Ratios and Cost Structures in Insurance Supervision

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Cost Structures and Ratios in Insurance Supervision

Agenda

1. Rationale for Inclusive Insurance monitoring
2. Challenges in some jurisdictions
3. Four KPIs, from a supervisory perspective
4. Adequate levels for KPIs and further monitoring options
5. Monitoring as a process

Risk-based supervision and proportionality principle

3-level approach to adopt proportionate measures:

1) **Understand** the market and identify the problems

2) **Assess** the risks

3) **Adopt** a proportionate measures.

Monitoring through data collection and KPI analysis is therefore a way to understand the market and assess the risk

Rationale for Inclusive Insurance monitoring

Inclusive Insurance Market Evolution

Sound financial performance and governance

Client Value and Consumer protection

High Flyer
- Massive Outreach
- Product Diversity
- Effective Infrastructure
- Long time experience

Aspirant
- Significant untapped potential
- Enabling Infrastructure
- Historical MI experience
- Large populations

Hidden Talent
- Some MI experience
- Community based with some commercial experience

Fledgling
- Limited MI experience
- Some potential due to population
- Growth unlikely without intervention
- Limited Outreach

Embryonic
- Smaller countries
- Very limited or no MI
- Limited or no infrastructure
- Unrest

Source: MI Landscape for Africa 2012

- **Snapshots of the Inclusive Insurance market, over time**: outreach, product types, channels used, players.

- **Measurement** of the deepening of financial inclusion

- Indicators of **impact** of policy and regulatory interventions

- Enabling **trends**' observation therefore anticipation rather than reaction

- *Through collection of:*
Number of insureds and target population size, premium volume, by entity, peril, product type, distribution channel.

Rationale for II monitoring (2)

Safe Market - Sound financial performance and governance

- **Failure** of entity can impact the whole market (current and future)

- Need for **trust** building among new insureds

- Same **financial supervision** as for conventional insurance for entities even if specific rules apply

- Need for **continuous coverage of LIH** to play its safety net goals

- Way to draw lessons on **successful programmes and best practices**, thus motivating new players and **foster** the II market, increase safety net availability

Example of failure of market

Zimbabwe MNO reached 1.6 M insureds in 12 months with life insurance product

Services and insurance are canceled over royalties payment issues with service provider (IT/services)

Regulator has to intervene to get the insurer to still pay some claims

63% of MNO user reported ruling out the use of similar products in the future

Rationale for II monitoring (3)

<u>Client Value and Consumer protection</u>

- Within **mandate** of insurance supervisory authorities

- More **vulnerable customers**

- Potential impact on **future insurance market development**

- Impact of non compliance can have **serious financial and social impact on Low-Income Households**

- **Client-centric** analysis of KPIs enables client value assessment.

> ✓ Is the experience from LIH with II in line with **good market conduct**?
>
> ✓ Do products offer **adequate value** to low-income households, addressing **needs** at **affordable** premiums?
>
> ✓ Are market players' behaviours **ethical** toward the low-income segment?

Examples & lessons from sample jurisdictions

Jurisdiction	CIMA region	Mexico	Nicaragua	Philippines
Type of data reporting	Compulsory	Compulsory	Compulsory	
Applicable for which products	Microinsurance as defined by the MI regulation (low premiums/low sum insured, for LIH)	All products registered whether MI or not.	Microinsurance as defined by the MI regulation (Max SI, simple products w/o exclusions etc...)	Microinsurance as defined by the MI regulation (indexed to minimum salary)
Which data and KPIs	1. Net income ratio 2. Operational Expense Ratio 3. Claims Ratio 4. Renewal Ratio 5. Turn-Around-Time 6. Rejection Ratio 7. Growth Ratio 8. Solvency Ratio 9. Liquidity Ratio	1. Registry number 2. Covered risk and type of cover 3. Nb of policies, certificates or endorsements 4. Sum Insured 5. Written Premiums 6. Acquisition, Administration costs 7. Margin 8. Number and Amount of Claims	1. Number of written policies 2. Number of insureds 3. Sum Insured 4. Written Premiums 5. Claims Amount 6. Number of claims	1. Solvency Ratio 2. Liquidity Ratio 3. Leverage ratio 4. Operational Expenses Ratio 5. Underwriting expenses ratio 6. Claims Ratio 7. Proportion of claims paid in less than 10 days
Frequency of reporting	Annually and Quarterly	Quarterly	Quarterly	Annually
Mode	Submitted to CIMA and national supervisory authorities	Electronically		

