



The Actuarial Profession
making financial sense of the future

GIRO Conference and Exhibition 2012

Juggling uncertainty the actuary's part to play

20th September 2012

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Fairness in Insurance Pricing

Update from the Discrimination Working Party

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Fairness in Insurance Pricing

- Background
- Quick overview of paper
- Consumer views of fairness
- Impact of pricing restrictions
- Alternatives to pricing restrictions

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Working Party Background

- GIPEC instigated GIRO working party to develop Profession's position in the discrimination debate
- Profession NOT Industry
- Focus on consumer
- Engage in public debate around fairness
- Audience is non-specialist interested parties
- Assist policymakers in making informed decision on how to share burden of costs
- NOT impact on industry, except where it impacts consumer
- NOT how industry deals with new legislation

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Potted history of gender pricing in Europe



- 2004 EU gender directive requires equal treatment in insurance
- Opt out for insurance if accurate and relevant statistical data is published and regularly updated
- Test Achats: European Court of Justice ruling March 2011

Article 5(2) of Council Directive 2004/113/EC of 13 December 2004 implementing the principle of equal treatment between men and women in the access to and supply of goods and services is invalid with effect from 21 December 2012.

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Potted history of gender pricing in Europe



- Test Achats: Advocate General Kokott opinion September 2010

“... legally inappropriate to link insurance risks to a person's sex. Differences between people, which can be linked merely statistically to their sex, must not lead to different treatment of male and female insured persons.... in particular, that gender is a characteristic which, like race and ethnic origin, is inseparably linked to the insured person as an individual and over which he has no influence. In addition, a person's gender, unlike, for instance, his age, is not subject to any natural changes.

”

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All in a backdrop of UK and European political pressure

- Growing sense that Fairness = Equal Treatment
- Differentiation should be understood by and pertain to the individual
- Age and location may also be under threat as rating factors
- In the UK, motor insurance industry particularly under pressure from OFT and Competition Commission



Growing public questioning of how insurance is priced; what personal data is used, and how; the use of proxy data

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Discrimination or Differentiation



Differentiation

- Different treatment based on a factor that can, in its own right, be justified as a predictor of risk
- So, in health, health status can be considered, meaning that it is legitimate to apply a different underwriting approach to each gender because it is physical differences that are directly related to gender that mean a customer is susceptible to a particular form of cancer



Discrimination

- Different treatment based on a factor that cannot, in its own right, be justified as a predictor of risk
- So in motor, gender has been used as an (effective) proxy to attitude to risk, level of testosterone, and is therefore now deemed to be discrimination

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Not a typical GIRO paper

- Written for non-specialist interested parties and policymakers
- Next step is to work with the Profession to circulate the paper to, and engage with, those outside the Profession
- Themes
 - Basic history and explanation of insurance
 - Including motor as a liability product
 - Impact of competition and adverse selection
 - Fairness in insurance
 - Impact of factor removal
 - Alternatives to controls on premiums
 - Consumer research on fairness in insurance

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The impact of competition



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Consumer Research

- Independent research carried out
- Over 1,000 buyers of Motor Insurance surveyed
- Work carried out by Consumer Intelligence
 - Part of on-going research into:
 - fairness,
 - third party data,
 - telematics,
 - consumer buying processes in General Insurance

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A Consumer's View on Fairness

Letter to the Daily Mail

I AM 21 and hold a full driving licence. As a qualified stonemason I need a car to find work, but the cheapest insurance quotes I can find are around £3,000, even for a small one-litre-engined cars. Obviously, I can't afford this. I've been using a 125cc motorcycle for more than a year and have made no claims or been given any convictions, so how are insurance companies able to get away with charging such ridiculous prices? When fuel prices go up by a penny a litre, the papers are full of public outrage, but when car insurance for young people goes up by hundreds of pounds, no one says a word. We're being penalised before we've even been given the chance to prove ourselves. **Up to 99 per cent of young people need a car to find work, but how can they when insurance is so high?**

I don't think it's fair to discriminate against young people. Treat us with respect and give us a chance.

