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Rating Systems and Double Entry

I recently received a press release advertising another earth-shattering automated insurance quoting platform. The press release reminded me of a conversation I had a few weeks ago with an industry veteran who cited chapter and verse a 30-year-old press release from an insurance industry technology organization promising single entry in the immediate future.

I have no clue how many automated quoting platforms have been built, or how many have crashed and burned. And we still don't have single entry on adequate scale. The question then is, "What in the world causes this industry to adhere to antiquated IT?"

Seriously! All admitted carriers must file their forms and rates. It's fairly easy, maybe expensive but fairly easy, for smart IT people to pull those public documents and build a rating engine. AI is going to make it even easier. Therefore, the issue is not getting the data and building a program per se, except now carriers have their own AI black boxes and they're no longer providing all the rating/underwriting data to state regulators.

Does this mean automated quoting platforms capable of quoting every carrier will never be available? I don't know but if not, it might be a blessing. In other words, "Be careful what you wish for." If such a phenomenal rating platform was built and successfully sold and implemented, most agencies would become obsolete. Most agents don't provide meaningful advice to clients other than, "Here's the lowest quote." And most consumers couldn't care less about anything other than "the lowest price." An agent and an agent's commission expense are entirely expendable in that environment.

Perhaps this is why so many technology firms keep building these rating engines because they know that if they succeed, they will get the agents' commissions, or at least a portion. Their reward, if they succeed, is huge. And that huge reward comes at the agents' expense.

Many economists and consultants consider these situations to be wasteful because, due to the lack of working technology, consumers are not getting what they want as efficiently as is theoretically possible. Furthermore, it is wasteful because agents are getting paid extra unnecessarily. This is a fair point so investors will continue trying to find a solution.

Whoever figures it out will likely become instant billionaires and a whole lot of agents, and maybe some companies, will go out of business.

And this might just be a reason for all the failures! There's a lot of money invested in keeping things the way they are. This is especially true for all the firms buying agencies because if commissions are cut, their already expensive acquisitions become debt and/or impaired asset anchors overnight.

If you think a breakthrough will happen sooner rather than later, and you're concerned for your future, the solution is simple. Stop quoting and begin advising on a professional level. To me and many of my agency/broker clients, this approach is more fun, more rewarding, and they make a lot more money. A high-quality rating engine will actually enhance this business model rather than threaten the standard agency model.

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Were my forecasts in 2016 correct?

In the summer of 2016, I gave a presentation to insurance distributor related executives that was the epitome of the "Come to Jesus" moment. That presentation remains the hardest I've ever given because I knew the audience was going to viscerally react. I knew they were going to circle the wagons and completely reject reality. They were going to don denial as if they were putting on a helmet.

I reviewed that presentation to learn if I went too far, didn't go far enough, or was completely wrong.

At the time, Zenefits, The Zebra, Lemonaid, Next, CoverWallet, Trov, CoverHound, Insureon, AssureStart, and Berkshire Hathaway's Direct Insurance Company were all getting started and most had significant investment capital behind them. A large portion, sometimes 100%, of the capital was from other well-known insurance companies. These were threats to agents because they were promising services and more transparency that agents generally didn't provide. Moreover, they had a lot of money behind them.

I suggested that regular agents were at a disadvantage because these companies spent capital rather than revenue and that gave them the opportunity to spend more than regular agents to get business. My point was accurate but wrong in some ways. It turned out the bigger threat was to carriers.

My next point was that carriers would become significant competitors to agents. This has happened but from an interesting angle. The carriers that provided the start-up capital for these virtual agents were indeed competitors. But the major change again affected other carriers. The reinsurers in particular seemed to have realized that a large proportion of regular carriers were mismanaged. Rather than selling reinsurance at the same price to them, they may have reduced the amount of capital available to traditional reinsurance and reallocated those funds to new markets, especially in the MGA/DUA world.

