Spotlight:
The future of pricing
A responsible revolution

Insurance POST

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A RESPONSIBLE REVOLUTION

Change is hitting insurers at a much faster pace than ever before. Are they ready to keep up and able to re-establish some of the trust that has been lost?

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There is much debate as to whether the insurance business model is broken. If it is, then it's certainly not beyond fixing. As traditional insurers grapple with a new wave of disrupters, consumers are losing trust and patience. Trust is slipping in the ultra-competitive home and motor insurance, with many viewing the claims process as complicated and daunting.

Yet with great pressure comes change and innovation. The industry is starting to adopt new processes and tools with a renewed focus on analytics to transform their services. Yet enhancing value and customer experience is only one side of the coin. Compliance still has to be assured and, in the fast-moving insurance landscape, that's only possible with a joined-up approach to analytics.

In a little over a decade insurance has become a completely new world. Today, price comparison websites have usurped the role once performed by high-street brokers, undertaking market research and educating consumers on the most attractive premiums. Their emergence was seen as a victory for transparency and consumer protection, but their rise has also had some unforeseen consequences.

Price comparison has changed the market dynamic. An insurer can't hope to thrive without appearing in price comparison search results, so the focus has shifted to competing on price rather than providing a good service. The result is a system that works for a few. The cheapest deal is rarely the best: a consumer may be drawn in by a low price but quickly disappointed by the lack of coverage that price obscures. Slashing coverage to achieve a cheaper offer has become a competitive strategy for some insurers, but the real cost is consumer confidence in the industry.

In opposition to this model, a new generation of digital disruptors has emerged. Where many have chosen to play it safe, these challengers are in tune with a changing customer base that's increasingly millennial and hungry for more flexible, accurate premiums. As a result, we have seen technology and data used as a tool to achieve on-demand pricing. Telematics, for example, is revolutionising car insurance, with actuaries using real-time data from sensors embedded in vehicles to calculate customer risk. This ecosystem may change from its current form, but the result is clearly a fairer, more competitive offering where safe drivers no longer have to foot the bill for higher risk ones.

To survive in the long term, incumbents will need to play the disrupters' game and invest in the latest technologies. Yet it's not only market pressures that are forcing insurers to change. Regulation remains an unknown quantity and how the FCA will intervene to ensure fair play is still unknown. Inevitably, however, the focus will be on promoting openness around pricing. There's consensus that pricing discrimination is a problem that needs to be solved, so actuaries and those leading pricing strategy must ensure their processes are well-governed and explainable. Technology is only the answer for insurers if they can first make it transparent.

The on-demand dynamic

To stay competitive, insurers should reform how they calculate risk and enhance their customer experience. Key to both, however, is pricing agility – the speed at which insurers can calculate or update a customer's risk profile. If the future of insurance is on-demand pricing, where a customer's premium changes month to month or cover switches on and off as needed, premiums could constantly change with risk being regularly reviewed and prices recalculated.

Ultimately, insurers will need to phase out the process of annually assessing risk by broad customer segments in favour of calculating risk at the segment of one. Achieving this requires real reform of the analytics function in most actuarial departments. While the industry is evolving rapidly, many actuaries have been slow to change. This is typical anywhere with longstanding processes and legacy technology.

Part of the solution is cultural. Actuaries should be encouraged to experiment with analytics and, by doing so, innovate. Discovering a use for a new type of data to more accurately assess a customer's risk is exactly how competitive differentiation is born. Breaking down silos will help with this. The actuarial function is often separate from other business units, but fostering collaboration between different departments will give them more insights and opportunities to be creative. As more services and interactions are delivered through digital channels, fresh insights and data will appear, giving new signals among the noise that shouldn't be ignored.

Another requirement that insurers must meet, however, is speed. With a personalised approach to pricing for new and existing customers, insurers will have to find a way to go from running hundreds of risk models a quarter to hundreds of thousands a month. The faster you can run these models, the more scenarios you can run in them and the greater the number of customers you can service. That means raw data needs to be refined, analytics ready and models productionised faster than ever before.

To service this growing demand, actuaries must look to new techniques, tools and applications. Automation will be crucial here. So much of the processes needed for data preparation, such as cleansing, can be performed more efficiently and rapidly by artificial intelligence. Machine learning models can also be automatically retrained to remain accurate. Automating the data production process ensures that the data can be made ready for analysis at the speed required.

Innovate responsibly

Many insurers are moving fast to make up lost ground, using open source tools to experiment with new analytical techniques. Yet this too has its challenges. Insurers must ensure that data is well managed, processes are clear and explainable, and decisions are accountable. Open source analytics tools and platforms can be highly effective in building the services of the future, but governance can be a drawback. You can end up with a highly complex analytical system made up of a large number of moving open source parts. Efficiency is not guaranteed and the system may not be able to productionise models at the desired speed.

There are also pitfalls from the regulatory perspective. Many off-the-shelf applications function as a black box, with inputs and outputs but no visibility on the decision that takes place. Awareness is growing in the industry of the dangers of algorithmic bias, where unwitting decisions made during the design phase end up having a negative impact on certain users. When analytics and AI are used to make decisions based on customer characteristics, the outcomes can discriminate against and alienate customers.

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Insurers won't be expected to solve algorithmic bias by themselves, but regulators will certainly oblige them to make their processes accountable and transparent. This will be difficult if not impossible when your systems are black boxes and your analytics process is fragmented and siloed across different parts of the company.

To develop new services and transform analytics function for the better, insurers need a platform that supports innovation while guaranteeing compliance. A single platform that governs all analytical models and decisions, from data collection to analysis, will give much-needed insight and transparency into core processes. At the same time, to keep up with the speed of the market it must also have the latest tools built-in to make your processes as streamlined and efficient as possible and manage the risks these new working practices present.

Insurers must be ready for radical change, but they still have to be able to show their workings. How exactly regulators will respond to market conditions is not known, but its possible to spot the direction of travel. In the heat of innovation, governance can't be an afterthought. An integrated, well governed approach to innovation will delight both customers and regulators, growing market share without breaking the rules.

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