Background on: Buying Insurance

Evolving Distribution Channels

Insurance Industry

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IN THIS ARTICLE

Overview

Insurance is generally bought directly through an insurer or through independent agents and commercial brokers who provide access to the products of several insurers. Direct writers dominate auto and homeowners insurance sales, while commercial insurance is more commonly purchased through independent agents or brokers.

Insurance distribution channels and processes are being transformed by technology advances and market pressures such as changing buyer behavior; new products; consolidation; expense pressures; growth challenges; and new non-traditional entrants.

Innovations in insurance distribution are not predicted to eliminate the role of agents and brokers. Incumbent players, whether agents, brokers or insurers, are likely to collaborate with firms offering buyer-oriented solutions, efficiency, and innovation.

Insurance agents and brokers

Many insurance companies use several different channels to distribute their products. In the early days of the U.S. insurance industry, insurers hired agents, often on a part-time basis, to sign up applicants for insurance. Some agents, known now as ***captive*** or exclusive agents, represented a single company. Others, the equivalent of today's ***independent*** agents, worked for multiple companies.

At the same time that the two agency systems were expanding, commercial insurance brokers, who were often underwriters, began to establish themselves in cities. While agents usually represented insurers, brokers represented clients who were buying insurance. Also, with the development of information technology, alternative distribution channels sprang up, including direct sales by phone, mail and the internet. Insurers also use other types of outlets, such as banks, workplaces, associations and car dealers, to access potential policyholders.

Both agents and brokers are known as producers. Traditionally, agents have represented the insurance company and brokers have represented the client, but the line between the two is no longer clear-cut. Generally, it is the broker's responsibility to seek out appropriate insurance coverages for the client and obtain the best overall price, terms and conditions, but sometimes brokers have agreements with insurance companies.

In addition to the agents and brokers who work for or who represent traditional insurers, there are agents and brokers working for surplus lines companies. The surplus lines market exists to insure risks that licensed companies decline to insure or will only insure at a very high price, with many exclusions or with a very high deductible.

Brokers may be retail or wholesale. Wholesalers act as intermediaries between retail brokers or agents and insurance company underwriters. To work with surplus lines companies, wholesale brokers must be licensed as surplus lines brokers in the state where the policyholder or the risk to be insured is located. Wholesale brokers may also work with other wholesale brokers in the London Market or elsewhere to secure coverage.

Wholesale brokers may also be managing general agents, who are given authority by insurers to underwrite and "bind" insurance—provide temporary coverage until an insurance policy can be issued. Managing general agents, who have a close relationship with the insurance companies they work with, may also handle claims and even help in the placement of reinsurance contracts—reinsurance is insurance for insurance companies. Managing general agents may also arrange so-called "program" business, which is specialty insurance for homogeneous groups of policyholders, such as members of a specific industry. These programs, often offered and endorsed by trade associations, may provide coverage at lower prices.

Independent agents steadily lost market share from the early 1980s through the early 2000s across all property/casualty lines, made some gains in the mid-2000s, but then lost share again in the late 2000s. Loss rate has slowed in in the 2010s. Direct channels include exclusive agency companies, direct marketers and direct sales (e.g., internet). Independent agents have lost significant personal lines market share since the early 1970s. Although the trend slowed from 2000-2007, it may be accelerating again.

The history of insurance sales

Risk sharing is not new. Various kinds of insurance enterprises have existed on and off for many centuries. The first U.S. insurance plans were organized around membership in an organization. In 1736 the Friendly Society, operating under a Royal Charter from England, was formed as a mutual company in South Carolina. It covered the fire losses of its members, who contributed directly to a fund that paid claims. However, the Friendly Society's existence was short-lived. It was dissolved six years later after a fire in Charleston destroyed hundreds of buildings.

Benjamin Franklin set up the first successful U.S. insurance company whose policies could be purchased by the public. Established in Philadelphia initially for the benefit of members of the Union Fire Company, its members voted to open it up to citizens outside of the organization after it had been in operation for a year or so.

