HOW TO SURVIVE AND THRIVE

in a Stagnant Auto Insurance Market

Driveway Software

In 2015, a study on usage-based insurance (UBI) was released by the National Association of Insurance Commissioners (NAIC) and the Center for Insurance Policy and Research. Its purpose was to examine how UBI is reshaping the auto insurance market.

It's a compelling topic, especially when one considers how stagnant the auto insurance market has become. **Auto insurance may be the largest insurance market segment in the U.S. — it represents $175 billion — but it's not growing. In fact, it's not even keeping up with inflation.**

"As vehicles and roads are becoming safer, premiums are falling," NAIC said. Consequently, "premiums in the private passenger auto insurance market … have only grown from $158 billion to $175 billion in the last 10 years." Furthermore, what growth we have seen doesn't derive from greater efficiency or output, but primarily from mergers and acquisitions, as Property Casualty 360 observed.

> How can an insurer thrive in a stagnant market with hundreds of competitors vying for the same premium base?

Competition is understandably fierce in such a market, and low-risk drivers are its holy grail. The situation raises an important question: How can an insurer thrive in a stagnant market with hundreds of competitors vying for the same premium base? We'll explore the answer to that question in the following pages.

Strategy #1: Expand your market share.

Auto insurance writers who want to command a bigger slice of the pie must position themselves at the front of the line. This is a strategy used by "some large insurers showing strong growth," NAIC said. Simply put, those insurers that capture new customers as they enter the market gain a competitive edge. As for how to do so, one answer is to be found in telematics.

Most of time, when insurers offer smartphone telematics, they're offering discounts only. But they could go further. Smartphone telematics could be leveraged as a marketing tool to attract more business. For example, an insurer could offer its free smartphone telematics app to first-time customers at no cost for 60 days, or on an unlimited timeframe. Once the relationship is established and those new customers are experiencing the benefits of driver coaching, daily tips and other value-added services, they're likely to continue after the trial period is up, or to think of your company as a top choice when they're ready to shop for auto insurance.

This strategy has been successfully used for years by Software as a Service (SaaS) companies, in the form of offering free trials. Why shouldn't insurance follow suit, with its own version of a free trial via smartphone telematics? By gauging prospects' level of engagement with their apps, insurers could easily

predict their likelihood of converting to paying policyholders, and thereby trigger relevant marketing campaigns to promote successful customer conversions. They could also monitor data to see which prospective drivers were the safest potential risks. Marketing efforts could then be refined to focus on the most desirable prospects.

In a market that's both stagnant and competitive, the importance of customer attraction and retention grows only more pronounced.

The app automation company Zapier compared the marketing potential of apps and other "engineering projects" to that of content marketing. "This is any web service, app, or free tool that offers value to your target market for little or no cost, while also tying in your product in a way that will be relevant to them either while [they're] using the tool, or immediately after," said Zapier blog contributor Nathaniel Eliason. When used to create value for one's target market, these tools can establish a business as the leader in its niche and help it acquire new customers at the same time.

Progressive is an obvious example of a major insurer that leveraged UBI telematics to increase its market share. Since its early adoption of UBI in 2011, it has amassed about $2 billion in premiums and 2 million customers through Snapshot. "If the Snapshot program were a stand-alone insurer, it would be a top 15 writer of private passenger auto insurance by itself," NAIC said.

In a market that's both stagnant and competitive, the importance of customer attraction and retention grows only more pronounced. Smartphone telematics makes it possible for insurers to expand their market share, not only by offering discounted rates, but by leveraging the marketing potential of their apps.

Strategy #2: Hone in on growing markets.

Until very recently — for over one hundred years, in fact — insurance premiums were determined "in the absence of true causal data," said NAIC. Insurers have traditionally relied on proxy factors to assess risk, based on variables including age, gender, marital status, territory and driving history.

For the most part, this method has held up since the advent of auto insurance. We have seen new variables enter the equation, such as credit score, education and job type, but overall, the approach is the same.

It's remained unchanged because it works — in the aggregate. **However, the traditional model leaves large gaps through which many highly-desirable drivers have fallen.** These previously underserved markets are particularly suited to benefit from UBI.

+ **Millennials.** Insurers who position themselves at the door with offerings that serve the youngest drivers are primed to catch them as they enter the market. Under the traditional model, millennials can expect to pay higher premiums than other drivers. However, not all young drivers are deserving of their 'risky' status. Also, millennials believe strongly in their uniqueness and want to be treated as individuals. By rating their premiums based on their own unique behavior, UBI offers a better deal while affirming their individuality — two important benefits that millennials will not find elsewhere.

