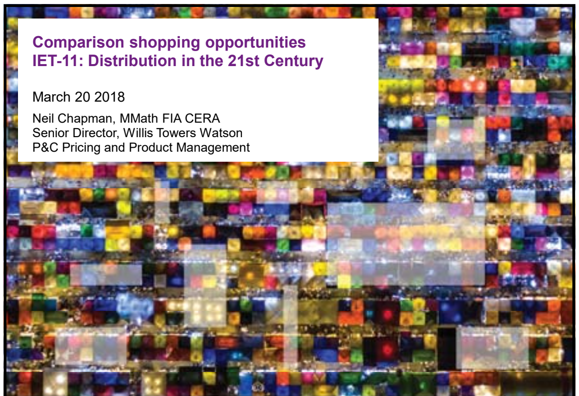

Comparison shopping opportunities
IET-11: Distribution in the 21st Century

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Neil Chapman, MMath FIA CERA
Senior Director, Willis Towers Watson
P&C Pricing and Product Management

WillisTowersWatson

What's this presentation about?

In some markets comparison shoppers, aggregators or price comparison sites have changed the nature of insurance distribution. They present new challenges to the approach to pricing insurance and other core functions such as policy administration and claims handling.

In this session we explore successes and roadblocks in the evolution of these distribution channels, growth opportunities and relevant constraints, and how actuaries can become more involved over the entire life cycle of a policy.

The four ages of UK personal lines distribution

The four ages of UK personal lines distribution

1. Agent/Intermediary	2. Direct	3. Aggregator	4. "Digital Direct"
			?
Pre-1995: Comfort	**1995-2006: Disruption**	**2007-2019?: Pain**	**2020+?: Panacea?**
Customer relationship owned and controlled by the agent/intermediary. Limited data with basic analytics. Long established brands.	Direct customer contact established, emerging analytical techniques with computer power, direct customer management skills developed	Insurers unwittingly outsource acquisition, intensely competitive environment, new capabilities required to succeed	"One stop digital shop". Big data and data science methods deployed to tailor offerings to customers, direct customer contact restored.

UK insurers are preparing (hoping) for a (kinder) post-aggregator era, but will it come?

Pre-direct (pre-1995)

Home service agents, high-street intermediaries, bordereau bank business

What was this world like?

- Customer data (beyond risk characteristics) resides with and retained by agents
- Agent can "sway" the risk presentation – both friend and foe in counter fraud, next best offer, etc.
- The insurer struggled to acquire contact rights for servicing and renewals and so was largely unable to tailor customer-centric service offerings
- Still a culture of "grateful for cover" amongst the populace, established brand names dominate, multiple product offerings, P&C products seen as secondary?

What did insurers need to be good at?

- Motivating and managing a sales force (or its union), managing broker relationships
- Computerising formerly manual tasks
- Developing post-tariff rating using "first generation" analytics and data
- Dealing with emerging risks as modern society interacted with traditional coverage definitions (mortgage indemnity, subsidence, etc.)

Is this all too long ago to be relevant?

Direct dominance (1995-2006)

Finally the insurer gets to deal direct with the customer…..

What was this world like?

- Emergence of lower operating cost models – new technology, single product, no legacy, no intermediary
- Prices are suddenly 15% to 20% lower
- Many new direct brands, and (reactively) direct sub-brands of established players
- New brands bring new accessibility (open beyond 5.30 and weekends!)
- "Policyholder" finally becomes "customer" – retailer CMOs enter insurance *en masse*
- Marketing is through TV and directories (pre-Google!), direct response with a price message
- Quote then sale by telephone, and latterly internet (say 2002+)
- Consumer buying experience = 5 times 8 minute phone calls to the big brands
- Retention rates remain high, retention save negotiation activities relatively small
- Cross-sell a focus (favouring multi-line insurers) – customer ID and address known, brand affinity, etc.
- Pricing = GLM, traditional (15-30) factor set, data obtained from the customer
- Analytical developments in marketing and pricing occur independently

Direct dominance (1995-2006)

Finally the insurer gets to deal direct with the customer…..

What did insurers need to be good at?

- Lead generation activities and cost per acquisition become important
  - CPAs are still high - marketing is about media optimisation (esp. direct mail response from lists having renewal date information)
  - Management of portfolios by conversion rate KPI emerges
  - Out-bounding targeting, price negotiation approaches matter
- Operational excellence focus is around call-centre management - customer experience is governed by call centre scripts and practices, waiting times
- Protecting the direct culture (separate brands, implementing modern technology separately from legacy systems)
- A good SCV becomes desirable as an analytical data asset
- Analytical data warehouses/resources become desirable for both Pricing and Marketing functions
- A "data acquisitive" mind-set emerges as a recognized competitive advantage
- Analytics is around DM response, media spend allocation, conversion rates, discretionary NB discounts, customer behaviours, LTV metrics

The "direct" age saw the emergence of many capabilities required for future success

Unstoppable aggregators? (2007-2019?)

