

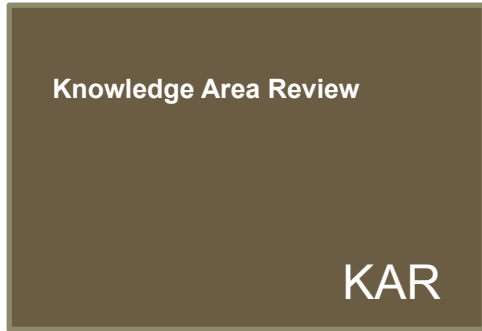


Knowledge Area Review (KAR 004)

Personal Lines Insurance: Global Pricing Innovation – Product Brochure

October 2014

KAR004: Personal Lines Insurance: Global Pricing Innovation



Insurers' adoption of intelligent pricing mechanisms (1/2)
Big Data improves efficiency in different business functions

CUSTOMER OUTCOME FRAMEWORK		
Big Data / Analytics Focus Areas:	Outcomes	Business Metrics
<ul style="list-style-type: none"> Retention Management New Product Innovation Sales and Marketing Effectiveness Customer Retention Customer Acquisition Customer Service 	<ul style="list-style-type: none"> Optimized call centers Personalized customer experiences Real-time customer insights Accurate customer segmentation Advanced level of market Risk Reduction Cost Reduction Increased revenue Cost Reduction Increased profits 	<ul style="list-style-type: none"> Risk Reserve Ratio Customer satisfaction Customer retention percentage Customer acquisition percentage Customer acquisition cost Marketing spend New Product Development Personal growth percentage Customer loyalty Operational risk
FRAUD MITIGATION		
<ul style="list-style-type: none"> Fraud across all lines of business is on the rise - making fraud mitigation a growing priority Reducing loss and expense - while accelerating claim settlement times - are key objectives Increasing the efficiency of Adjuster and SIU resources drives further expense reduction 		
RISK MANAGEMENT OUTCOME FRAMEWORK		
Big Data / Analytics Focus Areas:	Outcomes	Business Metrics
<ul style="list-style-type: none"> Risk Mitigation Cost/Risk Reduction Customer Retention Operational Effectiveness 	<ul style="list-style-type: none"> Risk Reduction Claims Reduction Advanced level of market Operational Effectiveness 	<ul style="list-style-type: none"> Claim Rate Operational Risk Customer Loyalty Claims Paying

The predictive modeling process
New predictive models are enhancing the ability to target non-renewals and segmentation of new business applications within a more efficient underwriting process

THE PREDICTIVE MODELING PROCESS

KEY INSIGHTS

- Considering the increasing use of these predictive models in the marketplace, carriers that fail to pursue similar underwriting tools will be facing adverse selection on a more scale, leaving them subjected to costlier underwriting processes in the face of adverse selection rate environment.
- Wall Street and rating bureau analysts are beginning to ask carriers, and carriers they will be employing to survive the next soft market, and predictive models are very much the focus of their questioning.
- Underwriters can leverage these tools to prospect for new, more profitable books of business. With the ability to identify sub-segments of business with a greater likelihood of generating profitable future volume, underwriters now can more adequately price productive books of business - in a much more uniform manner than ever before and pick the best risks, even from some of the more challenging classes.
- Most importantly, this targeted pricing gives underwriters from over pricing books since they can employ a tool that right prices the risk and its exposures.

KAR 004 is a companion resource to our monthly global periodical *The Insights Review (TIR)*, deeper full dives on a specific topic in the form of our *Certified Case Studies (CCSs)*, and unique, highly-distilled syntheses of the newest thinking in an industry, sub-sector or function in our *Domain Knowledge Scans (DKSs)*.

KAR (Knowledge Area Review) 004 on Personal Lines Insurance: Global Pricing Innovation contains information-rich slides which comprehensively describe the major trends in this area. It is certified by ICG to be based on publicly- and externally-sourced information only, together with the author’s industry insights. It comprises 76 pages of PowerPoint slides which offer:

- A synthesis of available information from applied science journals, research databases, public company records, etc.
- A unique blend of knowledge and insights from across the consulting industry – large and specialist– thereby avoiding bias and NIH (“not invented here”) issues on your projects
- Several relevant case study descriptions, including background information and key insights
- Several frameworks describing the trends in Global Pricing Innovation.

