

GIRO 2008 - Free Market Pricing Working Party

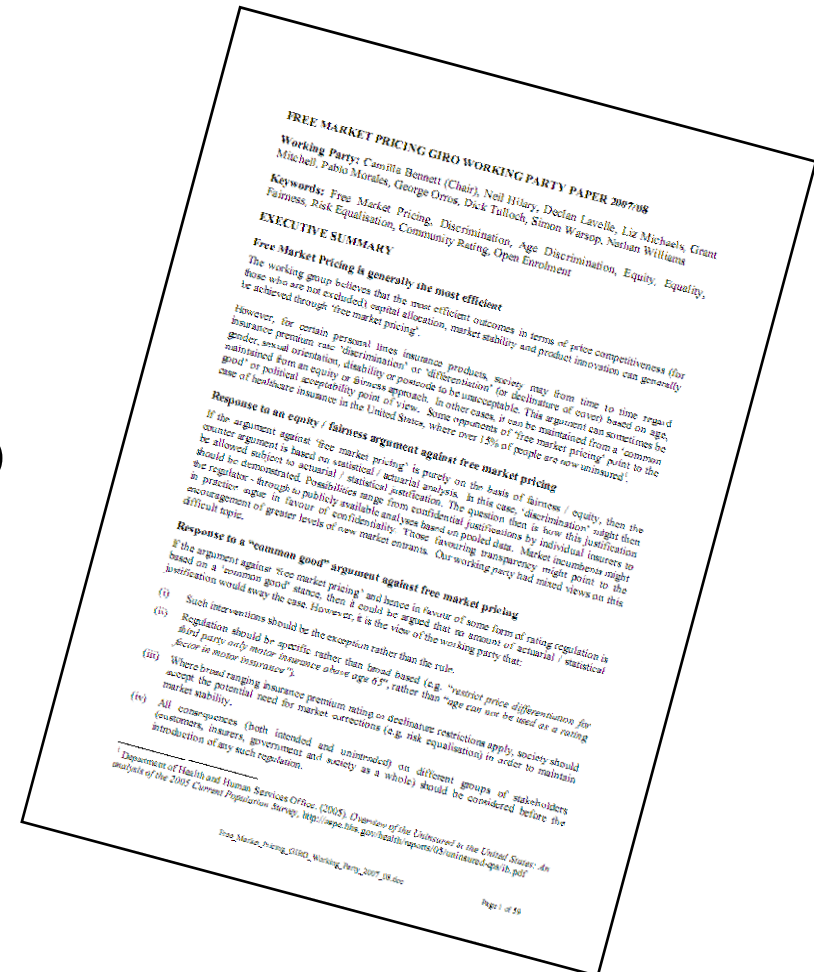
Irish Update - 23rd March 2009

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Free Market Pricing

- This presentation is based on work done for the 2008 GIRO Free Market Pricing Working Party.
- The paper produced for GIRO is available on the Society's Website.
- Our focus is on non-life insurance, but the principles extend to life insurance.





Free Market Pricing

- The Free Market Pricing working party grew from a Gender Equality Working party in 2007.
- The working party was motivated by EU proposals to extend the principle of equal treatment beyond gender, to include factors such as age and disability.



Free Market Pricing Working Party

- Terms of Reference
- What is Discrimination?
- 3 Market Models
- UK Market Failures with Free Market Pricing?
- Impact of removal of Rating Factors
- Some Case Studies
- Working Party's Conclusions



Terms of Reference

- Address,
- Consider,
- Review ...

the 'free market pricing' issues associated with personal lines general insurance



Free Market Pricing

- A '*free market price*' is a price determined purely by the forces of supply and demand without interference from an outside source, such as a government.

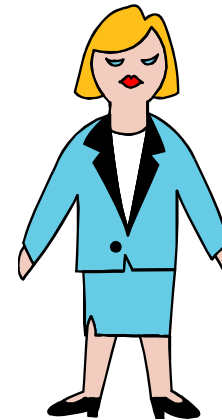
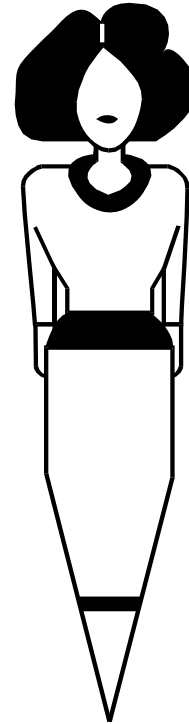
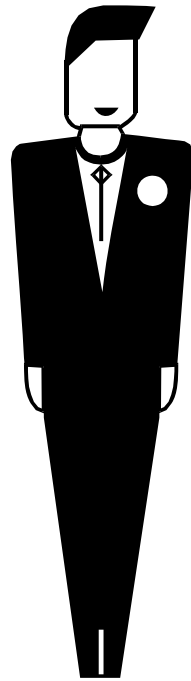


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What is “Discrimination”





What is “Discrimination”

- What is the difference between
 - **Discrimination** – illegal, against “common good”
 - **Differentiation** – legal, accepted by society
- Both can be used to separate a heterogeneous mass into homogeneous groups
- Society decides between ‘differentiation’ and ‘discrimination’



What is “Discrimination”

- Society sets the rule for ‘differentiation’ and ‘discrimination’
- Workplace
 - Race, Religion & Sexual orientation – **discrimination**
 - Age - **discrimination**
 - Gender - **discrimination**
 - Physical disability - **discrimination**
 - Physical status - **discrimination/differentiation**
 - Education – **differentiation**
 - Marital status – **discrimination**
 - Type of Car – **differentiation**
 - Occupation – **differentiation**



What is “Discrimination”

- Society sets the rule for ‘differentiation’ and ‘discrimination’
- Motor Insurance
 - Race, Religion & Sexual orientation – **discrimination**
 - Age - **differentiation**
 - Gender - **differentiation**
 - Physical disability - **discrimination/differentiation**
 - Physical status - **discrimination**
 - Education (type of licence, experience) – **differentiation**
 - Marital status – **discrimination/differentiation**
 - Type of Car – **differentiation**
 - Occupation – **differentiation**



What is “Discrimination”

Actuarial issues:

- The fact that a rating factor is considered as discriminatory does not mean that it would not be a perfectly good differentiator of underlying risk.
- Statistical Rating Analysis can only be based on historically collected data
- Companies have a store of valuable proprietary data
- Any Rating Factor must be practical and appropriate



Overview of Irish Legislation

Equal Status Act 2000 and Equality Act 2004

- Ban discrimination on nine grounds:
Gender, Marital Status, Family Status,
Age, Race, Religion,
Disability, Sexual Orientation, Membership of the Traveller Community.
- For insurance, differences in treatment are allowed where based on:
 - (i) Reliable actuarial or statistical data,
 - or
 - (ii) other relevant underwriting or commercial factors.



Overview of EU Directives

EU Gender Equality Directive 2004

- Member States may permit proportionate differences in premiums based on relevant and accurate actuarial and statistical data.
- Member States must ensure that accurate data relevant to the use of sex as a rating factor are compiled, published and regularly updated.
- In Ireland this requirement is currently satisfied (for motor insurance) by the Financial Regulator's publication of the Private Motor Statistics.
- The Society issued a Briefing Statement on gender equality in Insurance in 2004

EU Proposal 2008

- Proposed Directive on implementing the principle of equal treatment between persons irrespective of religion or belief, disability, age or sexual orientation was issued in July 2008.
- Motivation for the GIRO Working Party.



Age Discrimination ?





Age Discrimination ?

Some points of view:

- ‘You wouldn’t decline a risk on the grounds of race or disability so why should you decline a risk on the grounds of age ?’
- ‘The market works effectively there are loads of companies quoting for older (and younger) people’
- ‘Many companies prefer to quote for low risk drivers; this means it is harder to get insurance if you’re a high risk driver. Why should older people be treated any differently from any other high risk group ?’



Differentiation or Discrimination ?

Is Insurance Rating
'Differentiation' or
'Discrimination' ?

- What do you think ?
- Where next?
- What should be the principles applied?





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3 Market Models

- Free Market Pricing
 - UK Status Quo pre Gender Equality Directive
- All Pay the Same
 - or less extreme variations ...no age discrimination, no gender discrimination etc.
- Middle Ground
 - free market pricing, but with publication of supporting data



Free Market Pricing

- + Innovation driven by ever greater risk differentiation
- + All Customers are valuable – at the right price
- + Competition minimizes premiums and profits.
- + Can discourage risky behaviours.

- Potential for exclusion of certain groups.
- Can be perceived as unfair or discriminatory.



Middle Ground

- + Publication of data helps counter arguments about unfairness.
- + Can assist new market entrants.
- Potentially less incentive to innovate than in Free Market.
- Less innovation => higher premiums on average.