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A Consumer's View on Fairness

Article in the Lancashire Telegraph

A CAMPAIGN has been set up to reduce high insurance premiums in BB postcode areas caused by fake insurance claims.

In just four days more than 1,500 people have joined a group set up on Facebook protesting about high insurance costs.

The campaign has received the backing of Blackburn MP Jack Straw, who has spearheaded a campaign to overhaul the industry, due to rocketing premium costs.

He is also concerned about companies selling clients' details to personal injury firms.

Rob Daye, 38, from Galligreaves, Blackburn, who set up the group, has also launched an petition in the hope of getting 100,000 signatures in order to get the issue brought up in the House of Commons.

Mr Straw said: "The campaign is a fantastic idea, I give it my full backing. This is something that I have been pushing for the past 14 months and will continue to do so.

"I think that it is outrageous that people can be made to pay more for their insurance based on where they live rather than the risk they pose to others as a driver.

"It's like paying more for health insurance because you live next door to someone with cancer.

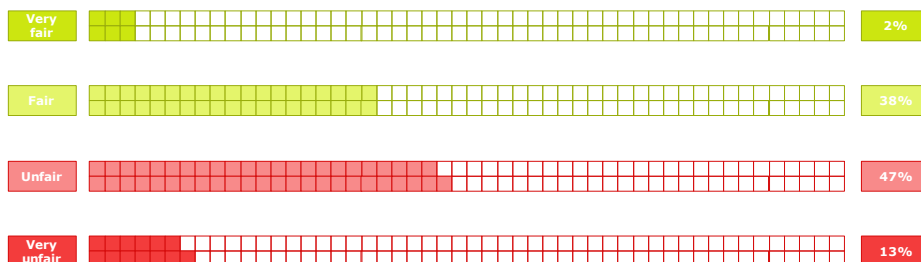
"I am going to see an insurance company about a case of someone in the BB1 area whose insurance premium increased by £700 because she moved from one part of the postcode to another part."

Mr Daye said: "I see it as victimisation, that people in BB postcode areas are paying for the wrong doing of a few people who scam the system.

"I personally have seen my insurance cost rise from £600 to £930 in just three years for a Peugeot 106 which only costs about £400."

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Q1: Do you think the way that car insurance premiums are calculated is fair?

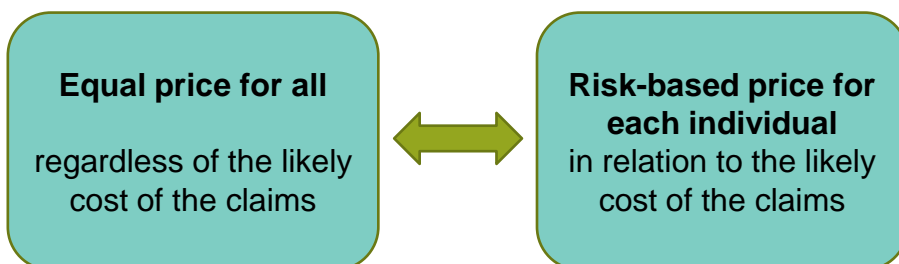


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Research by Consumer Intelligence: Sample 1,200 Motor Insurance Purchasers; June 2012 © Consumer Intelligence

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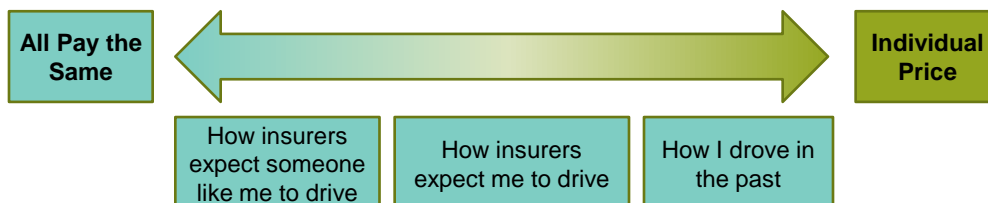
What's fair?



