Digital MGAs and direct to consumer – a reinsurer's perspective

Whether trying to penetrate the underinsured middle market in a cost-effective manner, or working to transform the sales and underwriting process to meet the needs of millennials, life insurance carriers are increasingly looking to go direct to consumer. A number of macro trends converge in a direct-to-consumer model. Global digitalization, the rise of millennials, the "graying" of agents and underwriters, underwriting rules engines, InsurTech ecosystems and mobile technology are combining to drive change. Whether it's long-standing incumbents or startup digital managing general agents (MGAs), the life insurance industry sees the need and the opportunity for direct-to-consumer models. But it has yet to truly crack the code to be successful on a large scale. There probably won't be a single best solution, but it's highly likely a few designs will prevail and prosper as a result of ongoing investments and experimentation. It's not just startups and traditional direct carriers looking at these trends, the reinsurance sector is no different. As stakeholders with unique expertise, perspective, and an appetite to share in the risk, reinsurers are also looking to penetrate markets and underwrite risks in new and efficient ways. We are identifying solutions and looking to bring them to our clients. It's through mutual innovation and growing the market for all stakeholders that we will prosper together while addressing the longstanding protection gap.

How are reinsurers approaching the challenge, and where do they fit in the equation? This paper will explore these considerations and others as more companies look to start or enhance a direct-to-consumer platform.

Distribution – buy or build?

Carriers are assessing whether or not they have the expertise to efficiently access and sell to new markets. They must ask themselves if they have connections to a variety of digital partners or affinity groups through which they can market their product and offer a compelling customer experience. Do they have the insight to effectively market to millennials by looking for trigger events via social media, leveraging influencers, or marketing and selling through online lenders? It's not unusual for a carrier to determine it doesn't have this expertise and decide to acquire it from an external source. Fortunately, there are startups focused on building platforms to target specific markets, but who lack the capability to take their solution to market on their own. One can think of these startups as digital MGAs. They're looking for partners to help in areas outside their core expertise. They may have the marketing savvy, but they look to insurers and reinsurers to help with basic product development, risk management, reserving, etcetera. Matching these needs can create complementary opportunities.

Carriers may find buying distribution and leveraging their intellectual property (IP) and expertise appealing, but how do they know which startup to work with? In some respects, it's a bit of a leap of faith, but this is also a question a reinsurer can help answer. Munich Re and other reinsurers are very active within the InsurTech space and can perform an initial vetting of various solutions, or offer a second opinion on solutions carriers uncover on their own. While not a guarantee of success (after all, we are talking about startups), an objective assessment/endorsement by a reinsurer can be beneficial.

Generally, carriers that elect to acquire the expertise outside their walls are not buying the expertise of these startup digital MGAs for a financial investment and taking ownership stakes. Instead, most carriers are leveraging traditional MGA contracts. Of course, startups by their nature tend to be very fluid. Therefore, if you elect to "rent" the expertise through a non-equity investment, remember to account for potential changes in circumstance. What happens if there's a change of ownership within the startup? Do you eventually want the option to invest in or acquire the startup? Will you be looking to partner with just one startup or several? If several, is that acceptable to all parties? These are just a few of the questions to consider.

Building the capabilities to go direct-to-consumer in-house often requires significantly more resources than contracting with a third party that already has a platform. Thus, it requires a much higher level of confidence of success. In this situation, a reinsurer may take a more consultative role from a product perspective. Reinsurers can help assess the mortality/morbidity impact of a new underwriting tool, application process, or target market. Reinsurers are then willing to back these perspectives by taking a portion of the risk.

If a carrier elects to build or enhance a direct-to-consumer platform and engage a reinsurer, questions similar to those previously raised still apply. Carriers need to take a long-term view. What happens if the business performs better than expected? Under what circumstances are carriers able to assume more of the risk? What if things don't go as well as planned? What are the reinsurer's options to raise rates or request recapture? Should reinsurers offer the same rate guarantees as traditional models where the direct writer designs the program on its own and then solicits reinsurance bids? Ideally, you are partnering with a reinsurer where there is philosophical alignment and true partnership—both parties are assessing the business and making proactive adjustments on a regular basis to maximize long-term success. Some treaty language may need to be tweaked to reflect the mutual uncertainty of these new initiatives. A passive carrier-reinsurer relationship or one in which one party is not incentivized is not a formula for success.

Pricing – mortality/morbidity and retail rates

As noted, going direct often involves not only new distribution, but new underwriting tools and processes, a different set of application questions, and a new target market. How do carriers evaluate the underwriting risks inherent with these changes? It's here that reinsurers are able to apply their broad market perspectives by assessing the interplay among several elements: 1) the target market; 2) the pros and cons of a direct-to-consumer model; and 3) product design and underwriting. Large data sets, modeling and research are then used to derive mortality and morbidity assumptions. This is often achieved by leveraging a carrier's current experience as a benchmark and then accounting for variances within the new program. For example, will the new target market likely result in better mortality/morbidity, does the new application process mitigate the risk of anti-selection, or is a new predictive model likely to effectively stratify risks? Again, the reinsurer will back their views by sharing in the risk.

What about final street rates? Can the reinsurer help in this area? The answer may vary by reinsurer. At Munich Re, we focus on mortality, morbidity, and lapse assumptions. Thereby allowing the carriers to address issues like marketing, commissions, and other acquisition costs that factor into rates. Carriers can then develop the retail rates and handle product filing. Our belief is that this is an effective way to leverage each party's expertise and strengthen the partnership. Speaking of street rates, it's worth noting that the newer direct-to-consumer startups are very sensitive to their financial models as they are burning cash. Therefore, marketing allowances become extremely important as final pricing is set.

