Whitepaper

ContactEngine

Inertia in the UK insurance market

Introduction

“The market is broken. I don’t like it and neither do our customers.” – the words used in May 2017 by Mark Wilson, CEO of Aviva, when describing the personal insurance market and how it penalises loyal customers with higher premiums.[1] The purpose of this paper is to explore the seemingly broken nature of the personal insurance market. For simplicity, the paper will focus on motor insurance, but much of the discussion can be applied to home and other personal insurance products.

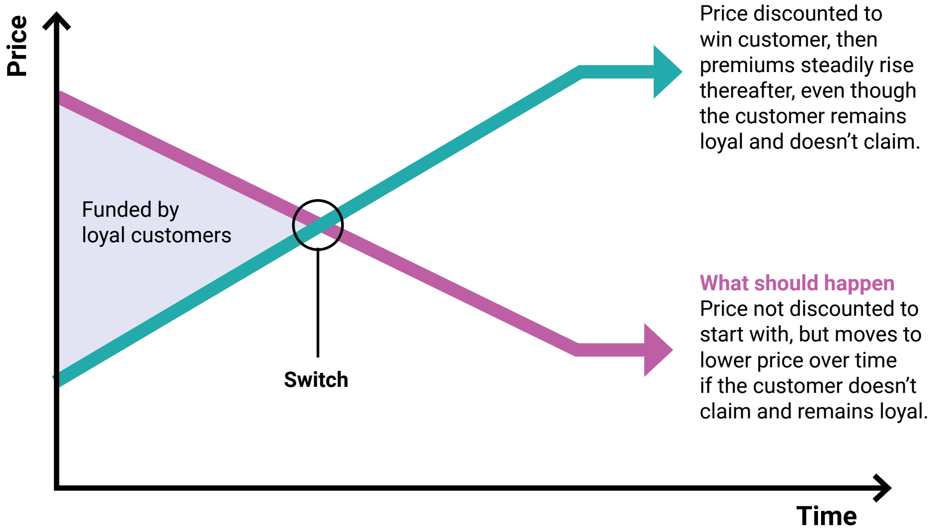
1. https://www.ft.com/content/f1c3a52a-3593-11e7-bce4-9023f8c0fd2e
Mark Wilson resigned as Aviva CEO in early October 2018

The loyalty penalty[2]

At renewal, customers who shop around can typically find an insurer offering an equivalent product at a discount to the renewal premium offered by their existing insurer. The discounts offered by insurers to attract new customers, or indeed to retain those that manage to successfully negotiate a lower premium at renewal, are necessarily funded by those customers that do not switch, as illustrated in the stylized example below.

Figure 1

The loyalty penalty



Furthermore, loyalty does not even appear as a factor that affects the insurance premium for a given customer. For example, as shown in Table 1, in an effort to improve transparency for customers, Aviva publishes on its website the factors that affect a customer's insurance premium, of which loyalty is a notable omission.

2. For the purposes of illustration, this stylized graph assumes that all premium-relevant factors other than the customer's tenure remain equal

Figure 1

Factors that affect your car insurance premium [3]

Customer-specific factors	External factors
• How far you drive • Where you live • The car you drive • No claim discount • Previous claims • Driving convictions • Who will drive the car	• Severe weather • Parts and repair costs • Nature of claims • Changes in the law • Number of claims • Insurance Premium Tax • Overheads

The symptom, or the cause?

Before diving into solving the loyalty penalty, it is prudent to question whether or not it is symptomatic of a more fundamental underlying cause. A sensible place to start in answering this question is to look at the three notable features of the market outlined in Table 2 below.

Table 2

Notable features of the insurance market

Feature	Relevance
The majority of new customers for a given insurer are 'switchers' from competitors, rather than new customers to the insurance market. For example, a 2016 study by Bain found that over 80% of customers in the UK who purchased a new motor insurance policy in the last 12 months had come from another provider[4]	Demonstrates the price-sensitive nature of the market in which customers "show fewer signs of inertia…have higher rates of shopping around and they do not appear to underestimate the benefits of switching or negotiating."[5] Indeed, the prevalence of price comparison tools significantly reduces the effort involved in shopping around.
The majority of customers will never actually use the insurance policy they purchase For example, between April 2016 and March 2017, only 10.4% of AXA UK's motor insurance customers actually made a claim[6]	The majority of customers experience only the beginning and end of the customer journey, rather than the middle part where companies can truly differentiate themselves beyond price.
Customers may exhibit overconfidence For example, consumers may exhibit overconfidence in their driving capability and purchase a cheaper insurance that does not afford them the suitable level of cover for their true risk profile[7]	The effects of overconfidence and other such behavioural biases lead to some customers placing an even greater emphasis on price at the expense of the correct policy for them.