All Pay the Same

- + Promotes Innovative Marketing and focus on Customer Service
- Risk of Cherry Picking and Market Wide Anti-selection
 - Requires Risk Equalisation of some type
 - Requires ‘Open Enrolment’ for Compulsory Insurances
- Overall Average Market Premium Probably Higher than Free Market.
- May Encourage Risky Behaviours



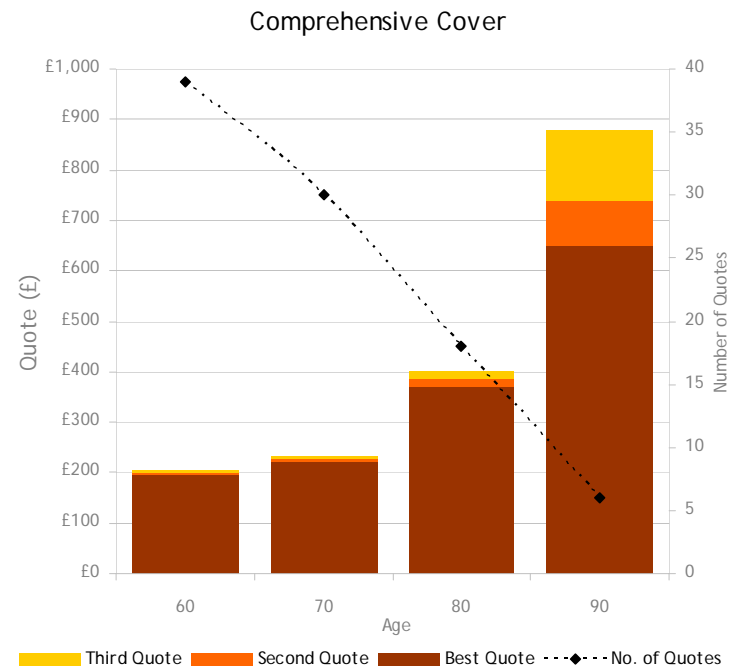
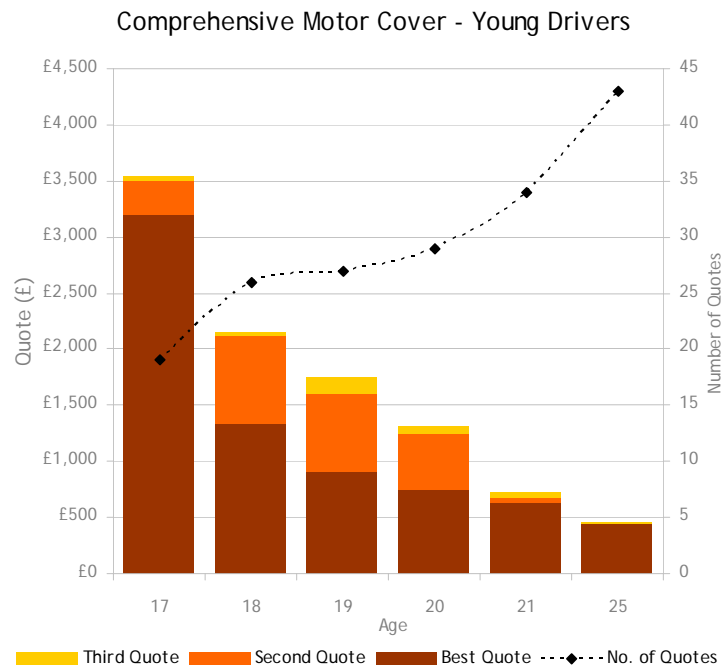
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Evidence of Market Failure - UK

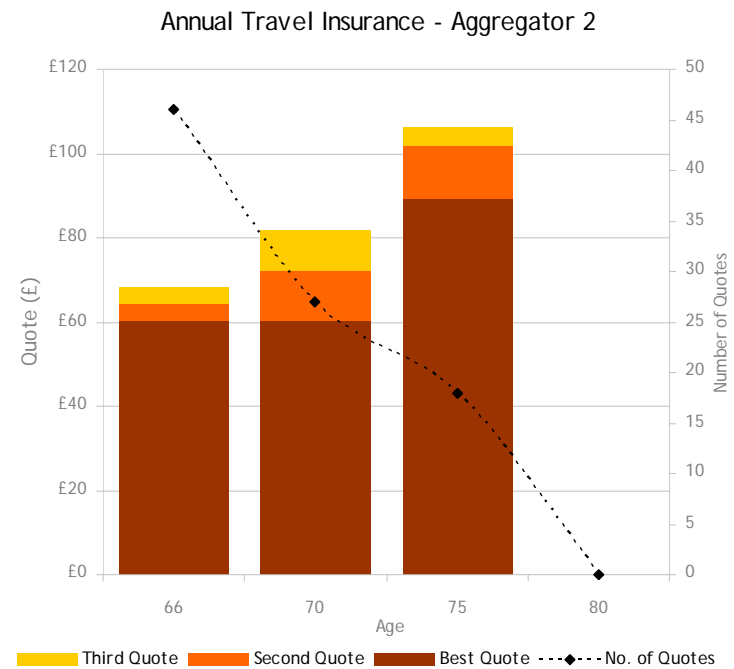
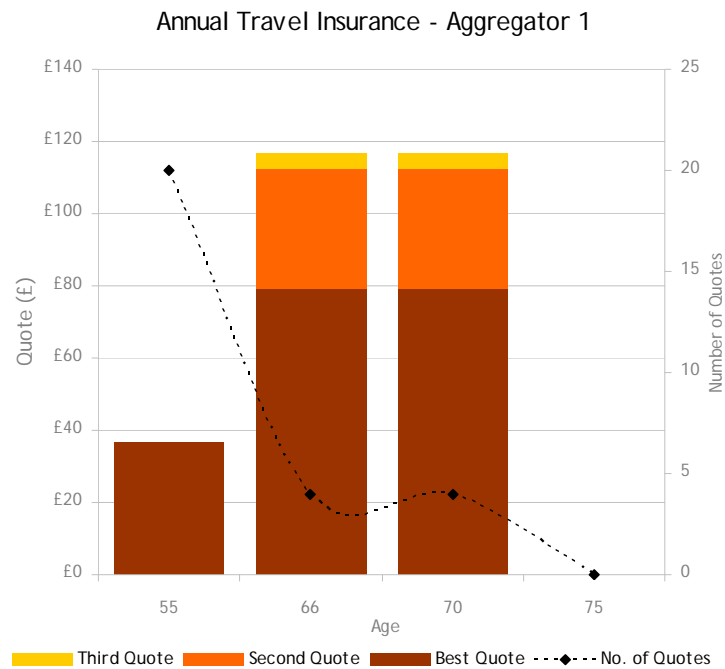
- Motor insurance – young and old drivers





Evidence of Market Failure - UK

- Travel insurance – older travellers



Above age 75, availability is available through specialist insurers –

e.g. Intune offer a policy with no upper age limit, although the price of worldwide cover is high.



Evidence of Market Failure - UK

- Household Insurance – flood cover
 - Actuarial Profession’s flood risk working party
 - Analysis suggest that insurance is widely available at reasonable cost in areas designated as high risk
 - Greater reliance on ‘Previously Flooded’ than Post Code



Evidence of Market Failure - UK

- Considered
 - Motor insurance – young and old drivers
 - Travel insurance – older travellers
 - Household Insurance – flood cover
- Conclusion
 - No evidence of lack of availability
 - Some availability restricted
 - Some declined
 - Some prices might be considered prohibitive
 - Signposting to specialist insurers could help bad press
 - No indication that legislation would improve affordability