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So what does fair mean? – Motor Example



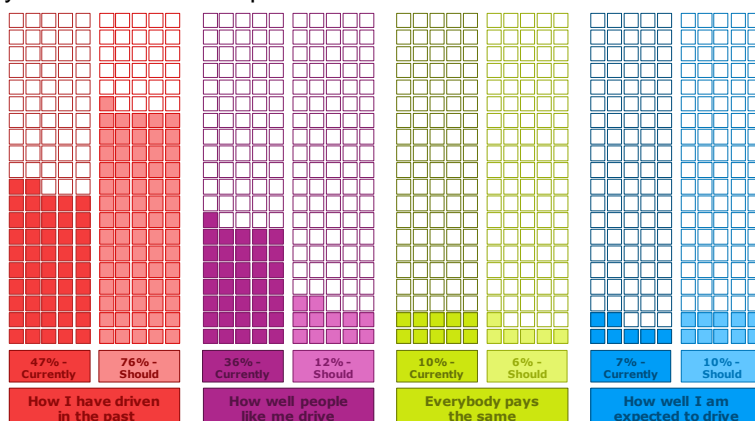
- Impact on you and your loved ones (or those you represent)
- 'True factor' vs proxy (Differentiation or Discrimination)
- Factors you can control vs those you can't
- Fairness in the public debate often centres around the extremes in pricing when it starts hitting affordability
- Compulsory insurances
- Should cross-subsidies be used to force affordability?

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Q2: How do insurance companies CURRENTLY work out how much you personally pay for your CAR insurance premium?

Q3: How SHOULD insurance companies work out how much you personally pay for your CAR insurance premium?



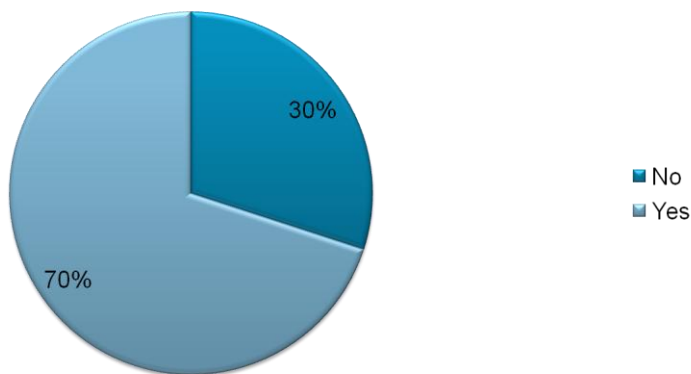
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Q4: So would you be happy to have a box fitted to your car that tracked your driving patterns and used the information to calculate your insurance premiums?

Only asked to those who said "How I have driven in the past" to Q3

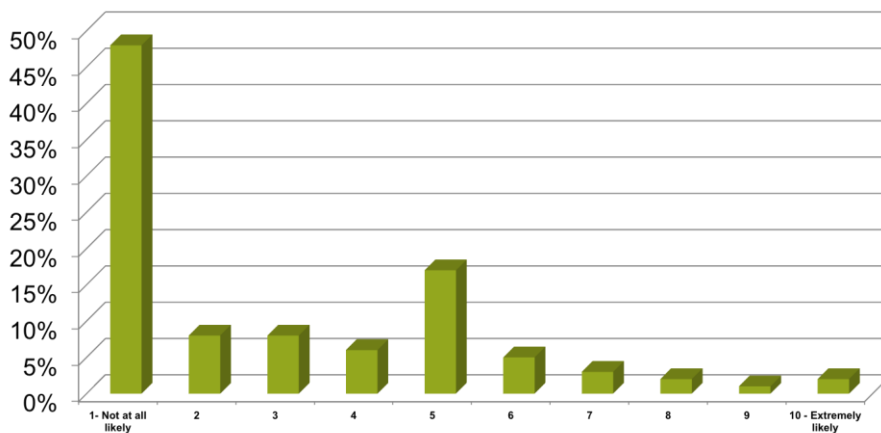


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Would you have a black box fitted?