In this hard market, the winners are these alternative markets and surplus lines. The admitted carriers' growth rate has been about industry standard growth, at best. Almost all true net organic growth (it drives me up the wall to read analysts identifying rate increases as "organic" growth – that's hiding reality) has been in surplus lines for commercial insurance.

I suggested the development of amazing risk management and loss control products would reduce the need for traditional insurance. This has happened but other forces were factors too. The best example is how soft the workers' compensation market has been in the last ten years. The work environment is much safer today.

But some of the other loss control devices which were obvious improvements haven't gone far. This makes me wonder if, because so many carriers' only "organic" growth is rate inflation, they really do not want to fully credit safety improvements on structures in particular because then, if widely adopted, the result would be deflation? The insurance industry, both carriers and distributors, largely work on the antiquated but enriching cost-plus model where they make a profit no matter how much something costs. In other words, if lost costs increase, they get rate permission to increase rates. The more premium that exists, assuming the number of shareholders remains steady, the better the C-suite looks and rate increases rather than safety might just be the better selfish solution. I'm sure this is just a wayward thought but one I should have offered in that presentation.

I also suggested that carriers would reduce agency commissions. They should have by now, but they haven't. A.M. Best released an important study early in 2024 showing commission expense has increased. It is now more than 50% of some carriers' total underwriting expense! What happened?

My theory is that between the consolidation of distributors through acquisitions and networks, the tail is now convincingly wagging the dog. Most carriers do not offer anything all that distinctive. Many do understand their lack of truly tangible competitive advantages so to avoid losing business to these very large distributors, rather than fixing the problem, they pay them more money. There are however a few carriers who have highly distinctive advantages. My research today proves this and their commission expense is far lower than normal.

My key point though was that the number of traditional agencies, agencies that participate in education programs and association meetings and are locally owned/managed, would decrease significantly. That has happened. The offset has been thousands of start-ups but almost all within a network environment because carriers refuse to think through how they can offset their concentration of risk by sponsoring start-ups like they used to do 40-50 years ago.

I then predicted the financial pressures supporting organizations would incur and I was dead-on about this, though the audience even more aggressively rejected this prediction.

Overall, my predictions were correct but flawed in two ways. The first was how the start-ups, funded mostly by carriers, especially reinsurers behind the scenes, would cause more disruption at the distributor level. But especially with their inside carrier-level knowledge, aided by their investors being reinsurers, the disruption took another turn aimed at carriers. Old, out-of-date carriers were the easier targets.

Second, this industry moves so slowly I still cannot believe some of the inevitable outcomes haven't happened. I came to this industry from IBM. When I walked into the insurance company office the first day 35 years ago, and the carrier for whom I worked was one of the more advanced in many ways, it was obvious the carrier was 20 years behind in technology and thinking. This industry is still behind. Part of its slowness is endemic to insurance because this industry does need to move somewhat slowly, but not this slow. Its savior is that P&C insurance is mostly mandated, a de facto public utility, with slow regulators too.

I think change is finally accelerating mostly because a handful of carriers have developed far better underwriting models than anyone else, enabling them to grow far faster while remaining profitable. They possess tangible competitive advantages enabling them to pay agents less money. One way or the other then, competitors will finally catch up or lose the business. Either way, the dogs might wag the tail again in the foreseeable future.

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Chris Burand is president and owner of Burand & Associates, LLC, a management consulting firm that has been specializing in the property/casualty insurance industry since 1992. Burand is recognized as a leading consultant for agency valuations and helping agents increase profits and reduce the cost of sales. His services include: agency valuations/due diligence, producer compensation plans, expert witness services, E&O carrier approved E&O procedure reviews, and agency operation enhancement reviews. He also provides the acclaimed Contingency Contract Analysis® Service and has the largest database and knowledge of contingency contracts in the insurance industry.

Burand has more than 35 years' experience in the insurance industry. He is a featured speaker across the continent at more than 300 conventions and educational programs. He has written for numerous industry publications including the Insurance Journal, American Agent & Broker, and National Underwriter. He also publishes Burand's Insurance Agency Adviser for independent insurance agents.

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