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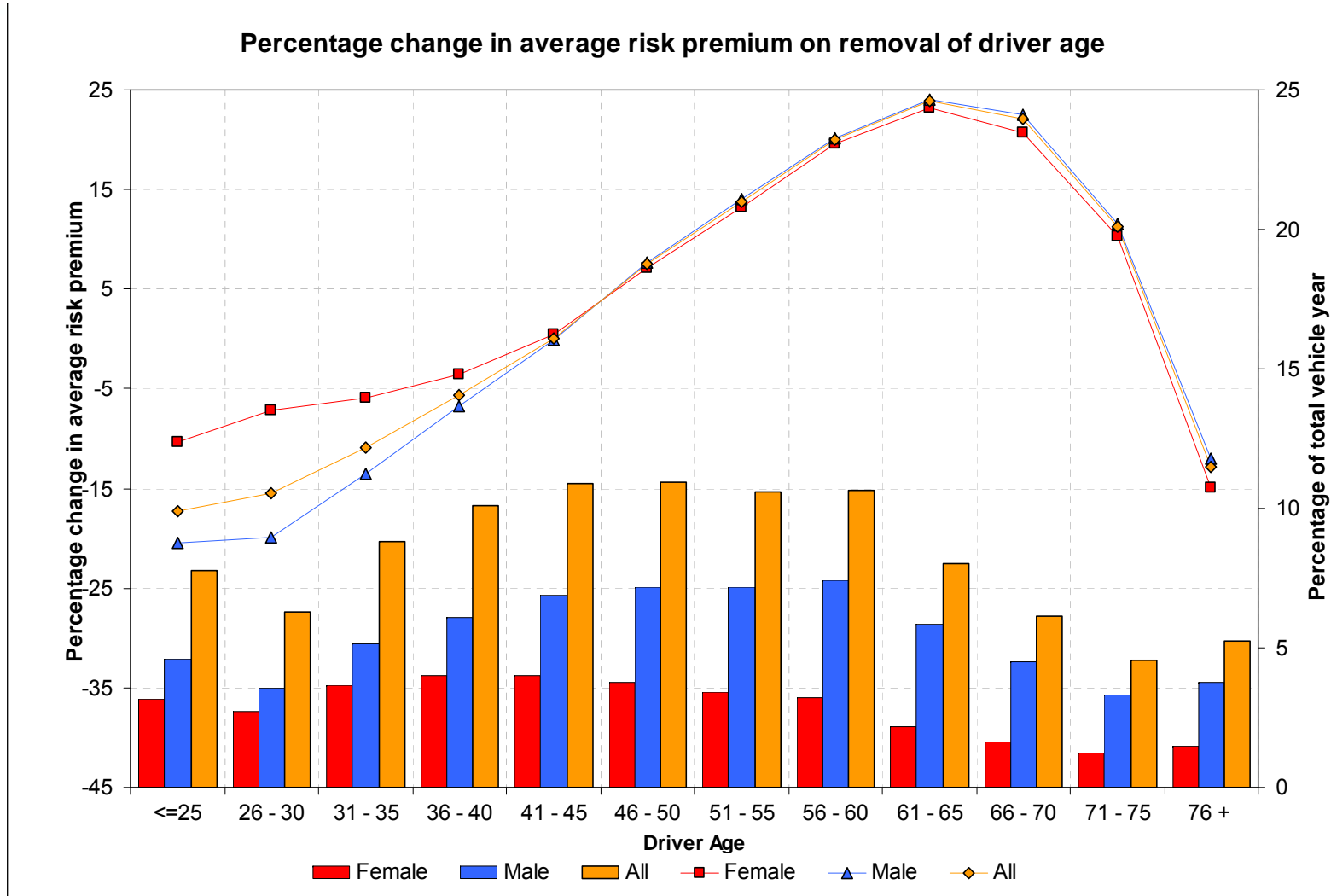


Impact of Removal of Driver Age

- Impact on premiums of removing Driver Age from rating
- UK Data contributed by insurers representing approximately 30% of UK motor market – Multi factor model allowed refitting with variables removed
- Irish Data from Private Motor Insurance Statistics 2002 to 2006 published by Financial Regulator – Simple age classification no detail on vehicle groups, vehicle age etc.

