Editor's Desk

The following is the complete email interview with John-Bernard Duler, president of MileSense, a San Francisco-based mobile software company that I conducted for my prologue for *Best's Review*'s October issue. Duler is the founder of Esurance, which was recently acquired by Allstate. He offered so many insights concerning the auto insurance business I thought it was important to publish his entire interview.

Lynna Goch
Editor
Best's Review

As the founder of Esurance, how do you view direct selling of auto insurance in 2011? Are insurers doing a good job harnessing this channel?

I would rate the direct selling of auto insurance in 2011 as C+/B-. The reason for this grade stems from the fact that the industry is still moving too slowly in innovation. Remember the late 90s? Esurance was disruptive and had a lot of firsts: first use of XML, Java-based rating engines, massive investment in data mining and SAS. The bottom line: Progressive and Esurance changed the auto buying experience forever.

We should stop looking at our own American industries and investigate what is happening in other countries. (If you do, you will find that experience fascinating.) In a lot of countries you buy personal lines insurance at a supermarket or at a bank counter. And we are not talking about distribution channels, some of these grocers and banks own their own insurance companies. In some countries insurance companies sell their product net. In other words, brokers can gross it up the way they want. You will see dynamic pricing and price optimization like the airline industry. What do we see here: a very static industry, heavily regulated, and burdened by channel conflict.

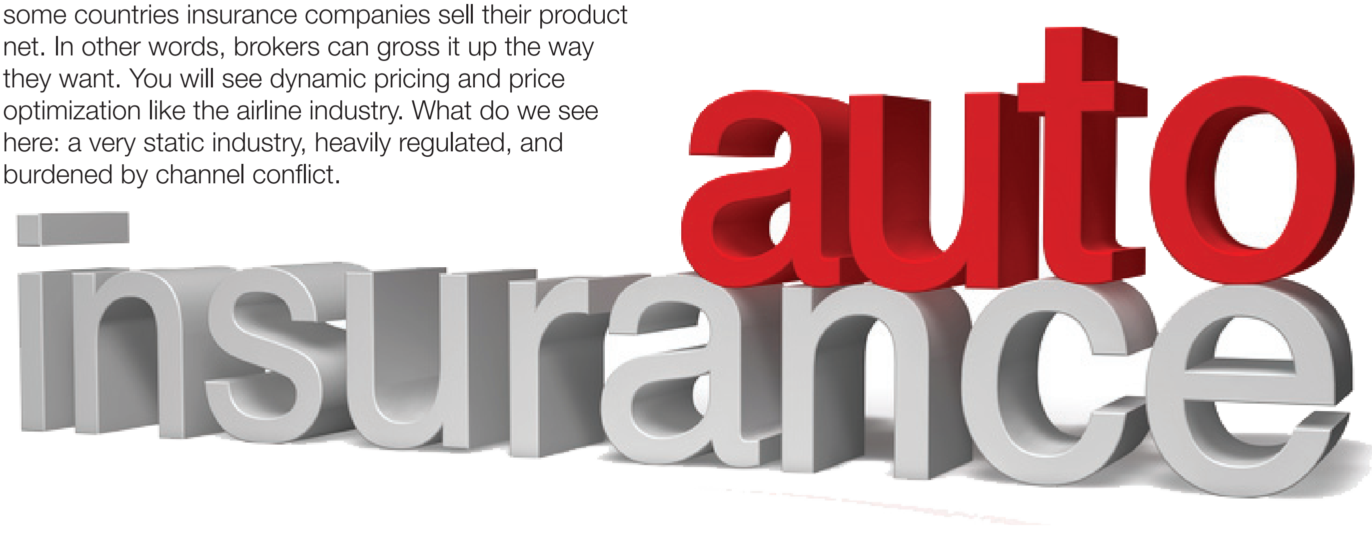
You could ask, why?

Inertia is often an answer I hear, but I am not satisfied with that answer. If inertia was the case, new entrants would come in and transform the industry such as what's happening with PayPal and the banking industry.

In addition, we are regulated at the state level with a patchwork of conflicting signals. Dealing with regulations is expensive and limits innovation. Are the consumers better off? I am not sure. In a perfect capitalist world (and if I remember my economics classes at Wharton), pricing should set by supply and demand. If insurance companies are overcharging customers and generating obscene profits, new entrants will drive prices down. More regulations tend to have the opposite effect.

