Chapter 3

Value-Added Services – Towards a New Insurance Model

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Value-Added Services – Towards a New Insurance Model

You might not know it from reading the news but life has never been better. Levels of poverty, child mortality and violence have declined dramatically, while life expectancy, health and nutrition have all increased[11]. And these improvements in our daily lives look set to continue as a conversion of technologies – the Internet of Things (IoT) and advanced analytics – increasingly monitor, predict, mitigate and eliminate common risks, from fires and leaks to high blood pressure and dangerous driving.

While this is all good news for humanity, for insurers it presents both challenges and opportunities. On the one hand, fewer risks mean fewer losses. On the other hand, it will be increasingly difficult to convince customers to pay for insurance when technology has so effectively minimised the amount of insurable risk they face; 57 per cent of our surveyed insurers expect the consequent reduction in premium income to be significant. Moreover, as risk levels fall, so too will the degree of variation among customer risk profiles, reducing insurers' ability to differentiate based on pricing sophistication[12]. New sources of both revenue and differentiation must therefore be found.

Fortunately, those same technologies that look set to undermine premium income and commoditise insurance could also unlock alternative revenue streams and value creation, as insurers use IoT and advanced analytics to offer new risk management and prevention services. Indeed, three-quarters (74 per cent) of our respondents believe differentiation in the insurance market will become more focused on the quality of such services than on the price of compensation-based insurance. And 87 per cent believe shifting these currently "value-added services" to be the core of their proposition would give insurers a much better chance of establishing digital "pull platforms" that draw customers in with a range fulfilling, convenient and sometimes unanticipated experiences.

Stepping forward as lifestyle partners, leveraging technology to enable customers to conveniently eliminate or manage risk, will mark a profound shift in insurers' business models and one that will hit in a relatively short time frame: four out of five (84 per cent) agree that there will be a shift from product-focused innovation to business model innovation in insurance in the next five years.

74% believe differentiation in the insurance market will become more focused on risk management and prevention services than on the price of compensation-based insurance

87% believe shifting "value-added services" to be the core of their proposition would give insurers a much better chance of establishing "pull platforms"

84% agree there will be a shift from product-focused innovation to business model innovation in insurance in the next five years