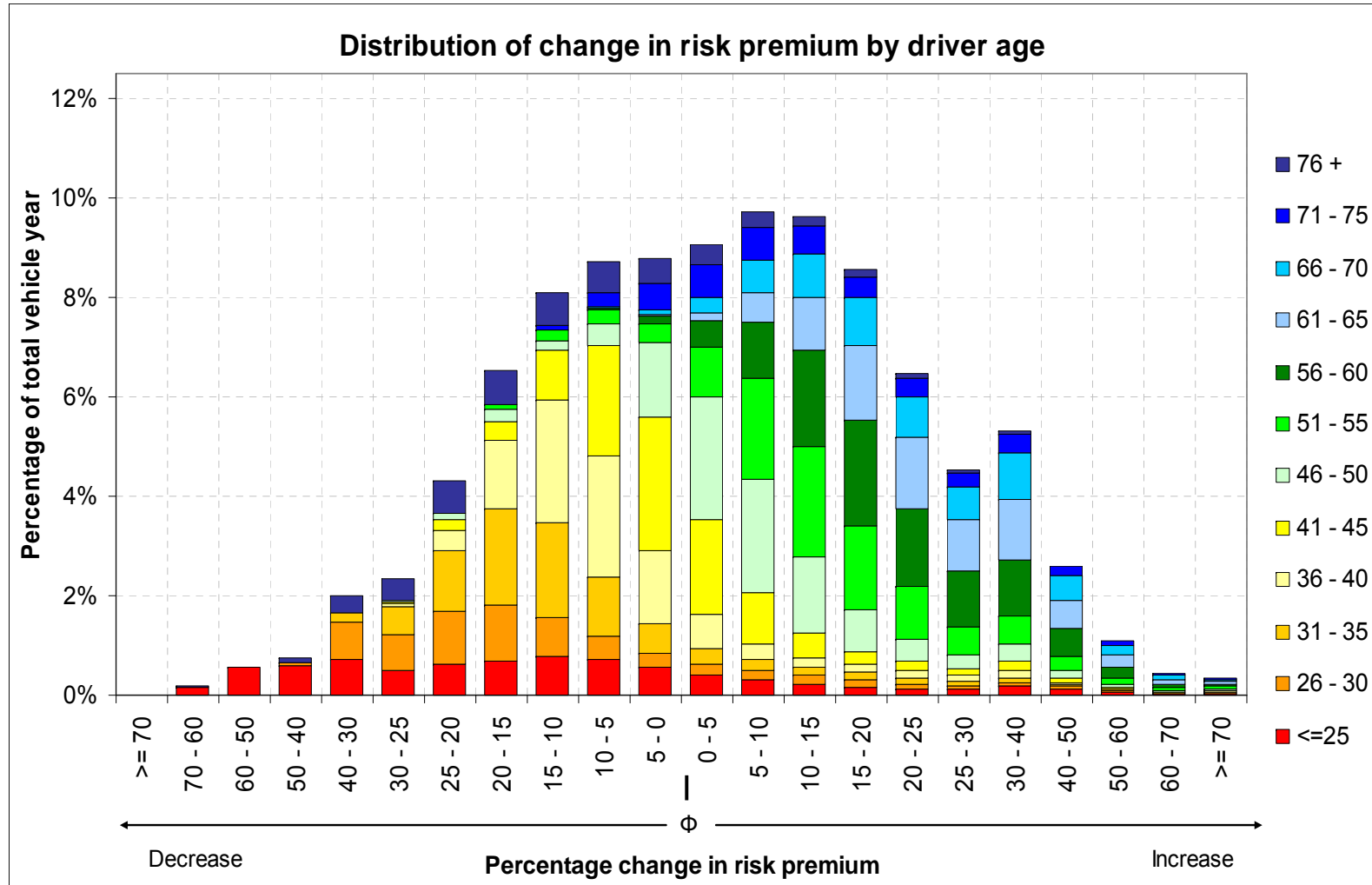


UK Data





UK Data





Impact of removal of driver age rating factor

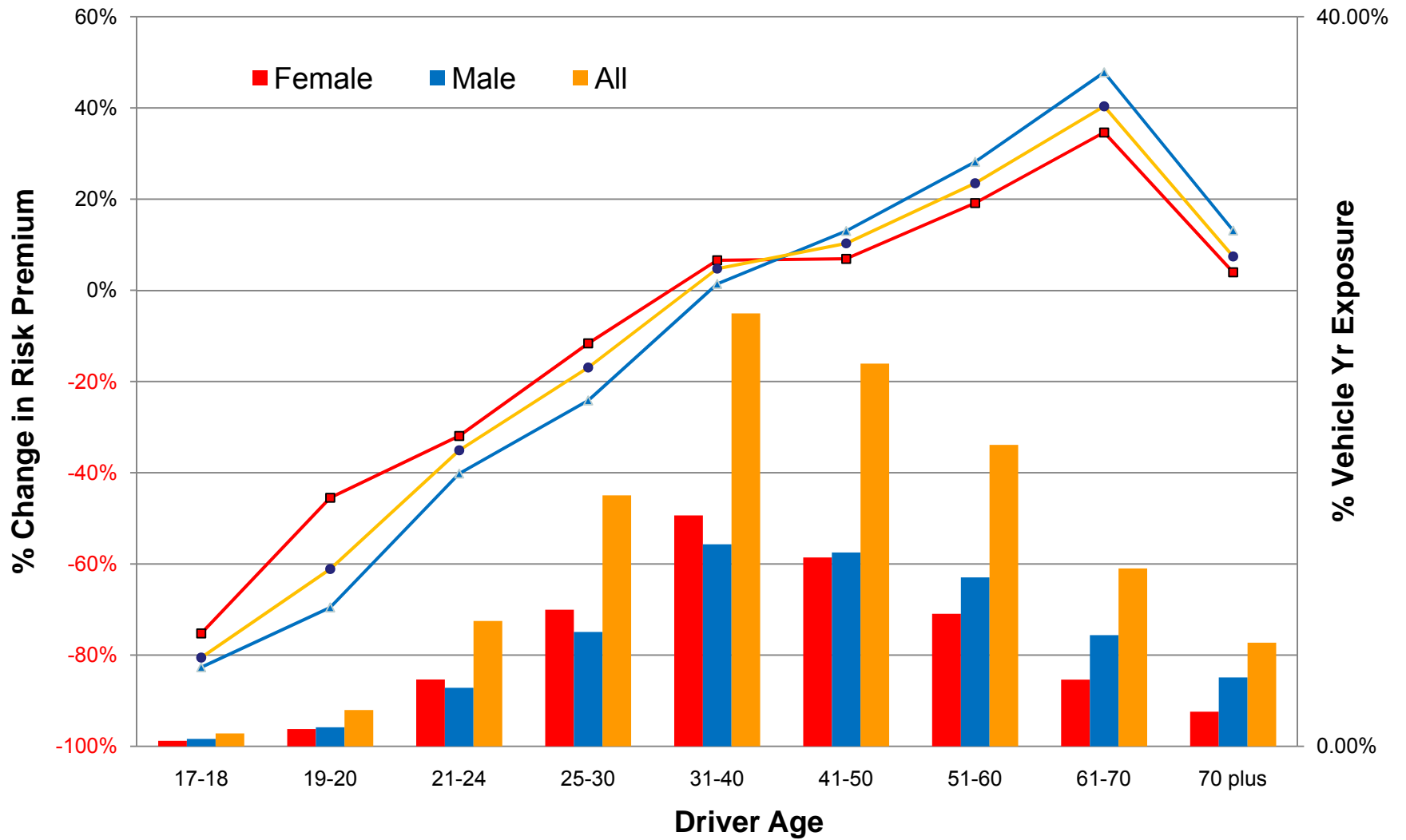
Winners/Losers - UK

- Those aged 46-75 would see increases of up to 24%,
- Under 25's / Over 75's would see decreases of 17%/13% respectively
- If other factors such as “years licence held” or NCD were removed the effect would be greater



Irish Data

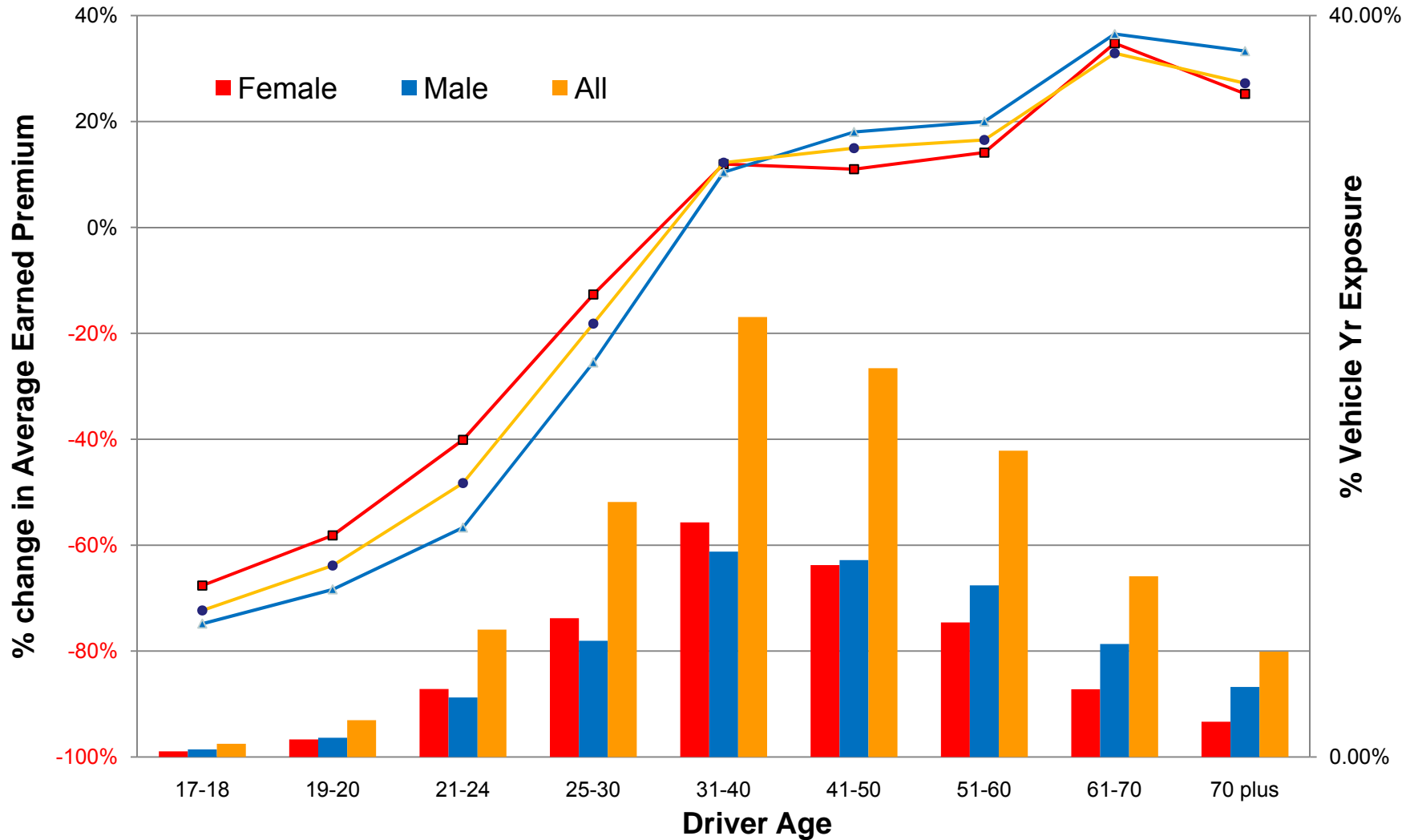
% change in average risk premium with removal of driver age





Irish Data

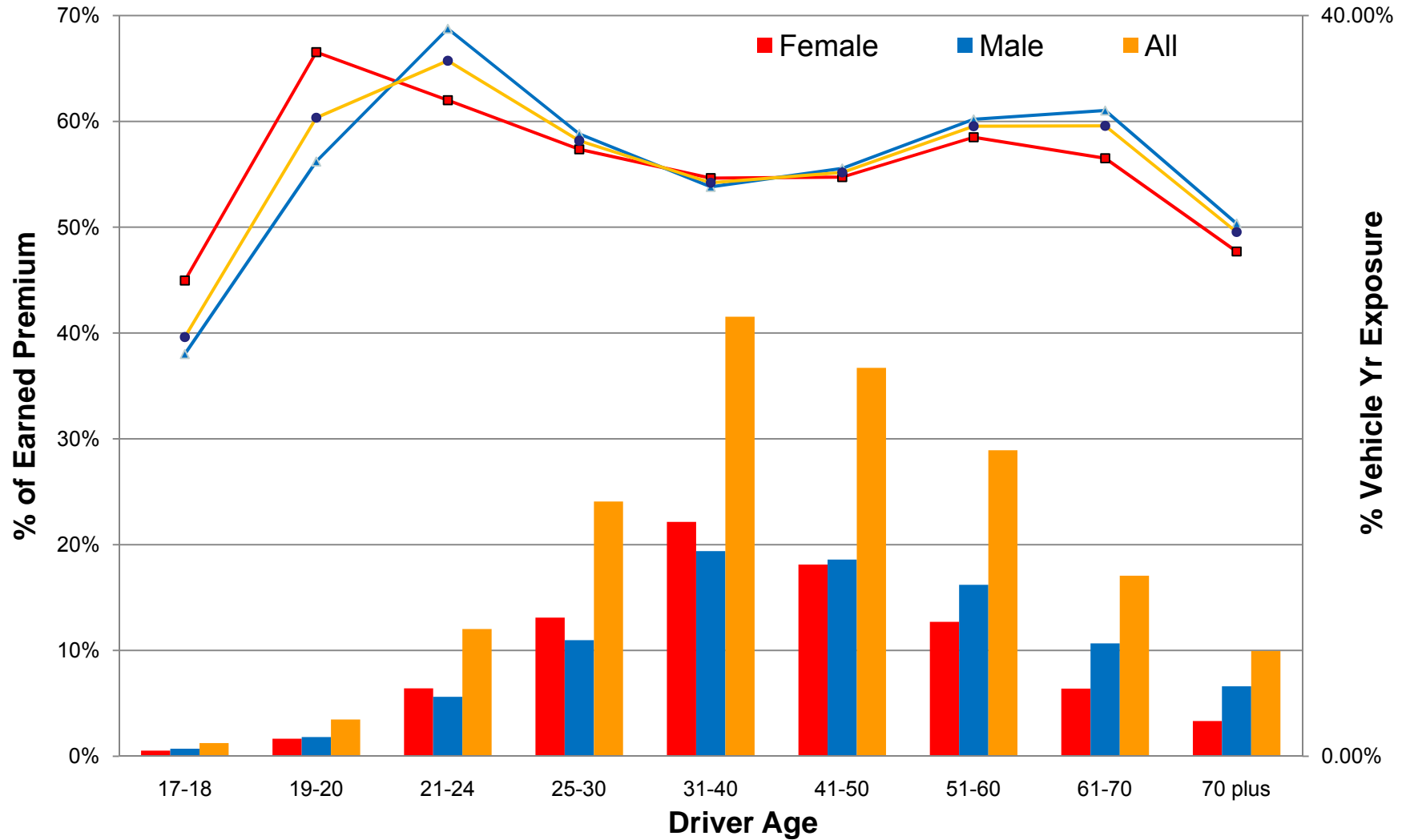
% change in average earned premium with removal of driver age