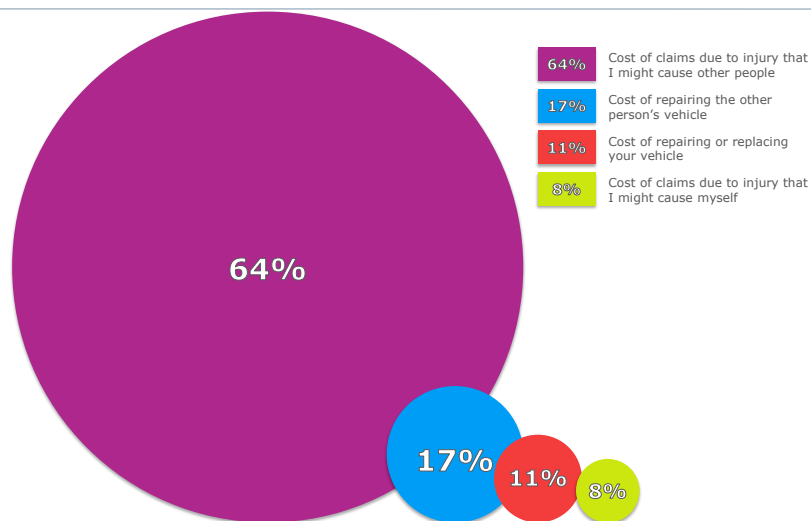


(Consumer Intelligence Insurance Behaviour Tracker surveys, March 2012)

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Q5: What do consumers think is the most expensive part of a claim?

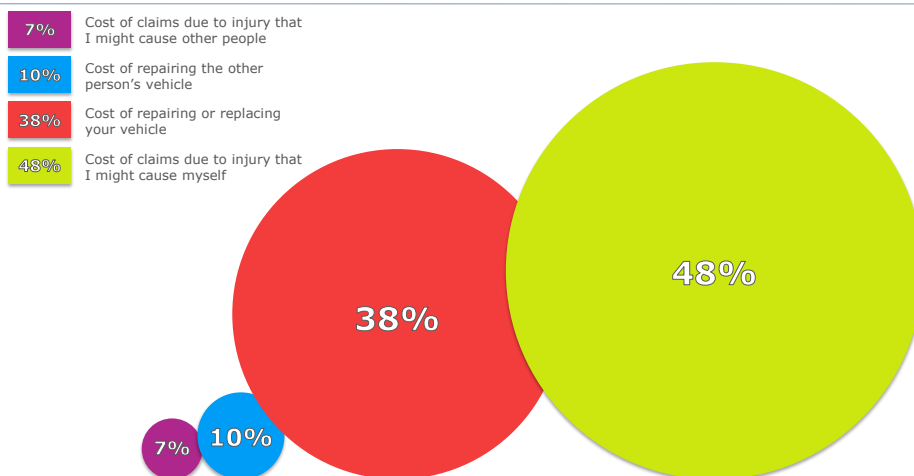


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Q6: And the least most expensive part of the claim?

