bringing profitability back from the brink of extinction

a report on the UK retail motor insurance market
Contents

3 Message from the CII and Ernst & Young
7 Executive summary
11 Methodology
15 A consolidating market
19 The evolution of the aggregator channel
27 Adapting to new business models
37 Investing for future profit
45 Who to contact
brining profitability back from the brink of extinction
a report on the UK retail motor insurance market

Message from the CII and Ernst & Young
Message from the Chartered Insurance Institute (CII) and Ernst & Young

Retail motor is the largest insurance market in the UK and one of the most competitive in the world. Tough competition prevails against a backdrop of long-standing poor underwriting performance.

In this, the fourth report delivered by the CII and Ernst & Young, we examine the changing face of the retail motor insurance market and examine where future investment will take place.

Over the last few years there has been a seismic change in the way consumers buy motor insurance. Subsequently, the distribution channels of five years ago are almost unrecognisable today. As a result, insurers’ profitability has deteriorated significantly. In 2009, the unadjusted net combined ratio for UK based insurers was 122.7%* for personal lines motor (source: Ernst & Young analysis of 2009 FSA Motor Returns). However, while many insurers have a stated aim to make personal motor a profitable class of business, periods of profitability are both brief and rare.

This report looks at where investment should be made in order to have a profitable class of business. We anticipate that the research will enable industry participants to benchmark and identify areas of focus for their own firms.

Finally, we would like to thank everyone involved in producing the report, particularly the industry leaders we interviewed and the CII members who provided their time and insight.

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*The net combined ratio is calculated by taking the sum of net incurred losses and expenses and dividing them by net written premium. A figure below 100% indicates that the company is making underwriting profit while a ratio above 100% means that it is paying out more money in expenses than it is receiving from premiums.
bringing profitability back from the brink of extinction - a report on the UK retail motor insurance market
Executive summary

We have seen the distribution of motor insurance evolve rapidly in recent years, leaving its history of face-to-face intermediation far behind. The development of online aggregators has been the latest and arguably the most profound step, but it is just one of many recent developments in technology and customer preferences that are reshaping the industry. The current model with its lack of profitability is not sustainable for many. The future will need to bring fundamental change for many insurers – in short, profitability has to be brought back from the brink of extinction.

It is against this backdrop that our survey was conducted to better understand how industry participants are facing up to the very considerable challenges that operating in the UK’s largest insurance market brings.

Conducted in the fourth quarter of 2010, we held 46 face-to-face interviews with senior professionals, in leading companies across the sector. We interviewed senior industry figures within insurance, including: insurers, aggregators, brokers, retail affinity players and brand assurers and others who are key players in the distribution landscape. We spoke to CEOs, COOs, CUOs, Heads of Personal Lines, Heads of Motor and Operations Directors. This was supplemented by 712 responses to our online questionnaire from the CII’s Underwriting Faculty membership.

We uncovered an unhappy picture as insurers and distributors struggle to make profit. Some have left the market and we predict that more will follow. The current view confirms there is no room for error for insurers who must manage the fine balance of claims, revenue and cost. Firms that can leverage scale will be positioned well to have an upper hand, as size continues to provide competitive advantage in certain aspects of the value chain, but this is unlikely to be enough. We believe the rapid changes UK retail motor has seen in recent years are far from over. Patterns of distribution will continue to shift, firms will further adapt their business models and the industry’s capabilities will evolve. We expect the dominance of the aggregator channel to reach around 49% of the total book by 2014.

Profitability will be enjoyed by the few who can demonstrate a firm grip on the fundamentals of their business through operational excellence (control over their claims costs, operating expenses and acquisition costs) and through customer centricity. The ability to convert the sale, cross-sell, up-sell and tailor products and experiences for maximum effect must be underpinned by high quality customer data. Whilst our report uncovers concerns around the quality of customer data in the industry, we also identify how the industry is moving to remedy this.

Many insurers hoping to reclaim their direct relationship with the customer will discover how aggregators plan to develop into ancillary sales. Whilst this will further eat into an area where insurers tell us they want to make greater profits, we predict direct insurers will respond with better customer journey design on their own websites and that, through this, retention will increase.

Our research also identified particular issues around pricing, underwriting and marketing. Companies need to have strong capabilities across all disciplines – being excellent at a few core business processes is not sufficient. Almost half of interviewees identified weaknesses in pricing skills as the greatest human barrier to maintaining or enhancing personal motor profitability. This is a combination of a lack of pricing expertise as well as system capabilities that hamper the ability to get products to market as opposed to a lack of product development expertise.

Competition for the best pricing and underwriting skills is intense but there is also increased demand for other specialisms, notably marketing, particularly where individuals can demonstrate strong knowledge of the commercially sophisticated consumer market.
The need for insurers to improve their rating and pricing sophistication, and strengthen ancillary sales capability, underwriting and brands points to the need for greater investment. Ongoing changes in customers’ preferences and the way personal motor cover is sold is putting distributors under pressure to invest in their own business models. Strict pricing discipline and the ability to select risk precisely across all channels is vital for success.