Irish Data

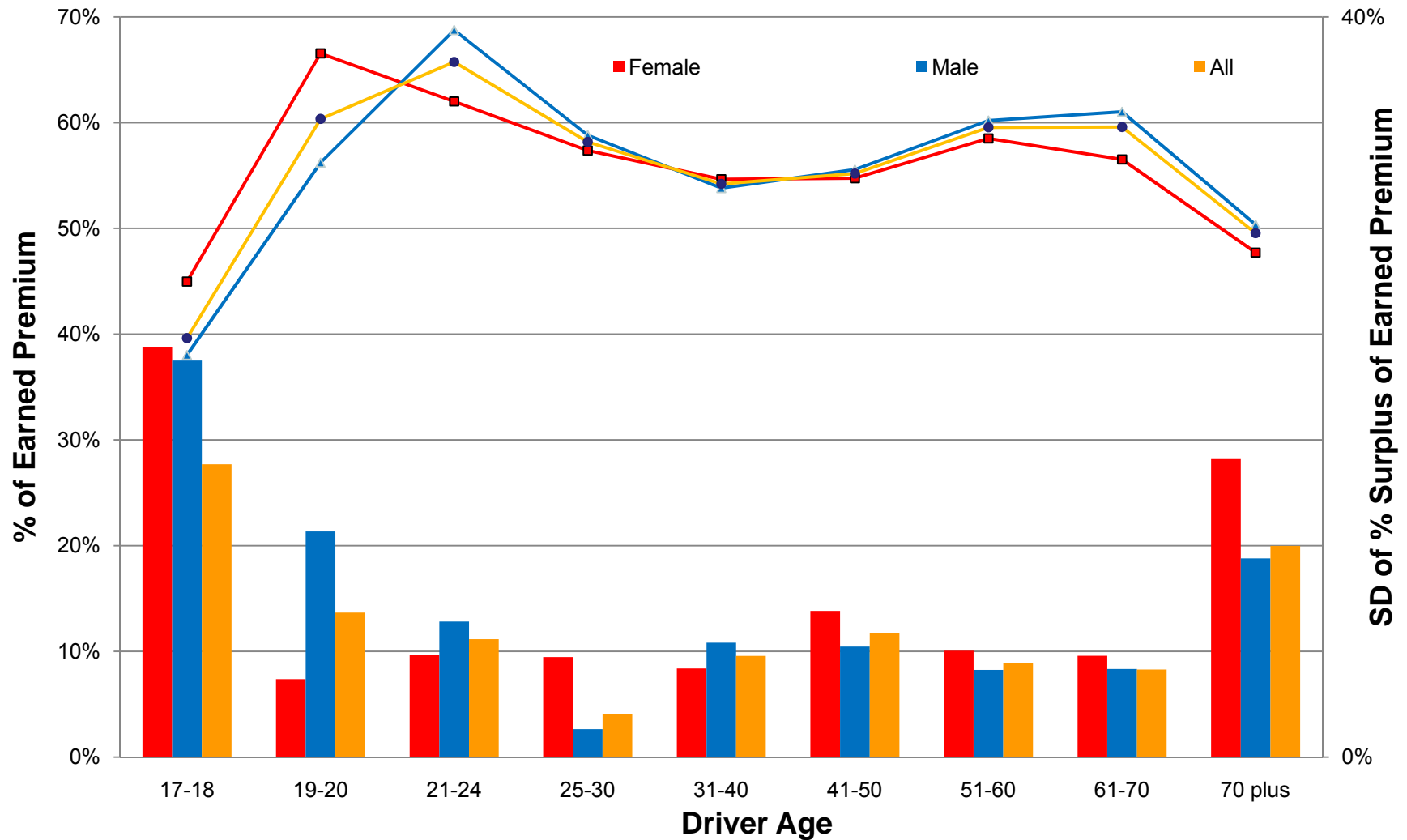
% Surplus of EP over Incurred Claims





Irish Data

% Surplus of EP over Incurred Claims with variance over years





Impact of removal of driver age rating factor

Winners/Losers - Ireland

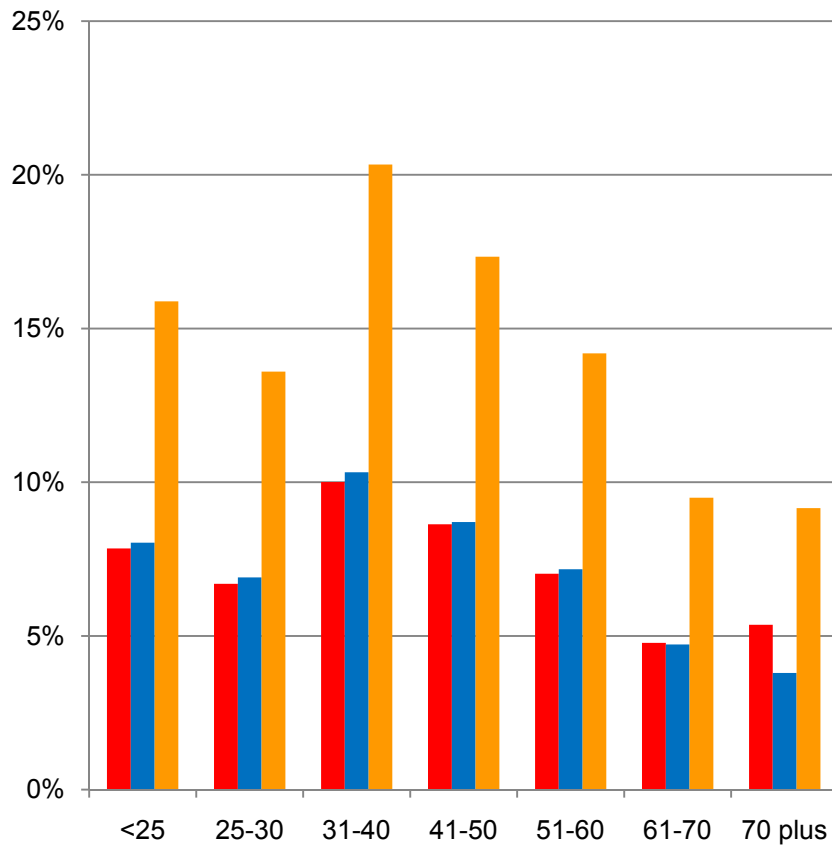
- Those aged 31 to 70 plus would see increases of up to 47%,
- Under 30's would see decreases of up to 69%
- Average movement much greater for males than females
- Profit not fully consistent with annual variance of experience (standard deviation)