UK price comparison websites ("aggregators") are shop windows, not brokers

A reminder of what UK aggregators are and do….

- No advice - only presentation and comparison
- Present prices from up to 150 partner brands…
- …based on the responses to around 100 customer questions
- Product form/cover is determined by each partner
- Partners may be direct insurers or intermediaries
- Often with multiple brands from the same insurance group
- Price calculation is undertaken externally, within prescribed time budgets
- The aggregator sits on top of a pyramid of XML quote messages
- It is paid per sale - a fixed amount negotiated separately with each partner
- It is prevented from remarketing at renewal…
- …and so interested in driving customer churn to increase new business
- Its most significant expenditure is on driving traffic to the website
- 3 (now 2) of 4 the main UK aggregators are owned by UK insurance groups

Comparison shopping sites, and how they changed everything

Experiences from 15 years of aggregators in the UK

- I'll address the following questions:
  - Have the aggregators experienced success?
  - How long did it take them to establish this position?
  - Why do they succeed?
  - What does it take for a risk carrier to succeed (on aggregators)?
  - What is the impact on the profitability of the risk carrier?
  - Is there a risk of something similar to the U.K. happening in other countries?
- Mostly, I'll address these points from the perspective of **private motor insurance**, in which the aggregators had the earliest and greatest impact

Have the aggregators experienced success?

YES!

- In the sense of their market share of new business.
- In permeating popular culture with high-profile advertising campaigns – meerkats, robots, opera singers – and so in developing brand awareness
- In the sense that they've defeated the insurers initial attempts not to play or to resist them.
- They've convinced insurers to accept them as a valid component of a multi-channel distribution strategy
- They've helped to propel some formerly modest motor insurers/intermediaries to the top
- They've now found ways to branch out from personal lines into SME and Life business
- In the sense that they're now generating material revenue streams from data products

NO!

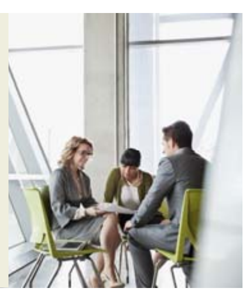
- Financial results for such dominant market entities are not material – they spend the vast majority of their revenues on TV advertising and search
- No, if you're a small aggregator, in that the barriers to entry and success are huge.
- In the sense that aggregators don't own the customer

MAYBE?

- Maybe, in the eyes of the competition authorities, who recognise their benefits in enabling a competitive and transparent market

Experiences from 15 years of aggregators in the UK

- Estimated to have involvement around **90%** of new **private motor** sales, and now **c.50% of Home**
- Aggregators have increased the size of the overall (new business) market by increasing renewal churn
- Market shares of the 4 aggregators are different for different products
- Different aggregators deliver different demographics to insurers



How long did it take them to establish this position?

2002 2003 2006 2007 2008 2009 2010 2011 2012+

2002 - 2006: The four 'ultimate survivors' launched,

2007 - 2010: Mass market advertising. Consumers embrace aggregator concept.

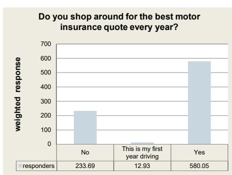
2011 - 2012: Quote manipulation and application fraud become endemic.

2012+: Larger 'aggregator resister' insurers finally concede the importance of the channel and begin to develop the capabilities to trade effectively on aggregators. Fortunes of 'big 4' vary with the success of their latest TV advertising campaigns.

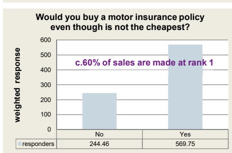
The rise of aggregators in the U.K. was co-incident with the roll-out of broadband (before mobile) and with the rise of internet shopping and consumer trust in e-commerce brands. Logically, this specific set of circumstances will not be repeated.

