Demonstrating the value of insurance to our customers and society

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Summary

- Value is highly subjective and insurers must find a way to demonstrate it through more than the price of their products.
- The industry works well when it aligns positive policy change with reducing unnecessary cost, this is a particular focus in the motor sector at present.
- Insurers must step up and embrace the transparency agenda.

At the very heart of the general insurance industry lies the value proposition we offer our customers and wider society. First, there is the product promise of helping retail and business customers to plan for the future and cope with bad luck, accident and disaster. Second, there is the industry's investment of our client assets and customers' hard-saved cash into the businesses and governments of Europe and the world, generating growth, jobs and prosperity by providing capital to the economy.

But value is always subjective. Somewhere along the way in the insurance industry's proud 400-year history, from the emergence of fire insurance among the ashes of the Great Fire of London to today's fiercely competitive quotes for car or travel insurance on price comparison websites, the value proposition that we offer consumers and society has become clouded. The worst financial crisis in living memory, and three years of the toughest austerity programme since World War Two, have compounded the difficulty in convincing the modern customer of the benefits we provide and the wider society we support.

It is now hard to see how the customer and the provider will ever agree fully on what value looks like in insurance. Maybe they never have agreed. But I believe a key part of getting more people engaged and in control of their finances is by helping them feel confident about the value that they and society get from insurance. So how do we communicate clearly the added value we offer – and achieve the seemingly impossible feat of improving consumer trust and confidence in our industry? A good starting point is driving out unnecessary costs, pricing risk accurately, and being ever more transparent in the process.

A good case study is car insurance. Here, there are two sides to the story. As a motor insurer where underwriting losses have been made for years, it can sometimes look like the customer is getting more than decent value for money and the price of motor insurance is too low. From a customer viewpoint, struggling with the rising price of essentials such as energy bills and food, it does not appear possible that insurers are making losses.

As a trade body, the Association of British Insurers (ABI) has a clear role in dispelling myths and shining a light on how our industry works. We recently provided, for the first time, a breakdown of outgoings as a percentage of premium income for motor insurance. Not only does the breakdown highlight that outgoings are more than 100%, but that personal injury claim costs now make up the largest proportion of motor insurance claim costs, with whiplash claims accounting for a massive 20% of premium income. We are making good progress in our campaign to reduce unnecessary costs and lower premiums are already feeding through in anticipation of legal and regulatory changes. But the test will be to see how customers respond and whether policymakers and commentators recognise the competitive nature of the market.

Driving out unnecessary cost is one part of demonstrating how insurers want to provide value to their customers; another is through the use of risk pricing to make the premium as personal as possible. But in certain markets, this can also lead to a perception of rip-off pricing and unreasonable behaviour by insurers. Young driver premiums are probably the most extreme version of this, with young people and their parents widely criticising the price of the premium, which seems completely unrelated to the value of the car. In reality, catastrophic and personal injury costs associated with drivers under the age 25 are the key factors driving the price of the premium, but many people simply do not understand this or the other risks that generate an average annual premium for a 17–18 year old driver of £1,853.

In this case, reducing premiums can be aligned to a noble public policy aim: improving road safety. This has two main benefits. Firstly, campaigning for changes helps to widen understanding of why premiums are set as they are. Secondly, if the Government agrees to change the way young people learn to drive, we estimate that the full ABI package of reforms (including a minimum learning period of one year, plus restrictions on carrying passengers and driving between 11 pm and 5 am) should help to reduce premiums for under-25s by an estimated 15–20%, thanks to a significantly reduced number of catastrophic motor accidents.

But questions about risk pricing can also be more subtle, such as when customers receive their premium renewal letters. It can be hard for customers to understand renewal price rises, particularly when they have made no claim and their circumstances have not changed – and especially if they pretend to be a new customer and get a cheaper rate than their renewal quote.

This may be linked to questions about risk pricing, but it is also a transparency issue. The transparency of products and processes is a key building block to help all of us in the industry to demonstrate value. It is probably also the most challenging to deliver. I think the whole industry recognises increased transparency with customers as one of the key drivers of the future. This is why ABI members in the life insurance market have recently signed up to an ABI Retirement Choices Code. The Code makes it compulsory for ABI members to encourage customers to shop around at the point of purchasing and annuity. But customers struggle to understand not only the products we sell, but also the way they are priced. ABI research has shown that a third of people did not understand that their insurance product premium included a first year discount, and that the increased cost in subsequent years is the 'standard' price.

Added to increasing consumer pressure for greater transparency is the significantly greater focus from regulators on how general insurance products are designed, sold and priced – particularly with the emergence of the new Financial Conduct Authority. The FSA has published a discussion paper on transparency, including proposals about publishing claims data and, along with its existing work on value for money, the signs are clear as to where regulatory focus will be targeted. The onus is on insurers to step up and respond: by winning the argument and reflecting on what it wishes to defend.

Ultimately, demonstrating value must always come back to the customer. Value is not simply about cheap headline prices, it is about what lies beneath and the customer's perception of the content of the product. Get that wrong and it impacts upon the trust and willingness of people to engage in the market and provides a path for the active and inquisitive regulator to follow.

If we can get to a place where there are minimal surprises between insurer and customer, in a market that is confident every product and service fulfils its promise, we will be well on the way to displaying the economic and social value of insurance for all to see in a way that resonates with the 21st century customer.