Those looking to continue the recent trend of rising prices in the industry will be bolstered by our findings which uncovered that a strong brand can mean that a 10% higher premium can be successfully achieved through some channels.

We think there is further potential to achieve differentiation through innovation; however, our interview team encountered fewer specifics than we would have liked. We suspect this is for reasons of commercial confidentiality rather than a lack of ideas.

Finally, where personal motor has gone, other markets are likely to follow. We feel it is important to stress that the changes examined by this report are not solely of relevance to companies specialising in retail motor. They are harbingers of change for other product areas in personal and commercial lines, which will in turn have a further impact on the UK insurance industry as a whole. In particular, we feel the home insurance market will be next to encounter the extremely tough operating environment depicted in this report. Unless lessons are learned from the way motor insurers have reacted to the advent of aggregators then we will see similarly difficult conditions here. We believe this will be the next profitability battle ground.
Methodology

Introduction to the research

The purpose of this research is to provide an insight into the current issues in the UK personal motor market. We want this report to contribute meaningfully to the industry-wide debate and, at a more strategic level, we consider the potential changes that may occur and the implications for industry participants.

Research methodology

Ernst & Young and the CII conducted detailed primary research between October and December 2010. The research was managed by a team of Ernst & Young’s insurance professionals and senior members of the CII’s Underwriting Faculty.

Participants

The research is based on data gathered from two sources:

Interviews – 46 structured interviews were conducted with industry leaders from across the insurance spectrum. The primary research focused on face-to-face conversations, which lasted approximately one hour. We interviewed insurers, aggregators, brokers, retail affinity players, brandassurers and others who are key players in the distribution landscape. We spoke to CEOs, COOs, CUOs, Heads of Personal Lines, Heads of Motor and Operations Directors.

Online – A shorter online questionnaire was used to gather the views of the CII’s Underwriting Faculty members on emerging themes in the market. We received 712 responses.

This primary research was supported by existing industry insights and secondary analysis.

Market coverage

The individuals and companies interviewed represented 70% of the primary personal motor insurance market*. The research was focused in the UK only and included a broad spread of organisations in terms of size and products/services.

Interview questions

The questionnaire comprised a mixture of qualitative and quantitative questions.

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* Calculated using Ernst & Young analysis, FSA returns, S&P Synthesys, company annual reports, Financial Services Commission of Gibraltar company regulatory returns. Gibraltar based insurers and Zurich 2009 GWP is estimated. Great Lakes (and other coinsurers) share of Admiral’s book has been included in Admiral. LV includes Highway for all years.
15 bringing profitability back from the brink of extinction: a report on the UK retail motor insurance market

a consolidating market
section summary

The market is highly concentrated

The total market is estimated to be worth £9.5bn GWP (2009)

Profit is today largely dependent on investment income and ancillary sales

Size matters: for brokers the majority of new business goes to a single largest provider
A consolidating market

The UK personal motor market

The UK personal motor market is characterised by its large size, slow growth, fierce competition, thin margins and high levels of concentration. In recent years the emergence of the aggregator channel has had a significant effect on patterns of distribution.

Personal motor is the single largest class of insurance business, with a Gross Written Premium (GWP) of £9.5 billion in 2009 (source: Ernst & Young analysis of Synthesis, annual reports, Financial Services Commission of Gibraltar). It is therefore, a critical market for any insurer with aspirations to be a major part of the UK insurance landscape.

The desire to participate in this large revenue pool means that competition among insurers is high, leading to very slim profit margins. The insurance market has made almost no money at all from the underwriting of motor insurance in the past 25 years, relying on investment income and sales of ancillary products to create a return on invested capital (figure 1).

Figure 1: Total motor market performance measured by net combined operating ratio (NCR), 1985–2009

![Figure 1: Total motor market performance measured by net combined operating ratio (NCR), 1985–2009](image)

Source: S&P, Ernst & Young interpretation

In 2010, insurers reported significant rate increases which should lead to a large overall increase in GWP for the market. However, while many insurers have a stated aim to make personal motor a profitable class of business, periods of profitability are both brief and rare.

In a low-margin market, scale is seen as one source of competitive advantage and frequently the largest insurers aggressively defend their market position.

From 2005 to 2009, the concentration of the market held by the largest 10 insurers has remained stable at around 77%, although the dominance of the largest five has lessened.
Similarly, for brokers we interviewed, new business is equally concentrated and our respondents said the majority of their business goes to their single largest provider (60%), 84% goes to their largest five and 93% to their largest 10. This concentration could surprise a public that might expect an independent broker to be offering cover with a broader range of insurance providers.