Examples & lessons from sample jurisdictions ₍₂₎

But they encounter some **challenges**:

Reluctance of insurance companies
to share data as:

- Time-consuming and costly process for submitting entity and analyzing organization
- Confidentiality issue
- What is inclusive insurance definition

⇒ **Not all data is received by supervisors**

Some products are **left out**
Definition of insurance reaching LIH may not include mass insurance
and other products actually purchased by LIH

Data is **not analyzed** as frequently as planned
Lack of resources or Inclusive Insurance-specific exposure

Limited/No actions taken

How premiums are spent –
Incurred Claims and Operational Expenses Ratios

No difference in the ratios' **definition** with conventional insurance products.
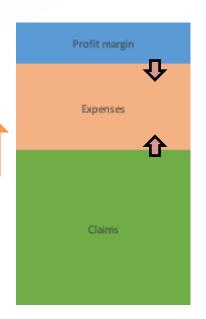Interpretaion and acceptable levels may differ though:

CR - Too high => **Unsustainable**

CR - Too low
ER - Too high => **Offers no value for low-income clients**

Profit margin

Expenses

Claims

How premiums are spent –
Incurred Claims and Operational Expenses Ratios (2)

Not only financial performance measurement but also important **client-value assessment from supervisory perspective**:

Possible reasons and concerns

- Hard earned income and need for cover/payouts from LIH
- CR - Lower than expected frequency (pricing issue or knowledge of/awareness on benefits and claims process)
- ER - Issues w/ intermediaries (commissions)
- ER - Inefficient processes

Overall sector Microinsurance Loss Ratios in Colombia, Year 2013

Ramo	Loss ratio 2013
Personal Accidents	18.5 %
Burial	21.9 %
Group life	31.1 %
Others	14.6 %
Excluding group credit life	23.3 %
Including group credit life	23.8%

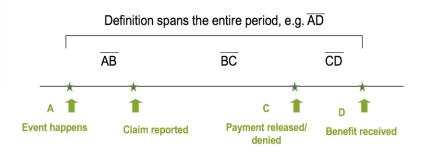*Source: A2ii Country Assessment – Colombia 2014*

Turn-Around-Time

Definition

- Not only the time for the risk carrier to approve the claim but actual time between occurrence and payout of benefits - client focus analysis,
- Enables to identify where the inefficiencies are,
- Not only an average.

Impact and benefits for LIH:

- Matches **needs** for cash as safety net
- Can plan if they know when to expect payouts (agriculture, health)
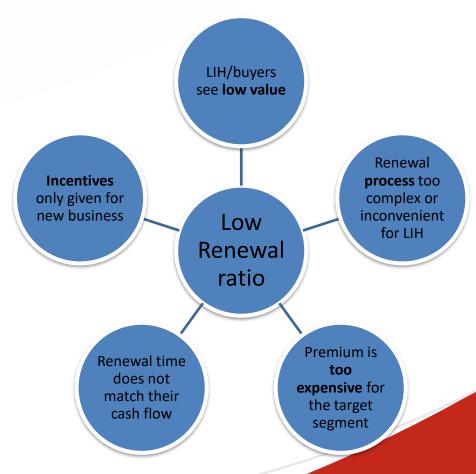- Holding promises and **trust building**

Definition spans the entire period, e.g. $\overline{AD}$

$\overline{AB}$ $\overline{BC}$ $\overline{CD}$

A — Event happens
Claim reported
C — Payment released/denied
D — Benefit received

