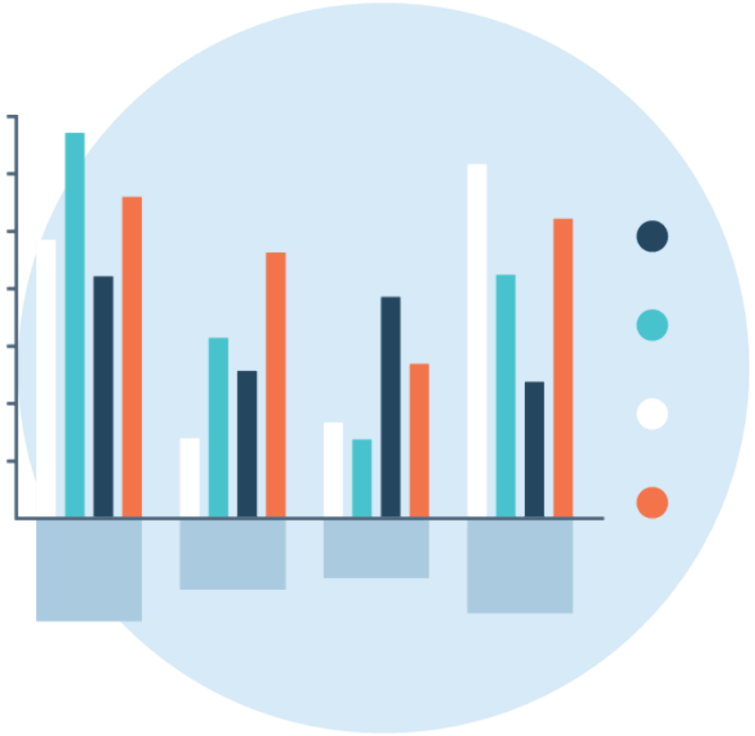
Deloitte.



Con-19-052 trends in general insurance pricing

Final report for the FCA

17 May 2019

Contents

- **Introduction and background**
- **Executive summary**
- **Business model innovation**
- **Case studies**
- **Impact on pricing practices**
- **Considerations for potential remedies**
- **Appendices**
  - Sources of information

Introduction and background

Overview

In accordance with our Call Off Contract dated 14 March 2019 between Deloitte LLP ("Deloitte"/ "We") and The Financial Conduct Authority ("FCA/"You"), we have set out in this final report ("the Report") the findings from our review of the General Insurance ("GI") market.

Summary of work performed

The scope of work required an answer to the following key questions:

- What new business models are developing in the motor and home insurance markets?
- What are the likely key changes over the next few years in the markets that will impact on pricing practices? What impact will these have, in particular on current market dynamics where longstanding customers tend to pay significantly more than new customers?
- How do the market developments impact on the types of remedies that might be most effective in addressing potential harms from pricing practices?

Structure of the report

In order to answer the above key questions, we have structured the main body of the Report into the following sections:

- Executive Summary – these bring together our findings to date;
- Business model development;
- Impact on pricing practices; and
- Considerations for potential remedies.

Use of the report

This Report is provided to you solely for your private use under the terms of our Engagement Letter. Our work was carried out solely to respond to the instructions given by the FCA and is solely for the use of the FCA.

You should not without our prior written consent refer to or use our name or the report for any other purpose, refer to them in any document or make them available to any other party. We accept no liability to any other party who is shown or gains access to the report.

For your convenience, this document may have been made available to you in electronic as well as paper copy format. Multiple copies and versions of this document may, therefore, exist in different media.

The Report may not be disclosed to any third party without the express prior written approval of Deloitte. Deloitte accepts no responsibility, liability or duty of care to any third party for any matters, observations or conclusions that are stated or implied in this report as it is private and confidential and has been prepared solely for internal use by you.

Introduction and background (cont'd)

Limitations and assumptions

In undertaking our work, we have relied on the completeness of documentation supplied by Management and on the accuracy of representations made by Management during the interviews undertaken. The limitations are as follows:

- Neither our work nor the views expressed in the report should be taken to comprise legal advice. We have based our suggestions and views on our knowledge of the current practical application of the applicable regulations, not on a legal interpretation of their terms. If a legal interpretation of relevant laws or any other legal advice is desired by the Company in connection with the work performed by us, the Firm should look to their legal counsel for this.

- Other than where specified in the scope of our work, our work did not constitute an audit or controls review of any kind. Other than where specified in the scope of our work, we did not carry out a specific review of your systems and internal controls and accordingly we cannot provide comments on their effectiveness or the ability of the systems and internal controls to support the business and its expected growth in the future.

Executive summary

The FCA asked us to identify the emergence of new business models and review their potential impact on pricing to understand the implications on potential remedies from the pricing review

What new business models are developing in the motor and home insurance markets?

- We identified a number of wider trends which are grouped under the areas of political, economic, social and technological that are driving and influencing change in the insurance market.
- We found that these trends were supporting 11 emerging categories of business models either through the introduction of new start ups or changes to the approach of more established business models.
- By reviewing a set of indicators for both likelihood and impact of the business model developments in the next 3-5 years, we established that the following were likely to be most significant:
  - Usage based insurance;
  - On demand insurance;
  - Auto-switching;
  - Bundled services; and
  - Multi-product.

  These developments are explained in detail later in the report.

What are the likely key changes over the next few years in the markets that will impact on pricing practices?

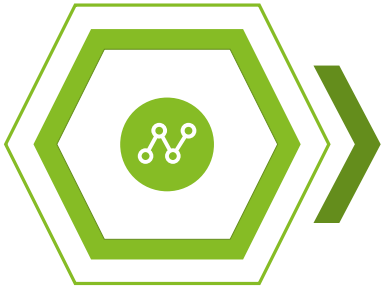
- Pricing in motor and home has two main components:
  - Technical (risk-based) pricing considers the risk presented by the customer to the pooled premiums of all customers; and
  - Retail pricing which reflects multiple factors including the likelihood of the customer to renew, the customer's willingness to pay, distribution costs and a profit margin.
- Intense competitive pressure, in part, through the growth in share of price comparison websites (PCWs), commoditised products and low investment returns have lead to firms using more aggressive retail pricing tactics to win new business. This has led to a market where longstanding customers tend to pay significantly more to subsidise new customers.
- Some of the emerging business models are likely to have a have a positive impact on pricing within the next 5 years, in particular those seeking to end the concept of the annual renewal cycle.
- Other innovations are ultimately underpinned by the same pricing practices and are unlikely to break the dynamic between new and renewal customers.

How do the market developments impact on the types of remedies that might be most effective in addressing potential harms for pricing practices?

- There are three broad categories of regulatory intervention proposed by the FCA:
  - Competition related remedies e.g. encouraging services that help consumers to shop around;
  - Consumer targeted remedies e.g. consumers education and increasing the ease of comparison; and
  - Pricing specific remedies e.g. action aimed at reducing price differentials between new business and renewal customers.
- Although some of the evolving business models will help to improve information for customers and increase competition in the long run, they are unlikely to make a material impact on current market dynamics and pricing practices in the 3-5 year time horizon.
- The FCA remedies proposed are unlikely to have an adverse impact on the emerging business models we identified. However, these emerging business models will have a limited impact on pricing practices in the absence of regulatory or legislative intervention.

Methodology and approach

Our approach followed three phases



1. Trend analysis

We identified 16 political, economic, social and technological trends through desk based research. We then assessed how these are likely to have an effect on the UK general insurance market in the next 3- 5 years.

2. Innovation assessment

Using our analysis of the trends, we produced a universe of innovations in insurance. We then refined this list to current trends in insurance business models through desk based research. Finally, we assessed the likelihood and market impact of each innovation in the next 3-5 years. We have defined these as:

- **Market impact**: the expected take up of an innovation by firms or customers.
- **Likelihood**: the probability that a trend achieves our assessment of market impact.

We assessed likelihood and market impact by reviewing a set of indicators (for instance quality of investors, scale of market players and market data).

3. Pricing impact review

Through a series of case studies and Deloitte subject matter expert (SME) interviews, we assessed the pricing practices associated with each innovation and how that differs to current pricing practices. We also assessed the likely impact of the innovations we identified on the current dynamic of longstanding customers, versus new business customers.

Business model innovation

Universe of general insurance innovation

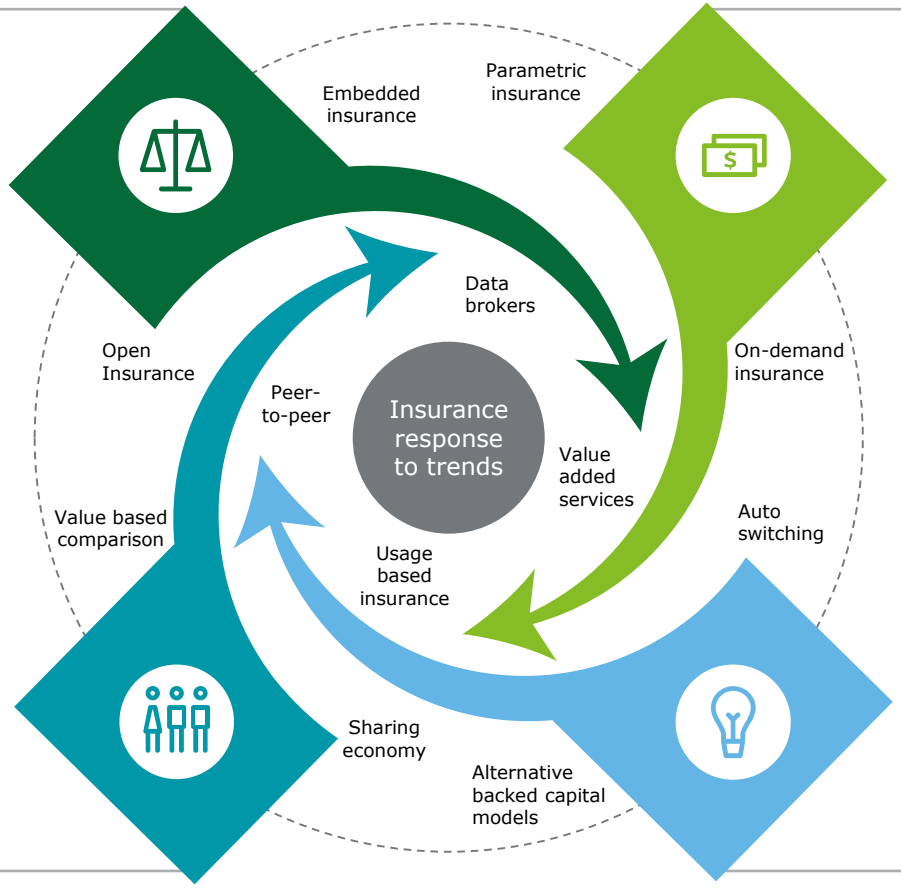
Based on our research and SME interviews, we developed a long list of the types of innovation in the GI market driven by changes in the political, economic, societal and technological environment

Political

1. Anti-trust
2. Anti-globalisation
3. Support for regulatory interventions

Economic

4. Platforms and ecosystems
5. Excess capital availability
6. Shift to services
7. Access economy



Societal

8. Evolving customer expectations
9. Evolving workforce dynamics
10. Shifting personal values

Technological

11. Digitisation
12. Blockchain
13. Big data
14. AI
15. Connected devices
16. Automation

Sources: - Deloitte Center for FS – InsurTech entering its second wave Deloitte Analysis

Technological innovations

These technological innovations are the key enablers for the future trends in the Home and Motor industry that we have identified over the next 3-5 years

Digitisation

- Digitisation is the conversion of existing processes into a digital format which in turn can be processed by technological systems.
- While in insurance manual processes have been digitalised, these process are undertaken in the same order as they were before. This has been a big exercise for large insurers with complex legacy systems. As well as back office modernisation, insurers have also had to focus on digitalising the customer journey.
- The advent of digitalisation has reduced barriers to entry for new start-ups.
- Customer expectations for insurance products have increased as other products and services become easily accessible online.

