Rethinking Digital Insurance Brokerage In Canada

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Abstract

The proliferation of InsurTech is beginning to extend outside of the traditionally dominant insurance markets of Europe and the United States. However, despite the existence of customer pain points among Canadian insurance consumers that match those of their international peers, innovation in the Canadian insurance industry has been slower to take hold. Start-ups looking to capitalize on this opportunity are faced with technology and regulatory hurdles, as well as insurance specific challenges including the obtaining of insurance distribution agreements, maintaining manageable customer acquisition costs and effectively automating portions of the insurance brokerage value chain. An alternative business model is outlined that addresses these core challenges and sidesteps the profoundly competitive race to seduce the minority of Canadians who are in-market for insurance products. This is achieved by appealing directly to customers who are out-of-market because they neglect to diligently shop for alternative coverage when their existing insurance policies expire.
INTRODUCTION

In recent quarters, the momentum of investments in insurance technology start-ups, or “InsurTech” as it is commonly known, has extended beyond the health insurance sector and beyond the US market. As of Q1 2016, data from CB Insights recorded InsurTech deal volume to be 6x that of comparable 2011 levels, with only a third of such deals attributable to health care related InsurTech start-ups.\(^1\) In Canada, where the direct opportunity presented by the Obama administration's 2008 Affordable Care Act was more muted, InsurTech remains largely untapped.

There are several opportunities technology companies can address in the Canadian insurance market. This review focuses on the 8 billion dollars that is paid annually by Property and Casualty insurance carriers to insurance distributors.\(^2\)

Approximately 70% of Property and Casualty insurance is distributed via a network of licensed insurance brokers who distribute on behalf of multiple insurance carriers. The remaining 30% is marketed directly to customers by insurance carriers via captive insurance agents.\(^3\)

The fixed nature of the products and the regulations governing distribution have meant that insurance brokers are largely unable to differentiate themselves from their peers. All incumbent brokerages offer the same fundamental value proposition based on helping customers identify the appropriate coverage at an acceptable price. Because differentiation among brokers is weak, customers tend to purchase insurance from brokers they know personally or from trusted referrals. This dependence on personal relationships imposes significant challenges to any broker looking to scale their operations outside of their immediate network. The resulting competitive landscape is highly fragmented and characterized by a large number of small and medium sized firms. Given that small and medium sized firms are resource constrained, it follows that the penetration of technology has lagged behind other comparably sized industries.

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\(^1\) CB Insights, Early-Stage Insurance Tech Deals on Pace for Quarterly Record, March 8, 2016
\(^3\) The proportion of direct vs. broker sales varies significantly between markets and particular organizations. In some Canadian provinces, including Quebec, direct sales by carriers represent a larger percentage of total written premiums.
Covera undertook a discovery process to identify the customer pain points relating to the distribution of insurance products. As customers recounted their experiences with the buying of insurance products, the following issues appeared most frequently:

- The majority of customers interviewed had never filed an insurance claim leading to the perception that insurance does not provide them with value;
- When the time comes to renew an active policy, customers are reluctant to restart the insurance buying process because the process itself is frustrating;
- Buyers are not provided with information explaining how insurance is priced which leads to a perception that coverage is too expensive;
- When deciding whether to file a claim, customers struggle when balancing the benefits of compensation against the uncertainty that their claim will be punished by higher monthly premiums;
- The purchasing of insurance products involves significant data entry friction;
- Carriers do not provide information to explain why premiums for the same coverage change upon renewal and the language of insurance policies is complicated and inaccessible;
- Customers make mistakes about the amount of coverage they need and tend to overvalue certain coverage features (such as lower deductibles for automobile insurance).