Source: Ernst & Young analysis, FSA returns, S&P Synthesys, company annual reports, Financial Services Commission of Gibraltar company regulatory returns. Gibraltar based insurers and Zurich 2009 GWP is estimated. Great Lakes (and other coinsurers) share of Admiral’s book has been included in Admiral. LV includes Highway for all years.
the evolution of the aggregator channel
section summary

The aggregator channel has brought about a major shift in patterns of distribution

We expect the aggregator channel to reach around 49% of the market by 2014

The rise in online sales is compromising data quality and increasing fraud
The evolution of the aggregator channel

The aggregators continue to grow their share of market

The impact on the industry of price comparison sites – referred to in this report as aggregators – can sometimes be exaggerated, but it is clear that the rise in online sales does represent a fundamental shift in patterns of distribution. It is forcing existing players to find new models for generating profits.

The relative merits of different channels have been hotly debated over the past three to four years, and the growth of aggregator-selected panels, containing both insurers and brokers, has made the reality difficult to establish. Our analysis of primary and secondary research leads us to believe aggregators will continue to grow and we expect their market share to reach around 49% of the market by 2014.

Figure 3: The extent of multi-intermediation in UK personal motor, share of GWP (2009) by channel

Our respondents’ view (shown in figure 3) is that approximately 42% of customers buy their insurance through aggregators but part of this figure is accounted for by broker and affinity arrangements via an aggregator site. If we take this into account, the true figure stands at around 32%.

The customer is the winner

There is no question that the advent of aggregators has done a great deal to educate personal motor customers about price and choice of provider. Our interviewees have differing views on their benefit to the industry as a whole; however, they are fairly unanimous in seeing customers as the main beneficiary of the rise of the aggregator.
As the ramifications of ‘austerity Britain’ take hold on household budgets, previously loyal customers faced with renewal premium increases may now question the wisdom of staying with their existing insurer. Undoubtedly, aggregator sites will benefit from this trend as consumers look for ways to reduce cover by adjusting product features such as add-ons and additional drivers and potentially trade in cars for lower-cost vehicles. Indeed, from a customer perspective, the survey supports the view that aggregators’ market share has yet to peak. All respondents expect the channel to expand its share of the market over the next three years. However, as a large number of brands on aggregators’ websites are brokers, insurers may find that the channel mix for new business will not change all that much.

The industry is the loser

The insurers we spoke to are divided on whether aggregators are good or bad for their business. Given that aggregator sales tend to generate lower levels of cross-selling and up-selling, the overall impact on insurers’ profitability has generally been negative. Aggregators have also provided a vehicle for highlighting weaknesses in insurers’ pricing strategies, which has led to greater rating transparencies now available through most insurers’ direct sale websites.

Our findings show that renewal rates for aggregator sales are also relatively low when compared to other channels. Our interviewees said the best-performing channels for renewal were affinity and direct and they view aggregators as the poorest performing in terms of retention.

“Aggregators have led to lower acquisition cost, much cheaper than traditional routes but taking up ancillary income. Retention rates are lower.”

Insurer

“Aggregators have enabled open price comparison which has driven down average premiums and increased commoditisation. Profitability and product innovation have decreased and [so has] loyalty.”

Insurer
The benefits of price comparison are running out...aggregators will plateau.

Retention is an area that aggregators tell us they are keen to develop through better customer journey design; those we surveyed identified ancillary sales and marketing as the two activities they are most likely to try to take ownership of during the next three years. Insurers who are hoping to reclaim the direct relationship with the customer and improve their own online presence to maximise ancillary sales will find this an unwelcome change.

Figure 5: Year and share of GWP by channel – current 2010 and projected 2014

<table>
<thead>
<tr>
<th>2010</th>
<th>2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Direct</td>
<td>25%</td>
</tr>
<tr>
<td>Broker Non-Aggregator</td>
<td>25%</td>
</tr>
<tr>
<td>Broker Aggregator</td>
<td>8%</td>
</tr>
<tr>
<td>Aggregator</td>
<td>32%</td>
</tr>
<tr>
<td>Affinity Aggregator</td>
<td>2%</td>
</tr>
<tr>
<td>Affinity Non-Aggregator</td>
<td>8%</td>
</tr>
</tbody>
</table>

Source: Ernst & Young analysis of CII survey respondent sample, 2010. The proportions are estimated from our primary research interviews and secondary research. The figure represents the proportion of the whole book, rather than just the new business component.

The pitfalls of online distribution

There is no doubt that online sales have opened up pricing to customers’ scrutiny and helped them understand how rating factors affect the cost of their insurance. Customers using the web to obtain quotations can see for themselves the pricing effect of postcodes, garaging, vehicle use, theft protection and other factors. These changes are often described as having improved transparency in the market, and at one level this is certainly true, but it masks the full picture.

A proportion of those surveyed expressed concern over the potential pitfalls of online sales. The first potential issue is the way that the initial prices quoted on websites tend to increase as the sales process continues, cover is adjusted, the excess is reduced and additional features are added. It is not unusual for the final price paid to exceed the initial ‘tease’ rate by 30% or more. The Office of Fair Trading reviewed pricing techniques in May 2010 and showed that this form of drip pricing has the most significant financial loss to the consumer compared to other pricing techniques (source: Office of Fair Trading, The impact of price frames on consumer decision making, 2010). As such, the industry will need to create powerful strategies to demonstrate that they are not putting the customer at a disadvantage.

