Association of British Insurers

Identifying the Challenges of a CHANGING WORLD

THE TRENDS FACING INSURERS TOWARDS THE 2020s

CHAPTER THREE

Changing Consumer

The industry's relationship with its customers has already undergone significant change over the last 25 years. In General Insurance, the emergence of direct sales and more recently the comparison websites has reframed the customer relationship and undoubtedly driven greater commoditisation. In the Life and long-term savings markets, there have been similar tidal waves of change with the development of personal pensions in the 1980s, the growth of the IFA market, the development of platforms, the recent partial removal of commission-based sales and advice and the implementation of pension reform. Against this backdrop, predicting further change to follow over the next two decades seems more like a statement of the obvious than analysis. Nevertheless consumers are continuing to change in a way that demands analysis.

Five over-arching trends broadly summarise how the consumer-insurer relationship is changing:

i. Greater demands of customer service and complaint resolution

ii. Expectation that regulators will provide greater protection

iii. More engagement in data use and risk pricing

iv. More segmented targeting by insurers

v. Multi-channel relationship, driven by the digital revolution.

Greater demands of customer service and complaint resolution

No insurer sets out to build a system with poor customer service, yet at a time when consumer expectations of product delivery and service are undoubtedly increasing and the digital revolution makes the insurer-customer relationship more public when things go wrong, insurers face the challenges of matching other sectors with higher satisfaction ratings and adapting to a new dynamic where customer communication is even more important.

Paying claims. No insurer in the future is going to meet the expectations of consumers or enhance its reputation and brand without paying legitimate claims in a prompt and customer-centric manner that is fully open and transparent. Insurers will still have to scrutinise claims for organised fraud, customer exaggeration or misrepresentation and compliance with Terms & Conditions but they will increasingly have to do so in a way that is fully open to public scrutiny and compliant with newly established permissions from their customers. The old media handling line of 'We don't discuss individual cases' will seem as obsolete as a dial-up modem in a world where the customer's experience is played out in public among online communities. A greater standardisation of the scope for what a claim covers and how service is delivered will also have to be renegotiated, almost certainly through a combination of conduct regulated and ombudsman established practice and the competitive dynamics of the market place. In an increasingly personalised world, customers may want more flexibility about how their claim is settled although speed is likely to be a standard requirement in a world where so much is transacted instantly. Rules and standard practice will only go so far and the human interaction will remain key; people making insurance claims will still be people dealing with an unwelcome or traumatic event, with their emotions heightened and an instinctive impulse to try and rectify the

> "Customers will increasingly expect to feed back on their insurance experience and rate it online just as they do their hotel or entertainment experience."

Paul Evans, Group CEO, AXA UK & Ireland

situation as soon as possible. Insurers who succeed in their customer service in this world will continue to value and invest in meeting the human aspects of an insurance claim, while operating by a set of public practices that can command a broader level of tacit support from their wider customer base, regulators and media. Publication of pay-out data and customer rating of insurers will be the norm with 'Trip-Advisor' style feedback from customers either on the product provider's website or on a separate insurance review site.

Speedy complaints resolution will be almost as critical as claims payment. In a contract-based, volume business where service delivery is dependent on the supply of highly accurate information and the exercising of good judgement, it is a cost of doing business that sometimes both or either of these critical factors will go wrong, even if the product sold was the correct one and the insurance company is acting in good faith in declining a claim either in full or in part. This makes the complaint process for insurers a vital part of 'future-proofing' their business so they can review contentious decisions promptly, benchmark against similar cases externally as well as internally, empower employees to a greater degree to resolve disputes and ensure, where appropriate, senior-level judgement can be exercised swiftly about how to tackle a significant complaint. This is not to say that insurers will have to agree with every complainant in order to maintain acceptable overall levels of consumer trust, **but complaints will have to be rejected on grounds that are evidently fair and consistent to the wider world with whom the process is likely to be shared through social media**. Complaints data will also have to be routinely subject to root cause analysis to convert the original complaints into long-term improvements in service. The danger for insurers may come increasingly – as it does sometimes at the moment – when they hold up the mirror to society on issues that it does not want to acknowledge, as when travel insurers are publicly blamed for the potential high cost of US health care for holidaymakers travelling with a serious pre-existing condition.
Customer needs, of course, are not limited to the claims experience, particularly in the life and long-term savings markets where it is the choice of product which can define the outcome, rather than the claim. Here, we will see an interesting blend of conduct regulation, technology shaped sales processes and insurer behaviour change the way sales are executed and commercial strategies are formed.

