the shrinkage. This has been occurring because the successful firms in the individual life industry are primarily focused on the affluent, which is only about 10 percent of the population. Growth and resurgence of the life insurance industry over the next 10 years will come from mid-market expansion.

The distribution barriers to such expansion have been eliminated. There are now many well established and highly suitable distribution channels for the mid-market, including:

- Various types of direct response: mail, media, Internet, outbound calls, etc.,
- Work site,
- Bank agencies,
- P&C agencies, and
- Specialist agencies that form relationships with professional firms, banks, etc.

The biggest remaining hurdles to success in the mid-market are:

1. Making sales simple and transactional for the agent and
2. Dramatically reducing the time and cost of placing new business. The elements of cost are:
   a) Agent compensation (or marketing costs for direct response),
   b) Underwriting, and
   c) Processing the application, setting up a new policy record in the administration system and issuing the policy.
3. Maintaining adequate risk selection in order to:
   a) Keep mortality levels within actuarial expectations and
   b) Maintain coverage at affordable levels for customers.

In order to address processing time and cost challenges, most companies are taking advantage of technology. The most high-tech and promising solution is e-applications with expert underwriting built in. Electronic underwriting often takes advantage of e-databases such as MIB, MVR and Rx history to supplement the screening questions. The current drawback is that there is little published data on the selection of risk efficacy of these tools. By 2020 these studies will have been done—the SOA has one in progress now.

In 2020 most companies, even affluent market companies, will use some e-tools in order to aid business placement by enhancing processing speed, and also to reduce placement costs. Affluent market companies will not rely solely on these tools to underwrite their policies, but many mid-market companies will come to rely on these tools entirely for the placement of the majority of their life policies. In addition to using these tools for life insurance, some companies selling voluntary/individual health plans will also avail themselves of these tools. However, studies on the morbidity expectations for policies underwritten utilizing e-underwriting and e-data may not be available by 2020.

Currently, at least five reinsurers that operate in the United States have e-underwriting software—although not all of them offer it to customers in the United States. The market for this software will grow and become a significant

[1] *ACLI Life Insurers Fact Book.*

source of growth for the reinsurers. Having this software, and providing companion e-underwriting rules building expertise, will provide competitive advantage for reinsurers seeking the mid-market trade. Some reinsurers will also provide "value added" in the form of expertise on how to take best advantage of e-data to build rules. Additional value added may come in the form of research on additional types of e-data—beyond Rx, MVR, MIB and credit reports—that could be useful for risk selection.

The Successful Insurer Of 2020

I shall call my vision of the successful company of 2020 "ZIP Insurance."

ZIP Insurance employs straight through processing (STP) tools to underwrite and issue policies at the point-of-sale, utilizing e-tools as described above. ZIP Insurance will not use underwriters for underwriting new business, but rather for establishing underwriting rules and updating them by analyzing data on e-application responses and keeping current on pertinent industry studies and developments.

ZIP's approach to business makes the sales process very transactional, thus lending itself well to the customer service representative (CSR) sales environments it has chosen for its distribution. ZIP Insurance software walks the agent through the sale, screening questions, payment and policy delivery. While the agent is taking the applicant through the drill-down underwriting questions (personal history interview or PHI), the software will automatically poll the e-databases it is programmed to access. The PHI, in combination with the e-data, will provide the software with the information needed to render an underwriting decision. If the sale is made, a credit card or electronic funds transfer payment can be accepted, and the policy will be printed or e-mailed, as the customer prefers.

The application and underwriting data is transmitted electronically to ZIP Insurance, and a new policy record is automatically set up in the policy administration system. Thus, all manual new business functions are eliminated in headquarters. ZIP will also have the data populate a new business database to track responses to application questions in order to spot problem areas.

ZIP has chosen to distribute entirely through bank and P&C agencies—primarily through licensed CSRs and loan officers. This distribution was chosen because:

- Cross-selling to an existing customer base is far more efficient than prospecting to new customers.
- Generally, customers will come to their bank or P&C agents, so home visits are usually not necessary.
- Between them, banks and P&C companies serve just about all the population that has income or assets.

The distribution network is built and supported through a wholesaling approach utilizing regional field managers (wholesalers) who are assigned to recruit agencies and train and support them. Headquarters provides phone sales and IT support to assist with sales or sales system issues that may arise.

The wholesalers monitor agent production, and work with agents that are underperforming. ZIP provides its agencies with assistance with mail, Internet and media advertising to bring in insurance customers. Finally, agents are encouraged to have an annual review with each of their insurance customers. The sales software has annual reminders built in, and the wholesalers encourage this as well. In the annual review sessions, the need for increased face amount is assessed, and the agent discusses additional coverages (riders) that can be added onto the policy, or additional products that could be purchased (such as health products).

ZIP pays total first-year agent compensation for all levels that is well under 100 percent of premium, and only modestly higher than renewal compensation. Agents find this low first-year compensation acceptable because the sales process is very quick and transactional, without any follow-ups required, and because there is no prospecting required. This compensation pattern is modeled after the custom for the sales of P&C insurance.

As a result of very low new business processing costs and low first-year agents' compensation, there is almost no first-year strain on ZIP's business, and thus it experiences excellent returns on equity.

ZIP's mortality experience is manageable due to:

1. A risk selection process that is of about the same quality as traditional nonmedical underwriting,
2. Much higher sales per agent than most companies currently experience—thus providing better risk spread,
3. Little selection gaming by the agent, as the sale is usually treated as a routine CSR transaction,
4. Follow-ups with customers on a sampling basis to verify application responses, and
5. Data monitoring to identify either adverse or anomalous results by agent and agency, by region, and by product and to improve underwriting questions.

Since ZIP is a young company in 2020, it has chosen to focus on the new business process and managing its distribution. It outsources its policy administration to a vendor which provides ZIP with a dedicated servicing group. Thus, ZIP has a small staff, who are not even all colocated. Its sales operation is run from the Midwest, its IT and policy service liaison operations are in the South, and finance, underwriting and analysis are in the Northeast.

In time, new business STP will be used by many insurers for life, disability and supplementary medical products sold on an individual or voluntary group basis. The industry will experience a resurgence, and most of the population will become adequately covered by life and disability insurance.

In 2020 competitive pressures are not very great for ZIP. Several other companies will be distributing in the same fashion as ZIP, with similar processes. Currently, in 2009, a life insurance company is using a ZIP process to sell through P&C agents. By 2020 there will be several players in this space, and many other companies in transition from people-intensive to fully automated new business placement processes.

As time goes by, competitive pressures will become ZIP Insurance Company's greatest challenge. The fundamental problem will be managing to stay competitive without returning to the industry's self-destructive cycle of increasingly restrictive underwriting, lower rates and higher agents' compensation, which led to the abandonment of the mid-market in the first place.

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