3. https://www.aviva.co.uk/car-insurance/your-car-price-explained/
4. http://www.bain.com/publications/articles/customer-behavior-loyalty-in-insurance-global-2016.aspx
5. https://www.fca.org.uk/publication/occasional-papers/occasional-paper-12.pdf
6. https://www.axa.co.uk/insurance/personal/car/claims/
7. https://publications.europa.eu/en/publication-detail/-/publication/b86d7f2d-9e77-11e7-b92d-01aa75ed71a1/language-en

If one were to summarise the above table, it would be as follows: the majority of customers are both price sensitive and active participants in the market, with only a minority actually claiming on their policy. This would suggest that that notion of a loyal insurance customer is at least in part a fallacy – whilst some customers are indeed truly loyal to a brand, other seemingly loyal customers are simply the manifestation of inertia.[8]

For the purposes of this paper, truly loyal customers are considered those that knowingly pay a higher premium than had they switched, as opposed to customers whose ‘loyalty’ is the result of being trapped in a contract or purely economic reasons.[9] For example, this group could include customers who have claimed previously, had a good experience, and, rather than moving to a cheaper insurer, are comfortable paying a higher premium with their existing insurer for a known level of service.

However, the remaining group of customers that do not, or struggle to engage in the market are where the problem lies, as they are being penalised and likely unaware of it. This group could be identified by their level of interaction with the company over the course of their tenure – they will be the customers who have little communication post-initial purchase and simply let their policies roll over each year. It is therefore not the loyalty penalty that needs to be resolved, but instead the penalty of unconscious inertia.

Resolving unconscious inertia

In apparent recognition of the core problem being one of inertia, the UK’s Financial Conduct Authority (FCA) issued rules in 2017 requiring insurers to:

(i) disclose last year’s premium to a customer at each renewal,

(ii) include text to encourage customers to check their cover and shop around for the best deal at each renewal, and

(iii) identify customers who have renewed with them four or more consecutive times, and give these consumers an additional prescribed message encouraging them to shop around.[10]

8. https://www.mckinsey.com/~/media/mckinsey/dotcom/client_service/Financial%20Services/Latest%20thinking/Insurance/winning_share_and_customer_loyalty_in_auto_insurance.ashx
9. As per the Financial Times’ Lexicon: “True loyalty requires both share-of-wallet and share-of-heart so that customers continue buying even when situational factors may make a repeat purchase difficult, such as stock outage or alternative providers trying to persuade customers to switch using promotional offers” (http://lexicon.ft.com/Term?term=customer-loyalty)
10. https://www.fca.org.uk/publications/increasing-transparency-and-engagement-renewal-general-insurance-markets-ps16-21. Interestingly, the FCA found that the addition of last year’s premium on insurance renewal quotes had little effect on motor insurance, but did on home insurance.

The intention of the above rules is quite clearly to encourage customers to participate in the market and seek out a better offer. Taken in isolation, these rules will drive more shopping around and therefore place an even greater pressure on pricing for new customers, which in turn will likely lead to lower overall premium revenue in the industry. However, subsequent to the FCA's rules being issued, the Association of British Insurers (ABI) and British Insurance Brokers' Association (BIBA), the two main UK insurance industry bodies, published new commitments as follows:[11]

- Not supporting excessive differences between new customer premiums and subsequent renewal premiums that unfairly penalise long-standing customers
- Members will take action so that customers' tendency to shop around at renewal is not used to lead to excessive pricing differences that unfairly penalise long-standing customers, and
- Firms should make clear in written, online or verbal customer communications that the new customer premium only applies for that year and subsequent renewal premiums may be higher.