I have always been surprised that banks did not enter the personal lines market. One reason was that the return on equity in our industry pales in comparison to the ROE achieved by banks. Well, the recent financial services meltdown we just experienced may change that. As bank regulators force banks to comply with Basel capital requirements, banks may see their ROE go down, and may become attracted by the economics of the insurance industry.

What about channel conflicts? That is a big one, and few executives are willing to go to bat on that. Today very few insurance companies have jumped in: Progressive deliberately, under Alan Bauer, moved aggressively into the direct market in the late 90's, alienating some agents, true, but with great success. Nationwide has bought non-standard insurance agencies to distribute their own



products. More recently, Allstate has bought Esurance. I expect others to set up different divisions to sell direct.

There is no sales and consumer marketing culture at most insurance companies. It is one thing for a VP marketing to run sales contests and golf tournaments for their best performing agents, but the VP marketing in a direct operation needs different skills: consumer marketing, direct marketing, data analytics, dynamic ad buying, real-time feedback loop and intelligence.

So yes, I would grade insurance C+/B- for their direct initiatives, and it is really too bad because insurance companies provide a fantastic customer service experience. Are you smiling?

Claims personnel, for the most part, are doing a phenomenal job; they are responsive, caring, and flexible. Our agents are small-business owners who genuinely care for their customers, love their job, and work long hours to serve their customers.

Now compare that level of customer service to other industries: when was your last raving customer service experience with ATT, or Microsoft, or Amazon? Our industry is based on one concept: We stand by our promise to pay claims and we deliver on that promise. Yet, why are we so bad at communicating with our customers? Granted, the industry has invested massively in advertising: ad spending by P/C insurers increased by 170% (from $1.7B to $4.3B) from 2001 to 2008.

So, if the percentage of insurance transacted direct versus through agents is much bigger in other countries, it is hard to believe that we are very different. We are not, and just watch the torrid growth of the three titans: Geico, Progressive, and Esurance.

Believe me, going direct is a hot subject today in the executive rooms. It will take the CEO to create a different structure that is built around the consumer experience and have the powers and funding to make things happen.

One problem today is the lack of valuable data on insureds, simply because agents filter that information. Don't take that negatively (and I have run my own independent agency) agents are the ones on the front lines, taking calls from their customers at 8:00 pm, on their smartphone on weekends; they are the first ones on site if there is a major loss, they are the ones presenting price increases, they are the ones finding alternative coverage somewhere else if the policy is canceled for a poor loss ratio. Agents are the face of the insurance company; they truly care deeply about their customers. They have seen your children grow, they have prepared you for the risk associated with teenage drivers, they have stood by you when you had a DUI, they have been your adviser and confidant over the years.

Nevertheless direct writers (not the ones with captive agents) capture a ton of data, analyze that data, and become better at it day after day. Capturing and treating data might just be the most important skill to have in the next five years.

Today we live in a world where information is at the fingertips of every consumer (literally with smartphones) and new revolutionary ideas are being harnessed and developed in Silicon Valley by the hour. This shouldn't be breaking news to anyone. And yet, the insurance industry is not reacting to these changes. This lack of innovation surfaces for a number of reasons. The current, unsettled economy doesn't lend itself to large risks. The state and federal regulations in insurance make it hard for new companies, or new branches on existing companies, to emerge. In order to harness the direct selling channel, auto insurance companies will need to think beyond their company and their brand. They will need to look at other corporate industries outside of insurance and see what these companies are doing to adapt to the changing consumer and economy and find ways to recreate those changes in insurance.

How will the role of the auto insurance agent change in the next five years?

The role of the agents has changed dramatically in the past 10 years and I expect even more profound changes in the next five years. Today, agents are overworked and underpaid. Being an insurance agent means being in a low-margin business; hours are brutal if you started from scratch and did not inherit the family business. CSR's work nonstop. Any mistake can result in an E&O claim. There is a lot of stress. Customers suffer from the state of the economy and resent the price of insurance and they unload that anger onto their agents. The job is hard, not glamorous, and underpaid. Therefore, their jobs aren't attracting new talent. There is pressure on fees being charged by some state regulators. How can you attract the best and the brightest if the revenues you bring are limited? I feel bad for the agents as they make the sale, they are the first person on the scene of an accident when the consumer is in trouble, and they also have to deal with complaints and closing accounts. They are the trusted adviser for the public and yet their job is thankless.