Connected devices

- Connected devices are internet enabled devices that are connected via a network. These devices provide customers and suppliers with a large amount of data about the performance of a device. Examples include sensors on pipes in houses or wearable fitness trackers.
- Data from these devices can be used by insurers to price risk but also as a risk management tool to help prevent losses occurring in the first place.
- The biggest perceived opportunity is seen in the home insurance market due to the number of devices in the home. Chubb, RSA and Aviva are all exploring smart home-enabled insurance policies.
- Barriers to overcome include customer concerns about privacy and trust, the cost of devices, and reliable broadband connection.

Automation

- Robotics exists in the insurance industry in the form of Robotic Process Automation (RPA). RPA performs repetitive manual tasks on a 24/7 basis removing the scope of human error and introducing the scope for robotic error.
- It improves the efficiency of processes and allows for deployment of high value employees to more important tasks.
- Robotics is an established concept in insurance and has already been used by several insurers.
- A limitation of robotics is that it cannot make cognitive decisions. It falls short of the capacity which AI delivers. There is development in the industry focussed on RPA with AI.
- In the financial sector, robotic algorithms are being programmed to execute an action based on agreed instructions.

Blockchain

- Blockchain is a database that is shared across a network of computers. Each new entry is a "block" which once added is impossible to change. This operates from an encrypted database of transactions. To ensure all the copies of the database are the same the network makes constant checks.
- Buzzvault is a start-up that launched in Q3 2018 that allows consumers to digitally catalogue their personal possessions on its app (supported by blockchain) to support the purchase of home insurance.

Big Data

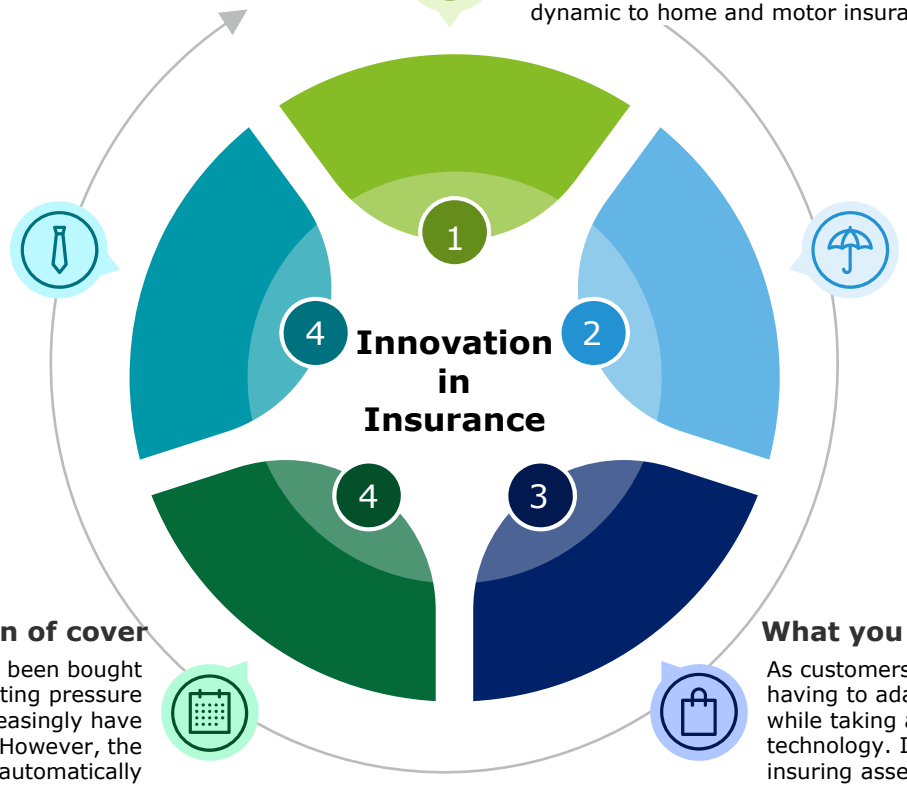
- Big data analytics involves extremely large data sets, both structured and unstructured, which can be electronically analysed to establish patterns, trends and connections.
- The biggest use cases for big data analytics lies in risk assessments, underwriting and pricing.
- Big data analytics allows for insurers to have a wider view of the market through the processing of highly fragmented data, thereby providing customers more tailored products or pricing.
- Big data analytics is a practice being used across the industry.

Artificial intelligence (AI)

- AI is where a machine considers its environment and reacts to achieve its goal. It does so through algorithms. Research is continuing in order to further develop its cognitive functions.
- The commercial applications of AI are now well advanced, with AI incorporated into a range of corporate and retail services, ranging from back office functions to customer communications.
- In addition to the use of AI made by any corporate, large insurers are seeking to use AI for risk assessment purposes.

Categories of innovation

In order to also consider innovation driven by customer behaviour we considered how the insurance market is developing from a customer perspective



Who the buyer is

There have always been situations in insurance where the "buyer" of insurance is distinct from its beneficiary (e.g. Block policies*). Economic and social changes such as the rise of platforms and the sharing economy (platforms increasingly buying insurance on behalf of their members) are bringing this dynamic to home and motor insurance.

How you buy insurance

The sales journey for insurance has historically been viewed as time consuming, difficult to understand and uninteresting. Firms are therefore investing in ways to make buying insurance quicker. These include automating the purchase of insurance, simplifying products, making comparison easier and bundling insurance with other services.

What you are buying

As customers embrace a more digital age, insurers are having to adapt products to attract and retain customers while taking advantage of the possibilities offered by technology. In some cases, insurers are moving from insuring assets to insuring events and packaging insurance as a component within a wider array of services.

Duration of cover

Home and motor insurance has historically been bought annually. However, innovative models are putting pressure on the annual renewal cycle. Customers increasingly have the option to buy insurance as they need it. However, the biggest change would come from services automatically moving customers between insurance policies to find the best deal with no fixed term.

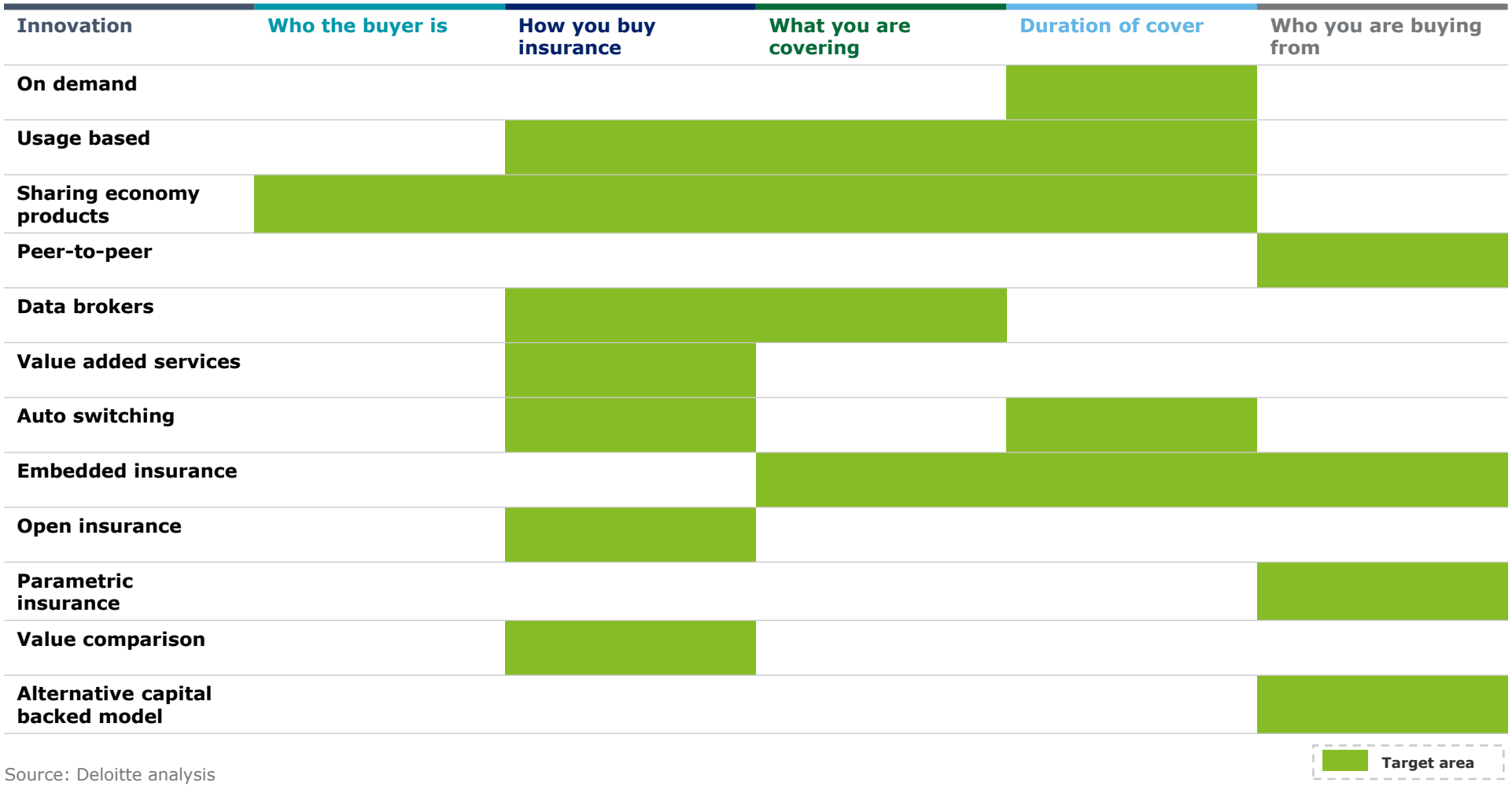
Who you are buying from

The insurance revenue chain involves affinities, intermediaries and insurance carriers. However, new entrants to the insurance market, primarily in the form of intermediaries, are seeking to seize the opportunity offered by these emerging trends and transforming the insurance revenue chain.

*Block buildings policies are buildings insurance products bought on behalf of tenants or leaseholders by lettings or buildings agents.