Expectation that regulators will provide greater protection

Conduct regulation will play a much more formative role over the next two decades in shaping customer relationships for the long-term savings, protection and general insurance sectors. Ironically this is because customers have high expectations of how far regulators will protect them even though they wield greater power in relation to their insurance company than they ever have given the accessibility of information and the relative ease of moving provider.

For the immediate future, regulatory focus will be on the avoidance of detriment; ensuring customers are not buying unsuitable products, informed sales processes and good product performance, with the underlying analysis increasingly driven by behavioural economics and competition models. Underpinning this however, in the UK conduct regulatory space, is a determination to have a more profound understanding of regulated companies' commercial strategies to be comfortable that sales and profit are being achieved in ways that are 'healthy' and fair and that the market overall is operating in a competitive way. While hard to argue with in principle, it is difficult to predict how this philosophy will be enacted over time. It could easily lead to an alternative – although not desirable - model of regulated 'utility' in which the approval, pricing, sales and performance of products are all scrutinised against regulatory benchmarks. This could drive unnecessary commoditisation and leave customers with a less innovative and responsive market as a result.

More engagement in data use and risk pricing

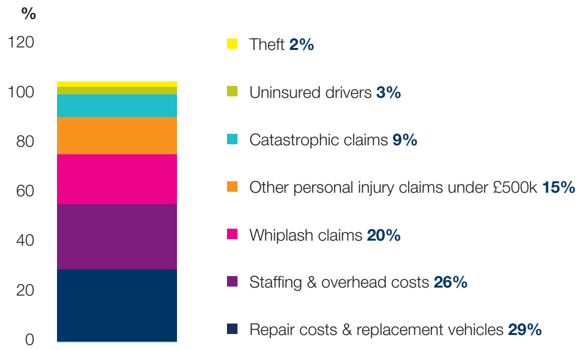
In a world where our **personal identity data** is more multi-faceted and publicly available, the means by which a customer agrees with the insurer who owns that data and how that data can be used to source and price a product will be vital. Vital to the insurer because it will be impossible to risk price effectively, fairly and competitively without access to all relevant 'public' information, but also important to the customer to ensure they are getting a product which is fully matched to their needs and priced appropriately. This is true whether the product is an annuity, a retail investment product, a critical illness policy or a home insurance policy. Insurers will increasingly have to establish permission levels about what data they need, how they are going to use it to risk price and how they will protect it. This will require a much more engaged process with customers working through the variety of channels which a customer will use to buy or renew a policy. Future dynamics around risk pricing are explored more fully later but the principle of 'informed consent' will be essential to the functioning of the market and to the likely future framework of data protection at an EU, national and international level. This is a framework which will have to reflect individuals' more permissive and fluid use of their data and to avoid reputational minefields around data permission.

More segmented targeting by insurers, offering a more personalised service

Insurer behaviour is also changing as they increasingly 'segment' the markets available to them to pursue customers who offer the best risk profile for their business model, using technology such as predictive underwriting. **Segmentation** has always been a feature of insurance, particularly in the highly sophisticated UK market where competitive advantage is sought and achieved through detailed risk assessments of potential customers. Because risk appetites will vary, as will business models and capital management strategies, the existing level of segmentation is usually only apparent to customers when those with specialist risk requirements such as high-risk flood properties try to use comparator websites. But with the future volume and granularity of data that will be available to feed computer models, the reality for most underwriters will be the use of segmentation at a level of sophistication hard to imagine now. The extent to which this increased use of segmentation is welcomed or criticised by customers will depend to a certain extent how far it is matched with greater personalisation of risk judgement and how competitive the UK market remains overall. For insurers dealing with the customers of tomorrow in a world where identity will be more defined and more public than ever before, it should be acceptable and expected for insurers to be much more explicit about which group of customers they aim to serve.