**THE VALUE PROPOSITION OF DIGITAL BROKERAGE**

A significant number of the above listed pain points relate directly to the analogue business practices common among incumbent insurance brokerages. Below, we have listed a number of ways in which a Digital Broker could leverage technology to alleviate these issues. Some of these functionalities have already been implemented by the direct sales websites of Canadian carriers. For brokers, many of these features remain difficult to implement due to the existing processes and legacy systems at the carrier level. The following list should, therefore, be understood as an ideal of what a digital broker in Canada would be capable of:
• It would allow users to purchase insurance coverage completely online with optional telephone contact. This would require the Digital Broker to present users with binding offers to contract as opposed to non-binding quotes. This would imply the availability of API based quoting engines, a development that is dependent on 1) the state of the existing technology stack of a given broker’s carrier partners and 2) the appetite of carriers to provide access to such API’s. While American P&C brokers have access to a variety of potential suppliers for online quoting, most brokers in Canada confront a quasi-monopoly dominated by a single software company when looking to gain access to online insurance quotes;
• A Digital Broker would establish robust technological connections with insurance carriers to facilitate the secure transmission of customer information directly to a carrier’s underwriters;
• A user’s information, active policies and past policies would be managed in a centralized nexus in order to facilitate renewals and cross selling of complimentary financial products. Users would be able to consult their active policies on demand and make basic changes to their files using a self-serve platform;
• The process of renewing active policies would be automated. Changes to coverage needs would be forecasted using non-contextual information (such as macroeconomic trends for a customer’s given age group) and contextual information about a particular customer’s situation;
• Data entry friction would be alleviated using a gamified UI/UX and by querying public databases to auto-populate customer information;
• Digital Brokers would apply machine learning & data science to generate “advice not price”. From the perspective of the user, this might be expressed in the form of explanations for why certain information is required and guidance of what is “market” for people in comparable demographic & contextual situations;
• Meaningful integration with mobile devices to make use of smart phone capabilities, for example the submission of digital signatures, the scanning of relevant documentation, and the geo-location of claims and assets.
To date, Canadian innovation in insurance distribution has been largely confined to a small number of web-based comparison sites. The revenue model for such sites is typically based on the sale of customer leads to incumbent insurance brokers, however, comparisons sites are increasingly building in-house brokerage capabilities to selectively capture the best quality leads.

The customer experience of these comparison sites is fairly standard - customers input their information in exchange for non-binding quotes. In order to purchase insurance coverage, customers generally need to speak with a licensed representative over the phone.

Some Canadian insurance carriers have invested in separate direct sales brands that are built around digital sales platforms. In some cases, these platforms include the capability for customers to purchase coverage fully online. The data that Covera has collected, through discussion with carriers and brokerage start-ups in Canada and internationally, has suggested that initial experiments with fully online purchasing have had below average conversion rates. A key opportunity for InsurTech start-ups will be to deliver the right insurance products via a distribution channel that optimizes for fully online conversion. Until such time, telephone contact will continue to remain an important part of insurance distribution.

**CHALLENGES FACED BY DIGITAL BROKERAGE**

If the regulatory and technology considerations relating to the creation of a digital brokerage can be managed, several challenges remain in the path of Digital Brokers. The three primary challenges include:

- Obtaining agreements with insurance carriers for the distribution of insurance products;
- Maintaining customer acquisition costs at manageable levels;
- Automating parts of the brokerage process effectively.
Obtaining Brokerage Agreements:

Entrants who are unfamiliar with the insurance industry will quickly learn that obtaining brokerage agreements is a significant challenge. The first instinct of a start-up looking to enter into digital brokerage may be to reach out to carriers, many of whom have innovation and technology representatives, and ask them for distribution rights. In reality, distribution agreements are allocated to brokerages that can deliver high volumes of good quality risks on a recurring basis. The industry catch-22 is that without distribution agreements, a brokerage cannot generate sales. This issue manifests itself anytime a distribution model is being disrupted – Amazon needed to secure a meaningful number of publishing distribution agreements during a time where it had little to no sales. Netflix and Apple encountered similar issues when launching their respective products.

As a general rule, Canadian digital brokerages will need to execute agreements with enough carriers that they can serve a sufficiently large percentage of a given market. In practice, this will necessitate relationships with multiple large standard carriers, in addition to multiple smaller non-standards carriers that are willing to write specialized risks (such as log cabins for example).