Main themes highlighted in this paper are:

- Strong actuarial analysis remains central to every insurer’s pricing policy
- Many innovations have arisen with the aim of capturing differential willingness to pay
- There is an industry focus toward reducing aggregate price sensitivity
- The rise and increased maturity of usage-based insurance has seen telematics-based motor insurance grow in mature markets.

Four main pricing components

For the purposes of this KAR, we have organized our thinking as follows

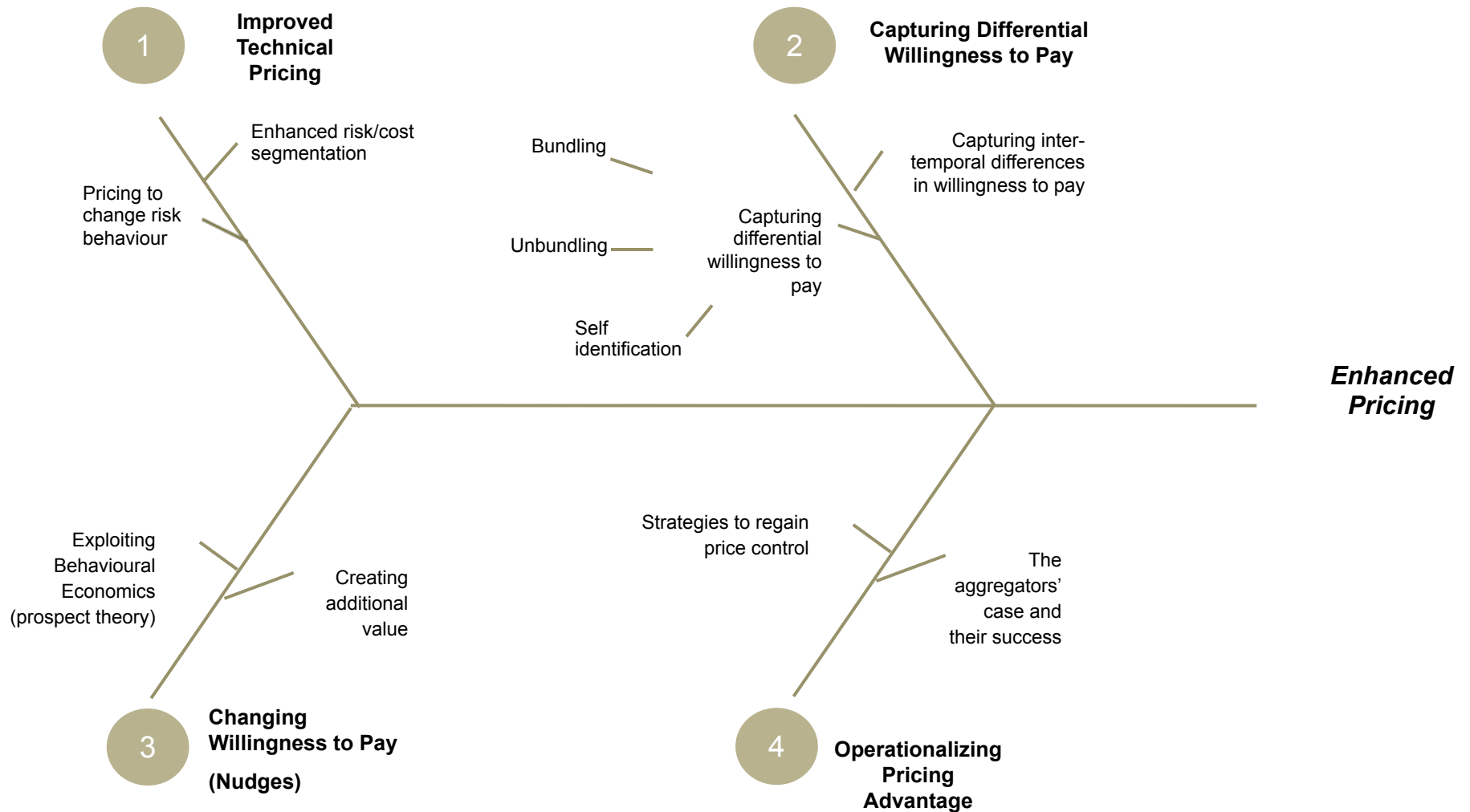


Table of Contents

Section	Component	Description
1	Executive Summary	Overview of our research and findings
2	Pricing Components	Overview of the key pricing components
2a	Improved Technical Pricing	<ul style="list-style-type: none">• Enhanced risk/cost segmentation• Pricing to change risk behaviour
2b	Capturing Differential Willingness to Pay	<ul style="list-style-type: none">• Capturing differential willingness to pay across customers<ul style="list-style-type: none">➢ bundling➢ unbundling➢ self selection• Capturing inter-temporal willingness to pay for individual customers
2c	Changing Willingness to Pay	<ul style="list-style-type: none">• Exploiting behavioural economics – prospect theory• Creating additional value and capturing the surplus
2d	Operationalizing pricing advantage	<ul style="list-style-type: none">• Strategies to regain price control• The aggregators' case and their success
3	Knowledge Sources	Relevant published materials for further reading

We have selected the best practice cases drawn from a selection of Financial Services and other industries globally