+ Millennials

Not all young drivers are deserving of their 'risky' status

+ **Seniors.** Older drivers log few miles on average. Given the well-studied correlation between mileage and claims, one would think they could expect lower premiums as a result. Some traditional policies do offer lower rates for seniors, but these do not accurately reflect the difference in risk that older drivers represent. **According to the Federal Highway Administration, seniors log an annual average of only 7,646 miles. They have fewer crashes and are less likely to be killed than drivers ages 35–54.** Yet The Chicago Tribune observed that "the standard pricing model barely distinguishes between drivers who log only 5,000 miles a year and those who log 20,000."

  Because UBI factors in mileage to the cost of a driver's premium, it delivers better rates than the traditional model can offer. Bear in mind, the U.S. Census Bureau found that the "90-and-older population nearly tripled" since 1980, "reaching 1.9 million in 2010." By 2030, over 57 million Americans are expected to be 70 or older, expanding this market area by 30 percent.

+ Seniors

They have fewer crashes and are less likely to be killed than drivers ages 35–54

+ **Unbanked drivers.** Ten percent of Americans don't use banks at all. An additional 17 percent are underbanked; they do have a bank account, but rely on alternative financial services like payday loans or payroll cards. **Together, unbanked and underbanked Americans constitute 27 percent of the nation.** Because most traditional insurers require a credit score before they'll provide coverage — or impose higher premiums on those with no credit — this area of the market has much to gain from UBI, whose superior data sets could eliminate the need for credit-based pricing altogether. By making it possible for previously-uninsured drivers to get coverage, it could add new customers to the market and increase the number of insured drivers on the road at the same time.

+ Unbanked drivers

UBI could eliminate the need for credit-based pricing

- **Low-income drivers.** The same is true of low-income drivers. UBI opens the door for those who haven't been able to afford coverage, by offering reasonable rates that they can lower themselves, with modifications to their behavior. "Pricing insurance on usage allows consumers to adjust the mileage they drive to fit the amount of auto insurance premium they can afford," NAIC said. The Insurance Research Council estimated that in 2012, there were 29.7 million people — over 12 percent of drivers nationwide — who were uninsured. In some States, the uninsured rate was up to 26 percent. UBI makes it possible to reach these under-served demographics, expanding the market by making insurance more attainable.

+ Low-income drivers

UBI opens the door for those who haven't been able to afford coverage

Strategy #3: Differentiate your offerings.

Insurance telematics position an insurer to differentiate their offerings in several important ways.

- **Affirm your customers' individuality.** "By deploying telematics programs, insurers can provide discounted coverage underwritten on the risk consumers personally pose, thanks to the accumulated data on their driving behavior," NAIC said.
- **Offer a significant discount for driving fewer miles.** For example, subscribers of the OnStar program at National General "can get discounts ranging from 7 percent to 54 percent depending on how many miles they drive per year," said NAIC.
- **Provide coverage to those who haven't been able to get it.** Drivers with no credit, bad credit or low incomes find the system slanted against them. With UBI, however, they can get affordable rates based on how they behave behind the wheel.
- **Deliver additional features that customers want.** Smartphone UBI can be integrated with a variety of value-added features that enhance the customer experience, including vehicle maintenance alerts, fuel reminders, concierge services, driver scoring and local information. Insurers could incentivize safe driving within riskier demographics — teenagers, for instance — by offering a discount to those who can maintain a high score. They could also appeal to parents with driving reports, curfews and geo-fencing alerts for their teenage children. Customers are thirsty for ancillary services like these, which could be harnessed not only to differentiate the insurer but increase satisfaction and introduce new revenue streams at the same time, said NAIC.

Strategy #4: Keep more of your profit.

UBI is more cost-efficient than the traditional auto insurance model. In fact, NAIC said that an insurer who uses UBI rating instead of proxies "could offer an 80 percent discount on the best drivers and still be profitable."

UBI makes this possible by assessing risk on an individual level. Obviously, granular risk assessment is bound to be more accurate than in the aggregate, but it was impossible to deliver before the advent of big data. Now that's changed. "Technology, due to advancements and reductions in price, allows insurers to directly measure factors that determine risk," NAIC said.

Fine-tuning the accuracy of risk assessment across one's customer base is a gigantic step toward profitability, but there's another that follows on its heels. UBI not only helps insurers better understand the risks their customers present; it also helps customers reduce those risks by becoming better drivers.

> Technology allows insurers to directly measure factors that determine risk.