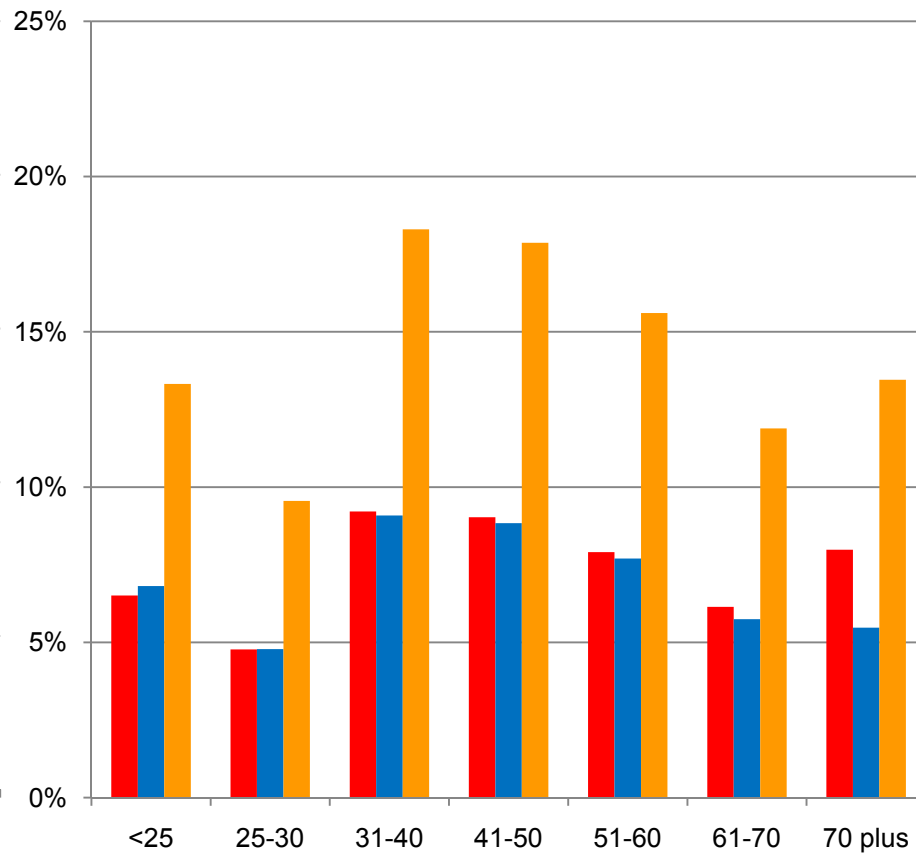
General Population – Age Distribution (Driving Ages)

Ireland

UK



Female Male All



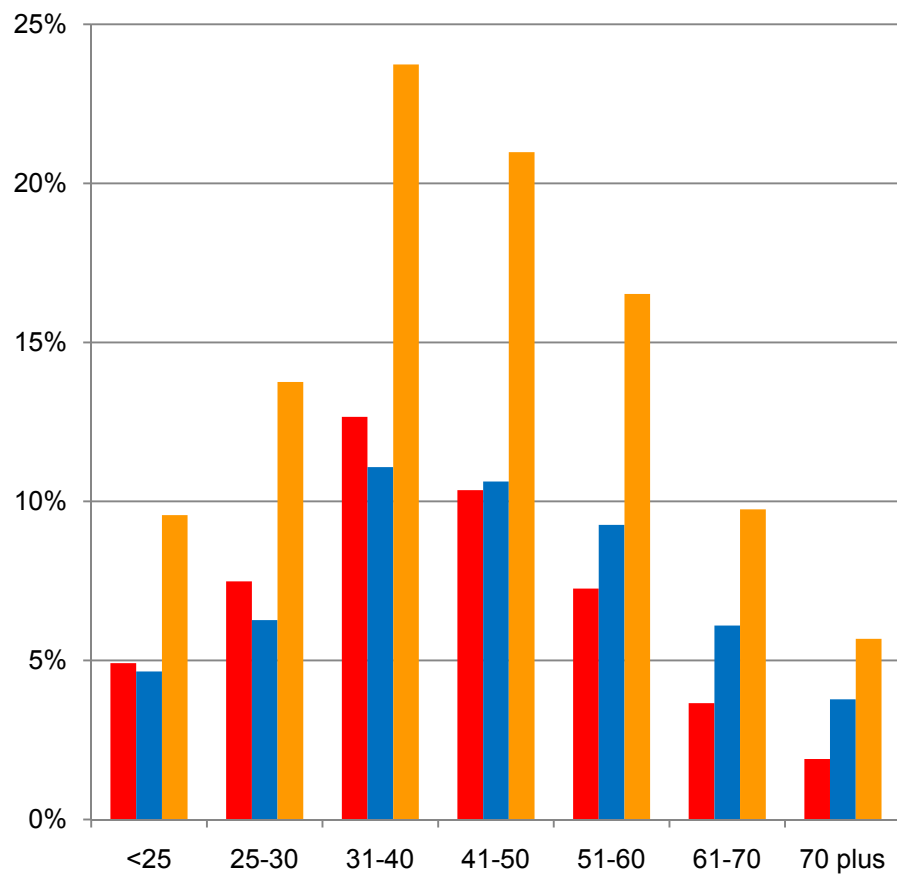
Female Male All



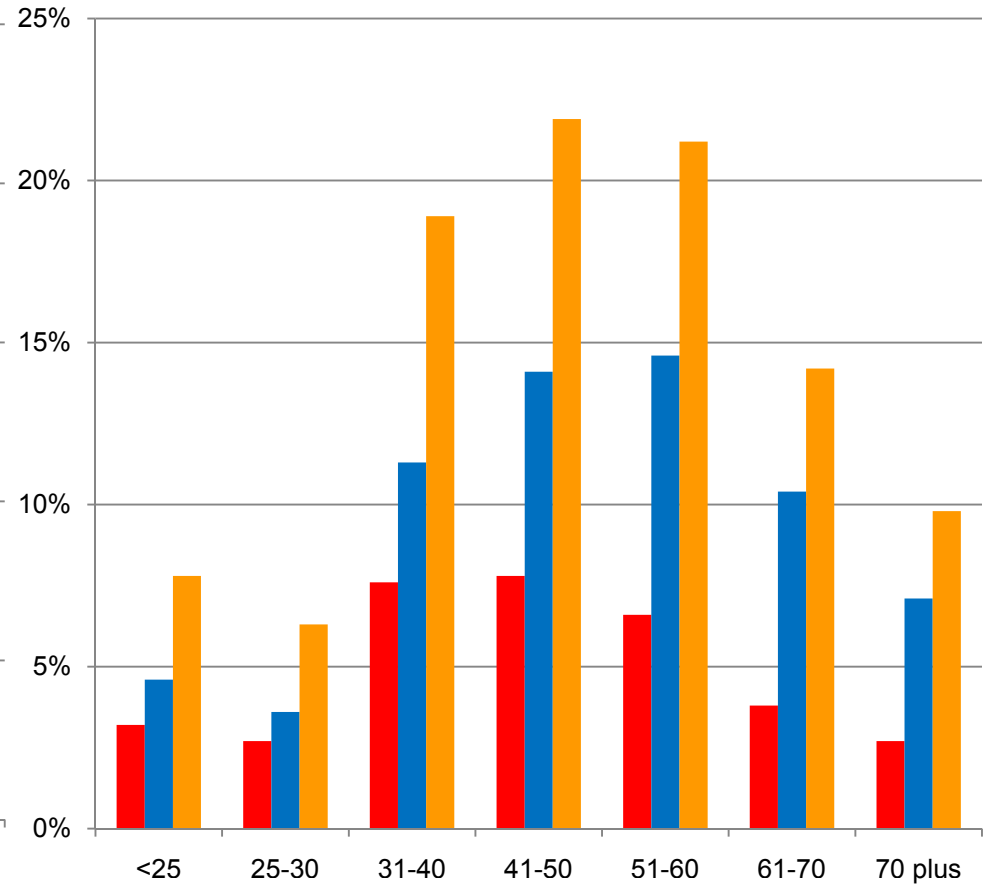
Insured Driver Population – Age Distribution