NORTH AMERICA



EUROPE



REST OF THE WORLD



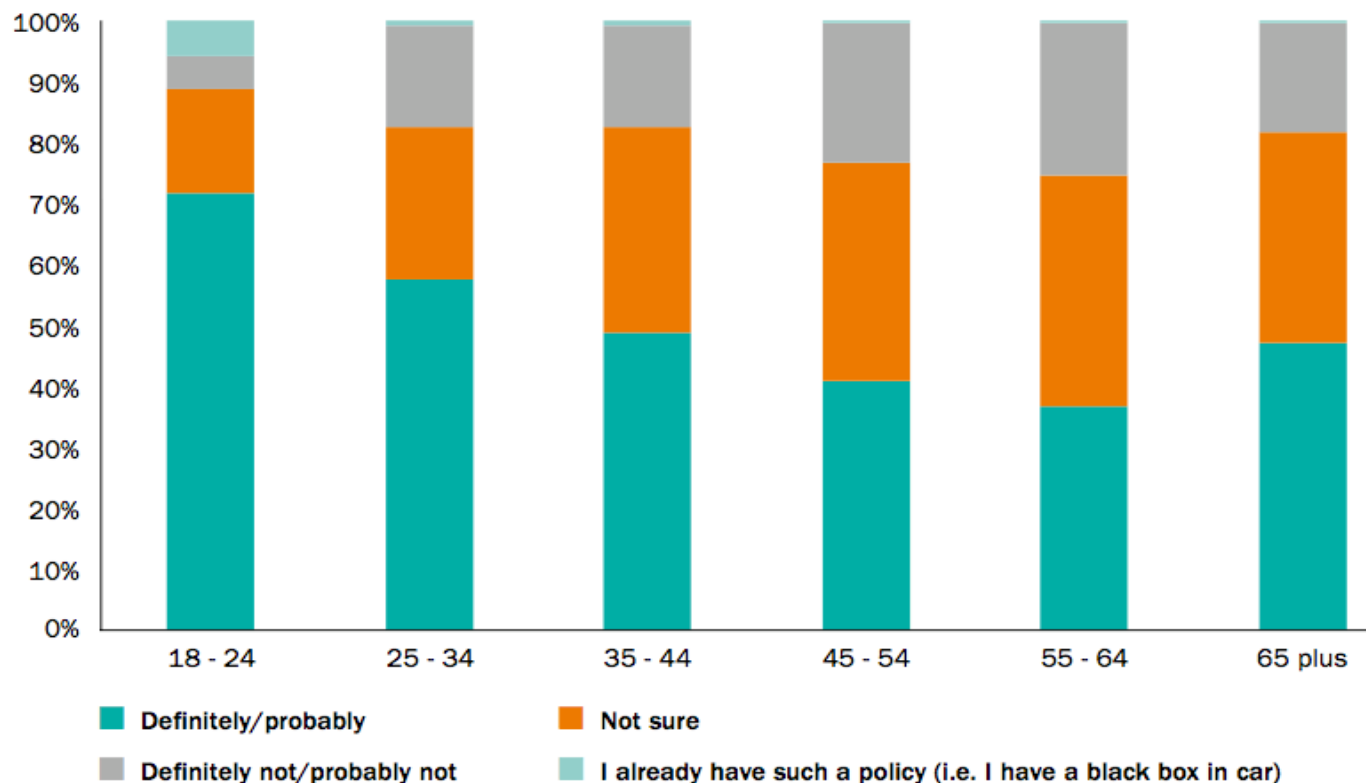
Sample 1: Innovation

The potential game-changer for motor underwriting and pricing is telematics

KEY INSIGHTS

- 57% of UK drivers are interested if there is a guarantee that their insurance premium will not increase
- Those who drive more frequently are more interested in telematics. 'Pay as you drive' products are therefore likely to penalise the very drivers who are most interested in telematics
- Working-age female drivers over 35 find a 'try-before-you-buy' option particularly attractive