Why do aggregators succeed? (1/4)

- Consumer factors:
  - Consumers **buy on price**, and the focus of these sites is on price
  - Consumers **want to save time**, and believe in the aggregator proposition of comparing the whole market
  - Consumers **don't always tell the truth**
  - Exhibited behaviour differs from declared behavior
  - This contributed to some insurers' believing that they could resist the aggregators



	No	This is my first year driving	Yes
responders	233.69	12.93	580.05



	No	Yes
responders	244.46	569.75

Why do aggregators succeed? (2/4)

- Market factors:
  - The telephone direct channel had paved the way, breaking the customer link with (and the economic case for) agents and intermediaries
  - U.K. average **premiums increased** on average by 70% between 2007 and 2011, owing to a **personal injury crisis** (which itself was fuelled by aggregators and the opportunity they provided for application fraud)
  - The introduction of **price optimisation techniques** opened a price differential between new business and renewal which encouraged shopping at renewal

Why do aggregators succeed? (3/4)

- Aggregator characteristics:
  - Aggregators are thin and **agile digital businesses**, consumer-focussed, with empowered individuals – they're **faster moving** than any insurance company management team
  - Aggregators have **made it easy for insurers** to link to them (via XML), they've driven sophistication in rating, which insurers like, and because they've outsourced the pricing calculations
  - Aggregators have developed extremely **effective marketing strategies** – e.g., giving a cuddly toy with each sale
  - Aggregators have **avoided regulation** by religiously avoiding looking like an intermediary offering advice – they're a shop window, no more

Why do aggregators succeed? (4/4)

- Aggregator characteristics (continued):
  - Aggregators have been **nurtured by** some of the very **insurance groups** who have gained most from them – Admiral, esure, BGL – to the disadvantage of those who do not
  - Their **model is simple** – CPA fee for new business, flat amount
  - They offer insurers a **lower acquisition cost** than they can achieve themselves (on direct or intermediated business)
  - They have **reduced barriers to market entry for new underwriters** (delivering volume and market composition/pricing data) and so they've encouraged competition, naïve capacity, and higher partner numbers
  - Because of their ownership structures, in that they haven't generally sought to float and burdened themselves with debt, threatening advertising spend

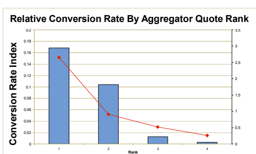
What does it take to succeed as a risk carrier (1/2)?

- This list is illustrative of the types of developments likely to contribute to success in an aggregator environment (but not exhaustive!)
- Insurer internal capabilities:
  - A step-change in **pricing sophistication** (technical and retail), fuelled by external **data enrichment** (DE), and leading inevitably to micro-segmentation, in order to combat the 'winner's curse'
  - Underlying this change, considerable **improvements to internal data**, **analytics** and **price delivery** mechanisms
  - A step-change in **underwriting counter-fraud** capabilities, again fuelled by external DE
  - Increased **operational agility** (e.g. in pricing implementation) in order to mirror the dynamic nature of the aggregator market, modern systems, and greater empowerment of staff
  - A '**test-and-learn**', not 'predict and measure' culture to pricing and to other aspects of the proposition – **rapid feedback loop** enabling an "experimental" mentality
  - Improved landing-page website design to support capture and up-sell, with **journey analytics**, MI and optimisation via A/B testing

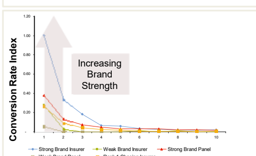
What does it take to succeed as a risk carrier (2/2)?

- Brand and product:
  - **Product slimming**, and **tiered product** forms to support targeted up-sell after click-through
  - **Brand proliferation**, with 'brand stacking' approaches to price differentials in order to 'dominate the results page'
- Aggregator relationships:
  - The forging of **strong relationships with the aggregator** in order to secure the best understanding of the environment and so how to succeed within it
  - Negotiated access to **aggregators' data assets**, over and above their standard MI packs, in order to understand market pricing and composition
  - A willingness to propose and develop '**special deals**' with the aggregator (e.g. cashback)
  - In general, **embrace them**, don't lag others in adopting this channel if its success is inevitable
  - A **coherent multi-channel distribution** strategy and supporting processes and systems, or distinct brands tied to distinct channels having different propositions to different customer segments

Pricing – The 'winners curse' and adverse selection



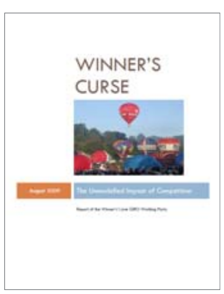
- The aggregator channel enables almost perfect competition between providers
- The key proposition of 'finding the cheapest provider' encourages customers to focus on price
- This results in an extremely price elastic environment, with price elasticities which can be well into double-digits
- Quote conversion rates depend heavily on rank, falling away quickly