Given that price wars are almost invariably bad for companies by eroding profit margins, it is hardly surprising that the interaction of the first two commitments would imply that insurers are willing to enter into a mutual understanding that they will compete less aggressively on price for new customers.[12] If they all act together, then none will lose out, but it is not clear how such an understanding can sit comfortably with anti-competitive legislation.

Whilst it is a positive that the industry is acknowledging the problem of inertia, and that regulators have taken some action to prevent it, it is likely that it will be technological advances that really drive change. This is already happening in the similarly price-sensitive energy market, with start-ups such as Flipper not only helping customers identify the best energy tariff for them, but also automatically switching

11. http://www.bbc.co.uk/news/business-440398469. As per the Financial Times' Lexicon: "True loyalty requires both share-of-wallet and share-of-heart so that customers continue buying even when situational factors may make a repeat purchase difficult, such as stock outage or alternative providers trying to persuade customers to switch using promotional offers" (http://lexicon.ft.com/Term?term=customer-loyalty)
12. https://www.investopedia.com/financial-edge/0810/the-pros-and-cons-of-price-wars.aspx

them to it when their existing tariff ends.[13] If such a platform existed in the insurance market, it would reduce inertia and increase customer churn by almost entirely removing switching costs, which primarily constitute time and energy at present.

Loyalty

The discussion presented above would suggest that investing in building true customer loyalty may not be the most sensible thing for insurers to do, but building other forms of loyalty such as reducing customer churn certainly is. This is an important distinction to make – there are ways to reduce churn that do not require true customer loyalty to exist, which mostly involve increasing switching costs for the consumer.

Examples to reduce churn

Multi-product discounts
Multi-product discounts are a way to create economic loyalty, whereby it is both cheaper and simpler for the customer to buy insurance products from the same provider. In addition, such bundling of products makes for higher switching costs at renewal, making it more likely the customer will stay.

Creating an ecosystem
Whilst multi-product offers can reduce churn, Bain argued in a 2017 report that insurers need to develop ecosystems to “provide comprehensive and innovative solutions to their customers’ everyday needs, helping them protect their health, wealth and personal property”. In practice this means offering “non-insurance services —such as home security, car maintenance, health monitoring, financial planning and much more—that are natural extensions of their core products”.[14] Getting this right and demonstrating a real understanding of what the customer needs would arguably be a way to create true loyalty, but it could also result in simpler economic loyalty with customers placing a higher value on the ecosystemn than more basic offerings. Of course, not all customers will value the ecosystem similarly.

Longer-term contracts
The annual nature of the insurance market is costly in terms of the regularity of churn that it drives. In principle, it would seem sensible to offer multi-year insurance products to suitable customers, such as those who can evidence longer no claims discount periods. However, this may ultimately prove financially unappealing given the many factors outside of the insurers control that can greatly affect margins, such as extreme weather, managing spurious claims, and Insurance Premium Tax.

13. https://flipper.community/
14. http://www.bain.com/publications/articles/customer-behavior-loyalty-in-insurance-global-2017.aspx

Conclusion

This paper set out to explore the broken nature of the personal insurance market, more specifically the fact that longer-serving customers tend to pay higher premiums than those that shop around each year.

As discussed in this paper, it is only for a subset of those longer-serving customers that the market is truly broken, namely those that unconsciously renew their policies each year, and those that lack the awareness and ability to shop around. Whilst regulators have stepped in to try and encourage customers to shop around, and industry bodies simultaneously committed to not offering such steep discounts for new customers, it will likely be technology that drives real change, and that technology will make it ever harder for insurers to differentiate beyond price alone.

To draw a controversial conclusion – perhaps insurance companies should accept the price sensitive market they are in and focus on ways to drive economic and contractual loyalty with maximum operational efficiency, rather than seek the holy grail of true customer loyalty.

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ContactEngine is the next generation Customer Engagement Hub technology that enables brands to proactively engage customers in AI-driven conversations to fulfil business objectives. ContactEngine automates outbound customer engagement across all channels and generates unique insights into the changing patterns of communication by applying demographic and intent analysis, linguistics and ground-breaking artificial intelligence principles to mans volumes of raw data. ContactEngine transforms the way global brands engage with their customers - saving brands millions and making their customers happier.

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