- Value-added assistance services, such as automated emergency services call-outs, are appealing to British drivers
- The technology is well established in the large fleet world, primarily as a means of optimising vehicle utilisation through routing and idle time management, but typically without any linkage to insurance
- Adapting personal lines telematics propositions to smaller and mid-sized fleets could offer many of the same fleet management benefits within the wrap of insurance.

AGE PROFILE OF UK CONSUMER ATTITUDES TOWARDS TELEMATICS INSURANCE



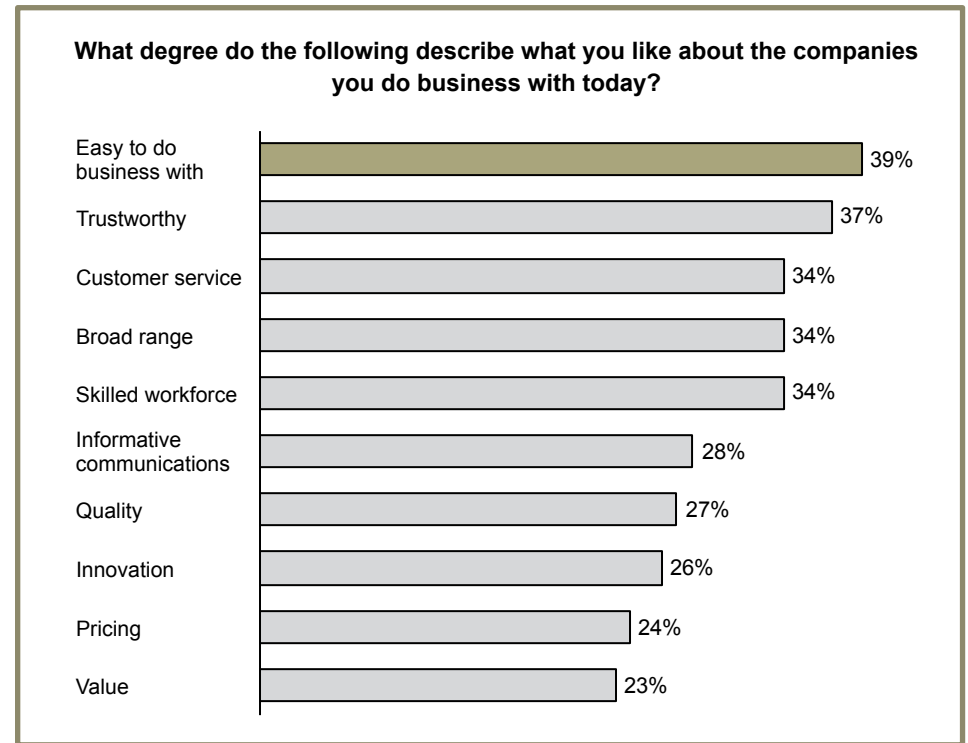
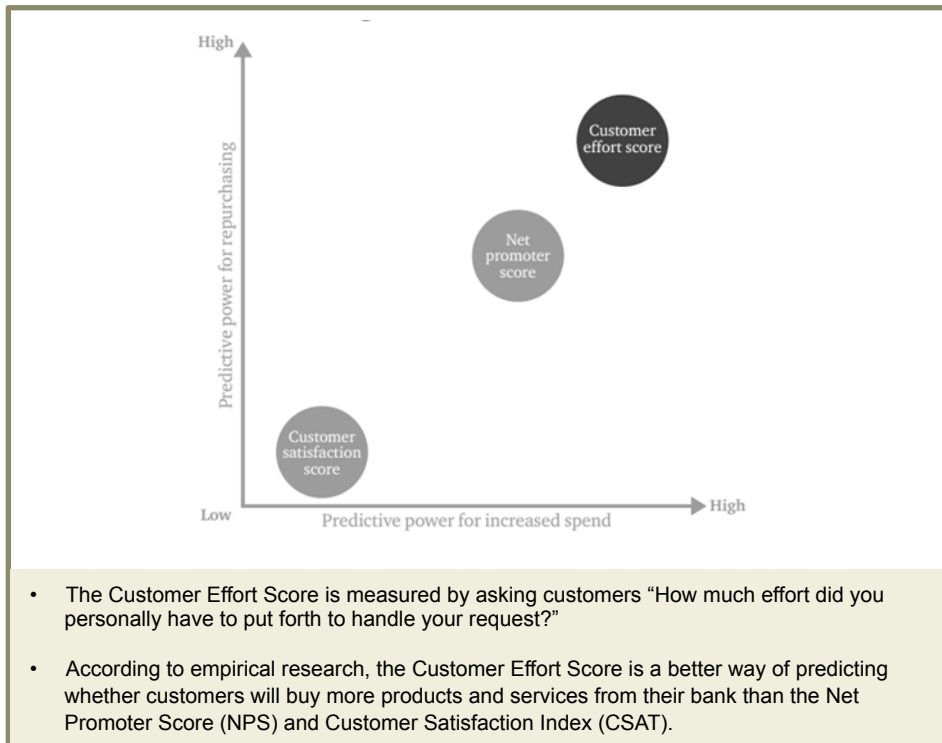
Source: Towers Watson/CGB fast.map survey – 2013.