Categories of innovation (cont'd)

A high proportion of the new business model innovation is targeted at the way consumers buy insurance, but there is disruption at all areas of the customer experience

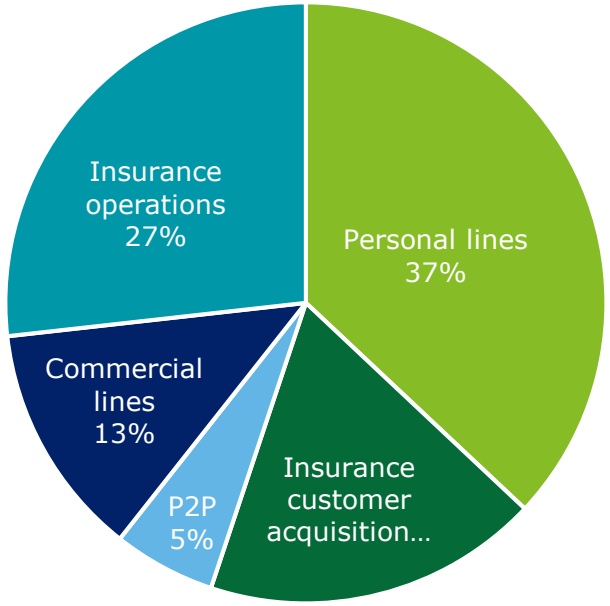


Source: Deloitte analysis

InsurTech as a source of innovation

InsurTechs have been a key driver of the business model development in personal lines and beyond. Traditional insurers are investing in and partnering with start-ups to benefit from these innovations

UK InsurTech start ups by area 1998 – 2018



Start ups in personal lines insurance, have been the most popular segment, accounting for 37% of new start ups between 1998 and 2018. The sector's importance is even more pronounced when combined with customer acquisition (which includes comparison-shopping platforms and lead-generation solutions, which are predominantly for personal lines). Together, the two segments account for over half of the total number of new start ups.[1]

Globally InsurTech activity peaked later than technology in other financial services industries. The number of new InsurTechs kept rising in both 2015 and 2016, at a time when start-up activity in the other financial sectors had already started declining. In 2017, InsurTech launches fell by 50% (to 88), but the sector still accounted for two-thirds of all new FinTechs, as non-insurance launches fell by 73%. InsurTech start up activity stalled in the first half of 2018, and since then only 4 launches appeared on Venture Scanner's database.[1]

The volume of investors offering seed capital funding to InsurTechs has reduced with investors preferring to finance more mature start-ups, who already have a proven concept and track record.

An example of start-ups struggling for funding is the contents, gadgets and bikes Managing General Agent (MGA) aimed at millennials, Kinsu. The start-up incubator, Advent Solutions Management backed Kinsu, with their cover underwritten at Lloyd's. Kinsu recently announced it will be shutting down and ending coverage for all customers in April 2019.[2]

In recent years, insurance incumbents have also become more confident in embracing InsurTech start-ups, collaborating and combining their strengths to create new ways of doing business to meet the evolving needs of their customer base. Instead of viewing InsurTech start-ups as disruptive threats, incumbents are beginning to see them as a vehicle for sustaining innovation.

Research carried out by Startupbootcamp InsurTech and PwC on 1,3000 established insurers found of them "believe the biggest impact to the industry will come from building new products in order to address the changing needs of the customer".[3]

A 2017 KPMG survey of insurance executives found 62% indicated that "their company either had already, or was planning to create, a venture capital fund to invest in InsurTech".[4] Many established insurance firms are partnering with the start-ups.

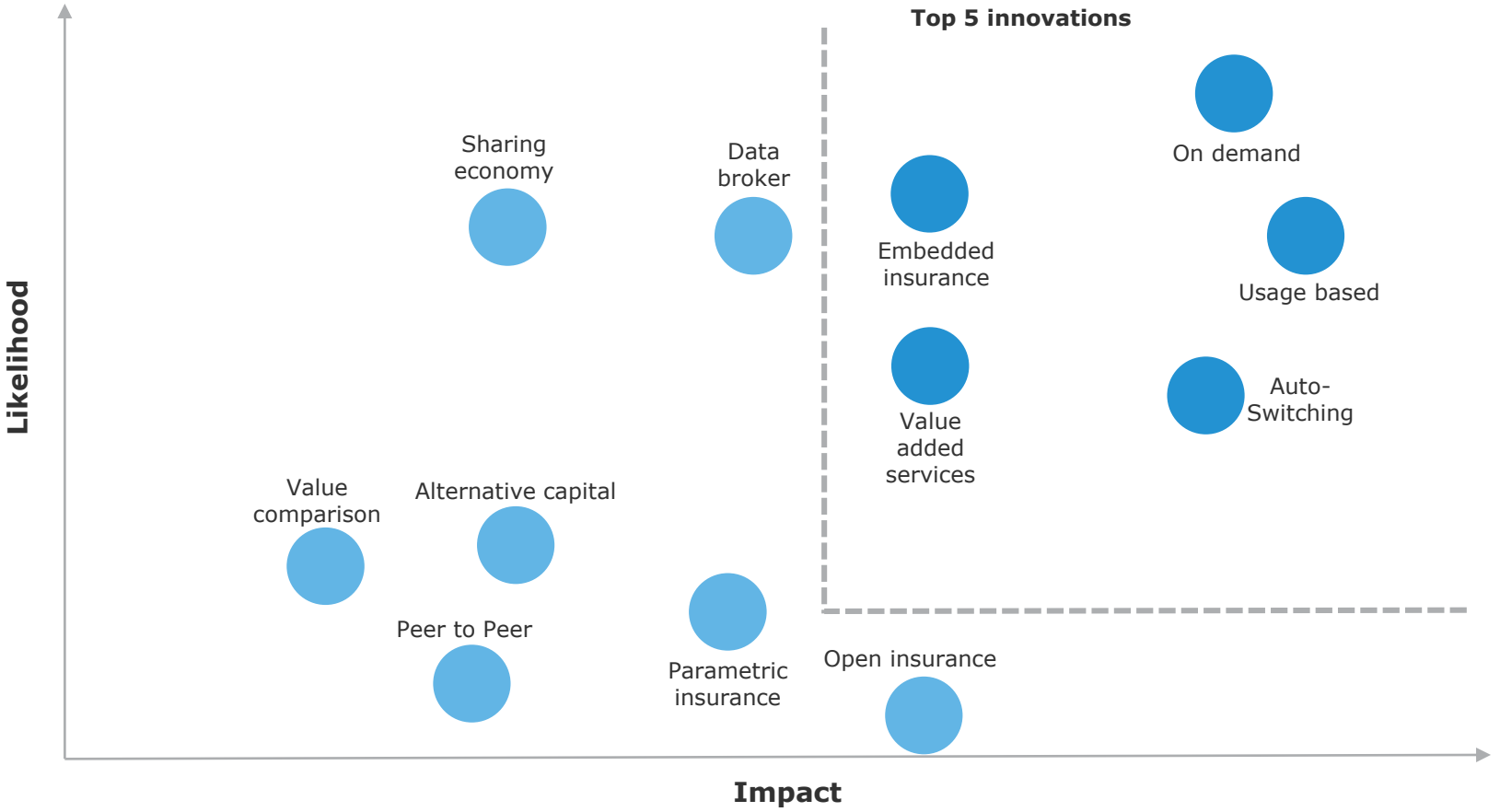
Axa Innovate (formerly XL Innovate) has demonstrated a strong appetite to work with start-ups by setting up a venture capital fund and directly partnering with InsurTechs. So far Axa have invested in Slice Labs and partnered with Brolly [5] (personal insurance app powered by AI), ByMiles [6] (pay-by-mile car insurer), and Trov [7] (on-demand single item insurer).

MunichRe have set up Digital Partners,[8] a unit with the specific aim of offering investment and expertise to disruptive start-ups to encourage innovative and digitization in the market. Examples of Digital Partners partnerships include Buzzvault (home insurance where content value is tracked via an app), BroughtByMany (insurance which is negotiated on behalf of a group of people with specific insurance needs) and Neos (home insurance with smart products to actively protect the home).

Source: - InsurTech entering its second wave - Investment focus shifting from new start-ups to more established innovators, Deloitte publication

Shortlist of key innovations

We have assessed the potential impact of each of these innovations on the UK Home and Motor insurance markets over the next 3-5 years



Detailed descriptions of each of these innovations can be found in the following pages, along with the analysis supporting the drivers of likelihood and innovation.

Case studies

On demand insurance

On demand insurance is expected to grow but the level of impact will depend on whether mass market customers begin to view this product as a substitute for the traditional annual insurance product. The move by traditional insurers into the space will increase penetration

Overview

On demand insurance allows customers to purchase coverage when they need it and only for as long as they need it, e.g. on-demand micro-duration insurance, or episodic insurance. This is typically on a pay-as-you-go basis with more flexibility around extending or terminating the period of insurance.

The key target market is often millennials as they have less affinity with traditional annual policies as they do not want to feel they are paying for cover when it is not required. In practice, insurers typically price in latency in the policy into an annual premium e.g. if you only drive 3,000 miles then the insurer expects the car not to be used for the majority of time.

This type of insurance is also reflecting the changing ways of working and the increase in self-employment and sharing of assets. There are a number of start-ups in the sharing economy sector (discussed later) operating an on-demand model.

This innovation was originally led by start-ups and smaller intermediaries, but is now being adopted by larger, more traditional players although only in limited areas to date.

We have also included subscription services under the on-demand heading. Although these subscription models are not strictly on-demand, as customers are committing to a fixed period of time (e.g. one month), they share the primary characteristics of having an on/off switch for the product and customers are not part of an annual renewal cycle and instead only need to be insured for limited periods. From an insurer perspective, these subscription models have the added benefit of obviating the need to offer customers premium finance arrangements, which are an area of regulatory scrutiny.

Potential likelihood and impact

Axis	Indicators	Rating
Likelihood	Number and scale of firms offering this service	↑
	Level of investment in this area	↑
Market impact	Take up of existing on-demand products	↓
	Technological change (e.g. driverless cars)	↑
	Move to service model (e.g. renting rather than owning)	↑

↑ Positive impact ↓ Negative impact

Examples of models

- **Trov –** is an on-demand insurance app for valuable possessions e.g. laptops, wearables and bikes. You can turn the cover on and off with your mobile.[9]
- **Wrisk** – offers one flexible plan for a range of different insurances which are managed via an app. Customers prices are based on their 'Wrisk' score.[10] Wrisk have partnered with BMW to manage and administer their car insurance.[11]
- **AvivaPlus –** offers home and motor insurance on a monthly subscription basis. Customers can change or cancel cover at any time with no interest charges or admin fees.[12]

Case Study – Cuvva [13]

Cuvva, launched in 2014, offers flexible pay-as-you-go car insurance that can be purchased by the hour, day, week or month, for when you borrow a friends car for example.

Cuvva also offered a subscription based model but due to difficulties around misuse this was taken off the market.

Cuvva claim to have designed their product "because of our own poor experiences dealing with insurance companies. Too often they were slow and painful, with an inflexible agenda." The company has raised over £2 million in funding from investors, including Seedcamp, Techstars and Tekton Ventures.

Usage based insurance

Currently the most widely adopted usage based insurance product is telematics. Telematics has shown growth in niche segments of the market particularly young drivers, the move to more app based products will help support future growth

Overview

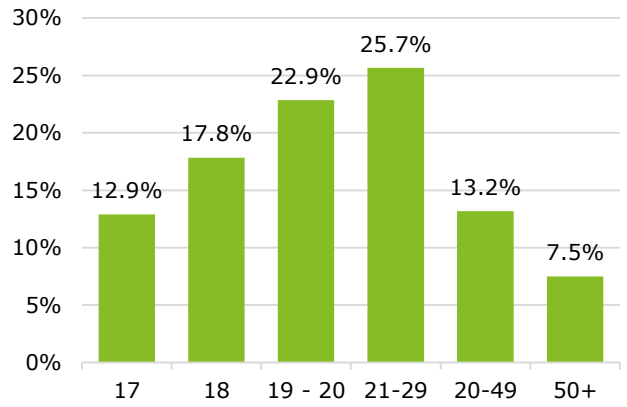
Usage based insurance is a form of individualised pricing where the customer premiums is based on how they act or how they use the insured asset rather than the risk profile of a customer of that type (e.g. "young driver living in London driving a Ford Focus"). The most mature area of usage based insurance is telematics or pay-as-you drive insurance. Through the use of telematics, insurers are able to refine customer pricing in real time based on how the customer actually behaves whilst they are insured.