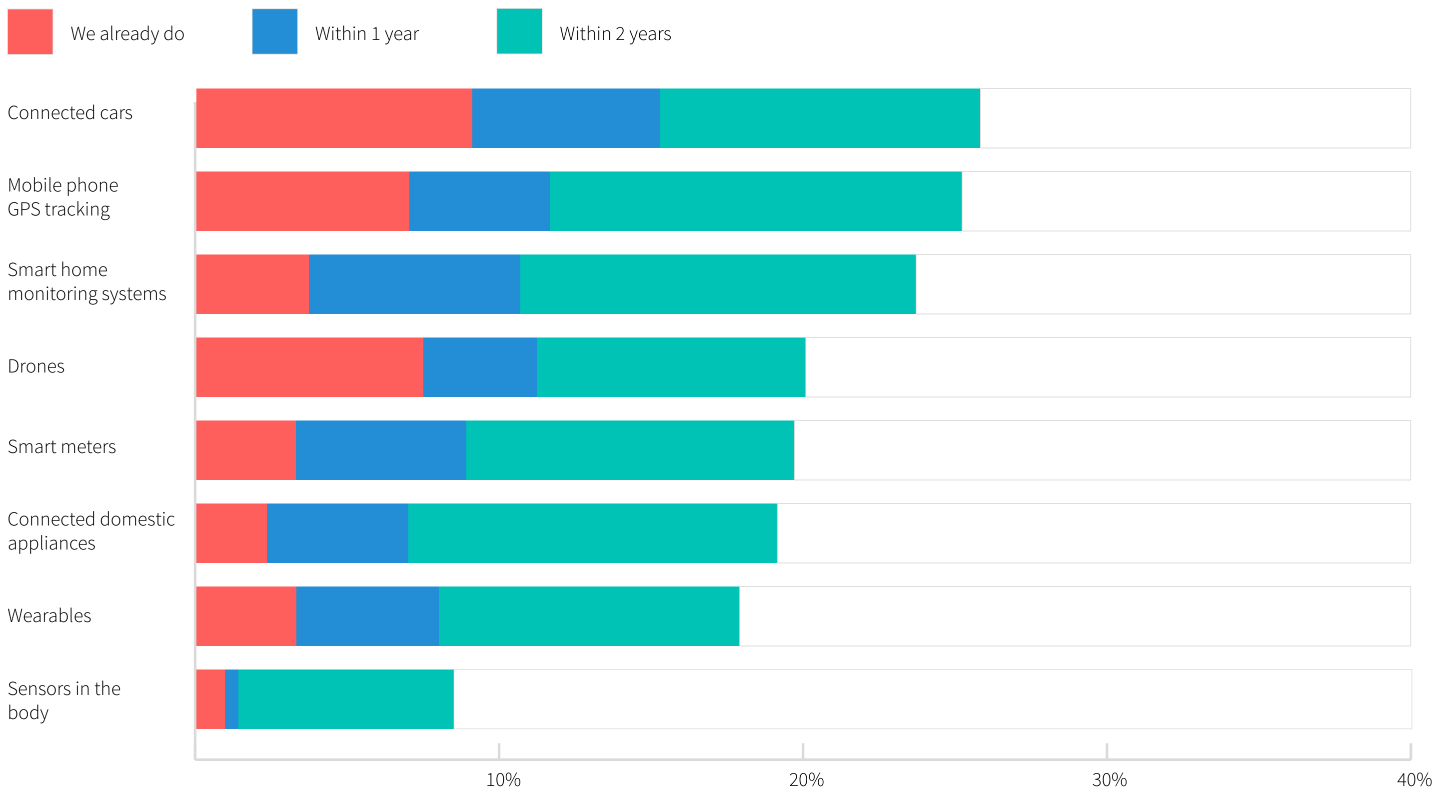
Preparing for a step-change

The industry is already preparing to make this step-change. Almost one-in-five (19 per cent) of our surveyed insurers have begun providing risk warnings based on data from one or more connected devices, a further 20 per cent have a pilot underway and 37 per cent are at the planning stage. US motor insurer Esurance, for example, has tapped into parental worries about teen drivers. Its DriveSafe programme allows parents to monitor their teenager's driving behaviour through a telematics device, providing customised alerts about unsafe driving behaviour and allowing parents to review trip details. German insurer Allianz has partnered with smart-home technology provider Panasonic, which supplies sensors that can detect any dangers in the home, such as leaks and glass breakages, sending alerts to the customers and Allianz, which then dispatches repair teams to address the problem. And AXA XL has partnered with Parsyl, a Denver-based supply-chain data platform, to enable shippers to cost-effectively place sensors alongside sensitive cargo. AXA XL analyses the data from these sensors, such as location, temperature, light, humidity, and movement, to generate loss-mitigation and risk-prevention advice.

Few areas of life do not generate data that could be used to deliver timely risk warnings to customers. Forecasts suggest there will be 20.4 billion connected things in use by 2020[13].

[11] *https://ourworldindata.org/*
[12] *Turbulance Ahead: The Future of General Insurance, Deloitte 2016.*
[13] *Gartner, Inc, 2017*

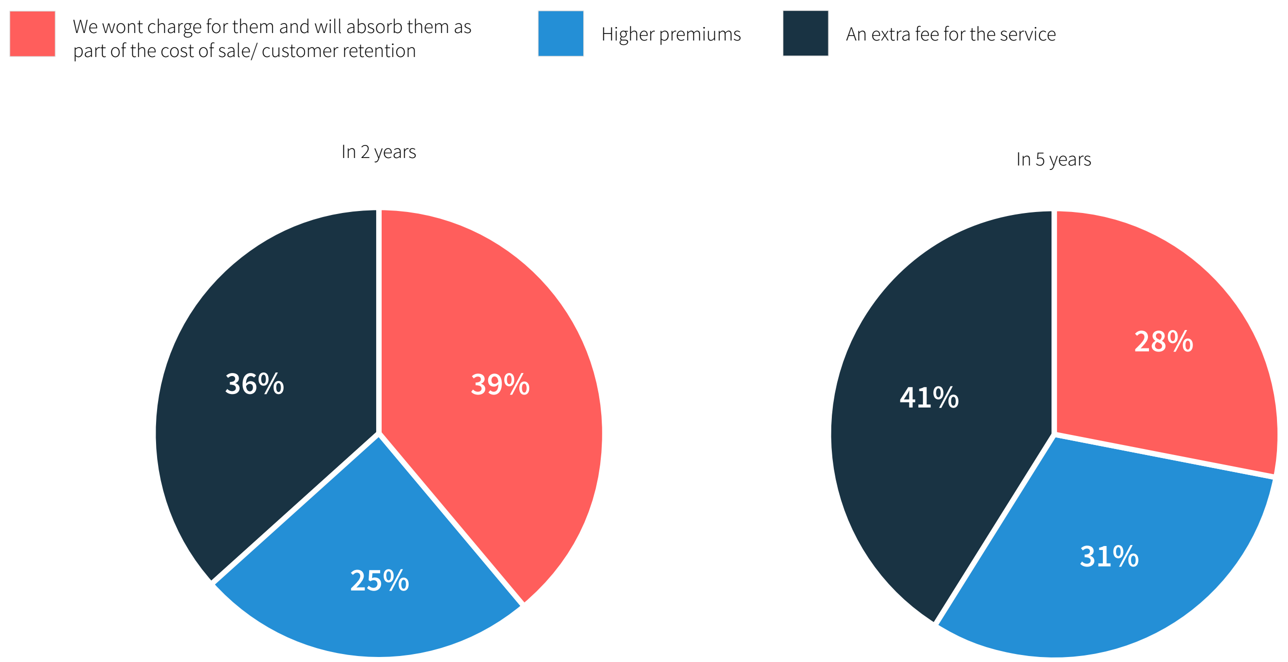
Insurers using or making plans to use connected devices as a basis of risk warnings