Sample 2: Ease-of-use drives Customer Satisfaction and Loyalty

Data shows that people are willing to pay for a better experience

Research from PWC has found that lowering customer effort is the best predictor of spend level and likelihood to repurchase

Research from Accenture found that customers identify “ease to do business with” as the most important driver of satisfaction



Sample 3: Human biases offer great opportunities for pricing to better integrate design into customer experience

HUMAN BIASES EXPLAINS WHY DECISIONS CAN BE IRRATIONALS

Several examples of irrational decisions are:

- **Loss-averse:** people are more likely to act to avert a loss than to achieve a gain.
- **Reference Point:** the way people place value on a change in probability (e.g. of winning something). People appear to place greater value on a change from 90% to 100% (going from high probability to certainty) than from, say, 45% to 55%, and place the greatest value of all on a change from 0% to 10% (going to a chance of winning from no chance). This despite the fact that all three changes give the same increase in utility. Consistent with loss-aversion, the order of the first and third of those is reversed when the event is presented as losing rather than winning something: there, the greatest value is placed on eliminating the probability of a loss to 0.
- **Anchoring Effect:** tendency to be influenced by irrelevant numbers. Shown higher/lower numbers, experimental subjects gave higher/lower responses. For example, experienced German judges proposed longer sentences if they had just rolled a pair of dice loaded to give a high number.
- **Availability Heuristic:** mental shortcut that occurs when people make judgments about the probability of events by how easy it is to think of examples. The availability heuristic operates on the notion that "if you can think of it, it must be important." The availability of consequences associated with an action is positively related to perceptions of the magnitude of the consequences of that action. In other words, the easier it is to recall the consequences of something, the greater we perceive these consequences to be. Sometimes, this heuristic is beneficial, but the frequencies that events come to mind are usually not accurate reflections of the probabilities of such events in real life.
- **Framing:** context in which choices are presented. For example, subjects were asked whether they would opt for surgery if the "survival" rate is 90 per cent, while others were told that the mortality rate is 10 per cent. The first framing increased acceptance, even though the situation was no different.
- **Sunk Cost:** rather than consider the odds that an incremental investment would produce a positive return, people tend to "throw good money after bad" and continue investing in projects with poor prospects that have already consumed significant resources. In part, this is to avoid feelings of regret.



Internal Consulting Group

Email enquiries@internalconsulting.com or
visit our website at www.internalconsulting.com