There are three different telematics models:

- Pay as you drive ("PAYD"): under these policies, premiums are set based on how far a driver drives.
- Pay how you drive ("PHYD"): involves insurance companies monitoring the driving style and behaviours of customers using a telematics device and using this data to produce risk indicators and create risk profiles. This is the fastest growing sector.
- Manage how you drive ("MHYD"): Insurers are looking beyond financial discounts and are now considering the connectivity provided by telematics devices as a way to develop deeper relationships with their customer by bundling other value-added services in with their insurance policies e.g. road side assistance, "grading" the insured's driving or flagging distracted driving.

Telematics remains largely focused on the young driver segment which insurers deem to be higher risk and therefore there is more potential upside from careful driving. A number of insurers, are now only offering telematics based products for that segment. Other target segments include elderly drivers, those with disabilities or drivers with convictions. This has a high overlap with vulnerable customer segments.

Telematics policies by age group in the UK



Source: IGO4 research for Post Magazine

From the recent FCA publications on pricing (*Pricing practices in the retail general insurance sector: Household insurance*, TR18/4) [14], it is clear that cross subsidisation is a key concern of the FCA, that lower risk customer segments are subsidising other higher risk segments. Some start-ups and established insurers are designing products in which customers can provide additional data in exchange for an individualised price. These are often promoted as a way for customers to get lower premiums by not being pooled with higher risk customers.

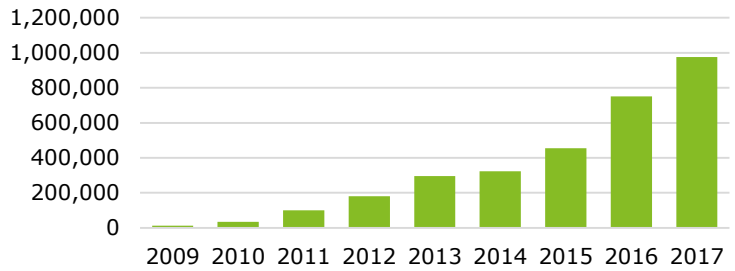
Penetration has been higher in fleet insurance where telematics have been made mandatory by certain groups due to the commercial and risk management benefits achieved by monitoring driving.

Usage based insurance

Telematics has shown growth in niche segments of the market particularly young drivers, the move to more app based products will help support future growth

Potential likelihood and impact

Telematics policies in the UK



Source: BIBA

The barriers to entry have reduced with the cost of providing, installing and removing the technology having reduced over time. Previously insurers would only invest where it was a high risk driver. Many solutions now are app based.

In 2017 3.57% of motor policies in the UK were telematics.[15] There are still barriers to adoption in relation to data privacy, however this market segment is mature.

However, usage based insurance outside of motor is still immature, with relatively low penetration in home insurance.

Potential likelihood and impact

Axis	Indicators	Rating
Likelihood	Number and scale of firms offering this service	↑
	Level of investment in this area	↑
Market impact	Current market size of usage based products	↓
	Technological change (e.g. driverless cars)	↑
	Move to service model (e.g. renting rather than owning)	↑

↑ Positive impact ↓ Negative impact

Examples of models

- **AvivaDrive** – involves using an app to track and rate driving skills. Customers with a high driving rating can earn a better price for their car insurance.^[16]
- **InsureTheBox** – is a black box car insurer which rewards for safer driving.^[17]
- **ThingCo** – the core proposition focuses on new technologies such as telematics, HD cameras, AI and an app for customer engagement.[18]
- **Ticker** – aimed at van and new drivers and backed by MunichRe. Ticker only offers telematics insurance along with an app where driving can be tracked.[19]

Case Study –ByMiles [20]

ByMiles offer a pay-as-you-go car insurance product, where premiums are charged monthly based on the number of miles customers drive. Customers pay a fixed annual cost upfront to cover fire, theft and accidental damage to the car whilst parked and are then charged a unique per-mile rate to cover their driving.

Usage of the car is monitored via a tracking device plugged into the car's dashboard. The premium charged is based on the number of miles driven only, and not on when, where or how the customer drives. ByMiles offers an app where customers can see the cost of every journey after it is finished.

ByMiles state that they aim their car insurance at customers who drive less than 7,000 miles a year and are aged 25 or older, i.e. those who are typically low risk.

ByMiles have insured over 2,237,822 miles of driving so far.

Sharing economy insurance

To date the number of players in the sector and adoption rates of specific sharing economy products has been low with customers preferring to add cover to their existing standard products

Overview

The sharing, or gig, economy is defined as a collection of online marketplaces where consumers, rather than corporates, share access to their assets, possessions and skills in order to earn a profit.

Sharing economy insurance products have evolved to cover this new type of risk, for users, asset owners and workers in the sharing economy. Products tend to be tailored to offer cover for short periods of time e.g. per night, and on-demand basis. These can be provided by either start up MGAs underwriting with insurer capital, or by insurers forming partnerships with sharing economy platforms (e.g. AXA have partnered with BlaBlaCar and Uber).

In the UK, models focused on UK home and motor are limited. Although the UK population are big users of sharing platforms (14 million in 2018 according to Deloitte survey research.[21]), suppliers are more limited by comparison (5 million).

There is still a gap in bespoke cover for the specific risks of transacting in the sharing economy. According to the Deloitte Squaring Risk Report,[21], 37% of home sharers reported taking out or upgrading a buildings and contents policy prior to sharing their property. Just under half of ride sharers took out a new motor policy or upgraded an existing one.

Potential likelihood and impact

Axis	Indicators	Rating
Likelihood	Number of start-ups in this area	↑
	Level and quality of investors in this area	↑
	Economic trend (sharing economy)	↑
Market impact	Low numbers of UK sharing economy "suppliers"	↓
	Potential market size	↓
	Insurers are bundling sharing economy insurance into services (e.g. BlaBlaCar and AXA)	↑

↑ Positive impact ↓ Negative impact

Examples of models

- **Dinghy –** provide on demand insurance for freelancers, including PI and PL, as well as cyber risk.[22]
- **SafeShare –** have developed insurance products for the sharing economy platforms.^[23]
- **Tapoly –** coverholder at Lloyd's. Flexible insurance products for anyone in the gig economy.^[24]
- **Guardhog –** in partnership with Hiscox providing usage based insurance for hosts and businesses.^[25]

Case Study – Slice Labs [26]

Slice Labs are an American-based InsurTech start-up focused on providing insurance products which they believe fit a customer's specific needs.

A key Slice product is a HomeShare policy which provides cover for individuals letting out their flats to guests on sharing economy platforms, such as Airbnb, this is offered on an on-demand basis. In the UK, this is offered through Legal & General, and underwritten by Great Lakes Insurance SE (a subsidiary of Munich Re).

In the US, the company is also backed by Munich Re, as well as Horizons Ventures, and XL Innovate.

Peer-to-peer insurance

There are very limited examples of peer-to-peer models in the UK

Overview

Customers with similar insurance needs are grouped into 'pools' to share in the benefits and costs of general insurance coverage.

There are different evolutions of the model:

1. Small groups with similar risk levels self-insure their deductibles to lower their premiums.
2. The same small groups share the risk of insurance by paying premiums jointly. If there is money left unclaimed by the end of the year, members get to share the remaining funds as a payback.
3. Self-governing P2P insurance whereby each participant pays a certain amount into a digital wallet using blockchain insurance. When a claim is made, each member pays a certain amount towards it. If no claims are made, then the money contributed is returned to the member.

The main advantage is seen as the ability for the model to offer lower premiums to customers.

There are limited examples of successful peer-to-peer models globally, and very few models in the UK. Guevara was established in the UK in 2013 targeted at motor insurance but closed in 2017.[27] The key challenge was gaining regulatory approval.

Potential likelihood and impact

Axis	Indicators	Rating
Likelihood	Number and scale of firms in this area	↓
	Lack of UK investment in P2P models	↓
Market impact	Performance of firms in this area	↓
	Market share	↓

↑ Positive impact ↓ Negative impact

Case Study – Laka [28]

Laka is a UK-based peer-to-peer MGA, backed by Zurich.^[29] and founded in 2017. Laka currently specialises in providing cover for expensive bicycles.

Consumers join Laka and are allocated to group risk pools, for example, a cycling club. There are no upfront premium payments for Laka members, instead at the end of each month claims are settled as part of the group risk pool plus a fee to Laka. Therefore the payment due by customers each month will change depending on the level of claims, however it is capped at £20 a month, which is deemed by Laka to be the market rate and has a stop loss from Zurich. This means that when claims are lower, customers all share in the benefit of paying less.

Claims are reported via an app and customers don't have to pay an excess as they are already incentivised to reduce their number of claims.

Data brokers

New start ups have taken advantage of the proliferation of open and accessible data and increased use of social media platforms to design products targeted at specific underserved and niche customer segments

Overview

In insurance, a data broker is a business that aggregates information from a variety of sources and processes it to enrich traditional data sources. It has typically been used to enhanced the understanding of the customer and therefore refine products or pricing.

Insurance data broking models tend to focus specifically on identifying customer segments with poorly served insurance needs and finding them appropriate policies. Through social media, customers with the same or similar issues are then grouped together, and the broker seeks to negotiate an appropriate policy with the insurer on their behalf. Products are only available through digital channels.

Target customers are typically those with more bespoke needs. Examples include the likes of people with heart conditions who need travel insurance, those that live in flood affected areas and those with thatched roofs.

The data is used to help more accurately calculate the individual or group's risk profile to enable them to offer a more competitive rate than the customers would receive from mainstream insurers with standard pricing models.

These brokers tend to have relatively lean operating models, leveraging outsourced providers such as call centre and claims handlers.

By their nature, these models are inherently niche. As a result, although the existing players are established and successful, there is limited opportunity for this market to grow in home and motor.

Potential likelihood and impact

Axis	Indicators	Rating
Likelihood	Number and scale of firms in this area	↑
	Technological trend: big data analytics and AI	↑
Market impact	Performance of firms in this area	↑
	Potential market size	↓

↑ Positive impact ↓ Negative impact

Examples of models

- **Avantia** – offer a home insurance product for those with more complex needs i.e. have non-standard risk such as being located on a flood plain.[30]

Case Study - BoughtByMany [31]

Bought By Many are a free members-only service seeking to find insurance for sectors which many otherwise struggle in obtaining it. In doing so, they seek to negotiate unique policies for these instances. They also provide their insurer opinion ratings based on quality or cover, independent reviews and complaints handling.

Though a relatively new sector of the insurance market, Bought By Many currently have 792,397 members divided amongst 321 groups. Initially, they brokered Pet Insurance, however, they have continued to expand in the areas of insurance they provide, including home Insurance.

There is a correlation with customer demand and the service which Bought By Many offers due to the difficulty faced by these customer segments in obtaining appropriate coverage. The policies which they seek to broker are designed to provide clear and concise wording so the customers are fully aware to the extent of their coverage. This attribute has been recognised by Fairer Finance and also endorsed by their customers. They operate a "snap claims" model whereby the claimant doesn't have to complete any forms.