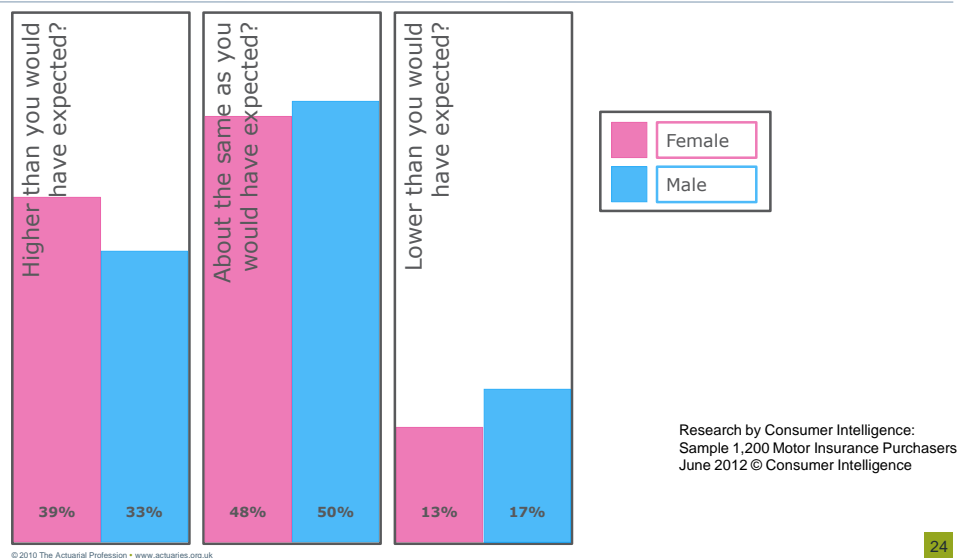


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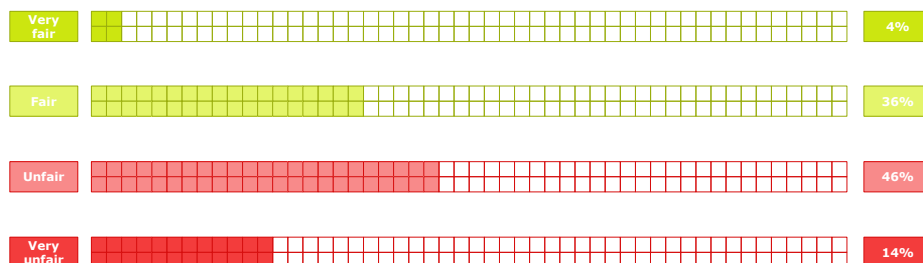
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Q7: 51% of the money is for third party BI. Do you think this figure of 51% is. . .



Q8: How fair do you think it is that this figure of 51% is reflected in the premium you are charged for car insurance?



Q9: Do you think the price you pay for insurance should be linked to the area you live in?



Just looking at the over 60s....

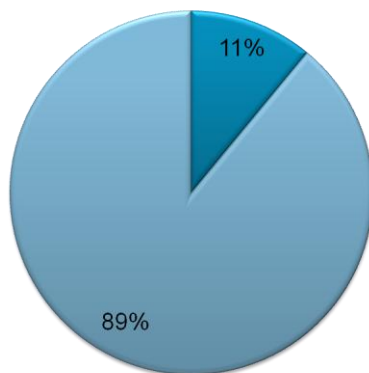


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Q10: Should people pay the same for Flood Insurance?



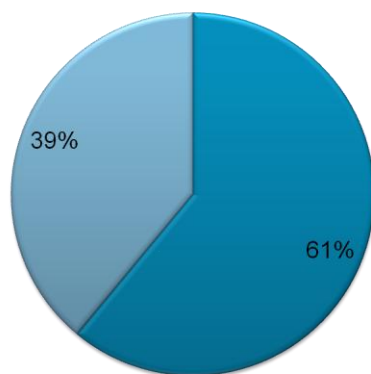
- Everyone should pay the same for flood insurance
- People who do not live in a flood area should pay less

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Q11: Older people's Travel Claims are higher. Should they pay more?



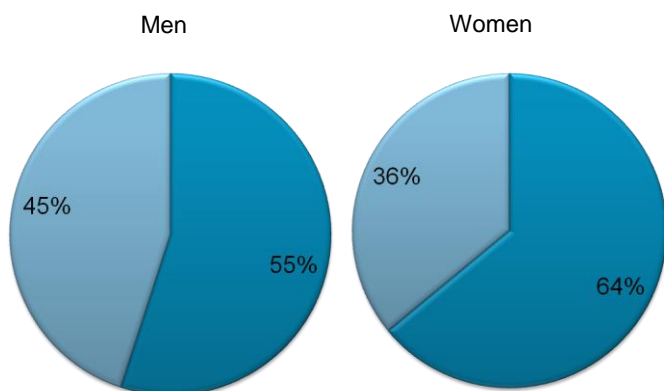
- Everyone should pay the same for travel insurance
- Older people should pay more for travel insurance than older people

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Q11: Older people's Travel Claims are higher. Should they pay more?



