The DTCC Will Provide a Much Needed Boost to Annuities Exchange Processing

Gartner RAS Core Research Note G00143570, Todd Eyler, 5 October 2006 R2192 02272008

Life insurers want to reduce the high cost of processing replacements, rollovers, and tax-free exchanges of annuity and life insurance products. The Depository Trust & Clearing Corp. (DTCC) will launch a service in 2007 that will help with the transport of the necessary documents and information, but receiving insurers will still need to determine which information needs to be shared and then send it. Insurers need to implement strong workflow capabilities for exchanges – whether the exchanges occur within or outside the new DTCC service.

Key Findings

- At least 30% of variable annuity sales result from 1035 exchanges and other replacements.
- It's common for these transactions to generate $100 in processing costs for the receiving insurer because of the "phone tag" and extensive use of regular mail for sharing the large number of disclosure, notification and other documents.
- A new DTCC service, to be launched in 2007, will reduce turnaround times on these transactions for the participating insurers from the current average 30 days to an estimated 10 to 14 days and reduce the cost of completing these transactions by 50% or more.

Predictions

- The new DTTC exchange service will not gain broad adoption for at least two to three years until distributors, particularly a few large brokerages, begin diverting new business away from insurers that aren't participating in the DTCC service.
- Along with focusing on efficiency during the next year, many insurers will focus significant time and attention on helping ensure suitability at the point of sale for key products, such as variable annuities and equity-indexed annuities.
- It will take at least five years to implement standardized XML forms that satisfy the requirements of insurers and the 50 U.S. state regulators and that can lead to a paperless process for the insurers that participate in the DTCC's exchange service.

Recommendations

- Actively participate in the new DTCC service, but also realize that a high percentage of exchange transactions will occur outside the DTCC service.
- Update industrywide databases to make it clear who to contact at the ceding insurer and what information is required to complete exchange transactions.

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- Make the relevant insurer-specific forms available at widely used aggregators like iPipeline so that receiving insurers can more easily access the forms necessary to complete exchange transactions.
- mplement a workflow management system that focuses on managing and tracking exchanges and streamlining information sharing between receiving and ceding insurers.

ANALYSIS

Overview

At least 30% of new variable annuity sales are tax-free exchanges of one product for another similar product – what is known as a 1035 exchange. A high percentage of sales for products like equity-indexed annuities, fixed annuities and investment-oriented life insurance products also result from exchanges. Many of the largest life insurers and broker/dealers are now focused on improving the current process, which is dominated by phone calls, "snail" mail and faxes, and which usually takes an average of 30 days to complete. It's the cost of these transactions, an estimated $100 per transaction for the receiving insurer, that has caught the attention of senior insurance executives at many large life insurers. Distributors also want an exchange approach that can speed turnaround times (and commission payments) and provide updated status between the initial request and final money settlement.

Analysis

The DTCC's Exchange Service: A First Step in the Right Direction

During the past three years, about 10 of the largest life insurers, six of the largest broker/dealers and ACORD have worked with the DTCC to expand the capabilities of the DTCC's Insurance Processing Service to help streamline exchange processing. The DTCC is to pilot test the new service during the first quarter of 2007 and then plans to put it into production in the second quarter.

What the Service Will Do

Route the Messages Required for Efficient Communication and Status Updates

ACORD and the DTCC have built a set of messages that, for participating companies, will minimize the phone tag that currently occurs between the receiving company (the company that receives the new business) and the ceding company (the company that loses the business) as they agree on the types of information needed to complete the exchanges. The messaging capability will help significantly with status reporting for all the parties involved (the ceding insurer, the receiving insurer and, particularly, the distributor). It will do this by providing up-to-date information on whether the exchange request from the receiving insurer to the ceding insurer is in good order and, if not, what still needs to be done.

Simplify the Exchange of the Required Forms

To approve exchanges, ceding insurers often require original, paper forms from the receiving insurer with "wet signatures" from the customer. The DTCC service will support the exchange of the imaged copies of the many disclosures, notifications, original contracts and other documents, as well as scanned signatures that are required to complete these transactions. For the participating companies, scanned versions of wet signatures and, later, electronic signatures will replace wet signatures. The scanned signatures will be attached to the imaged forms to minimize the very expensive and time-consuming use of regular mail.

Transition Away From Paper Checks

Instead of requiring the ceding insurer to send a check for the agreed-on exchange amount to the receiving insurers, the DTCC will electronically transfer the funds for the correct account the same day the ceding insurer confirms transaction completion. Commission payments may also be credited to the appropriate account at the distributor through the DTCC's commissions service.