Value added services

Some insurers are expanding their offering to attract and retain customers by including non-insurance products, often related to the type of insurance being purchased, as part of their customer proposition

Overview

As a result of the soft insurance market, established insurance businesses have sought to increase profitability by improving customer retention, improving risk pricing and reducing claims costs. In addition, new entrants to the market who are struggling to compete on price with incumbents (who often underwrite at a loss for new business) have sought ways to compete on the service provided. Both incumbents and new entrants have tried to achieve these aims by providing their customers with value added services. These services primarily take three forms:

1. Non insurance services such as helplines, tailored advice or risk management services.
2. Perks such as discounts on shopping, participation in events or membership of a community.
3. Free or discounted access to risk management technology that can both reduce the impact of a loss and also provide more accurate underwriting data to the insurer.

By providing some combination of the above services, insurance businesses aim to improve customer retention, and in doing so reduce their customer acquisition costs. These services can also provide insurers with additional underwriting data and reduce the cost of claims, which should result in lower premiums, so long as this upside is passed on to customers.

This innovation is relatively mature, with a wide array of firms operating in this space.

Potential likelihood and impact

Axis	Indicators	Rating
Likelihood	Number and scale of firms in this area	↑
	Level of investment in this area	↑
Market impact	Historical ability of firms to cross sell products	↓
	Market share of players in this area	↑

↑ Positive impact ↓ Negative impact

Examples of models

- **Dinghy** – dinghy package their insurance with an assistance product that provides an array of support to freelancers including chasing invoices and tax advice. [22]
- **Laka** – maintain a "club" alongside their insurance product which provides insureds with a variety of perks, such as discounts on equipment. [28]
- **Waggel** – customers buying pet insurance through Waggel also obtain access to discounts on pet accessories and access to services such as advice on pet nutrition. [32]
- **Homeserve** – as part of their home cover, Homeserve offers customers access to a system that detects and alerts the customer of water leaks [33]
- **Policycastle** – provide home insurance policy holders with advice on risk management as well as discounts on smarthome techolonogy.[34]

Case Study – Neos[35]

Neos, launched in 2016 and are now owned by Aviva. Neos home insurance products include smart home technology such as sensors and security cameras to actively protect the home. These devices are controlled via an app where the appropriate devices can be turned 'on' when you are leaving your home. The smart technology can also be bought separately to the insurance product.

The quantity and type of sensors that customers receive from Neos as part of their home insurance offering depends on whether customers have selected the 'Good', 'Better', or 'Best' package from Neos.

Neos state that they have created this product to help protect what is important to people and to rebuild customers trust in their insurers.

Auto-switching

The energy market has seen the emergence of 'auto-switching' services. These services use AI to move customers between providers whenever savings above a certain threshold could be made, having considered cancellation fees. This could be seen next in the insurance market

Overview

Auto-switching is a concept in which AI is used to shop around for the best policy and deals on behalf of a customer. The concept is centred around customers automatically being moved onto cheaper tariffs, saving them both time and effort.

Auto-switching works by means of an algorithm, automatically identifying the correct moment at which to switch a customer onto a cheaper deal, by looking through a price comparison engine for the best option available for the customer.

Until recently auto-switching services had only been offered by niche firms across the gas and utility bill space. 2018, however, saw the arrival of the "switching revolution", with larger firms, particularly the main PCWs adopting the technology and deploying it across the UK energy market.

Due to the market share of PCWs in the sale of personal lines new business, insurance looks likely to be the next target area. However, there are no insurance auto-switching services currently trading, as there are more structural challenges with switching in insurance compared to energy, with the current annual policies, the longer questions sets and varying insurer risk appetites and pricing models.

In addition, auto switching faces regulatory and contractual barriers. Auto-switching services would need to find a way to satisfy Insurance Conduct of Business Sourcebook requirements around establishing customer needs and the appropriateness of products. Auto-switching services would also be impeded by the no re-solicitation clauses that insurers typically seek to add to contracts with PCWs.

Potential likelihood and impact

Axis	Indicators	Rating
Likelihood	Level of discussion in this area	↑
	Lack of firms currently performing this activity	↓
	Regulatory and contractual barriers	↓
Market impact	Impact on auto-switching on energy switching	↓
	Market share of price comparison websites	↓

↑ Positive impact ↓ Negative impact

Case Study – AutoSergie[36]

AutoSergie is Comparethemarket's response to the auto-switching concept currently in the price comparison market. It operates with a simple logic but a complicated algorithm in which, if they believe a customer is paying too much for an energy deal, they inform their customer and then switch them to the cheaper alternative.

The level of discussion around auto-switching is growing at a phenomenal rate. So much so that in February 2018, Comparethemarket stated that they had no intention of incorporating auto-switching into their business model as they believed it took control out of the hand's of the customer. However by December 2018, they introduced their answer to auto-switching through AutoSergie. Furthermore, the growth rate of auto-switching is illustrated by the Director of the Consumer Campaign Group stating that PCWs would need to adopt the concept or perish. A statement which Comparethemarket's response seems to agree with.

The corresponding link to customer demand appears evident by the Comparethemarket's entry into this sector of the market. All PCWs have introduced their own auto-switching service and Comparethemarket's reasoning is to reduce the stress and hassle for their customers. According to the Telegraph, auto-switching earns a commission of £45 from the supplier each time someone switches indicating the pricing strategy across the market.

Embedded insurance

Embedded insurance is typically where non-insurance companies build an insurance product into a wider set of services. Often, the insurance is largely invisible to the customer

Overview

Embedded insurance is an established business model. One example is the long running Motability scheme, which offers people with disabilities insurance bundled with the lease of vehicles. This can be described as a marketing strategy which combines (usually related) non-insurance products together with insurance to be sold as a single combined unit. For example, insurance included in the financing of a new car or mobile device.

Although this is not a new trend, embedded insurance appears to be growing at a rapid pace as the sharing economy and the shift towards services leads to insurance becoming embedded into an ever wider array of different products.

This allows greater convenience for the consumer by purchasing several products from one company and switching several monthly payments into one, hence making bill payment simpler.

Embedding insurance can help companies to attract a greater volume of sales, and therefore to sell the package for a lower price than would be charged for individual items, hence creating savings for consumers.

The challenge is the transparency of the insurance product and its price. Customers may not be aware that they are buying insurance, or how much they are paying for their insurance.

Potential likelihood and impact

Axis	Indicators	Rating
Likelihood	Level of investment by large players in this area	↑
	Number and scale of firms involved in bundling	↑
Market impact	Level of investment in this area	↑
	Market share of players in this space	↑

↑ Positive impact ↓ Negative impact

Key players

- **BlaBlaCar –** BlaBlaCar partnered with AXA in France and the UK to bundle a ridesharing insurance product into the BlaBlaCar car-pooling service.[37]
- **Carphone Warehouse** – offers insurance through 'Geek Squad' for mobile phones purchased from Carphone Warehouse in the last 30 days. Also offers technical support and advice.[38]
- **Uber** – drivers for Uber are automatically covered by an AXA life insurance product from the moment they accept a delivery or pick up request to the point where that request is fulfilled. [39]
- **Canopy** – offers services to renters and landlords. One of Canopy's products is DepositFree insurance which replaces the need for cash deposit by covering the renter and landlord for everything typically covered in a cash deposit.[40]

Case Study – Peugeot [41]

Peugeot 'Just Add Fuel' is a finance package that includes a new Peugeot car from a set list of models as well as insurance and 4 other driving services. The car insurance and other necessary driving services are provided for 3 years. Customers pay a deposit upfront and then a monthly payment, with interest, for 3 years. Payments vary according to age, postcode and annual mileage.

Peugeot motor insurance is underwritten by UK Insurance Limited.

Young drivers or those with less than 2 years NCD are required to have a telematics device.

Peugeot have bundled these 5 car services with the purchase of a car to reduce the number of different payments customers have to make and simplify the purchasing process.

Open insurance

The use of open Application Programming Interfaces in insurance would have a significant impact but is unlikely to occur in the absence of legislation or regulatory intervention. There are no current insurer examples

Overview.[42]

In order to promote competition in retail banking, the Competition and Markets Authority mandated the adoption of the Open Banking Standard using an open application programming interface ("API"). An API is a set of functions and procedures allowing the creation of applications that access the features or data of an operating system, application, or other service. This particular API allows:

- open access to open data – i.e. allowing anyone, from third party providers to individual customers, to access publicly-available data such as pricing and product information; and
- controlled access to shared data – i.e. granting regulated third parties access to customer account transaction data, provided the third party has customer consent.

The success of open banking has led some insurance industry practitioners to consider the development of an Open Insurance equivalent. No firms have yet launched open insurance products in the UK, but this would entail the creation of an open API that would permit open access to claims data as well as controlled access to the personal claims histories of customers. This would drive more accurate technical pricing by improving access to claims data, make it easier for customers to switch providers and support new entrants.

Start-ups tend to support this concept as they have limited data and hence have more to gain from established insurers sharing their data, however, data rich established players appear to not be in favour as it impacts their competitive advantage by sharing their data. As a result, Open insurance initiatives have not yet gained traction.

Potential likelihood and impact

Axis	Indicators	Rating
Likelihood	Need for legislation	↓
	Level of discussion of this topic	↑
	Lack of players unilaterally committing to open APIs	↓
Market impact	Success of open banking	↑
	Impact of lack of claims data on emerging models	↑

↑ Positive impact ↓ Negative impact

Case Study – Monzo [43]

Monzo (formerly Mondo) was founded in 2015 with a view to build a banking experience centred around the smartphone. At the end of 2016, Monzo's offering consisted of a prepaid card and a mobile app through which this could be topped up.

Monzo have announced plans to focus on its core offering – namely current accounts and debit cards. In the longer term, it plans to offer additional products and services by using open APIs to transform its platform into a marketplace, where customers can use and purchase third-party solutions through the mobile app.

Monzo stated that they believes they can can provide additional value to consumers and convince them to switch at scale through allowing individuals, financial services providers and others to plug in via APIs. The bank pictures a future where:

- Surplus money can be invested in a marketplace lending platform with one click
- Individuals can choose from a number of mortgage providers that offer personalised deals based on transactional data held by Monzo
- International money transfers can be made in two clicks and customers can select from a range of providers
- Companies can verify an individual's identity rapidly by connecting to Monzo through an API rather than requiring paper documentation.

Monzo announced in plans for 2019 that they are considering ideas around 'clearer and fairer insurance when you need it'.^[44]

Parametric insurance

Parametric insurance does not aim to fully indemnify the pure loss of an incident but instead issues a pre-agreed payment amount upon the trigger of a specific event. Parametric products are not yet in use in home or motor

Overview

Parametric insurance is a type of insurance that does not indemnify the pure loss, but agrees to make a payment of a pre-agreed amount upon the occurrence of a triggering event. The trigger is a pre-defined parameter or metric that is easy to determine and is related to the insured's particular exposure. A trigger needs to be objective, transparent and consistent and insurers need to be able to model it. One example might be the level of rainfall in a particular location, or the length of a flight delay. Due to the short tail nature of parametric products they are popular with alternative capital providers (see next page).

The threshold for the trigger is set to align with the insured's risk tolerance, with premiums becoming a function of the level of cover set by the insured. The insured must not be able to influence this event to avoid the risk of moral hazard, this is why weather indices are a popular choice in parametric insurance. Generally, parametric insurance products are not designed to be stand-alone but the scope of parametric insurance is growing from covering natural disasters to non-physical damage.