Acquiring an established incumbent brokerage is the traditional method that entrants have used to secure distribution agreements with carriers. For start-ups, this may be impractical for several reasons. In theory, distribution agreements almost always include provisions that allow carriers to terminate when a brokerage changes hands. In practice, insurance carriers are reluctant to do so if a brokerage has accumulated a valuable book of business that may otherwise be reintroduced into the market. Carriers are thus incentivized to work with brokerages that wish to be sold. The result is often that a Carrier will agree to maintain distribution agreements on the condition that the broker of record remains with the brokerage for several years. Thus, start-ups that opt to acquire an existing brokerage must have both the short-term capital to do so and also the operational flexibility to introduce a new partner into their organizations for a prolonged period of time.
A further avenue for obtaining distribution agreements is by joining a broker alliance or "banner". Alliances are typically established to allow independent insurance brokers to pool their sales volume to communally negotiate distribution agreements. Typically, payment to such alliances is achieved by passing on a portion of a broker’s commission to the alliance. Start-ups opting for this method of obtaining distribution will be forced to take such agreements as they are. Depending on the business model employed by a start-up, the auxiliary services provided by alliances may not be value adding.

**Maintaining customer acquisition costs at manageable levels:**

Even the ideal digital broker will falter if it cannot drive meaningful traffic to its solution. Insurance advertising purchases command a high premium due to the fierce competition among incumbent carriers: insurance keywords are among the most expensive Adwords offered by Google. For incumbents, the significant lifetime customer value of insurance customers can justify investing heavily in marketing, but start-ups planning to go head-to-head against the carriers on this front will be unceremoniously steamrolled. The development of a growth strategy that amplifies the intrinsic strengths of start-ups (agility, leveraging technology, servicing neglected markets, etc.) is critical to the success of Digital Brokers.

**Automating parts of the brokerage process effectively:**

As stated above, telephone contact remains an important component of binding insurance contracts online. Much the way incumbent financial advisors have begun to be disrupted by a number of Canadian FinTech start-ups, it is likely that fully automated robo-brokerages will be developed and implemented for certain insurance markets. However, the evaluation and brokerage of insurance covering more complex risks may take longer to realize. In the short term, Digital Brokers should be focused on how technology can act as a force multiplier for a team of skilled and experienced licenced brokers.
RENEWALS AS WEDGE TO ENTER THE MARKET

Given the challenges facing digital brokers elaborated above, Covera was developed to utilize an InsurTech brokerage model that relies on the following three tactics:

**Side step the marketing spend of incumbents by targeting insurance renewals, a less competitive portion of the market:**

Roughly 75% of insurance customers (representing $36 billion of the total $48 billion in Canadian P&C premium) renew their insurance policies without investing the time to shop for alternative coverage.\(^4\) This despite the wide spread dissatisfaction that customers express regarding their insurance providers.\(^5\)

Of this cohort of insurance customers that renew without shopping for coverage, McKinsey & Company concluded that about a quarter of these customers stayed put largely to avoid the "inconvenience of shopping and switching," not because they are satisfied customers.\(^6\) Covera calculates that this cohort represents approximately $9 billion of P&C premium in Canada which represents a sufficiently large initial target group.

**Use technology to develop sustainable competitive advantages:**

The ideal feature set of a Digital Broker was set out above. While we believe that such functionalities are an important part of a well-executed digital brokerage, we also expect that they will become common place as the digitization trend of InsurTech takes hold. They do not, therefore, present a sustainable competitive advantage.\(^7\)

We believe that more sustainable competitive advantages can be developed in three ways: the integration of analytics and proprietary historical information, automation of non-critical tasks in the brokerage value chain, the cross selling of related financial and non-financial products.

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\(^5\) Bain Capital reports that the Average net promoter score of the largest US insurance providers is 30%. See Bain Capital, Customer Loyalty in the PC Insurance Industry 2014, at p1.

\(^6\) Ibid note 4.