- These are relatively impervious to brand effects but weak brands need rank 1 position more desperately
- The consequence of this intense competition is that sales are made at higher loss ratios, with higher churn and lower expected lifetimes
- **Knowledge of competitor pricing, active retention management and customer LTV measurement all become more important**

Pricing – The 'winners curse' and adverse selection

- The rise of aggregators and their impact on potentially weak pricing so worried the UK GI pricing actuaries that in 2009 they undertook this study…
- http://www.actuaries.org.uk/research-and-resources/documents/winners-curse-unmodelled-impact-competition-report-winners-curse-gi



Pricing – a leap in technical sophistication

- The rise of aggregators triggered an unprecedented drive for technical pricing sophistication in UK personal lines, with Motor insurance leading the way
- This trend was reinforced by some concurrent developments, including:
  - A surge in third party personal injury claims
  - The EU requirement for gender-neutral pricing
  - Technology enabling real-time data enrichment at POQ and the execution of sophisticated pricing algorithms
  - A wealth of useful proprietary data along with Government Freedom of Information developments
- **Data** developments included the adoption of an over-riding data acquisitive culture as a basis for pricing accuracy and granularity.
- Analytics developments have been geared towards extracting more granular and accurate risk models from the improved data, and enhancing retail pricing approaches
- Implementation developments have been geared towards rating **agility, granularity and delegated authority**

Pricing – a changed function and processes

- Controlled, restricted
- Theoretical correctness
- Long review cycle and MI
- Predict and measure
- Monthly/weekly change slots
- Reliant on IT support
- Manual processes
- Actuaries

- Empowered, encouraged
- Commercial focus
- Rapid review cycle and MI
- Test and learn
- Intra-day changes
- Direct systems access
- Increased automation
- Analysts, data scientists

Traditional **Aggregator**

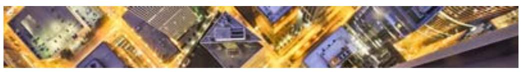
Underwriting – the rise of application fraud

- Increased price transparency **enabled customers to undertake experiments** around the effects of rating factors on price and differences to competitors' rates, and increased their awareness of cover, options and add-ons
- "Financial expert" websites were better able to provide and evidence "money saving" tips, and customer **remoteness from the insurer encouraged risk misrepresentation**
- Here's an example sequence of quotes on an aggregator progressing from the correct risk to deeply misrepresented and fronted risk………**saving 87% of premium**

Quote	Driving	Age	Garaging	Claims	NCD	Postcode	Premium	% of correct premium	Notes
1	IOD	24	Road	1	0	SE18 1PT	£3,425	100%	Correct details
2	IOD	24	Road	0	0	SE18 1PT	£2,960	86%	Accident was on someone else's policy
4	2 Named	24/51	Road	0	0	SE18 1PT	£2,890	84%	Add parent as driver
3	IOD	24	Road	0	2	SE18 1PT	£2,168	63%	Named driver NCD(?)
5	2 Named	51/24	Road	0	5	SE18 1PT	£1,026	30%	Fronting
6	2 Named	51/24	Garaged	0	5	SE18 1PT	£926	27%	Fronted address has garage
7	2 Named	51/24	Garaged	0	5	NR13 5NN	£435	13%	Insure at fronting address

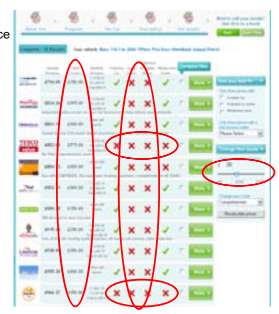
Underwriting – application fraud mitigation

- This became a **very significant issue**, with an estimated 5% to 10% more premium on aggregator transactions lost to application fraud compared with phone transactions
- As UK personal lines moved onto aggregators, **underwriting approaches (and footprints) were generally cautious** – if for no other reason that underwriter referrals effectively became declines
- As a response to the application fraud risk, **underwriting became focused on data-enriched counter-fraud**, with increased verification based on credit and ID data, CUE (historical claims) and DVLA (historical convictions), device ID, etc.
- **Underwriting rules became more numerous and more complex,** aligned with more granular and sophisticated pricing



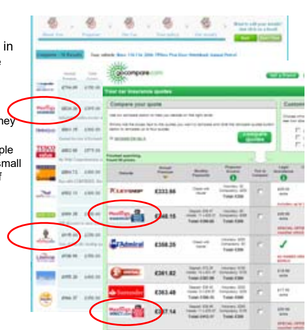
Product – slimming, proliferating and ancillary up-sell