Parametric insurance is becoming an increasingly popular concept among insurers due to the low operational costs of underwriting and claims processing. Although there are parametric products currently live, there are very few in the personal lines space. This is partly because these products are still relatively immature, but also because motor and home perils tend to either be closely tied to losses or lack suitable triggering events. However, it is likely that as, cars and home become more connected, elements of cover in motor and home will come to include parametric components (e.g. automatic £1k payment in the event of a fire to cover emergency accommodation).

Potential likelihood and impact

Axis	Indicators	Rating
Likelihood	Lack of personal lines parametric players	↓
	Level of investment in this area	↑
	Dependence on the ability to create triggers	↓
Market impact	the nature of home and motor insurance	↓
	Increased connectivity of homes and cars	↑

↑ Positive impact ↓ Negative impact

Case Study – AXA [45]

In 2014 AXA launched a parametric insurance team as part of AXA Corporate Solutions. Due to the success of this they have further invested in the development of this product by launching AXA Global Parametric in 2017.

AXA Global Parametric will offer a broader range of products in many forms, currently offering parametric business insurance across several industries from Agriculture to Gas & Energy.

Insurance claims are based on an independent parameter that is correlated to the customers losses and claims payments are then triggered automatically if the agreed-upon threshold is reached.

AXA's parametric insurance offer includes an analysis of the companies sensitivity to weather, such as what are the consequences of draught or heavy rainfall on revenues.

The insurance cover is then adapted to the needs of the company. This depends on where the company is physically located, what time period is being considered and the amount of pay out that would be required.

Finally, if necessary, the claims process is triggered based on weather data within a few days.

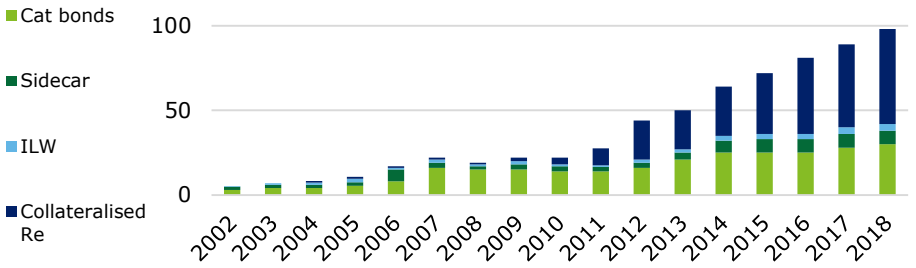
Axa advertise the benefits of this product as a simplified and innovative insurance model which provides a 'seamless' experience and greater certainty for customers.

Alternative capital

Alternative, or third party, capital is moving beyond 'traditional home' of property catastrophe treaty reinsurance to other lines of business, but is still rare in direct insurance

Overview

Growth of alternative (re)insurance capital (USD bn)



Source: Aon

(Re)insurers are increasingly looking to alternative, cheaper, sources of capital and are viewing 'alternative capital' – reinsurance agreements with institutional investors - as an effective source of capital to be combined with debt and equity on their own balance sheets. From a consumer perspective, alternative capital backed models are likely to have lower premiums. In addition, the lower cost of capital can make products viable that would otherwise be impossible due to the high capital hurdle rate for insurers (e.g. micro insurance).

Due to the structuring of insurance linked securities and the risk appetite of investors, traditionally alternative capital has been focussed on short tail, high severity/low frequency (re)insurance business such as property catastrophe treaty. Accordingly, there are no current UK examples of alternative capital backed motor or home products. Investor appetite is developing, and any risks with robust modelling which provide a good risk adjusted annualised return will be considered by potential investors.

Potential likelihood and impact

Axis	Indicators	Rating
Likelihood	Lack of UK alternative capital backed direct models	↓
	Level of investment in this area	↑
Market impact	Better cost of capital hurdle rate	↑
	Unsuitable for long tail risks (e.g. motor liability)	↓

↑ Positive impact ↓ Negative impact

Examples of models

- **IBOTT SPA** [46] – a special purpose agreement within Lloyd's of London taking a pre-defined quota share of Syndicate 1969 relating to sharing economy motor business insurance classes.
- **Limestone Re** [46] – ILS cession from Liberty Mutual including a quota share of its high value homeowners business in the United States alongside property catastrophe treaty business.
- **Sussex Capital** [46] – ILS investment administered by Brit including collateralised insurance of appropriate property risks.

Case Study [46] – AmWINS auto book securitisation

The MGA arm of AmWINS, a US based insurer has ceded a portfolio of new non-standard motor insurance risk to AIG-owned ILS fund manager Alphacat, through a fronting arrangement with Redpoint Insurance Group.

The underlying motor insurance policy business is targeted at consumers in Texas.

The deal was structured and book run by Ledger Capital Markets, which aims to make the securitisation process more streamlined to enable the expansion of the ILS market in to other lines of business. Alphacat's investment is provided through a Protected Cell Company managed by Artex in Guernsey.

Collateral for the contracts is provided on a 'just in time' basis designed to match the growing exposure of the book of business over time. Ledger will provide automated daily updates of premium, exposure and loss metrics to enable investors to develop a view on the performance and trade on the securities.

After one year there will be a reinsurance to close to enable investors to come 'off risk' and avoid issues of trapped collateral eroding annualised earnings.

Value comparison

In recent years there has been a move towards enabling customers to select insurance based on value. On aggregator websites customers can chose to rank and select insurance policies based on several metrics and this can include the quality of the product as well as price

Overview

Price has traditionally been a major factor in customers decision making when choosing an insurance product. However, as concerns have grown that customers do not understand their insurance products and lack trust in insurers, there has been increasing discussion of how customers could better compare the value of insurance products.

One area where this change is visible is in price comparison. PCWs aggregate the policies and prices on offer from different suppliers of insurance. Historically, PCWs sites focused on comparing insurance products based on price. However, PCWs have increasingly introduced features which filter policies on value measures such as claims rates and customer service, which allows customers to compare insurance products based on the quality and therefore value of the product.

However, the complexity of home and motor insurance products means that true value comparison would require a further step. Firms would need to provide a single policy wording, back by a panel of insurers. This would provide customers with a range of prices and service levels, whilst allowing customers to make a like for like comparison. No firm has currently taken this step in home and motor. We note that having a single policy wording would also facilitate the launch of auto-switching services.

Potential likelihood and impact

Axis	Indicators	Rating
Likelihood	No current examples of this service exist	↓
Market impact	Where value comparison is currently possible, Customers appear primarily price focused	↓

↑ Positive impact ↓ Negative impact

Impact on pricing practices

Current pricing practices – Risk price

Insurers use traditional modelling techniques to develop the risk price based on a standard set of risk factors

Risk price

The risk price is the premium a customer would pay based purely on the risk they represent.

- Customers on average provide around 25 data points during a quote process for home insurance, which are used as rating factors for the risk premium.
- Most insurers in the UK use the General Linear Model (GLM).[47] regression model to determine the risk price for each peril.
- GLMs are a generic regression method which provides more flexibility than standard regressions therefore it can be used to fit a variety of processes and allows a range of different model structures to be fitted.
- In personal lines, GLMs are used for fitting models for:
  - Claims frequency;
  - Claims average cost (severity);
  - "Burn" cost; and
  - Loss ratio.
- They can also be fitted across all claims types or perils.
- Once models of the individual components are finalised, it may be necessary to combine the individual models into a single structure. This involves calculating the fitted values for each component and combining together to get the fitted risk premium.

Typical rating factors for private motor and home insurance

Motor	Home
Insured driver: • age • marital status • age of licence • type of licence • occupation • residency • convictions • accidents/claims in last 5 years	• Policyholder age • marital status • number of children • occupancy • age of property • number of bedrooms • sum insured • type of property • level of cover.
if named drivers, for each driver: • age • marital status • age of licence • type of licence • occupation • residency • convictions • accidents/claims in last 5 years	
vehicle details including: • vehicle group • vehicle value • immobiliser/alarm • rating area • overnight parking • excess • NCD (No Claims Discount) • whether NCD is protected • use • policy duration.	

Source: General Insurance Premium Rating Issues Working Party

Current pricing – Pricing algorithm design

Changes in the design of pricing algorithms could theoretically lead to particular groups of customer suffering harm

Advancements in customer segmentation could have a negative impact on customers

The use of big data analytics and the rise of the internet of things ("IOT") is allowing insurers to hyper-segment customers to an individual level. Although this is beneficial to some customers, there is a market level risk that some customers will become "uninsurable". Granular segmentation could also aggravate any flaws in the design of the algorithm

Personalised pricing

The increasing complexity of algorithms could limit insurer's oversight of their pricing practices

As pricing algorithms become more complex (and in limited cases are supported by cognitive AI) there is a risk that insurers do not have full oversight of how their pricing works. In particular, they may have no oversight of issues with the design of the algorithm, such as unconscious bias, errors or negative impacts on specific customer segments. Many pricing models now rely on the use of third party data, but there has been issues over the provenance and oversight of data by insurers as they relied on assurances by the data providers themselves rather than performing their own diligence on the data source.

Oversight of algorithms and data

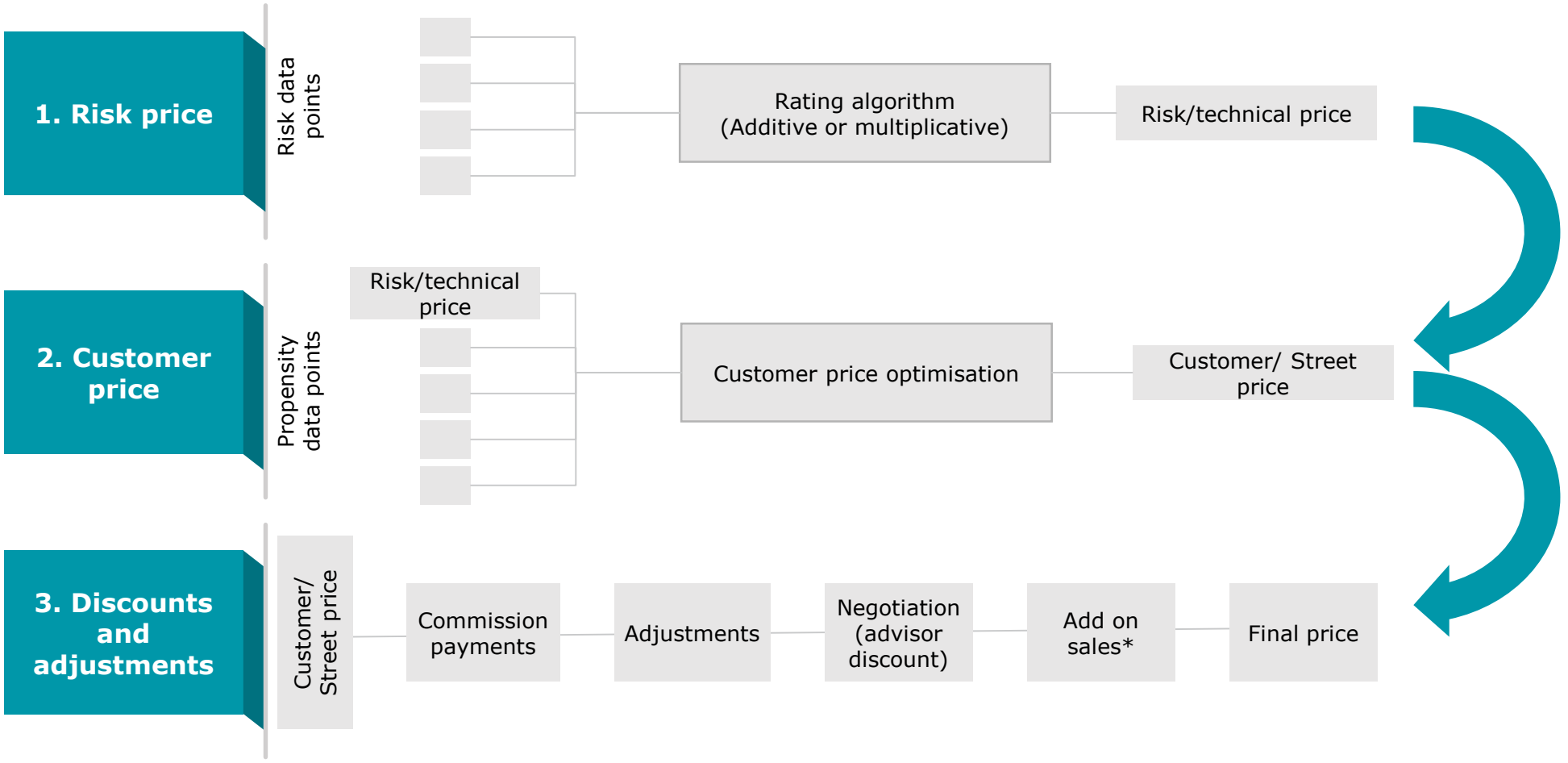
Increased customer segmentation combined with a lack of oversight could lead to vulnerable customer or disadvantaged groups being subject to unfair prices