In February 1752 a notice was printed in Franklin's newspaper asking people who were interested in subscribing to the terms and conditions of a new mutual fire insurance company to appear at the Court House in Philadelphia. Among other business at its first meeting was a decision to call the company "the Philadelphia Contributionship for the Insurance of Houses from Loss by Fire." The first policy was issued in June of that year.

Soon, other mutual insurance companies were formed, followed by stock companies. The Insurance Company of North America (INA), the first U.S. stock insurance company, was founded in 1792. At first it sold only marine insurance but soon offered fire insurance as well and was the first company to insure both buildings and their contents. A few years later, in 1795, the first U.S. insurance agency opened in Charleston, South Carolina. Known as Davis & Reid, and later as the Vigilant Insurance Office, it advertised that it offered a choice of "underwriters," entities that assumed the risk.

As the population expanded and moved further away from the East Coast, where most insurers were based, the need for a formal distribution system grew. Companies created networks of agents, assigning them specific geographic areas, and set up branch offices managed by general agents, later known as “managing general agents,” or MGAs. Agents’ compensation changed from fees for applications to percentage commissions on premiums collected.

The Hartford was the first insurer known to have attempted direct marketing. Founded in 1810, it had an agency network but wanted to expand into areas not serviced by its agents. In an early advertisement, it announced that people who lived in areas where the company had no agent might apply through the Post Office directly to the Secretary of the company. But its efforts were unsuccessful. Apparently, people were not ready to buy this new product through the mail.

As the industrial revolution progressed, the growing complexity of the business world spurred the growth of the insurance brokerage business. Most of the country’s major brokerages came into existence in the 19th century, starting with Johnson & Higgins in New York City in 1845. The firm became part of what is now Marsh Inc. in 1997.

As the 19th century ended, the first liability policies were issued: employer liability was followed by auto liability insurance. The introduction of liability insurance led to further expansion of the insurance business and to greater specialization among distributors, with general agents mostly selling liability insurance and independent agents fire insurance.

Today, all agents are licensed by the states in which they do business and sell whatever coverages the companies they work with offer. Independent agents sell more commercial lines insurance than personal lines (auto and home insurance). The reverse is true for captive agents. Managing general agents tend to focus on commercial risks and often have authority from the insurance companies they work for to accept business on their behalf, subject to certain terms and conditions. Large brokers focus on commercial lines.

Over the decades, distribution systems have changed. Some insurance companies that started in business using their own sales force switched to independent agents because as companies started to write business in unfamiliar locations, they needed to rely on local people who knew the area.

The term “captive” or “exclusive” agent has become associated with companies known today as direct writers. One major difference between captive and independent agents is that the independent agent rather than the insurer legally owns access to policy renewals. Captive insurance agents may be employees of the company or independent contractors.

The concept of direct writers developed at the beginning of the 20th century. Generally, they were mutual companies that sold insurance to farmers and others in specific agricultural businesses, such as millers, at a time when a quarter of the nation’s population lived on farms. Because they were familiar with the risks, they were able to undercut the competition. Many of the direct writers, which are today among the largest auto and home insurers, began by selling auto insurance directly to farm bureaus in the 1920s. Among the best known are State Farm, Nationwide, American Family and Farmers. Other companies such as the United States Army Insurance Association, now USAA, sold to the military and yet others sold to state automobile clubs.

Nowadays, the term “direct writer” may apply to any company using captive or exclusive agents, as well as companies selling directly to consumers through the mail, Internet or through telephone solicitations, although technically the latter are “direct marketing” or “direct response” companies. These direct response companies use salaried employees or company representatives to interact with consumers offsite, whereas agents generally conduct some business with their policyholders face-to-face in their office. GEICO, one of the largest auto insurance companies that today markets directly to consumers, started in 1936 as the Government Employees Insurance Company, selling to government employees and some military personnel.