Monetisation – short term pain, long term gain

With premium income expected to fall, insurers must of course look to monetise these new services. According to our survey, the majority (61 per cent) of those insurers who intend to offer value-added services over the next two years anticipate charging for them, whether through higher premiums (25 per cent) or an extra fee for the service (36 per cent). However, this still leaves a significant minority (39 per cent) that do not intend to attempt monetisation in the early years of developing these services and instead expect to absorb the cost within their sales and customer retention budgets.

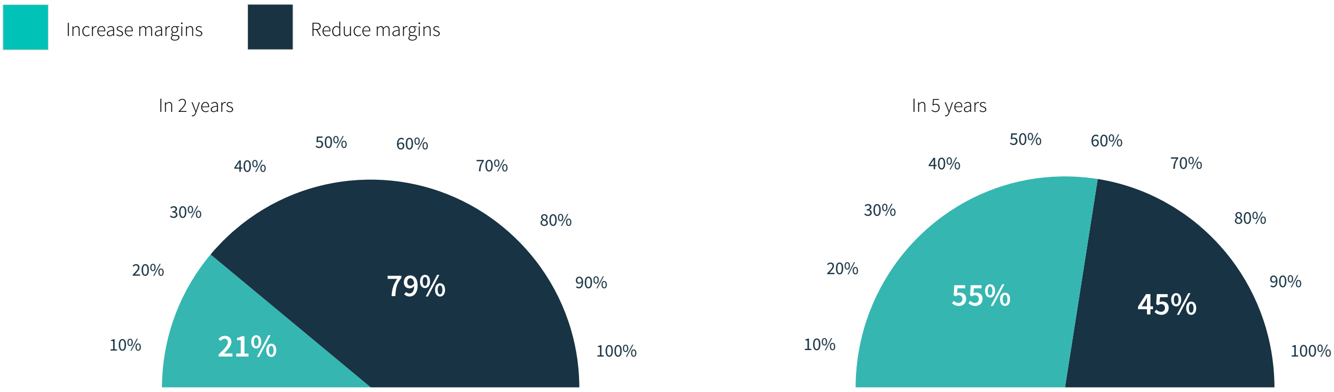
How do you foresee your organisation monetising value-added services over the following timeframes?



There appears to be a widespread strategy of short-term pain for long-term gain. A significant proportion (58 per cent) of those currently willing to soak up the extra costs plan to shift them on to the consumer by 2023, either by raising premiums or charging a separate fee, although there are some who conversely anticipate having to abandon charging having done so initially.

This strategy chimes with profitability expectations: a vast majority of our cohort (79 per cent) expect the impact of value-added services on profitability to be negative in the next two years, compared to just 21 per cent who expect it to be positive. But, by 2023, the pendulum swings the other way and the percentage of respondents expecting a negative impact drops to 45 per cent, against a higher figure of 55 per cent who think the impact on margins to be positive.

What will the impact of value-added services on margins be in the following timeframes?



Value challenge

As risk management and prevention services develop, the aim should be to shift customers on to the kind of subscription model that is increasingly common in the digital economy – witness Spotify, Netflix, Apple's iTunes or Amazon's Prime package. First, however, customers must be convinced that services are good value for money. Herein lies a challenge: 88 per cent of our cohort fear consumers may undervalue risk prevention services because they do not experience the effect of risks that do not crystallise. Indeed, over half (54 per cent) see low appreciation of value by customers as a significant barrier to their organisation investing to develop such services; the same percentage cited concern that customers might even actively dislike the intervention in their lives that risk prevention necessarily entails.