As a result of the above factors, there is a risk that insurer pricing algorithms are having a disproportionate (and potentially unfair) impact on particular classes of customer e.g. vulnerable customers or members of disadvantaged social groups

Segmental impact

Overview of pricing practices

There are typically three steps involved in producing the customer's final price



*Price of add-ons is normally fixed

Note: Where the insurers add in the cost of expenses varies between insurers.

Current pricing practices

Variability between similar risks in customer pricing generally occurs at the second stage of the pricing process once other factors are used to load or discount the price, which depend both on the insurer's risk appetite and their knowledge of the customer's willingness or propensity to pay

Customer price

The customer price is derived by loading or discounting the risk price.

- Loading and discounting is based on factors such as the insurer's expenses, the price elasticity of the customer and the likelihood of the customer to purchase additional products.
- There is a trade-off in the online customer journey between underwriting need and customer experience. As a result, the market is seeing a move to capturing fewer data points as part of the customer journey, with insurers relying heavily on "enriching" the risk data provided by clients.
- Insurers use an array of data, collected from the customer and 3rd party sources such as government data and open source data, to understand the lifetime value of the customer.
- The "lifetime value of the customer" is based on factors such as the customers likelihood to buy add-ons, likelihood to renew, their price elasticity and their susceptibility to cross-selling.
- Some data can be used for customer and risk pricing. For example customer quote behaviour can reveal that they are "gaming" the provision of data, which can correlate to other higher risk behaviours.

Discounts and adjustments

- Finally insurers typically allow sales agents and distributors to adjust premiums within defined parameters in order to win business.
- This could take the form of negotiation or giving a third party distributor permission to "flex", or vary, commission upwards or downwards at their discretion.
- Some brokers charge negative commission in the first year in order to win new business particularly since the emergence of the PCWs which has impacted broker's retention rates in motor and home.

Market dynamics

The rapid penetration of PCWs into general insurance distribution has encouraged customers to shop around but has also driven an increased focus on price of the core product. Providers have discounted year one premiums to be competitive and win new business to the detriment of long standing customers

Distribution channels

Insurers now have a choice between a variety of distribution channels beyond direct or traditional brokers. PCWs have caused the biggest disruption to the insurance market in the last 10 years.

The PCW model has helped support customers to shop around as entering their details once can generate multiple quotes, rather than requiring them to go to several insurers directly either online or by phone. Although many customers go back to their existing insurers, many more customers use PCWs as a research tool to help them negotiate with their current insurer.

In order to win market share of new customers, insurers and brokers have needed to offer a competitive price to feature at the top of the list of quotes returned to the customer. In order to recoup the impact on margins of new business, the practice has been to charge renewal customers more. This has had a detrimental impact to those who have been the most loyal and stayed with an insurer for several years.

Providers (both insurers and brokers) have used the approach of 'brand stacking' where they have created multiple brands with slightly different pricing and features in order to dominate as many places on the first quote page as possible.

Business bought through other channels (e.g. direct and affinities) has followed a similar path as insurers and brokers needed to offer a competitive rate to continue to win business.

Other insurers have focused on offering more premium products to differentiate themselves from the price competition but these are typically targeted at more niche segments of the market.

Core versus add on pricing

Due to the competitive focus on pricing of the core product, providers have sought to identify different profit pools.

One approach taken has been an increased focus on the sale of add-ons, which typically have a low fixed cost to the insurer but can deliver high profit margins to insurers and distributors.[48]

The number of add-ons have also become more prominent as the core products are often designed to be more basic in nature, in order to reduce the original price to the customers.

A key component of additional revenue for insurers has been the sale of premium finance e.g. offering customers the ability to pay for their insurance premium in instalments, often with an interest rate charge.

In its 2017 annual report, Admiral reported £202.9million of revenue or £64 per vehicle, attributable to 'other revenue' associated with the sale of core car insurance i.e. due to add-on sales, up 8% from the previous year. £55.5 million of the £202.9 million is from the fees charged to customers paying for their car insurance in instalment plans.[49]

Market dynamics – Dual pricing

Longstanding customers are being penalised by dual pricing as premiums are increased after year one to compensate for the cost of winning new business customers

Dual pricing is almost universal in retail insurance. This is the practice whereby insurers (or intermediaries) discount new business premiums to win business (potentially even accepting a loss on new business) before loading costs onto renewal customers, sometimes without any cap.

There is a lack of transparency for the customer in understanding what is driving the increase in the renewal premium as insurers (or intermediaries) are not required to disclose this. This is also counter intuitive as renewal premiums should be lower (assuming a good claims history) as insurers have more accurate data and do not have customer acquisition costs.

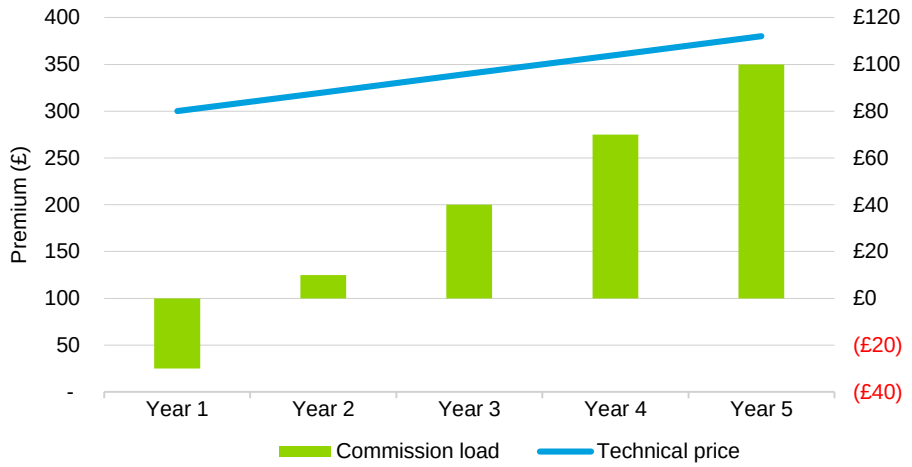
Progress has been made with the introduction of requirements for insurers to show last year's price on the renewal notice, as stated in the FCA publication titled 'Transparency in insurance renewals' in 2017.[50] . However, a later review in 2017, titled 'Firms falling short of renewal expectations'[51], found that some firms were either not implementing the rule for all products or failing to provide correct premium information or not presenting it clearly to the reader.

In the example on the right, we show an example of how a broker might have used this approach to compensate its negative commission in year one with increasing commission loads in year two to five. In this indicative example, the technical or risk price has increased by 26% whereas the retail price has increased by 78%.

Example of dual pricing model in retail GI

Pricing structure	Year 1	Year 2	Year 3	Year 4	Year 5
Technical price	£300	£320	£340	£360	£380
Commission load	-£30	£10	£40	£70	£100
Optimised price	£270	£330	£380	£430	£480

Example retail dual pricing



Assumptions:

1. Flat market
2. Renewal quotes accepted
3. No claims

Source: Deloitte analysis

Market dynamics – Propensity pricing

Although common practice across many industries, in insurance this practice means that customers with similar risk profiles could end up being charged different premiums

Propensity pricing is common practice across many industries and is used by a range of insurers and insurance intermediaries, particularly in the pricing of personal lines products. It involves analysing customer data in order to segment a given customer base and estimate the lifetime value of different segments of customers. Relevant propensities may include propensity of customers to:

- Renew the primary insurance products year-on-year at given renewal prices;
- Buy and renew add-ons and/or cover extensions; and
- Pay by instalments (purchase premium financing products).

This approach can lead to customers with similar risk characteristics being charged different retail premiums.

A particular concern is the customer segments that are penalised through this approach with higher premiums more likely to be charged to those that are considered vulnerable as they do not actively understand that shopping around has a financial benefit or they are on lower incomes and need premium finance.

Example of different customer prices under propensity pricing

Example propensity factors	Customer 1	Customer 2
Technical price	**£100**	**£100**
Channel customer arrived through	£ 102.00	£ 110.00
Customer quote behaviour (gaming)	£ 105.00	£ 132.00
Time left before renewal date	£ 117.80	£ 145.50
Whether customer is paying in instalments	£ 120.25	£ 200.65
% interest charged on instalment payments	£ 122.60	£ 230.00
Whether client checked other insurers before buying	£ 138.00	£ 250.00
Whether client has sought to renegotiate in the past	£ 141.00	£ 270.50
Whether the client has paid any fees in the prior year	£ 148.50	£ 300.00

In practice, generally, not all of these factors would apply to one customer.