As the number of companies opting to use multiple channels grows, categorizing a company as a direct writer or agency writer is becoming less helpful. Among the first direct writers to use independent agents to sell in rural areas, where it may not be profitable for a direct writer to set up an office, was Allstate, in 1974. A decade later, in 1983, the Hartford began to market its personal lines products directly to what was then the American Association of Retired Persons, now known solely by the acronym AARP.

Life insurance sales

Beginning in the mid-1870s, the life insurance industry developed along the same lines as the property/casualty side of the business, using captive agents to sell their products. But unlike agents who sold property/casualty insurance, life insurance agents often collected premiums at the home, on a weekly or monthly basis. This form of distribution flourished until after World War II, when home service agents were gradually displaced by a type of independent agent known as the “personal producing general” agent. Over time, the number of agents closely connected to one life insurer began to decline.

Distribution through banks and other entities

In the early days of insurance, insurance policies were sold at banks. But the 1916 National Bank Act limited banks’ sale of insurance, except in small towns. In the 1990s various court decisions allowed banks to get back into the business of selling insurance, culminating in the 1999 Gramm-Leach-Bliley Act, which said that banks, insurance companies and securities firms could affiliate and sell each other's products. Since that time banks have bought hundreds of insurance agencies and brokerages, and bank sales of all kinds of insurance have grown significantly.

Life insurers began to market life insurance and annuities through banks (mostly fixed annuities, which are similar to other bank products) and financial planners or advisers in the 1990s. A large portion of variable annuities, which are based on securities, and a smaller portion of fixed annuities are now sold by stockbrokers. In three states, Connecticut, Massachusetts and New York, consumers can purchase small life insurance policies directly from savings banks, without going through commissioned salespeople. This practice, which other states refused to follow, began in the early 1900s.

It is not uncommon for insurance companies to make arrangements with various entities, in addition to banks, to make their products available; they include workplaces, associations, car dealers, real estate brokers, pet shops and travel agents, among others.

Worksite marketing

Worksite marketing is the selling of voluntary (employee-paid) insurance and financial products at the worksite. The products may be on either an individual or group platform and are usually paid through periodic payroll deductions. Worksite sales of life and health insurance totaled $8.4 billion in 2018, up 4.5 percent from 2017.

Online sales

With the introduction of the internet in the 1990s, insurers began offering policies online. As consumers began to be increasingly comfortable purchasing products of all kinds over the internet, online aggregators began to appear. Aggregators collect information on prices, generally for auto insurance and term life insurance, which are the most standardized, so that consumers can compare the cost of coverage from one company to another. Eventually, many agency companies as well as direct writers began to offer internet platforms, making it possible for consumers to purchase an insurance policy directly online without the aid of an intermediary.

Licensing of insurance agents and brokers

The insurance business is regulated by individual states. Insurance agents and brokers must be licensed to do business in the state in which they conduct business. To be licensed, producers must comply with the state's requirements, including professional educational mandates. Each state also has regulations governing the termination of agents by insurance companies. Most states base their rules and regulations on a National Association of Insurance Commissioners model law, but many have additional requirements.

While there is no national producer licensing system, over the years there have been efforts to make licensing more uniform and to streamline the approval process.

In 1996 the National Association of Insurance Commissioners established the National Insurance Producer Registry to develop and operate as a national repository for producer licensing information. In 1999 standardization was given another push with the passage of the Gramm-Leach-Bliley Act (GLB). GLB would have established a National Association of Registered Agents and Brokers (NARAB) if a minimum of 29 states had not passed reciprocity laws for agent licensing by 2002. While 29 states met the requirement in time, the push for uniformity has continued. In 2015 the National Association of Registered Agents and Brokers Reform Act of 2015 was passed. The law, known as NARAB II, established a nonprofit board with the power to grant insurance agents and brokers approval to operate on a multiple state basis if they meet certain qualifications and are fully licensed in their home state.