- Aggregator sales rates are extremely price sensitive, but **less sensitive to product features**
- Where reducing cover enables reduced prices, the volume gain might typically outweigh the reduced customer appeal
- So, as U.K. personal lines went onto aggregators, **products 'slimmed-down'** with:
  - **increases in** compulsory and 'suggested' voluntary **excesses**
  - **removal** into optional add-ons **of cover elements not valued by *all* customers**



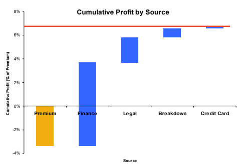
Product – slimming, proliferating and ancillary up-sell

- Insurers adopted other approaches in an attempt to maximise sales in the aggregator environment:
  - adopting a **'tiered' multi-product approach** often comprising a 'rank 1 chaser', a 'standard cover' and a 'money no object' product range
  - **'brand stacking'** – running with multiple brands, having similar products with small price differentials, with the intention of dominating the quotes screen

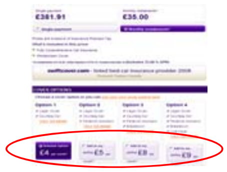


Product – slimming, proliferating and ancillary up-sell

- In order to secure rank 1 and a sale, insurers became more willing to **take a loss on the core cover**, seeking to enhance profitability through the sale of relatively profitable ancillary covers
- Ancillary sales propensity models became an important input to price optimisation models



- It became common (in motor) to achieve net **ancillary income equivalent to between 10% and 15% loss ratio**, often underpinned by sophisticated landing-page design and analytics



- In recent times, there has been regulator interest in the value provided by some ancillary products

Aggregators' impact on pricing, underwriting and product

A conclusion

- **Customers like internet price comparison**, and in the U.K. they have 'voted with their feet' to embrace the channel over a relatively short period of time
- This rapid shift in distribution has necessitated a **profound change in the required** approaches to insurers' core strategic **competencies**, of pricing and underwriting, along with their product forms
- These new approaches have required **step changes in pricing** data inputs, the sophistication of pricing analytics, price delivery systems, underwriting approaches and product management
- Those established **insurers who have embraced price comparison**, and whose pricing and underwriting approaches have developed most rapidly, **have out-performed** the 'aggregator-deniers'. Many of the largest, fastest growing and best performing insurance groups in the U.K. have strong aggregator presence, despite the technical challenges that this channel provides
- Taking a positive view, this has been, and continues to be, an interesting and exciting time to be involved in insurance pricing and underwriting.

What has been the impact on risk carrier profitability?

- The main initial detrimental impact to insurers were to the loss ratio, through exposing pricing to customer experimentation and to a perfect market with 'winner's curse', and also to the retention rate and so to customer LTV
  - **Loss ratios** were typically **impacted by between 5% to 50%** according to whether the insurer embraced and developed appropriate sophistication and agility in pricing and underwriting, especially around data enrichment to counter application fraud
  - Initially, the profit impact of the different aggregators was different according to the extent to which they 'assisted' the customer in completing the question set
  - Now, for the best insurers, aggregator business delivers **lower loss ratios than for other channels**, but retention rates remain lower than other channels
  - Aggregator retention rates for Motor are **typically around 55%**, and may have been closer to 80% for strong direct brands prior to aggregator
  - Achieving even that retention rate has become costly, as save activities and expenditure have ramped-up. It would not be out of line to spend **1.5% of total premiums on renewal save**
  - Managing the winner's curse becomes a challenge – can you identify where you're being selected against and deal with it – it is often in areas in which you don't have the factor/data e.g. driving experience not rated – these are the 50% loss ratio deterioration cases
- On the up-side, cost per acquisition is lower than through other channels – effectively the insurers have outsourced TV advertising to the aggregators

Is this just a U.K. phenomenon?

- **Consumers overwhelmingly have internet access** and are used to buying online from a range of competing providers in an aggregated portal, whether for travel, hotels, white goods, etc.
- Insurers like to argue that their product is more complex or essential than these other products or services but **consumers generally do not wish to understand insurance** in sufficient detail to accept this assertion
- There are U.K.-based insurance/aggregator groups (e.g., BGL/CTM, Admiral/Confused) having strong ambitions to export the model, and considerable expertise, and restricted U.K. growth opportunities
- There will be small, ambitious insurers who recognise price comparison as an opportunity to grow rapidly – ultimately it may not matter what the established insurance groups think or do
- There's low barriers to replication – one aggregator tends to spawn a second one as they're easy to establish
- We've seen in the U.K. that 3 or 4 aggregators is 'about the right number' – is 25% of the local market going to deliver a viable aggregator business?

Willis Towers Watson