...people don’t know what they are buying – too much price focus.
The second concern is that customers may be making decisions without fully understanding their implications. A strong focus on price-led marketing can lead to product features being relegated to the small print. Cover marketed as being ‘comprehensive’ is often less complete than customers realise, which may not become clear until a claim is made. Experience has shown that the reputation of the industry is easily damaged by such practices as illustrated by the negative publicity surrounding the volcanic ash cloud situation in 2010.

"Customers value advice more and more...perhaps this could signal a return to brokers." Insurer

"Aggregators create a pure price focus and don’t allow for long term stable pricing." Insurer

The impact on data quality and misrepresentation

Another effect of the growth in online sales has been on the quality of data gathered by insurers and distributors, which, in turn, has enabled greater levels of application fraud to take place. Without the need to complete and sign a paper application form and/or talking to an insurer/broker sales representative, customers transacting online are more likely to filter the facts in their responses. Excessive ‘tweaking’ of factors on websites during a quotation process may sometimes raise alarm, yet insurers expressed concerns that aggregators are not doing enough to tackle this. This has two key knock-on implications:

The first is the risk that inaccurate information undermines the quality and value of insurers’ databases, with a consequent impact on segmentation and pricing decisions.

The second is the risk, identified by several respondents to our survey, of an increase in underwriting fraud. One insurer cited an example of a Global Positioning System (GPS) supported product where around 50% of policyholders regularly parked their vehicle away from the registered address. If the growth in application fraud is as widespread as some respondents believe, then the underwriting and claims processes will need to evolve to address this.

"I recognise that customers want to use online but it’s a challenging business model to market. [There are] higher levels of application fraud which is harder to price. 47% of applicants don’t live at the address given for pay as you drive schemes." Insurer

There is an opportunity to improve data quality as aggregators collect vast amounts of information. This data is not currently being shared, but we are seeing signs that both insurers and aggregators are realising the mutual value in investing time and resources in deeper data analysis.
Barriers to entry

“Access to the market has been dominated by brokers especially if you don’t have a direct brand – aggregators have removed the barriers to entry and increased competition in the market.”

Insurer

Our findings show that most aggregators charge a flat fee for every converted policy lead (the ‘cost-per-sale’ pricing model). For a figure of around £50 per policy written, an appropriately authorised insurer or broker can place their brand on an aggregator panel. If the product and price are genuinely competitive, insurers can expect an almost immediate response in terms of quote volumes and, subject to their customer acquisition process, to convert and maximise these sales.

Yet, even though aggregators have decreased barriers to entry, insurers that want to achieve significant scale still need to invest in their own direct business capabilities – usually dependent on a strong brand, powerful IT systems and operational capabilities – as well as building relationships with brokers. Furthermore, insurers often find they are restricted by their aggregator agreements in how they can price in other channels, having committed to providing to aggregators their ‘lowest available price’.

For insurers with ambitions to grow they will need to be adept at multi-channel distribution. However, the scale of investment required for insurers looking to operate in all the major channels remains a deterrent to many.
section summary

Brand is more important than ever – price is far from being the only decision factor for consumers

Increased concentration and the capital efficiency pressures of Solvency II will lead more insurers to exit the market

The home insurance market will become the next battle ground for profitability
Adapting to new business models

The multi-intermediated model

The future needs to change fundamentally for many insurers. The difficulty in achieving profitability on the core product is driving the industry to change its business models. This has led to a greater focus not only on better pricing and underwriting but also on maximising ancillary sales and other revenue streams. However, the ancillary sales model is becoming more difficult to execute for insurers. As they search for a competitive edge, insurers and distributors are increasingly looking to strengthen their brands and improve their customer segmentation approach.

Whilst some level of multi-intermediation already exists through the use of wholesale broking arrangements, this tends to be largely focused on serving niche segments, as opposed to the mass market.

The traditional model, whereby the insurer could generate profits from the core product together with ancillary and up-selling and cross-selling, is reducing in importance as the relationship between the customer and insurer becomes more complex. This changing dynamic, shown in the current model, reflects distributors’ increased focus on securing additional revenue schemes, as well as commission. This has a limiting impact on insurers’ ability to boost their profitability via ancillary sales.

Figure 6: Differences between the traditional and current motor insurance distribution models

<table>
<thead>
<tr>
<th>Traditional model</th>
<th>Current model</th>
</tr>
</thead>
<tbody>
<tr>
<td>Customer</td>
<td>Customer</td>
</tr>
<tr>
<td>Insurer</td>
<td>Insurer</td>
</tr>
<tr>
<td>• Underwriting profit</td>
<td>• Underwriting profit</td>
</tr>
<tr>
<td>• Investment income</td>
<td>• Investment income</td>
</tr>
<tr>
<td>• Up-sell/cross-sell revenues</td>
<td>• Up-sell/cross-sell revenues</td>
</tr>
<tr>
<td>• Ancillary revenues</td>
<td>• Ancillary revenues</td>
</tr>
<tr>
<td>Distributor/partner</td>
<td>Aggregator</td>
</tr>
<tr>
<td>• Insurer commission</td>
<td>• Fees for converted leads</td>
</tr>
<tr>
<td>• Up-sell/cross-sell commission</td>
<td>• Sponsored links/advertisements</td>
</tr>
<tr>
<td>• Ancillary revenues</td>
<td>• Profit share</td>
</tr>
<tr>
<td>• Profit share</td>
<td>• Profit share</td>
</tr>
</tbody>
</table>