- Everyone should pay the same for travel insurance
- Older people should pay more for travel insurance than older people

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A Consumer's view on Fairness: What does it all mean?

- Consumer's view of fairness is very volatile
- There is a massive need to educate
 - The perils of not educating are a consumer backlash
- Education is about the way you talk to consumers
- There is a MASSIVE need to engage consumers on their terms

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Restricting rating factors – so what?

- In the first order, it redistributes costs, rather than changes overall costs
- But there are second order effects with consequences for:
 - Consumers, ie purchasers
 - General public, ie non-purchasers
 - Insurers
- Leading to a financial and wider effect on society

Restricting rating factors – so what?

Consumers (Purchasers)

- Redistributes cost burden from higher to lower risks
 - may change purchasing behaviours
 - may reduce incentive to manage risk
- Have to provide data to substitute for proxy
 - more questions or telematics

General public (Non-purchasers)

- Impact of making higher risks cheaper to insure
 - e.g. more accidents & road deaths
- Impact of making lower risks more expensive to insure
 - e.g. could lead to increased uninsured driving

Restricting rating factors – so what?

Insurers

- Higher expenses
 - to implement new regime
 - on-going e.g. obtaining external data, telematics
- Pricing uncertainty
- Increased purchasing by high risk customers

Most of which drive up premiums for everyone

- Higher prices reduced demand
- Reduced demand reduces capacity
- Which leads to yet higher prices

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Is there another way ... ?

- Fairness in the public debate often centres around the extremes in pricing when it starts hitting affordability
- Reducing high claims costs associated with high risks will tend to reduce differentials without the need for price controls
- Perceptions of inaccessibility can be tackled via improved customer information

Reducing the high risks

Reduce the chance of a claim

- Young drivers
 - Telematics (education)
 - Restrictions on number of passengers
 - Increased minimum driver age
 - Improved training
 - Graduated licenses (and re-testing for very old drivers too)
- Flood
 - Improved flood defences
 - Improved planning regulations

Reduce the size of a claim

- Bodily injury costs
 - Whiplash Fraud
 - Remove referral fees
- Maintain or increase discount rate
- Reduce legal costs
- Pay to 'make people better' rather than General Damages on Whiplash claims

Improve consumer information

- Improve sign-posting to insurers who cover niche markets
 - e.g. older consumers
- Improve accessibility of information showing the claims cost differentials
 - e.g. split of claims by type, split by age etc
- Engage with customers and regulators to build understanding

Conclusions

- There is no simple definition of what is fair
- It is not our role to determine what is fair
- It is up to policymakers to decide, but....
- Important they understand implications of decisions
- Extreme differentials in pricing are better addressed by tackling costs rather than pricing controls
- How well people understand and sign up to definitions of fairness depends on understanding of insurance and how it is priced

Membership

- Liz Michael (chair)
- Camilla Bennett
- Fod Barnes
- Andy Goldby
- Craig Fothergill
- Laura Doddington
- Jay Stewart
- Owen Morris
- Nicola Vaughan
- Gordon Rigg
- Laura Hobern
- Gary Yeates
- Graham Wright
- Chris Halliday
- Cherry Chan
- Sherdin Omar

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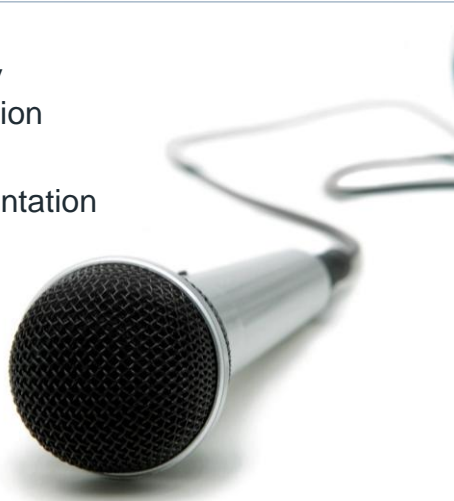
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Questions or comments?

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