Rules engines and underwriting

The primary business drivers for direct to consumer should be enhancing the consumer experience and lowering acquisition costs. The reinsurance community is eager to support direct-to-consumer opportunities and the mainstream reinsurers offer underwriting rules engines to facilitate these goals. Here are some questions to ask as you look to build or enhance your direct-to-consumer platform.

Ask the reinsurer...

- Does the rules engine offer sufficient functionality to easily develop rules and reflexive questions around both the response to application questions and information brought in by third parties?
- Is it easy to integrate new tools and data sources?
- What underwriting tools need to be used to produce the expected mortality/morbidity results?
- What questions need to be asked of the applicant and in what order? How is this balanced with pricing and the customer experience?
- Who controls the ruleset? Is it easy to update?
- Will the reinsurer still support you on the product/pricing side if a competitor's engine is used?
- In what way will the reinsurer support the development of customized rules?
- Perhaps most importantly, does the engine have an analytics module, and is the reinsurer able to help monitor the business as it emerges and support changes to improve results?

Ask the distribution partner...

- Will they leverage your rules engine or are they purchasing their own?
- If they're purchasing their own, who will manage the rules?
- If the carrier is designing rules, how is the intellectual property (IP) protected?
- Which party is administering the business?
- How does this affect commission structures and allowances?

Intellectual property and brand control

Channel conflict aside, a big question may be which party controls the customer relationship, the brand, and the data? Also, what about IP in terms of product design, application questions, customized pricing, etc.?

Brand and relationship

Many startup distributors looking to take on the role of an MGA are doing so in conjunction with other services and engagement models, and/or they are looking to build into other services as they gain success and scale. As a result, many startups will want to be the dominant brand facing the customer, and they may want to administer the business as part of that. There may be flexibility on the part of a startup here, but it's worth exploring with your partner and determining whether their view of the customer aligns with your philosophy.

Reinsurers will likely be interested in the publicity that comes from being associated with the program, but there will be no interest in the direct relationship with the customer. That said, access to the data for analysis and future R&D could be an area of interest and a potential topic for discussion.

Intellectual property (IP)

Startups often bring a "hook" into the customer experience to incentivize members of the target market to do business with them. The hook may be through wellness plays, affinity groups, philanthropic ventures, etcetera. But what if the hook is a unique product design or access to data that affects pricing? Digital MGAs may or may not bring a third-party administrator (TPA) to handle administration and claims. Regardless, fronting carriers and reinsurers are bearing the risk of claim. Who then should own the IP? Who is doing the heavy lifting to understand it and monetize it? Even where there is clear co-creation and joint IP is involved, what happens if the relationship doesn't last, the startup doesn't survive, or they sell to another investor? What happens to the potentially valuable IP that was created?

The following is a short list of IP examples that are concerns for key stakeholders:

- Startups – marketing platform, technology stack, customer engagement model, possibly product design
- Carrier – underwriting rules, product design, application
- Reinsurer – underwriting rules, software (rules engine), predictive model if developed by reinsurer, combination of risk selection tools and expected mortality/morbidity

This is just a sample of IP topics that should be considered, and there is overlap. All can be sorted out, but it's important to address factors like this up front.

How to manage the risk

Entering a new market/distribution channel introduces risk. Managing these risks is key to a successful direct-to-consumer program and will allow one to expand efforts in this market. As a reinsurer, we have many ways to manage the risk that will allow a carrier to better position itself for success.

Anytime a carrier enters a new distribution system or a new market, the risk of anti-selection must be considered. The risk of anti-selection exists in any insurance program. What one must consider when entering a new market is how anti-selection may increase or decrease given the new market. As a reinsurer, we can assist in providing tools and techniques to find and manage anti-selective behaviors. Anti-selective behavior can be driven by the insured (e.g., smoker nondisclosure) or distribution; methods exist to manage this risk both during the underwriting process and post-issue. More importantly, as we see many different programs, we can alert you to new forms of anti-selection.

Program under-performance may be as big a risk as anti-selection. If a program does not deliver material future sales, doubts will be raised about your entire direct-to-consumer initiative. Reinsurers see how programs can be modified to enhance their probability of success and can share these learnings with you. One of the key areas where a reinsurer can assist is in enhancing straight-through processing rates (without giving up mortality). This ensures that you are providing your clients with the optimal customer experience.

As a reinsurer, we provide all of these services in exchange for risk. How you structure the reinsurance will be a key component of its success. We believe that the direct company should have some "skin in the game" by retaining a portion of the risk as this ensures that throughout your organization, the risks associated with a DTC program are monitored and managed. However, with reinsurance, you are better able to manage both earnings and capital strain.

Winning times four—expanding the pie for everyone

Ideally, moving toward a direct-to-consumer model is a win for each stakeholder—direct writers, startup companies and digital MGAs, reinsurers and the public.

Carriers not only benefit by engaging a reinsurance partner that can assist in vetting all aspects of the program, but also aligning with a reinsurance partner willing to share in these new risk types. If a startup is involved, it's often a relatively low risk investment when compared to going it alone.

Reinsurers should be taking the perspective that they can add the most value by bringing new distribution to carriers and/or helping carriers design new programs whereby both parties share in business brought in through the program. As a result, reinsurers do not compete with their core clients and grow revenue without having to invest in infrastructure such as filing, licensing and commissions that are outside their core competencies.

Startups win by leveraging incumbents' institutional knowledge and infrastructure that allows them to focus on their unique IP without having to build an entire business and navigate the regulatory environment on their own. Thus, speed to market can be realized.

Most importantly, the public benefits by increased access to products that protect customers and their families from unforeseen financial events that might otherwise be catastrophic.

It's an exciting time for our industry and the rapid pace of change is undeniable. At Munich Re, we are eager to work through all the details and complexities in order to help our industry thrive through mutual innovation.

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