Source: Ernst & Young analysis

Figure seven (overleaf) looks at how costs, revenues and, consequently, profits/losses are generated for a typical insurer. It makes clear that many insurers are running at an overall loss on their motor product: most of the incoming revenue is offset by the claims indemnity, operational costs and reinsurace premium. The picture would be even worse were it not for ancillary sales, but it is clear that no amount of these can compensate for poor pricing and risk selection or poor claims management. In part, the willingness of capital providers to support this will be influenced by economic conditions and the lack of alternatives elsewhere. In our view, this is why insurers are being forced to increase pricing and drive the insurance profit cycle upwards.
There are likely to be insurers for whom the return is insufficient and they will withdraw from the motor class or will only focus on particular segments where a return is possible. They may also try and counter difficulties presented by the current model in achieving ancillary sales. So what can insurers do now to avoid this scenario and improve profitability?

Our primary research identified a number of key factors that insurers themselves consider essential to achieving improved profitability thorough different channels. A large proportion (70%) of the insurers we spoke with named the most important profit lever in the aggregator channel as the ability to select risk precisely and, similarly, 68% of insurers said it was the most important factor for direct business as well. Our findings show that insurers still identify ancillary sales as one of the most important ways to enhance their own profitability on business written through aggregators and, as a result, insurers are being forced to rethink their models for profitability. Insurers also identified the access to specialist markets and niche segments that brokers can provide as an important driver of profitability.

Source: Ernst & Young interview respondents
Price discipline

Whilst our survey shows that the ability to select risk precisely is the most important factor in maximising profit, price discipline also ranks highly. For insurers trying to maximise profit, price discipline is one of their top three profit levers when operating through brokers (56%), when operating through aggregators (47%) and when going through the direct channel (42%).

Given that aggregators ruthlessly expose any price weakness, with some sites allowing insurers to change their pricing and rating factors on a daily basis, those without efficient systems and processes, and sophisticated data analytic capability, will be under serious threat. Many insurers do have the capability to change rates on a daily basis yet few actually did in practice, tending instead to change price weekly or less often. It is little wonder therefore, that insurers tell us they are planning to invest in stronger pricing and underwriting capabilities. When asked which elements of the personal motor underwriting value chain might change in the medium term, more insurers identified pricing and risk selection than any other area.

This is supported by pricing and underwriting being the main focus of insurers looking to increase headcount – 45% of respondents mentioning this (product development was mentioned by 24% of respondents as their next highest priority, with 12% equally stating marketing and sales/business development as the next most important). Without these skills, insurers will find it increasingly difficult to compete and certainly harder to keep their loss ratios under control.

We believe that the ability of customers to switch to a lower premium will be constrained as the savings available in the past three years will no longer be on offer as insurers fix their rating models and all apply price increases. That said, there will always be variation in prices as insurers view risks differently and have different risk appetites.

Battle of the brands

Motor insurance is often wrongly referred to as a commodity because customers view it as the same irrespective of provider. Yet aspects such as the impact of brand, product features and distribution models mean the motor insurance market does not act as a pure commodity market.

In this industry, marketing and branding have emerged as increasingly important elements of the insurance value chain. Most customers will probably look for fewer than five organisations to provide them with a motor insurance quote, so a strong brand is essential for any insurer or intermediary aiming to be on that shortlist. Despite the fact that a strong brand gets pushed into second place (60%) as the top priority for most insurers selling directly, we see this as intrinsically linked to the first placed item: reputation for good service (78%).

The branding strategies adopted by motor insurers vary according to their business model and their perceived attributes. The most commonly used attributes are value for money, extent of cover and the quality of claims handling, but intangible features such as an insurer’s size, stability or mutual status are also used. Several of the large groups maintain a number of brands to support direct business, aggregator sales, niche market segments and the broker channel.

Strong brands are not only vital for direct insurers: the survey shows that personal motor distributors have also increased their total advertising spend over the last three years. No wonder then that the majority of insurers we spoke to say their advertising expenditure has increased as a proportion of GWP over the last three years: with significant increased investment made in online (58%) and TV advertising (45%). The result of this has been that we are now all familiar with the opera singer, the meerkats, and a resurgence in the popularity of former Formula One racing driver Nigel Mansell!
It is interesting to note the difference in priorities for insurers when working through aggregators. Notably, insurers believe that product flexibility (ability to add or remove additional features) is of greatest importance and this supports the more price-led philosophy of the aggregator. However, the role of the brand is once again shown to be comparatively important by a high proportion.

