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Understanding Changing Distribution Channels

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With supply of re/insurance significantly outstripping demand in this extended soft market, many underwriters have become considerably more proactive about the ways they source business. Although no new distribution categories have displaced the traditional channels of direct sales, broker production and delegated authorities, the insurers have had to adopt more advanced methods to assess and rank each, to deduce their relative value. With this approach insurers hope to concentrate their efforts on the distribution channels, which promise profitable, and growth business. Garnering a quantitative understanding of the nature of the underlying risks is the key to delivering actionable insights, which guide the focus towards profitable business.

Perhaps the most significant shift to distribution strategies is the increasing volume of business funnelling through Managing General Agencies (MGAs) and other intermediaries that accept business on behalf of insurers under delegated authority. Whilst the precise figures are unknown, it is evident that delegated authorities are growing in prominence as shown in a Conning & Co. study of the US MGA market which measured 2014 premium at $33 billion, up from $27 billion in 2012 (a 22% increase). Members of the American Association of Managing General Agents wrote premium of $25.97 billion last year in the US and Canada, of which $5.12 billion was written into Lloyd's. An increasing volume of UK, European, Asian, and Latin American business is also assumed through MGAs.

This shift in distribution tactics has an impact on risk carriers. They spend more time analysing portfolios of risk, and less underwriting individual risks. The same effect will arise for carriers participating in market consortia and facilities targeting specific classes of business. The syndicates supporting Aon's new 'Client Treaty' which is 20% Lloyd's following facility are anticipated to assume between $500mn-$600mn of premium in 2016 from this single contract. Under this facility, cessions are automatic without referral and accordingly all the underwriting was performed through analytics of the projected portfolio. According to Aon's analysis, the portfolio is profitable, and may outperform that of other brokers.

Another development is the acceleration of internet-based underwriting platforms deployed by insurers to attract business from regional and often extremely distant brokers. Such platforms delegate underwriting authority to algorithms, and have the potential to bring swathes of new, profitable business to insurers who would previously have had no access to risks bound online. However, most of these streamlined channels remove some or all of the ability of underwriters to scrutinise individual risks.

Whilst the shift towards delegation of authority may appear to be a loss of control, this evolution towards delegated authority is not a negative progression. The current soft market is different from any that came before, as Internet technology is sufficiently advanced to allow unfettered contact between underwriters and ultimate insureds. This contact allows underwriters to reach brokers and assureds in otherwise uncharted territory. This can present a substantial opportunity for suppliers to access niche sector where rates are strong. The LMG have identified the potential of streamlined distribution channels and through their sponsorship of the Target Operating Model (TOM) are building a technology network designed to give the London Market an edge in this race to provide capacity to the global marketplace.

To sell successfully though such direct channels, underwriters must embrace the opportunity to assume proactively some of the functions historically provided by brokers. This has been applied to full effect in the UK motor market where models for automating the pricing and binding of risks are deployed by insurers onto Confused.com (the Admiral subsidiary).

As costs rise relative to declining premium income, insurers are increasingly outsourcing some of their usual core responsibility. Whether underwriters are moving away from the client through delegated authority or closer through web-based placement systems, they are in each case switching to the assessment of portfolios rather than individual risks.

The methodology behind portfolio underwriting is substantially different to the traditional approach. Quantitative analysis is essential. The data delivered is vast, and can easily be analysed to assess the worth of each new channel adopted or under consideration. It can be used not only to determine pricing and capital allocations, but also to identify those areas of business which offer profitable expansion and are in keeping with existing corporate plans and business models.

Big-data analytics can also identify uneconomic books of business and marginal distribution channels. The biggest cost insurers face is likely to be the allocation of capital to unproductive or unprofitable lines. Such dead capital drives loss and cost ratios directly downwards. Segmental analysis can help to eliminate this cost. Further, it can do so relatively cheaply. The average marginal cost of technology for insurance companies – of which analytics is just a portion – is roughly 3.4% of gross written premium. Investment in technology can bring loss ratios down by identifying attractive distribution channels and flagging-up those which do not meet their cost of capital.

For insurers, automated segmentation analysis can include business scoring by segmental growth, profitability, size and ultimate value rankings based on these factors. Such systems provide underwriting businesses with actionable insights. They can be applied to existing portfolios to steer companies towards new distribution channels which present the possibility of profitable diversification and growth. They can also drive marketing campaigns to attract premium from lines of business or geographies that would benefit the portfolio. This analysis can further inform new product development, and lead client-facing risk management initiatives.

The banking industry has been transformed by the use of analytics. By harnessing the power of big data, it segments existing clients and potential customers based on demographic factors both for marketing campaigns and profitability forecasting. Analytical insights are fed into pricing models, and used to support credit scoring. Insurance businesses can do the same – and should do, as the pricing slump deepens, and the way in which insurance products are distributed continues to change and evolve.