Ireland

UK



Female Male All

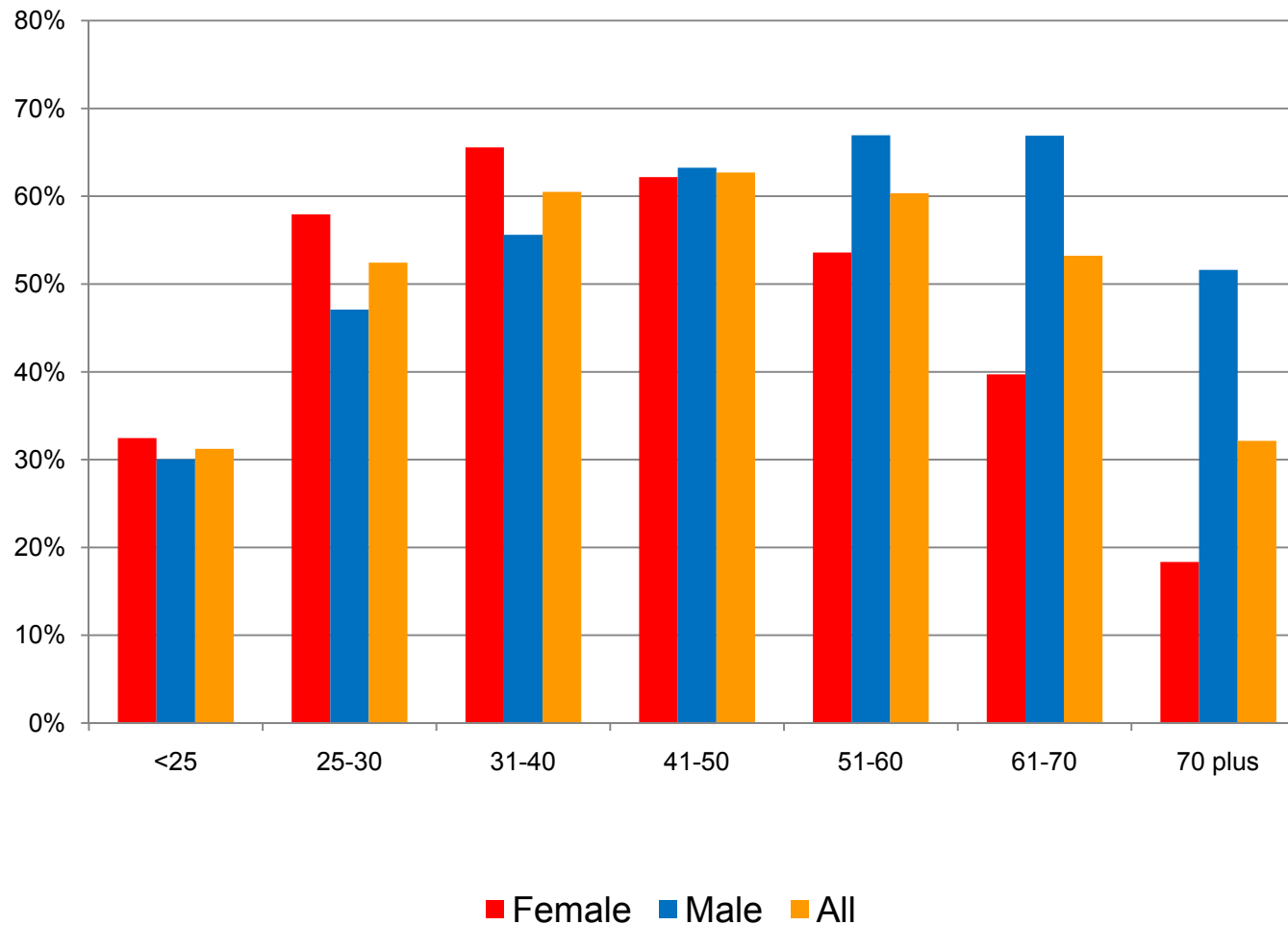


Female Male All



Driver Population Data - Ireland

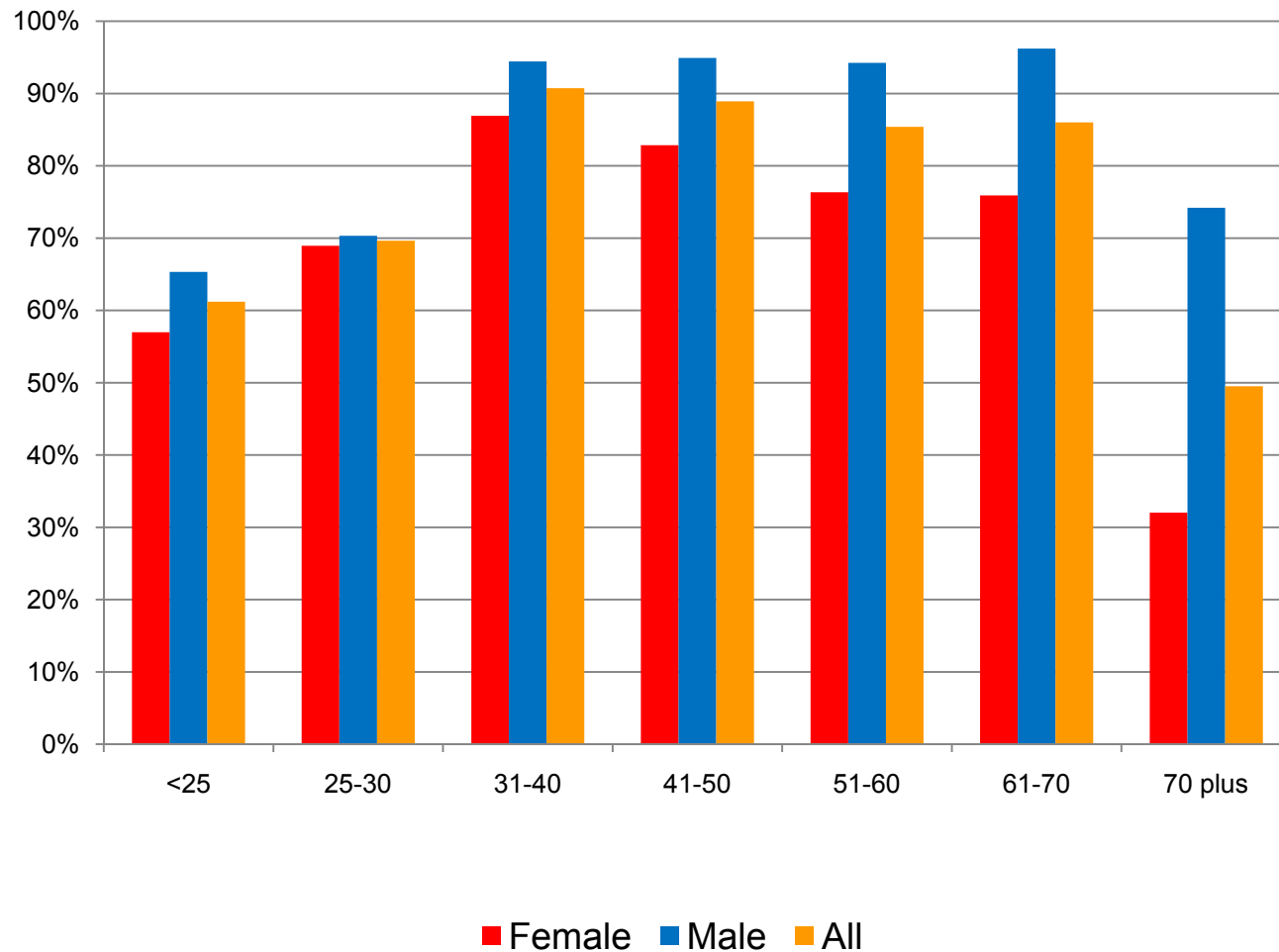
Insured Driver Population as % of Overall Population in Age Group





Driver Population Data - Ireland

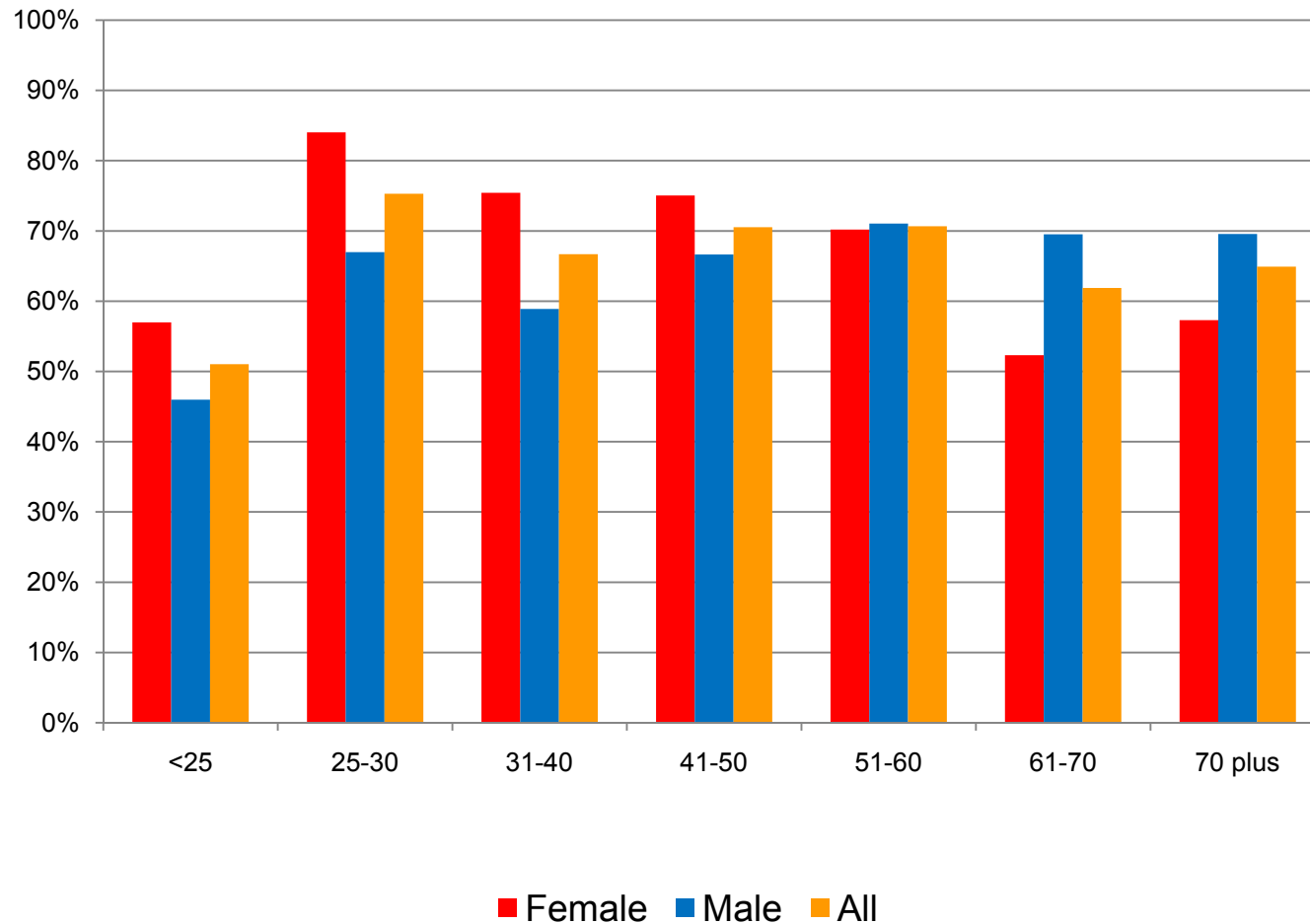
Licensed Driver Population as % of Overall Population in Age/Gender Group