Source: Ernst & Young interview respondents

“50% of customers choose a price which is not the cheapest.”

Aggregator

Source: Ernst & Young interview respondents
Using brands to achieve profitability

Insurers believe that a strong brand and good product features will allow them to win business even if they are not the cheapest. Our research clearly identifies the significant importance of brands in allowing companies to differentiate. Only 20% of insurers said they generally only won business on the cheapest price, which is contrary to perceived wisdom, and, even more surprisingly, all aggregators and brokers felt a strong brand or strong product could win customers even if it is not the cheapest. A much larger group, (40%), said that a strong brand could allow them a 5% higher premium per policy, while a further 40% think that a strong brand will allow them to secure a 10% higher premium per policy. Distributors were even more confident, with half saying they would expect a 10% uplift.

Figure 11: Insurers and distributors’ views on the price differential per policy that can be achieved by a strong brand or good product coverage when trying to win new business through an aggregator

<table>
<thead>
<tr>
<th></th>
<th>Distributor results</th>
<th>Insurer results</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>5% uplift</td>
<td>10% uplift</td>
</tr>
<tr>
<td>Strong brand</td>
<td>50%</td>
<td>40%</td>
</tr>
<tr>
<td>Good product</td>
<td>50%</td>
<td>33%</td>
</tr>
</tbody>
</table>

Figure 12 shows the other non-price factors distributors see as being critical to their future success in the aggregator channel. Product flexibility is essential in getting to market in the first place as are unique special offers. The right balance of both obviously helps to achieve a higher ranking on aggregator results pages and, once there, the branding elements are an essential part of progressing the consumer towards a purchase decision.

Figure 12: Key profit levers for brokers and aggregators when working through the aggregator channel

Source: Ernst & Young interview respondents
These quotes illustrate the diversity of advertising strategy deployed but figure 12 shows the overall market picture:

“ Our marketing spend has increased but become much more efficient. We track very closely – cost per visitor, cost per quote, cost per acquisition...” Aggregator

“ No real advertising spend except on aggregators.” Distributor

“ We spend almost no money on advertising – aggregator and affinity do it all.” Insurer

Mintel’s research shows that 90% of the consumers who have used an aggregator have utilised one of the top four brands. Moneysupermarket.com is reported as the leading player in terms of consumer recall of usage, with 70% of aggregator users having obtained quotes or purchased products through the site.

Aggregators are increasing their expenditure over time at a considerable rate, with TV advertising accounting for the majority of spend for direct insurers and aggregators: 67% of total spend by the 10 highest motor insurance spenders goes to TV (source: Datamonitor, Marketing and advertising strategies in UK personal general insurance 2009).

The large advertising expenditure obviously contributes greatly to the cost of acquiring customers. Nearly two thirds of our respondents, (63%), say their customer acquisition cost has increased as a proportion of revenue.

As an industry, motor insurance providers and aggregators combined currently spend more on advertising than all other insurance classes, but the gap between direct motor and home advertising expenditure is narrowing as shown in figure 13. The home insurance industry should be prepared to learn lessons from the competitive dynamics in personal motor – if the aggregators move into their industry (as many interviewees predict they will) and the market responds in the same way, similar issues with profitability will be experienced by this currently profitable market. We see no material difference in the structure and nature of the home market that means the scenario would not be replicated. The future viability of the market will be determined by the reaction of the industry.

Figure 13: Top 10 direct insurers’ advertising spend (£m), by product, 2006–2009

Source: Datamonitor UK Personal Insurance Distribution Report 2010
The role of brokers

Despite the rapid changes of recent years, brokers remain a very important channel for customers and insurers in the personal motor market. The aggregator channel is not currently well-suited to non-standard risks, and this is therefore an area where brokers can make a real difference by finding the right coverage for customers. Several of the brokers interviewed also see niche specialisation as central to the profitability of their own business models, since it gives them the chance to demonstrate capabilities that aggregators typically cannot match.

The strength of the insurer/broker relationship is viewed as the most important non-price factor for over 80% of insurers working with brokers. They too see the benefits of a strong broker brand (70%).

Figure 14: Key non-price factors for insurers working with brokers

![Figure 14: Key non-price factors for insurers working with brokers](image)

Source: Ernst & Young interview respondents

The importance of brands raises a challenge for brokers as even the largest will struggle to match the marketing power of the aggregators and direct insurers. As a result, many brokers rely on differentiated marketing that stresses their quality of service, expertise, understanding of a niche segment, or their local credentials. Brokers are also looking to expand into other areas of the value chain (figure 15).

Within the increasingly aggregator-influenced distribution space, brokers have countered threats to their share by adapting to this channel. A number of the large players have responded by placing their own brands on price comparison sites.
Figure 15: Services insurers expect to be buying in from brokers in three years’ time

Even greater concentration ahead

The ongoing squeeze on broker and insurer profitability has only reinforced pressure to consolidate. Larger broker networks continue to consume smaller players, and, in the process, the broker universe is polarising further into mass-market firms that rely on brand strength and high volumes, and smaller players that rely on reputation and niche capabilities. A majority of the insurers surveyed view brokers as being well-placed to take ownership of policy servicing in future, a potentially valuable source of additional revenue. Aggregators will also consolidate over time. Few aggregators will be able to sustain their current levels of marketing spending to support a market that is not growing and the lower price differentials which are potentially reducing the value they can demonstrate to customers.