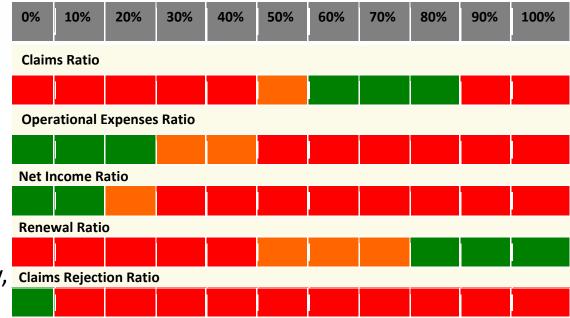| Number of Days	Number of Claims	% of Total Claims
0 to 7 days	___	___%
8 to 30 days	___	___%
31 to 90 days	___	___%
More than 90 days	___	___%
	Total ___	100%

Renewal Ratio

- (1- Lapse Ratio)… other names.

- Often **lower** than in a competitive / conventional insured segment.

- Example:
  20-30% upward, 60% good, 85% excellent
  vs. 95% + in competitive conventional insurance segment

Many potential reasons for a low renewal rate

Adequate levels for sample KPIs

- Differences, for some ratios, by:
  - Perils
  - Maturity of product
  - Target segment served

- Striking sustainability <u>and</u> client value

- Supervisory analysis by entity, product type, channel.

0%	10%	20%	30%	40%	50%	60%	70%	80%	90%	100%

Claims Ratio

Operational Expenses Ratio

Net Income Ratio

Renewal Ratio

Claims Rejection Ratio

Other procedures for regulators' monitoring of II markets

Ad hoc additional data request for a specific entity or product

On-site visits to consult documents and database

Mystery shopping

Interviews with intermediaries and end-clients for **feedback** on II experience

Different **frequency** for different (information) requests

Monitoring is a whole process

How? An efficient monitoring process

Request	Monitor ratios	Analyze	Act

Request
- Only the necessary variables that will actually be used and analyzed
- Only data with low reporting costs for insurers

Monitor ratios
- Calculate the Key Performance indicators:
  - Growth ratio ($/#)
  - Renewal ratio
  - Incurred Claims Ratio
  - Incurred Operational Expenses Ratio
  - TAT,
  - Claims rejection Ratio

Analyze
- What do the indicators teach us?
- What are the acceptable minimum/maximum targets for these ratios?

Act
- Comparative evaluation and feedback to entities
- Sanctions and measures
- On-site Investigation
- Modification of regulation / policies

Thank you.

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Value Measures in P&C Insurance

Pilot as a transparency measure and supervision expectations

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Financial Conduct Authority

What is the background of this initiative?

- Market Study into General Insurance (GI) add-ons (2013)

    - Overall finding : Competition was not working well

    - Poor value in add-ons and stand alone product

    - No commonly available measures to assess the value for money for GI products

- Various remedies Implemented

    - Deferred opt-in period for specific products

    - Banning opt out sales

    - Improving information provision

- Decision to introduce a measure of value and transparency over value – leading to a discussion paper DP15/4

What was the scope of our discussion paper?

- Discussion papers explore few matters in order to implement value measures:

  - Scope & Granularity

  - Options for a value measures

    - Claims Ratio as a stand alone value measure

    - A scorecard approach with 3 measures; claims frequencies; claims acceptance rates and average claims pay-out

    - Claims ratio plus claims acceptance rate

  - Reporting & Publication

    - Point of Sales Versus Market Wide Transparency

  - Other Measures Considered (see appendix 1)

What approach have we retained for the Pilot?

2 overall objectives:
- Provide consumer groups, firms and market commentators with additional indicators of value
- Influence firms to review and improve the value of their products

Pilot Design
- Market Transparency: data collected by the FCA and published on our website

- Firms in Scope: all firms operating in the UK (including EEA passporting firms)

- 2 sets of data to be published – Year End 31/08/2016 and 31/08/2017 – Published in January

- Pilot Products:

    - Home (combined buildings and contents)

    - Home Emergency insurance

    - Personal Accident insurance (as an add-on)

    - Key cover (as an add-on)

- Value Measures: Claims Frequencies, Claims Acceptance Rate, Claims Pay-Out – see definitions in appendix 2

Value Measures Pilot – Data Publication

How the data was published?