With more transparency over the customer base will come greater **visibility on pricing and projection** factors, consistent with constraints imposed by competition law and insurer relationships with third party suppliers. Connected to the world's information sources as never before, consumers in 2030, whether aged 17 or 70, will expect to understand how financial products are priced and expected to perform. In a product like insurance where the blend of risk factors will have a variable impact on the eventual price, this will be especially true. The old maxim that purchasers of such products should leave the engine unexamined to work under the car bonnet will feel outdated and commercially non-viable, whether it applies to fund management strategy, total charges and costs in a pension or the components of a total price for a motor insurance policy. The emergence of this trend is already apparent in the recent ABI industry agreement on charges and costs in pension products or indeed in the motor insurers' breakdown of the component parts of an average motor premium as part of the ABI campaign on whiplash costs (see Figure 11). It will also become apparent as regulators and insurers consider the best ways to engage customers with disclosure for retail investment products, which is likely to result in a broader mix of projection presentation and simpler descriptions of the potential outcomes.

Figure 11: Breakdown of average UK motor insurance premium, 2011



Source: ABI (2013) "Lifting the bonnet on car insurance -what are the real costs?"
Notes: Percentages relate to the amount *paid out* by insurers, relative to an average motor premium of £440 in 2011.

Those customers who have been successfully sold a product should see a greater industry focus on the **retention of existing customers** than has been the case in recent years in the general insurance market (see Figure 12). This will be especially true given the future challenges of amassing all the relevant data and the increasing pressure to pay claims to customers' full satisfaction; the more service levels increase and are the focus of investment, the more commercial sense it makes to retain an occasional claimant and cross-sell to them. Retention will not be easy given the ease with which instant connectivity will allow customers to be tempted to rival providers, some broker antipathy to cross selling to 'their' customers and the current pricing dynamics of the general insurance market which can see insurers discounting the price for new customers heavily at the expense of existing customers. Over time, these pricing practices may have to change if they are not to incur increasing levels of political and regulatory scrutiny and prove counter-productive to insurers' own commercial imperatives to retain customers who fit their business model and risk appetite.

Multi-channel relationships driven by the digital revolution.

Cross-selling will be made much more straightforward by the **connectedness** of the future. Most customers will have a relationship with their insurers through a variety of channels, including online, through brokers and the mobile telephone.

"To significantly improve insurers' reputation, we need to consistently do the right thing between now and 2025, focusing on the long-term benefit to customers of an insurance industry they can fully trust. We have to navigate short-termism and take difficult decisions now before future challenges become insurmountable."

Stephen Lewis, CEO General Insurance, Zurich UK

Figure 12: Percentage of customers remaining with same motor / home insurer at renewal, 2012

Source: ABI Consumer Survey 2012.
Note: "Home" based on 8309 respondents, "Motor" based on 7754 respondents.

Customers will expect to be able to move seamlessly between these channels, including on the same transaction, demanding sales and claims processes that are not dictated by the means of distribution and with technology that is genuinely customer-friendly not just more efficient in the back office.

For platform based businesses, the demands of customers are likely to increase to a more interactive and real-time update service, which may not sit easily with the investment dynamics of a long-term portfolio. For insurers using comparators, the increase in connectedness could help tackle the current 'hollowing out' problem where important differentials get squeezed out of the sales process by constraints on space and functionality.

The trade-offs for both insurers and customers here will be the cost of providing this type of service in the face of cash-conscious consumers who would ideally like ever-more sophisticated, personalised and digitally-enabled service while paying lower prices. One approach may be to codify service levels and charge accordingly, a principle which works well in the transport sector and is practiced to a certain extent with packaged accounts in the banking sector. Another approach may be to segment so relentlessly that better customer service can be provided for a smaller number of customers without impacting profit.

Another outcome may be the happiest of all; that the cost of new IT systems is offset by higher productivity enabling investment to be maintained in customer-facing staff and competitively low prices. In the long-term savings market, however, average costs of a new workplace pension are already at 0.52% with larger schemes going as low as 0.30%[9] so there is a limit to how much lower these prices could conceivably go and still be economic for the provider with good service levels for the customer.

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Join the debate

How far will insurers have to adapt current claims and complaint practices to meet changing consumer expectations?

Is the insurance industry sufficiently focused on the future data ownership and protection aspects of its customer relationships?

How will increased use of segmentation feel to customers?

How quickly can the industry prepare for a fully multi-channel future?

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[9] ABI (2012) "Time to Act: Tackling our Savings Problem and Building our Future"