Broker models will need to adapt, as their profitability comes under pressure. At an industry level, this will increase the distributors’ purchasing power and reduce the choice of distribution partners insurers have to work with. In turn, insurers looking to build or maintain significant shares in the personal motor market need to develop branding, infrastructure and capabilities across several channels. This is illustrated by the way that even insurance groups that have kept their direct brands off comparison sites typically sell through aggregators, using other brands. The resulting duplication is putting particular pressure on capital, skills and management. In conjunction with the capital efficiency pressures of Solvency II, we are certain that this will encourage more insurers to exit the motor market and sell or move their UK personal motor books into run-off, as companies such as Corinthian (HSBC), NIG (RBS Insurance) and Chartis have already done.

Impact on other classes of business

With regard to predicted future patterns in distribution channels over the next three years for other classes of insurance, most expect the rise of the aggregators to continue. This presents another threat to insurers, who have to date, relied on the relative inertia of customers in lines such as household.

Overall, the majority of survey respondents believe that the broker channel will reduce in significance across all four product lines of motor, household, travel and SME.
section summary

A lack of pricing expertise and data capabilities are the biggest barriers to profitability

Expect to see better risk pricing over the next three years: just under 80% of respondents said this was the single most critical initiative to improve profitability over the next three years

Expect insurers to increase headcount in underwriting and pricing

Expect aggregators and brokers to increase headcount in marketing
Investing for future profit

Investment strategies

Changing business models require changing capabilities. The need to develop capabilities across a wide range of disciplines, and often across several distribution channels, requires companies to invest at a time when many are already under pressure to improve their operational and capital efficiency. We asked our respondents to identify their barriers to success and how they planned to overcome them.

Underwriting

Almost half of the interviewees identified weakness in pricing skills as the greatest human barrier to maintaining or enhancing personal motor profitability. This lack of pricing expertise and system capability is hampering the ability to get products to market. Just under 80% identified better risk pricing as the single critical initiative most likely to improve their profitability over the coming three years. This is an area where we believe urgent attention is required, evidenced by the complete lack of underwriting profits made in recent years.

Better management of claims issues around areas such as credit hire and claims management (60%) followed closely behind. (Another Ernst & Young report recently highlighted the importance of managing the claims experience well – European motor claims: is customer satisfaction enough?)

“We have made a big investment in underwriting and pricing but will continue to recruit [this skill set].”

Insurer

Figure 16: Most critical initiatives over the next three years for insurers

When insurers were asked what changes in headcount they expect to see over the next three years, underwriting and pricing were identified as the most likely areas for growth, with 45% of interviewees anticipating increasing these skills and 24% anticipating an increase in product development headcount. This will be essential if insurers are to return a profit.
A number of interviewees stated that they had already added to their capacity in these areas, although some felt it was becoming harder to attract the best underwriting talent to what is increasingly seen as a marketing-driven business. If so, insurers hoping to build sustained profitability in personal motor will need to redouble their efforts to ensure that their pricing and underwriting capabilities are best in class. There was also a realisation from many that they need to develop these capabilities in-house, with more focus on training and development.

“\nWe are looking for a leaner management structure – a particular need for direct marketing skills; the growing business needs underwriting, pricing and sales support.  

— Insurer
\n”

“\nWe need to encourage and educate people for technical specialties. Build pride in our profession!  

— Distributor
\n”

“\nWe would expect claims staff members to increase – should not cut costs on claims as we need to deal efficiently with this.  

— Insurer
\n”

The capture and analysis of customer data is a capability currently receiving a lot of attention from insurers. Several of the firms we surveyed see this as an area of potential competitive advantage, and one that should complement improvements in pricing and underwriting capabilities. Insurers believe that new data – or better analysis of existing data – will generate new and improved rating factors. These in turn could help insurers find hidden pockets of value in the over-served personal motor market.

Whether such ‘golden segments’ remain to be discovered is unclear, but insurers are looking at a range of potential information including their own databases, data gathered by distributors and data obtained from third parties, such as credit agencies or affinity partners. The customer information captured by aggregators, brokers and direct insurers’ own front-end applications have the potential to be particularly valuable in terms of understanding customer behaviour and risk.

However, gathering more data is not the same as making good use of it. There are three key challenges:

One is to gain confidence about the quality of the data, particularly at a time when online applications are making customer-supplied information less reliable. For instance, our findings reveal that insurers are less confident about the quality of their customer data than any other information they hold, with 63% rating the quality of their customer data at 3 out of 5 or worse (with 1 being poor and 5 good). A number of interviewees state that they have an even lower level of confidence in data sourced via the aggregator channel.

Another is to effectively convert this data into rating factors – a much harder step that requires extensive research and testing.