\(^7\) We define sustainable competitive advantage to mean company attributes or abilities that are difficult to duplicate and provide a superior or favorable long-term position over competitors.
• **Analytics and Historicals:**
  Because Covera will be built on a fully digital infrastructure, it will be possible to build proprietary data sets regarding the purchasing behavior of our customers. In the short term, this information can be combined with public data sets and used to provide insights during the brokerage process. This will allow for an "advice not price" value proposition that online comparison sites and traditional insurance brokers cannot readily replicate;

• **Automation of non-critical tasks:**
  While we believe that the human interaction of a licensed insurance broker remains a key component of insurance distribution, we see opportunities for using technology to make the day-to-day tasks of insurance brokerage paperless and more efficient. This could include the development and continuous improvement of customized tools to replace off-the-shelf broker management systems;

• **Cross selling of complimentary products:**
  Covera has the long-term vision of becoming a multi-disciplinary platform for the finance, maintenance and management of insurable assets. We believe that the insurable assets of our customers will be increasingly purchased, financed and managed via digitally stored smart agreements. Such agreements will provide unique opportunities for cross selling, bundling, and optimization for digital brokers that have invested in the requisite technology.

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**Create value for insurance carriers:**

We believe that a digital broker that focuses on automating customer shopping during the renewals process would provide value to insurance carriers. Firstly, Covera will provide an upselling opportunity that Carriers can use to retain the clients that they deem sufficiently valuable. Covera will also provide a compelling and agile partner for the creation of engagement opportunities with their customers.

Whether it be through the offering of risk reducing IoT devices or loyalty incentive programs, Covera will have the flexibility to engage with customers in ways that incumbent insurance
brokers cannot replicate efficiently. The fully digital infrastructure upon which Covera will be built will enable it to scale rapidly and without the network limitations imposed on incumbent insurance brokerages.

Most importantly, Covera will enable insurance carriers to improve market share by customizing their approach based on the specific needs and behaviors of the 70-80% of customers who consistently renew with their competitors. Carriers seeking to gain market share are taking notice that, despite the tremendous amount of money spent on marketing to the price sensitive segment of serial insurance shoppers, industry premium growth and relative market share have been stagnant.

CONCLUSION

A renewals-based digital insurance brokerage would appeal to the ‘silent majority’ of Canadian policy holders that do not shop around when their policies expire. In terms of total premium, this segment of the market is approximately 4x larger than the customer segment that is actively in-market for insurance products.

Customers who diligently shop on an annual basis are the least loyal and most price sensitive insurance consumers. Traditional online comparison sites have been designed to appeal to this relatively small group of insurance customers. Industry observers have stated that this “very busy segment of serial shoppers make the price-centric marketing message appear more successful than it actually is”.

We believe that customers who renew their coverage are unresponsive to marketing messages based solely around price and are instead seeking convenience and value added services. Similarly, marketing narratives based on ‘security & piece of mind’ fail to resonate with such consumers given that they already have coverage in the event of a loss.

\[^a\text{Ibid note 4}\]
Appealing to customers that are not currently in-market for insurance products requires different ways of thinking. Alleviating the inconvenience of shopping and switching insurance coverage is a fundamental consideration. However, the provision of other value added services and the cultivation of sustainable competitive advantages are factors that will not be ignored by successful digital brokerages in Canada.

A digital insurance broker that is successful in Canada will have several long-term growth trajectories available to it. As the proliferation of digital contracts reaches other aspects of the Canadian economy, a digital broker could evolve into a nexus for managing and optimizing the various products and services that relate directly and indirectly to insurable assets. Such a platform would significantly reduce the recurring stress & inconvenience currently felt by tens-of-millions of Canadians. Perfect coordination between finances, maintenance and insurance would likely require innovation at the product level, and not only the distribution level. Ultimately, a data enabled and fully digital insurance brokerage would have the potential to evolve into a full stack digital insurance carrier.

About the author:

Scott Loong is the founder and CEO of Covera.co, a direct to consumer digital insurance brokerage that is currently in development. Covera is based in Montreal, Quebec and intends to broker personal lines damage insurance (P&C Insurance). Scott Loong holds a law degree and an MBA from McGill university.

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