Ratios and Cost Structures in Insurance Supervision

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IAIS representative

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International Association of Insurance Supervisors (IAIS)
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

- 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.

Source: MI Landscape for Africa 2012

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

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

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

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

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

**Client Value and Consumer protection**

- 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

<table>
<thead>
<tr>
<th>Jurisdiction</th>
<th>CIMA region</th>
<th>Mexico</th>
<th>Nicaragua</th>
<th>Philippines</th>
</tr>
</thead>
<tbody>
<tr>
<td>Type of data reporting</td>
<td>Compulsory</td>
<td>Compulsory</td>
<td>Compulsory</td>
<td></td>
</tr>
<tr>
<td>Applicable for which products</td>
<td>Microinsurance as defined by the MI regulation (low premiums/low sum insured, for LIH)</td>
<td>All products registered whether MI or not.</td>
<td>Microinsurance as defined by the MI regulation (Max SI, simple products w/o exclusions etc...)</td>
<td>Microinsurance as defined by the MI regulation (indexed to minimum salary)</td>
</tr>
<tr>
<td>Frequency of reporting</td>
<td>Annually and Quarterly</td>
<td>Quarterly</td>
<td>Quarterly</td>
<td>Annually</td>
</tr>
<tr>
<td>Mode</td>
<td>Submitted to CIMA and national supervisory authorities</td>
<td>Electronically</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
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
  \[\Rightarrow \text{Not all data is received by supervisors}\]

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. Interpretation and acceptable levels may differ though:

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

- 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

<table>
<thead>
<tr>
<th>Ramo</th>
<th>Loss ratio 2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Personal Accidents</td>
<td>18.5 %</td>
</tr>
<tr>
<td>Burial</td>
<td>21.9 %</td>
</tr>
<tr>
<td>Group life</td>
<td>31.1 %</td>
</tr>
<tr>
<td>Others</td>
<td>14.6 %</td>
</tr>
<tr>
<td>Excluding group credit life</td>
<td>23.3 %</td>
</tr>
<tr>
<td>Including group credit life</td>
<td>23.8 %</td>
</tr>
</tbody>
</table>

*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
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:

- LIH/buyers see low value
- Incentives only given for new business
- Renewal process too complex or inconvenient for LIH
- Premium is too expensive for the target segment
- Renewal time does not match their cash flow
Adequate levels for sample KPIs

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

- Striking sustainability and client value

- Supervisory analysis by entity, product type, channel.
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**
  - 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

Michael Sicsic – michael.sicsic@fca.org.uk
Head of Supervision, General Insurance
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)

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

3 main expectations

- 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

Some Early Observations

- 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 which could include internal costs and relevant external cost as well 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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