88% agree there is a danger that consumers will undervalue risk prevention services because they do not experience the effect of risks that do not crystallise

This is particularly the case in personal lines, where customers may be blithely unaware of the risks they face or the value of mitigating those risks, as is amply demonstrated by the large numbers who have little or no insurance[14]. Little wonder that 94 per cent of our respondents believe risk management services are likely to take off more quickly in commercial lines because commercial customers have the risk knowledge to understand their true value.

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[14]According to the ABI and ABTA, in the UK, over a quarter (28 per cent) of households do not have home contents insurance, even though the average cost of home contents insurance works out at less than £3 a week; one in five Brits still travels overseas without travel insurance; and 67 per cent of dogs and 84 per cent of cats are still uninsured.

Partnering for value

Our research indicates that successful providers of risk management and prevention services will be those that don't just flag problems but also provide solutions. More than nine out of ten of respondents agree that customers are more likely to value risk prevention services if they can see action being taken. This will ultimately come down to the quality of the partnerships that make up the insurance-as-a-platform ecosystem: 95 per cent believe delivering risk-prevention services that customers truly value will require insurers to work with external partners. Indeed, numerous examples of such partnerships are already underway. Aviva, Covea, RSA and Legal & General, for example, have all partnered with HomeServe labs to offer customers their LeakBot device – a smart connected water leak detector – backed up with repairs and servicing carried out by HomeServe's UK-wide team of skilled engineers.

74% of insurers see difficulty finding partner organisations as a barrier to their organisation investing in value-added services

Finding suitable partners will not necessarily be easy, however. Nearly a third of the insurers we surveyed saw difficulty finding partner organisations as significant barrier to their organisation investing in value-added services; a further 39 per cent saw it as a moderate barrier.

Building on the smart home

Until recently there was little opportunity for home insurers to offer data-driven services. Christmas 2017 marked a tipping point, however, as households took a bet on competitively priced voice-activated smart speakers, notably Amazon's Echo and Google's Home devices. Figures from comScore showed a 50 per cent surge in the number of US homes using smart speakers between November 2017 and February 2018, with penetration now at 20 per cent of homes with WiFi[15]. Comfort with Echo and Home, which dominate the space, are expected to encourage householders to invest further in connected home kit, such as smart thermostats and security systems. Forecasts now suggest that the penetration of home control and connectivity devices in UK households will grow from 8.4 per cent in 2017 to 28.6 per cent in 2022[16].

There is clear potential here for insurers to access data flows from smart homes to help policyholders protect the places that matter most to them, with alerts, guidance and practical assistance. It is still early days though: just four per cent of the household insurers we surveyed provide warnings based on data from smart home monitoring systems, a further nine per cent have launched a pilot and 14 per cent are at the planning stage. Some are also using data from smart meters and connected domestic appliances to deliver risk warnings. Again, the numbers are low (four per cent and three per cent have respectively launched services) but it is clear this is a growing trend. Dynamic pricing of home insurance is on the agenda too, with seven out of ten expecting to offer it within five years, a similar proportion to in motor lines.

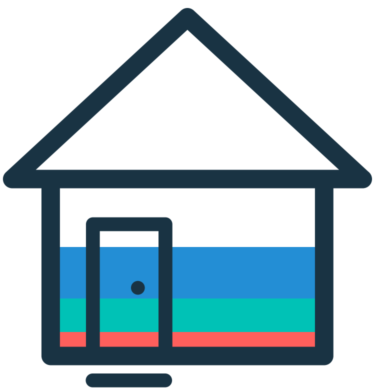
What progress has your organisation made towards offering risk warnings based on data from connected devices in the home (household insurers only)?

Smart meters

- We already do - 4%
- We have a pilot - 6%
- We are at the planning stage - 12%

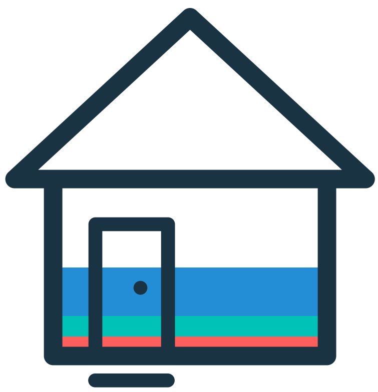
Smart home monitoring systems

- We already do - 4%
- We have a pilot - 9%
- We are at the planning stage - 14%



Connected domestic appliances

- We already do - 3%
- We have a pilot - 6%
- We are at the planning stage - 14%



Connected home risk management services will not be the preserve of insurers, however. Amazon is also moving into this space, leveraging its market-leading voice-activated smart speaker to build a proposition in partnership with a leading insurance group. In October 2018 the tech giant teamed up with NYSE-listed Travelers Companies to offer smart home devices and insurance and risk-management information. The smart home kits include security cameras, water sensors, motion detectors, a smart home hub and a voice-activated Amazon Echo Dot, through which policyholders will be able to ask Alexa about billing, payments, property maintenance and home safety.