Driver Population Data - Ireland

% of Drivers with licenses who are Primary Insured Driver





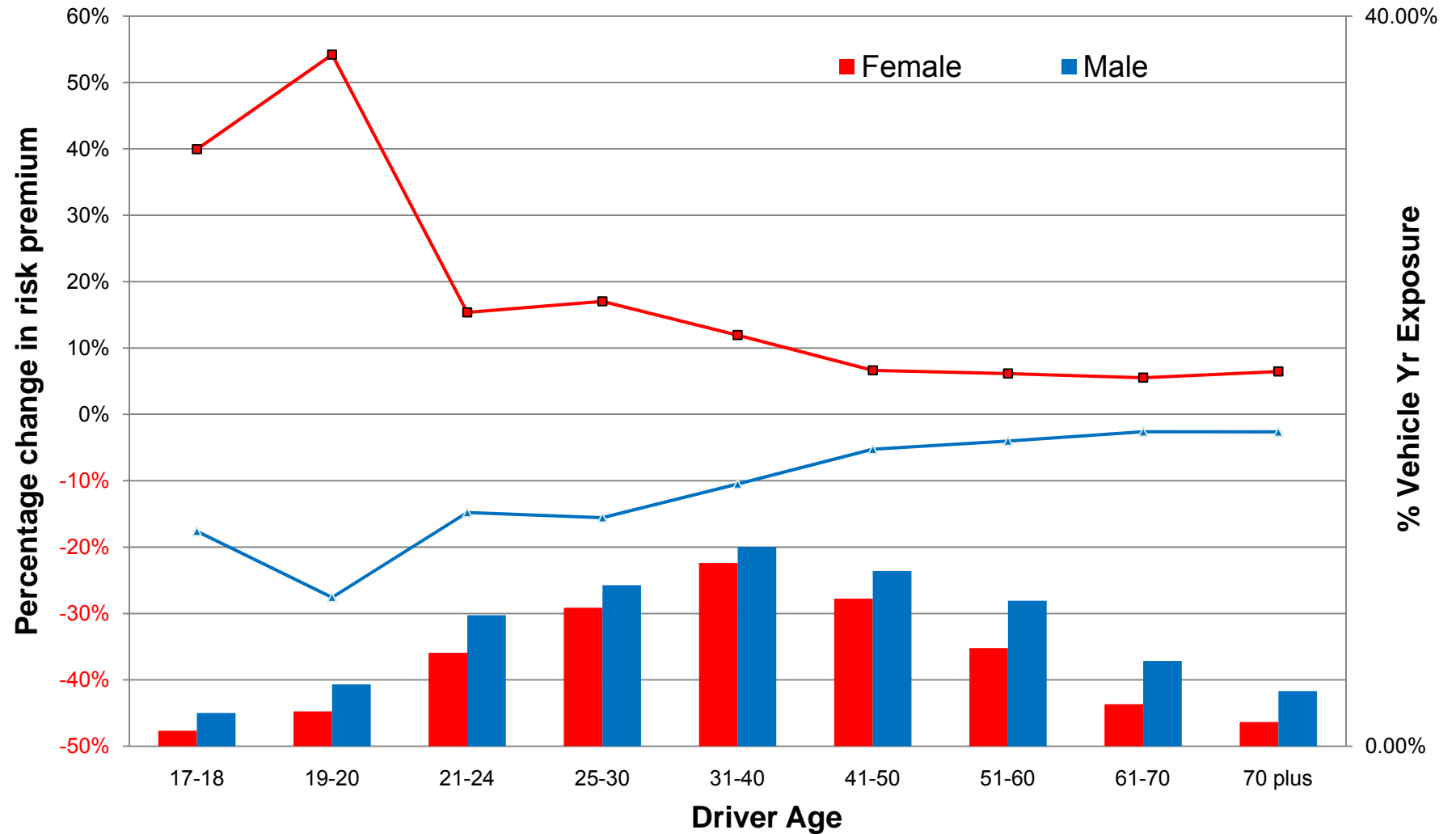
Driving Age Population Data

- 50% of Irish Population less than 40 (UK 41%)
- 47% of Insured Irish Drivers less than 40 (UK 33%)
- 6% Irish Drivers over 70 (UK 10%)
- Insured Driver Exposure only represents 66% of licensed drivers
- For ages less than 50 Females are the most likely to be the primary insured driver
- Insured Male/Female split shows much higher Female insured drivers than UK
 - Ireland 48%/ 52%
 - UK 66%/34%



Irish Data – Gender

Percentage change in average risk premium with removal of gender





Impact of removal of driver gender rating factor

Winners/Losers - Ireland

- Least impact on those over age 40
- Females under 30's could see increases of up to 55%
- Males under 30's could see decreases of up to 27%



Impact of removal of rating factors

Other Impacts

- We have assumed no change in mix of business
 - In practice, premium changes could alter the mix materially
 - This would reduce underwriting profitability and/or lead to increased average premium rates
- Insurance of higher performance vehicles by the very young would be encouraged
 - increase in road accident injuries and fatalities?
- + Change in risk premium profile may increase coverage of younger drivers
 - i.e. combat the uninsured driver problem.



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Case Study 1 : New Jersey Auto

Very highly regulated market. As of 2002

- Insurers had to “Take all comers”
- Regulatory rate caps were applied
- There was slow regulatory approval for rate changes
- + many other restrictions

Impact

- Less customer choice
- Fewer Insurers writing business than in other US States



Case Study 1 : New Jersey Auto

Reforms passed in 2003 to free up market

New York Times reported in 2006:

- *“For the first time in decades, prices for coverage are falling in the state and insurance companies are fighting for drivers’ business.”*
- *“while some drivers are worse off, the vast majority of consumers have gained from the changes”.*
- *“Insurance regulators say more than 75% of New Jersey’s drivers are now paying less”*
- *“insurers’ prospects of profits have risen, even as they have generally lowered prices”*



Case Study 2 : Health Insurance (Ireland)

- In Ireland Health Insurers must apply
 - Community Rating (“All Pay the Same”)
 - ‘Open Enrolment’
- Legislation was passed to support this through Risk Equalisation
- Originally two Main Market Participants
 - VHI (legacy state owned insurer)
 - BUPA Ireland



Case Study 2 : Health Insurance (Ireland)

- BUPA complained about punitive risk equalisation scheme, and made several legal challenges
- BUPA eventually withdrew from the market
 - book transferred to Quinn Healthcare
- In July 2008 BUPA won a legal challenge in the Irish Supreme Court, where Risk Equalisation legislation was found to be flawed.
- In November 2008 an age related premium levy was announced - as an interim measure - while a new risk equalisation scheme is devised.



Case Study 2 : Health Insurance (Ireland)

Comments

- Society:
 - Accepts community rating as meeting common good
- Industry:
 - Concerns over dominance of legacy state owned company and thus limited and inequitable access to market
 - Simplistic methodology that does not reward business efficiencies
- Problem:
 - Legal provisions and interpretations of complex technical issues



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Working Party's Conclusions

- Free Market Pricing is generally the most efficient in terms of price and capital.
- “Fairness” can be adjudicated using statistics.
- “Common Good” may override Fairness if Society decides...but should be the exception rather than the rule.



Free Market Pricing Working Party