There is no way for the agent to handle sales, transactions, billing, claims for an auto client bringing $150 in revenues annually.

Technology drove the changes in the past 10 years, and expect technology to transform our industry in the next five years. I just happen to be located in the heart of Silicon Valley. Just as the impact technology has had on financial services, commerce, auctions, gaming, and advertising, expect a revolution for the insurance industry. You already know the winners, or you guess easily: anybody who has invested in the right technology strategy in the past 3-5 years. I am talking about policy management systems, claims, real-time transactions and information. Those companies will be able to scale and cope with the explosion of mobile.

So, the role of the agents?

- Agents must move away from day-to-day transactions and become trusted advisers.
- Agents should invest in higher education and become consultants focused on assets protection, and not a sales rep.
- Agents should stay away from customers targeted by Geico, Progressive, or Esurance. They won't win on price.
- Agents should invest massively in technology and move to SaaS/cloud computing. Independent agents know that managing passwords across multiple platforms is a nightmare. Look for solutions such as Okta.
- Focus on what they are best at: human interaction, crisis management, trusted advice (and back that up with real knowledge).

What is the biggest challenge for auto insurers in the direct selling distribution channel?

First of all, the existing infrastructure is a challenge (your technology and your people today). If your organization is committed to go direct, you must change both.

The people are the most difficult to change, and it won't happen. So invest in new staff and different skills: marketing and product management are key.

On the technology front, evaluate candidly what you have in place, and be brutally honest. Don't postpone difficult decisions. Make sure your backend can scale, review your architecture, and scrap it if you need to. Buy off-the-shelf products; don't build something unique in-house.

Then commit to direct channel, and do not look back. The customers you serve will have gone somewhere else anyway. Do not believe that you will destroy your existing business. What happened in other countries should serve as a guide. At some point there is a new equilibrium between each channel.

Simply understand that your customers want choices, and those choices will be different at different times in their lives. Don't be surprised if your customers are more price sensitive. The financial crisis we have experienced since 2008 has impacted the lives of millions of Americans. At a time when people have lost their house to foreclosure and can't pay college tuitions for their kids, you need to expect that your clients will look elsewhere for better prices.

Several auto manufacturers such as Renault/Nissan have started to market low-cost automobiles which, until now, were reserved to third-world countries. A brand new car with no-frills, no leather, and no power windows is a very interesting alternative.

An insurance product is no different, yet you see coverage options and features being added when your customers are looking for a better price. If you do nothing, they will go somewhere and may never come back. They will miss their friendly agent, but may not have the choice.

So, what is next?

Mobile will disrupt the insurance industry in a massive way, with a magnitude larger than when the Internet transformed it in the late 90s.

Our company is currently in stealth mode and I can't disclose much, but I can certainly tell you that we are working hard at bringing mobile to the insurance industry.

Please spend some time looking at how mobile is transforming other industries: look at PayPal and the secular banking industry, look at mobile payments versus Visa, look at the amount of transactions on eBay mobile, look at commerce. These changes will affect you.

Let me give you some numbers: there are close to 600,000 new Android/Google smartphones activated EVERY DAY. By the end of 2011 55% of Americans will have smartphones.

Today 52% of the 18-129 have a smartphone, versus 19% in the 50+ range. Chances are that the failure to present a coherent mobile strategy for a very attractive market (demographics and income) will be the most important mistake for insurance companies in the next three years.

Insurance companies will be hard pressed to be innovative. They don't want to copy what happened in the 90s. They need to look outside their industry and find a new route.

I believe that mobile will be the way of the future given the wealth of statistics showing the increasing numbers of users switching to using smartphones over using the Internet. It will be interesting to see what innovation comes for the insurance industry using mobile platforms.

In addition, auto insurers in the direct selling distribution will need to adopt effective telematics options that allow them to identify risk. Progressive is continually updating their Snapshot feature. Insurers that want to stay on top need to identify efficient ways to utilize analytics to create a driver's risk profile. All auto insurers need to think of how they can create something beyond Snapshot that can truly change the industry—therein lies the challenge.