The power of the connected car

Of course, motor carriers have more experience in the risk information and advisory services space, flowing from their head start in telematics: 37 per cent of our surveyed motor insurers provide advice on driving behaviour using data from connected devices, with a further nine per cent having a pilot underway and 20 per cent at the planning stage. Telematics devices, however, will seem an increasingly rudimentary data source as the unstoppable rise of the connected car and eventually the driverless car generates an unprecedented data exhaust – studies suggest there will be market penetration of connected cars of nearly 100 per cent in major European economies by 2022, partly driven by the EU's eCall mandate[17]. The advanced connected car of 2018 generates around 30 gigabytes of data per month to the cloud while autonomous vehicles could be uploading over one terabyte by 2025[18].

These vast plumes of data present the opportunity for insurers to advise not just on driving behaviour but on many aspects of car ownership itself. Vehicle data such as oil temperature, brake wear and tire pressure could be used to advise on maintenance, how to save fuel or even on the optimum time to sell the car.

Whilst there have been serious questions asked about how easily insurers will be able to access connected car data – automotive manufacturers generally require new car buyers to sign contracts that give them the right to the vehicle but not the data within – in Europe, the EU General Data Protection Regulation (GDPR) has levelled the data playing field between insurers and automotive manufacturers, and indeed all original equipment manufacturers (OEMs) of connected devices. Data from connected devices qualifies as personal data for any party able to link it to a specific individual, even if the data is purely technical; as such, car owners or users have the right under GDPR to transmit data from their vehicle to any third party, including their insurer[19].

Insurers are certainly keen to leverage this opportunity. Last year, we reported that 69 per cent of motor insurers anticipated using data from connected cars to formulate risk warnings by 2022. This year's research gauged progress towards that ambition. 12 per cent already provide risk warnings based on data from connected cars, nine per cent have a pilot underway and 20 per cent are at the planning stage. However, the bulk of the industry is still in the slow lane and may well be overtaken by those with the appetite and analytical capability to keep pace with our fast-changing world.

What progress has your organisation made towards offering risk warnings based on data from connected cars (motor only)?

[15] https://www.comscore.com/Insights/Blog/Smart-Speaker-Penetration-Hits-20-Per cent-of-US-Wi-Fi-Households
[16] Statista.com 2018
[17] Counterpoint Research Internet of Things Tracker, April 2018
[18] Gartner, Inc, June 2018
[19] What EU Regulation says about Car Data, Federation Internationale de l'Automobile

More than an insurance company

It is not only insurers who will be vying for the risk prevention space. Embedded sensors and connected devices mean a wide range of companies, including not just the digital platforms such as Amazon but also automotive companies and original equipment manufacturers, will be in a position to offer risk prevention and mitigation services to customers. And, as part of their proposition, they will inevitably include insurance, potentially relegating the traditional insurer to a white label, dumb-pipe provider.

90% per cent of our respondents agree that if incumbent insurers want to remain in control of the customer relationship, they can no longer afford to be "just an insurance company"

Insurers do though have a head start because they have the actuarial knowhow to truly understand risk, and that knowhow is about to be upgraded as connected devices generate second-by-second data streams to deliver unprecedented modelling accuracy and analytical insight. However, to meet the threat of new contenders in their space, insurers must change, and fast. Nine out of ten of our respondents agree that, if incumbent insurers want to remain in control of the customer relationship, they can no longer afford to be "just an insurance company".

Chapter viewpoint: MarkLogic

There is no doubt the industry faces a turning point. Some companies will opt to become high volume utility players while others will embrace new business models that promise fatter margins, leveraging the latest technologies to offer customers innovative data-driven value-added services. Insurance Innovators' important research shows, however, that this may prove a difficult transition for some, with many yet to unlock the necessary budget to start piloting new services. This caution may prove costly as agile new entrants are already innovating at speed, delivering smart solutions for today's connected customer.

To prepare for this profound shift in what it means to be an insurance company, insurers must go back to basics: understand the customer. Only when insurance companies have a comprehensive 360-degree view of the customer and their data will they be able to engineer the right solutions. This means two things. First, a change of behaviour and culture so that people and processes across the enterprise are 100 per cent customer-centric, with the space to innovate on behalf of the customer. Second, unlock the data already held in company siloes so that everyone in the organisation can move forward, armed with the customer insight to deliver solutions that truly make a difference and for which customers will be willing to pay. Get the foundations of culture and data right, and companies can then build for a sustainable and profitable future.