Ancillary Income Maximisation

- What do we mean?
- Why are we talking on this topic?
- What is happening now?
- Ancillaries and the pricing process
- Maximising the profit
Ancillary Income

- Precise definition will vary from company to company depending on accounting basis
- We’ll define it as income received from services other than the core insurance contract, such as:
  1. Add-ons sold in addition to core coverage
  2. Referral fee income (credit hire, personal injury)
  3. Income received from handing-off leads to third parties
  4. Administration fees
- We’ll focus on 1.

What do we want to maximise

- Two problems with potentially different answers
  - How to maximise ancillary product sales
  - How to maximise overall profits
- Which you do and how hard it is depend on where you sit in the value chain
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Why the focus on add-ons?

- Unbundling a major trend over last 5-10 years, caused by:
  - similar activity in other industries (e.g. airline)
  - panel intermediaries seeking bigger role in value chain
  - success and format of UK aggregators
  - growth of new direct brands competing on (core) price
- Add-on income now a material proportion of turnover
  - add-on income > contents only premiums in many cases
- Choice of a major UK insurer to emphasise ancillary contribution in its published financial results
- Common for UK motor insurers to be able to achieve ancillary contribution equal to 10-15% GWP
Where does the power lie?  
Distribution

- All about ownership of sales process (last touch)  
  - And perception of value
- Aggregators indicate common add-ons to assist comparison  
  - But don’t (yet) offer quotes for similar cover
- Panel intermediaries in strong position, as usual  
  - More traditional brokers also
- Future potential to increase transparency to policyholder

Where does the power lie?  
Manufacture

- Distributors have simpler job as costs do not change based on add-on choice  
  - Possible selection effect to manufacturer
- Manufacturers can price for risk effect, potentially offering better prices
Why the focus on add-ons?

Companies can afford to make deductions to the production costs + acquisition costs reflecting their ability to upsell a wide range of add-ons.

Source: Gareth Howell's presentation to 2010 Pricing Seminar, Zurich Insurance Company

Capturing some of the consumer surplus

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Capturing some of the consumer surplus

Company without add-ons

- Core Price
- Consumer surplus
- £
- Purchase price
- Consumer perceived value

Company selling add-ons

- Core Price
- Consumer surplus
- Add-ons purchased
- £
- Purchase price
- Consumer perceived value

Price partitioning, segmentation

Some interesting figures

- £700-£800
- £200-£250
- 40%
- £142,000,000
- 104,597
- 14 days
- Injury referral fee
- Credit hire referral
- Highest APR (Confused.com)
- Admiral “total ancillary contribution”
- PPI complaints in 2010
- Time taken to start outbound upsell call by broker

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Motor examples

Add-ons
- Finance
- Legal expenses
- Breakdown
- Courtesy car
- Personal accident

Core cover extensions
- NCD protection
- Voluntary excess and excess buyback
- Windscreen cover

Add-ons by major price comparison site
Motor - interesting examples (1)

Motor - interesting examples (2)
Motor - interesting examples (3)

Spain - multas - insurance for legal expenses involved with contesting road traffic offences

Germany - fahrschutz - driver protection for injury – sold as an add-on to non-comprehensive policies

Switzerland – marderbiss – insurance against furry animals biting through engine cables

Italy - eventi naturali - natural catastrophes

South Africa - vehicle credit shortfall - essentially gap insurance to cover (outstanding finance - total loss payout)
Motor - another example from South Africa

**Buddy@OUT**

Finally, a designated driver at your disposal – at all hours of the night!

OUTsurance partnered with Good Fellas and put together an innovative optional product to add to your current car insurance package. Buddy@OUT provides you with a great option to get home safely after you enjoyed a few drinks and would rather be escorted home to ensure your safety and that of others. We are the only insurer in South Africa that offers a service such as this - taking the lead against driving under the influence of alcohol.