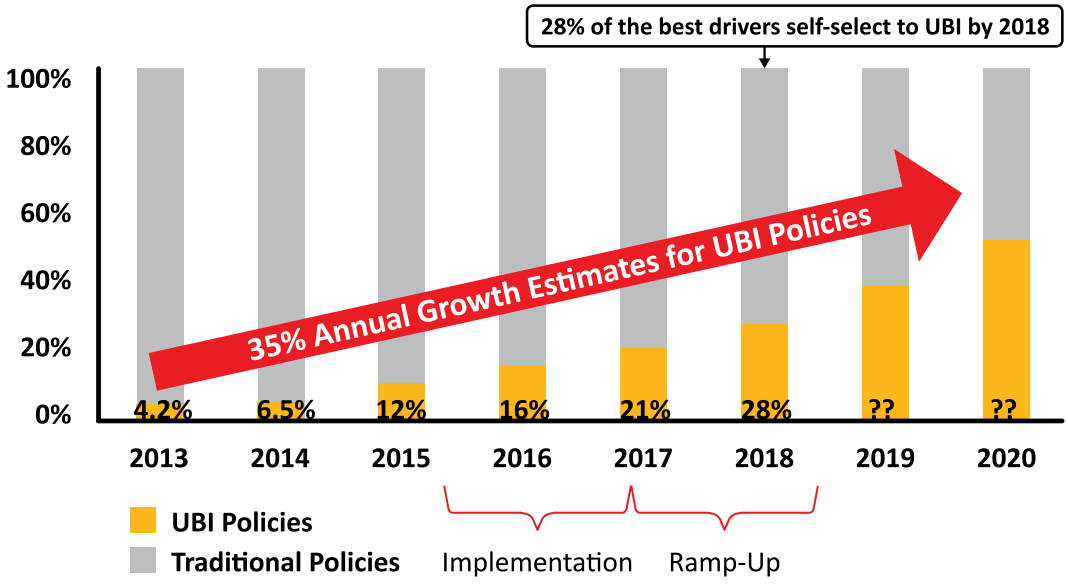
Telematics can detect risky behaviors like rapid acceleration, speeding, hard braking and sharp turns. Combined with smartphone gamification, this data can be harnessed to improve drivers' habits, making road safety a fun objective and inspiring drivers to compete against themselves and each other. As policyholders improve their scores, everyone wins: they achieve lower rates, while their insurer achieves a lower loss ratio.

Finally, UBI empowers insurers to detect and deter fraud, capturing premium leakage due to rate evasion. For example, drivers using smartphone telematics can't report a false garaging address, because their parking location is supplied by GPS data. It's also impossible to misrepresent the number of miles driven annually. Theoretically, telematics data could even be used to detect unreported drivers in a household by noting patterns in driver behavior. According to the Coalition Against Insurance Fraud, premium rating errors cost insurers 10 percent of the $161.7 billion in personal auto premiums written each year. Insurers that succeed in stopping the leak can become more profitable overnight.

Strategy #5: Take action sooner than later.

As we've seen, smartphone telematics offers several strategies to help an insurer thrive in a stagnant market: expanding one's market share, making it possible to hone in on previously-unavailable or growing markets, differentiating one's offerings and improving one's profitability. To capitalize on those advantages, however, initiative is everything.

Smartphone telematics is still somewhat early on the technology-adoption curve. We've seen innovators and early adopters respond to it already. Now it's making waves among the early majority. "According to SMA Research, approximately 36 percent of all auto insurance carriers are expected to use telematics UBI by 2020," NAIC said. UBI telematics are now available in all but five jurisdictions of the U.S., and more than five insurers offer it in 23 States. By 2020, it's predicted that insurers will be receiving over 25 percent of their premium revenue ($30 billion) from telematics-based insurance programs.



With that in mind, now it's important to position oneself as a fast follower, for three reasons:

1. **Setup takes time, and time is market share.** Currently UBI has a market share of 14 percent, with an annual growth rate of 35 percent. An insurer who decides to enter the UBI game in 2016 may need up to a year to implement their program, and by the time they've ramped up operations mid-way through 2017, almost one third of the market would be lost to them. Bottom line, those who begin the process promptly get to the starting line sooner.

2. **Late adopters can't see the data.** With analytics comes insight. Proceeding without data is like running blind. "Competing insurers entering the market later are placed at a serious disadvantage because they lack the valuable, large and statistically-credible UBI data sets to lure existing customers away from their insurers with better pricing," NAIC said.

3. **Adverse selection is real.** Insurers aren't the only ones adopting insurance telematics: between 2013 and 2014, the number of customers using UBI nearly doubled, rising from 4.5 to 8.5 percent. Furthermore, those who adopt early are likely to be the most desirable candidates. "It makes sense that someone who drives a lot, at unusual times and unsafely probably will not sign up for these programs," NAIC said. "The early adopters will bring in good drivers and can rate them at fairly cheap prices." Once adopted, turnover is likely to be low. "Insurers are keenly aware that the first telematics device consumers install will most likely be their last, and they will almost certainly remain with their existing carrier as technology evolves," NAIC said. As a result, late adopters stand to compete more and more fiercely for an ever-smaller pool of riskier drivers.

Conclusion

In a stagnant market, those insurers who manage to buck the trend and thrive are those who innovate — and there is currently no innovation more important for personal auto insurance than UBI telematics. Yet the advantages to be gained are time-sensitive, as those who leap fastest stand to gain the most.

Perhaps NAIC said it best:

"The competitive advantage gained by insurers with a telematics UBI program over non-UBI insurers is enormous, especially considering that even late adopters may not be able to catch up."