A third challenge is the capacity of firms’ IT systems to allow vast amounts of data to be reviewed and analysed sufficiently quickly so that pricing decisions can be made and passed on in a matter of hours.

Among respondents expecting to refresh their motor insurance technology during the next three years, credit scoring (78%), fraud technology (77%), and pricing (44%) are identified as some of the most important capabilities to develop.
From the distributor’s perspective, there is potential value to be released here too. The survey shows that customer analytics is one of the few areas of underwriting where distributors expect to increase their provision of services in the future. In particular, aggregators with the right capabilities may be able to sell customer data to insurers looking to hone their risk selection, and inform their pricing and underwriting decisions.

Marketing

We've already discussed the importance of strong brands to the business models of insurers and distributors, and both groups' desire to build up ancillary sales. Clearly, for this to become a reality, both require strong marketing capabilities.

Personal motor insurers have placed much greater emphasis on their marketing capabilities in recent years, as they attempt to keep pace with the rapid changes in personal motor distribution. Even so, many of the online marketing skills that are vital for firms hoping to thrive in a direct and aggregator-led market are still immature. Many firms are looking to recruit marketing professionals from outside the insurance industry, since this is where many of the skills are strongest.

According to the survey, more than half of insurers’ marketing employees now have a non-insurance background, and distributors report a similar proportion of staff without meaningful experience in the industry. This has helped firms to build their marketing expertise quickly, bringing knowledge and experience from industries that may be ahead of insurance, particularly in online marketing. It is also notable that marketing is the area where aggregators and brokers expect their headcount to expand the fastest over the next three years.

Marketing capabilities are not limited to human skills. An organisational inability to transition quickly to an online sales model is identified as one of the largest potential barriers to improving profitability in personal motor, while improving front-end sales capabilities is one of the key reasons cited for the IT investment plans of both insurers and distributors. Indeed many non-price factors that insurers look for when working with aggregators directly stem from marketing issues (see figure 13).

Strong capabilities in pricing and underwriting, data management and marketing are essential for firms looking to adapt and survive in the UK personal motor market, but they do not tell the full story. The survey shows that, among other areas, insurers and distributors also see product development and claims management as important capabilities for success.

There may not be much that insurers feel they can do to generate sustainable differentiation through product design in personal motor – indeed our respondents failed to highlight any innovations they were considering to improve their profitability. Some did make comments around telematics and improvements to vehicle safety, but we did not hear any particularly innovative solutions, although this may be explained by commercial sensitivities.

“I would like to see innovative telematics – pay as you drive pricing. There’s a long way to go still as this will only become viable when manufacturers are willing to fit this as standard.”

Insurer

“An EU directive to adopt [usage of telematics] would mean factory fitting and enable us to provide better pricing. Already available in Czech Rep and Poland. The barrier is high costs. EU regulations will demand emergency call applications.”

Insurer
Profitability: winners and losers

Our interviewees had some interesting views on who would be able to operate profitably in the future market. It was acknowledged that some firms from all distribution categories will succeed but that those firms that really understand the customers they are targeting, the numbers and distribution channels are likely to have a competitive advantage.

Other firms expected to fare well are affinity brands such as the large supermarkets. Their unparalleled trove of rich customer data may reveal which customers are more loyal and less likely to be price sensitive. Reliable customer data seems to be critical as some mentioned the threat of Google entering the insurance market with its formidable customer data set and brand strength.

**winners**

“Google in the aggregator business.” Insurer

“Affinity business groups (John Lewis, Toyota).” Insurer

“Anyone who manages price well through the aggregators.” Insurer

“Companies who are good at risk selection and underwriting.” Insurer

“Lawyers.” Distributor

“Low cost directs with well developed pricing models.” Distributor

“Those that understand their businesses and are really close to the numbers. Understand different distribution channel dynamics really well – understand they are there to make a profit.” Distributor

“Brokers and intermediaries who can work collaboratively with the underwriters and be supportive and understanding of insurers’ agendas.” Distributor
Brokers without a strong brand, specialist focus or mass reach are likely to struggle. Brokers need to focus on and demonstrate what their contribution to the value chain is and not merely distribute through aggregator sites.

Finally, claims farming organisations (including personal injury lawyers) and credit hire companies are expected to be “losers” in light of the Lord Justice Jackson report.

Interestingly some commented that the customer is likely to bear the brunt in the next few years, due to price increases from insurers trying to balance their loss ratio.

losers

“They are not good at risk selection and underwriting.” Insurer

“Any insurer who cannot get on top of pricing and claims.” Insurer

“Those with no scale or weak brands.” Insurer

“Multi-distribution channel companies – difficult to keep control and focus.” Insurer

“Brokers, unless they have big brands behind them.” Distributor

“Mid-sized brokers.” Distributor

“Those insurance companies not good at risk selection and underwriting.” Insurer

“Brokers who don’t have a niche/ ability to differentiate – don’t give access to unique distribution anymore.” Insurer

“Smaller and lesser known brands not as trusted and respected.” Distributor
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