Begin the Transition to a Fully Electronic Process With XML Forms

ACORD has built a generic, standardized XML form, form 951, that will standardize the formats and data types used to request an exchange. Standardized, state-specific forms needed to process exchanges are still under development. The National Association of Variable Annuities (NAVA) will continue with its efforts to find an electronic signature alternative that meets the requirements for ease of use, real authentication and nonrepudiability, and low cost. Gartner expects that it will take at least five years for the widespread adoption of standardized XML forms for annuities exchange processing and at least two more years for a viable electronic signature alternative to emerge that's endorsed by a large number of life insurers and most of the state regulators, and that can emerge as an industry standard.

Broad Industry Adoption of the DTCC Service Will Take at Least Two Years

Gartner expects a significant reduction in the costs of processing 1035 and other exchanges because of fewer status calls, the much reduced use of regular mail and the replacement of paper checks with electronic fund transfers. However, broad industry adoption will probably take at least two years, and even after that and over the long term, a high percentage of exchange transactions will still occur outside of the DTCC service. The DTCC's highly successful Fund/SERV service for automatically processing mutual fund sales and exchanges, for example, was launched in 1986 and still now only processes about 50% of these types of transactions because certain distributors and mutual funds still use proprietary processing approaches. During the next two years, most insurers will:

- Continue to work with their legal departments to minimize the need for wet signatures and original documents. Most legal departments will not be comfortable with imaged documents and scanned signatures when they're ceding business to other insurers. Even the initial participants will require a high percentage of ceding transactions to be processed offline as exceptions. Particularly when ceding business, insurers will have to become confident that other participating insurers are consistently sending them the right types of information in the right formats to meet their "in good order" requirements.

- Wait for a high volume of transactions to occur on the service before they participate. Many life insurers, particularly those processing a larger number of ceding transactions than receiving transactions, will only participate when they believe that they have to. When salespeople – particularly salespeople from large brokerages – threaten to steer their business to the more efficient insurer alternatives that process new policies and contracts more rapidly and pay their commissions more quickly, many of these holdout insurers will respond. Gartner expects that six of the largest variable annuity manufacturers will actively participate in 2007, many of the Type B (fast follower) insurers will follow in the 2008 through 2009 time frame, and many of the holdout (Type C) insurers will begin participating in the 2009 through 2010 time frame and beyond.
- Focus on ensuring suitability at the point of sale. The DTCC service will only be accessed once the salesperson has gone through a suitability process and selected the annuity or life insurance product. When it's fully operational and transacting a high percentage of exchanges, the DTCC service will make it easier for insurers to monitor whether sales are in compliance or not, after the fact, by providing an electronic audit trail of the exchange process. However, regulatory rules like the NASD's 2821 and New York's Regulation 60 are forcing salespeople to go through a more robust suitability analysis prior to the sale. To help their distributors with the pre-sale suitability requirements, many insurers will provide Web-based illustration capabilities during the next year, for example, that make it easier for insurers to monitor how their products are being explained and help ensure good, pre-sale suitability practices.

Recommendations

Insurers should actively participate in the new DTCC service, but plan on processing the majority of their exchange transactions outside of the DTCC service because it will take at least two to three years for the new service to mature and gain widespread adoption. To significantly drive down the costs and turnaround times for exchange transactions, whether the exchanges occur within or outside the DTCC service, insurers should:

- Update industrywide contact information and requirements repositories. A major reason why exchanges take so long is that the receiving insurer isn't sure who to contact at the ceding insurer; what the phone number, mailing address and e-mail address are for that person; and what the information requirements are for the ceding insurer. Given that these transactions take so long, insurers also need to set the expectations early in the process with the salesperson for when the exchange is likely to be completed. Insurers should update the best currently available industrywide contact database for exchanges – Cooperative Technologies' 1035YellowPages.com – with their updated information. This database already has information from 1,900 insurers. Insurers should also update other industrywide databases as they become available.
- Make your forms available to insurers and distributors through aggregators. It will take at least five years before all the forms, from regulators and insurers, required to process exchanges become standardized XML forms. In the interim, insurers should make their forms available at leading aggregators like iPipeline. iPipeline already manages and distributes new business forms for 100 insurers and 725 brokerage general agents (BGAs), broker/dealers, banks and other distributors.
- Implement a workflow management and tracking system for 1035 exchanges. The workflow system should be able to: 1) schedule and prompt the customized workflow required for a particular type of exchange; 2) create customized types of correspondence required to process the exchange; 3) provide management reports on the status of exchanges; 4) provide an audit trail for all the steps completed in the exchange to meet regulatory requirements; 5) manage and apply any state-specific requirements for the exchange; 6) manage and apply any internal business requirements for exchanges; 7) integrate with new business systems and agent databases to minimize data re-entry; 8) integrate with external databases that provide information and requirements for ceding insurers; and 9) have an intuitive user interface. Cooperative Technologies currently provides a workflow application, CT1035, that's optimized to manage 1035 and other exchanges. CSC's AWD workflow applications come with templates for managing the exchange process and, with some customization, could also handle these requirements.