One phone call gets you home safely

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Add-ons – key features and characteristics

- Core extension/contractual benefit/extra service
- Flat priced or segmental variation?
- Included by default? Take-up rate?
- Segmental impact on core experience?
- Externally sourced?
- Fixed cost per unit or subject to utilisation?

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Household examples

Buildings specific
- Buildings AD
- Buildings PNCD

Apply to both
- Instalments
- Garden Cover
- Home emergency
- Legal expenses
- Pets

Contents specific
- Contents AD
- Contents PNCD
- Personal Possessions
- Cycle
- Student
- Keys
- Freezer
- Caravan
- Hobbies

Linked to Contents
- ID Theft
- Money / Cards
- Pet
- Golf
- Annual travel
- Home security
- PA

Household exotica (from Australia)

- Lawn Bowls Full House
- International Sporting Record
- Multiple Births
- Burnout of Electric Motors
- Pet Injury Cover

Standard
- Lawn Bowls Full House
- International Sporting Record
- Multiple Births

Add-ons
- Burnout of Electric Motors
- Pet Injury Cover
Household is less of a commodity product

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Add-ons listed on results page for major price comparison sites

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Key levers of control

Underwrite additional covers in-house or source externally?

Product design
Core cover definition
Selection of add-ons offered

Delivering the customer to the right channel

Bundle design
Defaulting (ticks on aggregators)
Ordering of ancillaries offered in the call centre

Add-on income maximisation

Pricing of add-ons
Risk rating vs. flat rating
Discounting and offers
...and pricing of core cover!

Ancillaries and the (optimised) retail pricing process

Data

Technical inputs

Periodic refresh process

Data

Source, collect, manipulate, deploy

Parameterisation

Validation

Offline calibration

Performance analysis, creation of management information and iterative refinement of retail pricing parameters

Periodic calibration process

Implementation

Dynamic Optimiser
or Table based rates

Calibration environment

Parameterisation

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Technical inputs to the retail pricing process

- NB and R require different approaches for including add-ons in LTV calculations
  - at NB the game is to establish the expected uptake of add-ons
  - at R it’s more about recognising existing add-on holdings
- Uptake propensity models
- Risk premium models for core covers which adequately reflect the influence of add-ons
- Cash flow models for add-ons are needed:
  - separate claims cost models are used where appropriate.

Technical inputs to the retail pricing process

- Importance of factors related to customer attributes, sales process and agent behaviours
Ancillaries and the (optimised) retail pricing process

Data
- Technical inputs
- Calibration environment
- Implementation
  - Dynamic Optimiser or Table based rates

Parameterisation
- Offline calibration
  - Performance analysis, creation of management information and iterative refinement of retail pricing parameters

Periodic calibration process

Periodic refresh process

Retail pricing implementation

- Rates should allow for the expected contribution (+ve or –ve) from add-ons and core cover extensions
- We wish to capture and store the following:
  - Probability of uptake for each add-on
  - Expected contribution (including impact on core) for each add-on
  - Expected LTV inclusive of core coverage and add-ons
- We can use this information in real time in the call centre or to drive targetted outbounding later on
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MI for maximising ancillary income

- Take up rates and combination rates by product and segment
- Cost and income comparisons
  - Core risk cost varies depending on add-on and this should be reflected in MI
What should actuaries be doing?

- Design/Analysis of:
  - Core offerings
  - Cross subsidy
  - Experiments
  - Script, screen and packages
- Optimisation (including core product)
- Moral guidance (TCF)?

The future of ancillary products

- Ancillary value targeted by organisations further up the chain:
  - Eg Aggregators could offer policy building services
  - Increased transparency bad for manufacturers?
- Telematics offers new ancillary services and charging models
  - Road side assistance
  - Carbon offsetting
- Gender proxy?
  - Beware sales process!
Any questions?

• Expressions of individual views by members of The Actuarial Profession and its staff are encouraged.
• The views expressed in this presentation are those of the presenters.

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