Property/Casualty Insurance Distribution

Agency writers, whose products are sold by independent agents or brokers representing several companies—and direct writers, which sell their own products through captive agents by mail, telephone, or via the internet and other means—each account for about half of the property/casualty (P/C) market. There is a degree of overlap as many insurers use multiple channels.

A.M. Best organizes insurance into two main distribution channels: agency writers and direct writers. Its agency writers category includes insurers that distribute through independent agencies, brokers, general agents and managing general agents. Its direct writers category includes insurers that distribute through the internet, exclusive/captive agents, direct response and affinity groups.

- In 2019 direct writers accounted for 53.5 percent of P/C insurance net premiums written and agency writers accounted for 46.1 percent, according to A.M. Best.*

- In the personal lines market, direct writers accounted for 64.5 percent of net premiums written in 2019 and agency writers accounted for 35.4 percent. Direct writers accounted for 61.9 percent of the homeowners market and agency writers accounted for 38.0 percent. Direct writers accounted for 65.8 percent of the personal auto market and agency writers accounted for 34.1 percent.*

- Agency writers accounted for 76.5 percent of commercial P/C net premiums written, and direct writers accounted for 22.6 percent.*

*Unspecified distribution channels accounted for the remainder.

- There were an estimated 36,500 independent agencies in the United States in 2018 (latest data available), down from 38,000 in 2016, according to the Independent Insurance Agents and Brokers of America's (IIABA) *2018 Agency Universe Study*.

- The IIABA says the 2018 decrease primarily reflects a new data resource providing more accurate and insurance industry-focused data, along with increased mergers and acquisitions.

- In 2018 the estimated percentage of small agencies (less than $150,000 in revenue) accounted for 35 percent of all agencies, while jumbo agencies (revenue of $10 million or more) accounted for 2 percent of agencies.

- The proportion of agencies in small towns and rural areas returned to 19 percent in 2018, where it had been in 2014, after falling to 9 percent in 2016. About half of agencies are in large metropolitan areas.

- In 2018, 12 percent of the agencies in the study were involved in acquisitions, 1 percent merged with another agency, and 3 percent converted from exclusive or captive agencies to independent agencies.

Charts and graphs

Life Individual Market Share by Distribution Channel, 2010 and 2019

	2010	2019
Independent agents (1)	48%	53%
Affiliated agents (2)	41	36
Direct response (3)	4	6
Other (4)	7	5

(1) Includes brokers, broker-dealers, personal producing general agents and registered investment advisers.
(2) Includes agency building, multiline exclusive and home service agents.
(3) No producers are involved. Excludes direct marketing efforts involving agents. Includes internet sales where consumers submit online applications.
(4) Includes financial institutions, worksite and other channels.

Source: *U.S. Individual Life Insurance Sales Trends, Industry Estimates, 1975-2019, LIMRA*, 2020.

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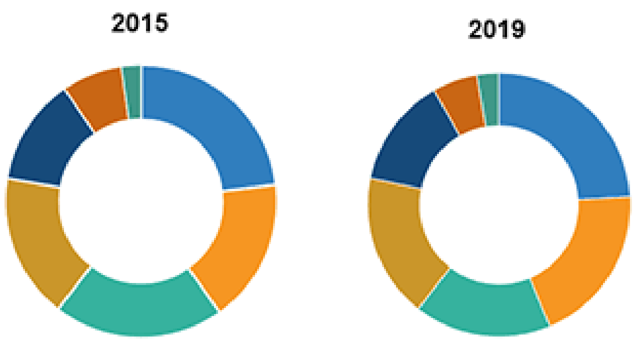
Sales Of Individual Annuities By Distribution Channels, 2015 And 2019



	2015	2019
Independent broker-dealers	23%	24%
Independent agents	17	20
Career agents	20	17
Banks	17	18
Full-service national broker-dealers	13	14
Direct response	7	6
Other	2	3

Source: *U.S. Individual Annuities, 2019 Year in Review*, LIMRA, 2020.

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