Assumptions:

1. Flat market
2. Identical technical price of £100

Source: Deloitte analysis

Impact of trends on market dynamics

We set out in the table below the impact of the trends we identified on current pricing practices and market dynamics

Trend	Pricing practices used	Impact on market dynamics and treatment of longstanding customers	Level of impact
On-Demand	• Pricing models used are more akin to the pricing used in the sale of add-ons where the price has a greater fixed component. Insurers are also likely to consider a customer's willingness to pay to cover the specific item. • Traditionally annual policies are bought to be in place in case of an event, whereas customers of in-demand policies are buying due to a perceived need at the time, which could be correlated with an increased likelihood of claiming. • Insurers pricing approach will become more sophisticated as machine learning looks at customer behaviour of when a product is covered and likelihood of a claim.	Consumer prices are not necessarily cheaper overall, but longstanding customers are not charged more.	
Usage Based	• The data generated through the usage based approach provides insurers with more accurate risk data. Pricing can be more individualised, unlike now where prices are based on generalised risk factors. • However, pricing practices will largely continue as present with insurers simply applying additional data to their existing GLM models e.g. telematics pricing. Over time this is expected to become more sophisticated as machine learning can learn from the huge volumes of data provided.	The link to the individual's own risk profile and the increased transparency involved with customers being able to see their own driving behaviour will enable customers to make more informed choices at renewal.	
Sharing Economy Products	• Sharing economy products would not necessarily be priced any differently to traditional products, it would be based on the claims experience of that sub-sector of the market. Insurers do have to be able to understand when the asset is being shared or not, which may rely on the customer advising the insurer. • Where the platform is involved as a distributor, this could decrease transparency of pricing year on year as platforms could either use their power to benefit customers or introduce additional costs to the value chain e.g. commission.	As cover is potentially being turned on and off and there is therefore no annual renewal cycle, it would disrupt the current longstanding customer dynamics.	
Peer to Peer	• Under a Peer-to-peer (P2P) model insurers set prices based on the pools of premium rather than individuals, although insurers will seek to identify the risk presented by each individual in the pool in forming their price. • Although P2P insurers target underwriting at a profit (unlike mutual) this benefit is normally passed on to customers in some form.	The link to the claims performance of the pool as a whole rather than the individual means that pricing is more variable and thus breaking the link to traditional renewal pricing.	
Data Brokers	• Data brokers consolidate groups of people with similar risks. • Their model acts against the trend towards individualised risk and could allow otherwise "uninsurable" risks to be placed. • Otherwise, pricing works in the same manner as for other books of business.	Data brokers provide access to insurance products for those who may not be able to access insurance at an affordable rate. However the lack of options, may see these models build up a larger than average renewal book.	

● High level of impact ○ No or very limited impact

Impact of trends on market dynamics (cont'd)

We set out in the table below the impact of the trends we identified on current pricing practices and market dynamics

Trend	Pricing practices used	Impact on market dynamics and treatment of longstanding customers	Level of impact
Value added services	• Insurers bundling insurance with value added services typically offer a discount to the retail price. In addition, use of any risk management services can reduce the risk price paid by customers. However, retail pricing works as normal.	Value added services are used by providers to increase the stickiness of customers. The risk of losing access to value added services could increase customer inertia, and thus result in greater numbers of longstanding customers.	
Embedded insurance	• Bundling insurance products with non-insurance services reduces the transparency of the price of the insurance element, making it harder to compare to standalone insurance products. • The insurers providing the underlying products, will typically use the same pricing techniques as they would to pick a traditional affinity scheme.	Embedded insurance products are used by providers to increase the stickiness of customers. Customers will also have less opportunity to shop around at purchase. However, these products will not have an annual renewal cycle with corresponding price increases.	
Auto-Switching	• This involves the customer being automatically switched to a cheaper alternative as soon as possible (considering any costs of switching). • This pricing practice would offset the inertia of customers, leading to fewer renewals. • Auto-switching would not necessarily be done annually, so it could break the annual renewal cycle.	Auto-switching would end the annual renewal cycle, increasing new business premiums. To retain customers at renewal insurers are likely to need to reduce renewal premiums.	
Value Based Comparison	• Currently providers on PCWs often offer more stripped down or basic products to reduce the premium and hence appear higher in the list. • Basing selection on value rather than price, would still be underpinned by the same risk-based pricing techniques. • Insurers may choose to develop more premium products to continue to be placed at the top of the screen.	Price is still likely to be an element of consideration for customers therefore there is likely to be a limited impact on longstanding customers, unless this innovation is paired with auto-switching.	
Parametric products	• This insurance does not involve indemnifying the loss but paying out automatically when a specific event occurs. • Pricing practices would differ as insurers would be modelling the likelihood of multiple events occurring as opposed to the individual's customer risk profile or propensity to renew.	Parametric products typically are not subject to renewal pricing, and longstanding customers would not be disadvantaged.	
Open Insurance	• Creating an open API for insurance would make it easier for new market entrants to launch insurance products and improve technical pricing in the market as a whole as all insurers would have access to the full claims experience of the market. • Retail pricing would be unlikely to be affected.	Likely to increase transparency for the customer of their own risk profile and allows access to a greater set of providers. No expectation it would change the annual renewal cycle.	

 High level of impact No or very limited impact

Considerations for potential remedies

Consideration of potential remedies

The market developments identified will help support improvement in the treatment of longstanding customers in the long term but remedies are likely to be necessary in the short term to effect change more quickly

Likely remedies to current market practice

The FCA's diagnostic work on general insurance pricing practices and their potential harm to the consumer ("*Pricing practices in the retail general insurance sector: Household insurance"*, TR 18/4) identified a number of possible remedies.

Broadly, these split into two pillars:

Specific policy options for the FCA include:

- Introduction of a price collar on renewal customers;
- Complete price discrimination ban across equivalent products to different consumers with the same or very similar risk characteristics and costs to serve;
- Stricter regulation of the use of big data to inform pricing;
- Raising consumer awareness of firms' pricing practices and making comparisons publicly available; and
- Embedding a "switching culture" with reminders for switching providers.

How do the market developments impact on the types of remedies that might be most effective in addressing potential harms from pricing practices?

A number of the business model developments in the general insurance sector are aimed at disrupting current market practices and 'fixing' perceived issues for customers in the sector today. These are typically driven by the emergence of new start-ups who see this as a way of capturing market share from traditional players.

As shown in the previous section, the most disruption would be caused by changing the annual renewal cycle of policies. Innovations that focus on changing the duration of policies would have the most affect.

A second sub-set of innovation is aimed at reducing customer inertia by making it easier for customers to shop around. This includes auto-switching which has made in-roads in the energy sector, and the potential for open insurance. In 2017 *The Telegraph* reported that 5.5m customers (or one in every six energy customers) switched supplier to save an average of £200, indicating that significant strides in embedding a switching culture have already been made. These innovations would help support the demand levers which the FCA is considering addressing in its list of potential remedies.

However, currently most of the market developments discussed are focused on a sub-set of motor and home insurance customers, often particular niches e.g. young drivers. In a 3-5 year time frame the current pricing practices and the traditional annual cycle are likely to remain dominant for the mass market.

Appendix

List of insurers used in case studies

On-demand insurance

1. Trov
2. Wrisk
3. AvivaPlus
4. Cuvva

Usage-based insurance

1. AvivaDrive
2. InsureTheBox
3. ThingCo
4. Ticker
5. ByMiles

Sharing economy products

1. Dinghy
2. SafeShare
3. Tapoly
4. GuardHog
5. SliceLabs

Peer-to-peer

1. Laka

Data brokers

1. Avantia
2. BoughtByMany

Value added services

1. Dinghy
2. Laka
3. Waggel
4. Homeserve
5. Policycastle
6. Neos

Auto-switching services

1. AutoSergie (CompareTheMarket)

Embedded insurance

1. BlaBlaCar
2. Carphone Warehouse
3. Uber
4. Canopy

Open insurance

1. Monzo

Parametric insurance

1. Axa

Alternative capital backed insurance

1. IBOTT SPA
2. Limestone Re
3. Sussex Capital
4. AmWINS

Sources

Business model innovation

1. InsurTech entering its second wave, Deloitte Center for FS
2. https://www.bankingtech.com/2019/04/millennial-insurtech-kinsu-shuts-down/
3. https://pwc.blogs.com/press_room/2016/07/surge-in-insurtech-start-ups-aimed-at-improving-customer-service-new-pwc-and-startupbootcamp-insurte.html
4. https://home.kpmg/bh/en/home/insights/2018/08/insurance-innovation-through-acquisition-and-investment.html
5. https://www.insurancebusinessmag.com/uk/news/auto-motor/axa-makes-deal-with-insurtech-brolly-93541.aspx
6. https://www.insuranceage.co.uk/insurer/3354786/insurtech-futures-axa-teams-up-with-on-demand-motor-broker-by-miles
7. https://www.businessinsider.com/axa-insurance-startup-trov-uk-millennials-insurtech-tinder-airbnb-2016-11?r=US&IR=T
8. https://www.munichre.com/digital-partners
9. https://www.trov.com/
10. https://www.wrisk.co/
11. https://www.bmw.co.uk/finance/insurance/car-insurance
12. https://www.aviva.co.uk/insurance/avivaplus/
13. https://www.cuvva.com/
14. Pricing practices in the retail general insurance sector: Household insurance, TR18/4, https://www.fca.org.uk/publication/thematic-reviews/tr18-4.pdf
15. STRUCTURE OF THE UK AUTOMOTIVE TELEMATICS MARKET With a focus on the use of telematics in road safety solutions – IOT UK
16. https://www.aviva.co.uk/insurance/motor/aviva-drive/
17. https://www.insurethebox.com/
18. http://www.thingco.com/#about
19. https://www.ticker.co.uk/?gclid=EAIaIQobChMI9rSyorPD4QIV5pXtCh29NAjcEAAYASAAEgIY6fD_BwE
20. https://www.bymiles.co.uk/
21. Squaring risk in the sharing age - How the collaborative economy is reshaping insurance products – Deloitte and Lloyd's of London 2018
22. https://getdinghy.com/
23. http://www.safeshareinsurance.com/
24. https://www.tapoly.com/
25. https://guardhog.com/
26. https://slice.is/
27. https://heyguevara.com/
28. https://laka.co.uk/en/
29. https://youtalk-insurance.com/news/zurich/disruptive-bicycle-insurance-start-up-changes-name-to-laka-and-partners-with-zurich
30. https://www.avantiagroup.co.uk/
31. https://boughtbymany.com/
32. https://www.waggel.co.uk/
33. https://www.homeserve.com/uk/insurance-cover
34. https://policycastle.com/index.shtml
35. https://neos.co.uk/
36. https://www.comparethemarket.com/autosergei/?SRC=CU11&TrackerID=43700039773070954&msclkid=edbed4aedd95178f6f1a880a34456317&ds_rl=1251650&gclid=CL2V3IW2tOECFQ5gGwodDhIIfw&gclsrc=ds
37. https://www.blablacar.co.uk/axa-partnership
38. https://www.carphonewarehouse.com/
39. https://www.uber.com/en-GB/drive/insurance/
40. https://www.canopy.rent/
41. https://offers.peugeot.co.uk/just-add-fuel
42. How to flourish in an uncertain future, Deloitte LLP
43. https://monzo.com/
44. https://monzo.com/blog/2019/01/29/2019-features/
45. https://www.axa.com/en/newsroom/press-releases/axa-launches-axa-global-parametrics
46. https://www.artemis.bm/

Sources (cont'd)

Impact on pricing practices

47. General Insurance Premium Rating Issues Working Party (GRIP) report, 2007.
48. https://www.raconteur.net/risk-management/insurance-companies-competing-on-price-and-value
49. https://admiralgroup.co.uk/sites/default/files_public/annual-report/2018/02/2017-full-year-results-annual-report.pdf
50. https://www.fca.org.uk/firms/transparency-insurance-renewals
51. https://www.fca.org.uk/publications/multi-firm-reviews/firms-falling-short-renewal-expectations

Deloitte.

Mark McIlquham

Head of FS Audit & Assurance practice

Email: mmcilquham@deloitte.co.uk

Laura Scarpa

Director, Insurance Regulation & Strategy

Email: lscarpa@deloitte.co.uk

Hugo Martineau-Needham

Manager, Insurance Regulation & Strategy

Email: hmartineauneedham@deloitte.co.uk

James Rakow

Partner – Actuarial, Rewards & Analytics

Email: jrakow@deloitte.co.uk

Nigel Walsh

Global Deloitte Lead for InsurTech

Email: ndwalsh@deloitte.co.uk