Home Insurance (combined buildings & contents)

Firm	Claims Frequency 2016	Claims Frequency 2017	Claims Acceptance Rate 2016	Claims Acceptance Rate 2017	Average Claim Pay-out 2016	Average Claim Pay-out 2017
Liberty Insurance Limited	5% to 7.4%	5% to 7.4%	97.5 to 100%	97.5 to 100%	£2,000 to £2,499	£3,500 to £3,999
Liverpool Victoria Insurance Company Limited	5% to 7.4%	5% to 7.4%	80% to 84.9%	92.5% to 94.9%	£3,000 to £3,499	£4,000 to £4,499
Lloyds Bank General Insurance Limited	2.5% to 4.9%	5% to 7.4%	90% to 92.4%	92.5% to 94.9%	£3,500 to £3,999	£3,000 to £3,499
Methodist Insurance Plc	10% to 12.4%		87.5% to 89.9%		£2,000 to £2,499	
MS Amlin Underwriting Limited	2.5% to 4.9%	5% to 7.4%	90% to 92.4%	90% to 92.4%	£4,000 to £4,999	£3,000 to £3,499
Qmetric Group Limited	2.5% to 4.9%		85% to 87.4%		£2,500 to £2,999	
Royal & Sun Alliance Insurance Plc	5% to 7.4%	2.5% to 4.9%	97.5 to 100%	97.5 to 100%	£1,000 to £1,499	£1,000 to £1,499
St Andrew's Insurance Plc	2.5% to 4.9%	2.5% to 4.9%	87.5% to 89.9%	92.5% to 94.9%	£5,000 to £5,999	£6,500 to £6,999
Tesco Underwriting Limited	5% to 7.4%	2.5% to 4.9%	90% to 92.4%	90% to 92.4%	£1,000 to £1,499	£1,500 to £1,999
The National Farmers' Union Mutual Insurance Society Limited	7.5% to 9.9%	5% to 7.4%	95% to 97.5%	95% to 97.4%	£5,000 to £5,999	£6,500 to £6,999

What we have learned from the Pilot?

Feedback after the first publication

•Consistency of definitions used

- Required additional refinement and discussion with firms

- Quality and granularity of the data

- Benchmark between firms to identify some gaps

- Overall buy-in from the industry – moderate pick-up by consumer groups and media

Feedback after the second publication

- Improvements are visible in the data set – comparison between 2016 and 2017

- Some firms have made product improvements

- Some firms have improved their management information to assess the value of their product

Next Steps: we are currently considering either a third pilot or moving to consultation to implement value measures publication into our rules.

What are our expectations in Supervision?

<u>3 main expectations</u>

- Firms should have a process to review and assess the value of their products – that should be part of their conduct risk framework

- Management Information to identify potential harm and to drive actions to resolve it

- Appropriate oversight and challenge from Senior Management and Board

<u>Some Early Observations</u>

- Granularity of data is essential to get meaningful management information

- Need to go back to the drivers of the metrics:

    - Product design; is it possible to claim? Is it a real risk?

    - Sales Approach; do people know they have the product?

    - Distribution Channel; any impact on the value for the end customer?

Q&A

Appendix 1
Other Measures Considered

As part of the Discussion Paper (DP15/4), we have considered other measures :

- Capturing the cost of distribution; including commission and other incentives

- Customer Satisfaction Rates

- Customer Retention Rates

- Time to Settle

- Percentage of Claims settled in "full"

Appendix 2
Definition of the Measures

Claims frequencies: how often consumers are claiming on their insurance policies – calculated as the number of claims registered, divided by the average of policies in force

Claims acceptance rates: how likely claims are to be accepted – calculated as the number of claims registered less the number of claims rejected; divided by the numbers of claims that have been registered

Average claims pay-out: Average claims pay-out zhich could include internal costs and relevant external cost as zell as pay outs to policy beneficiaries: For example, cost could include internal or external claim investigation costs or payments to third parties to repair a customer's damaged wall

Thank you.

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