

CAPCO

**INSURANCE POLICIES – ARE
THEY REALLY COMMODITIES?**



OVERVIEW

Gen Z, currently 20 percent¹ of the Canadian market, is coming of age in a world of online streaming, digital shopping and pay-for-use services. More and more products are being 'commoditized' as we have digital solutions that allow us to compare, select and purchase products quickly. The insurance markets are betting that Gen Z will drive the purchasing of insurance policies online.

Online purchases depend on factors² such as brand familiarity, refundability and the consumer's product knowledge³. The market must be able to see goods as interchangeable with no difference in who made them classify them as commodities.

With trends pointing towards the prevalence of online purchasing of insurance, we can't help but ask: **Is insurance an online commodity?**

BRAND FAMILIARITY

Consider that customers are more inclined to purchase an item online if they've previously purchased it or have already interacted with the brand. For insurance, particularly with the Gen Z client base, it will be the first time they are buying this type of product. They won't have the experience or familiarity that they need to trust that their purchase is right for them.

They may receive recommendations from friends or family, but given that their backgrounds (socio and cultural tolerance), assets, and liabilities may be different, their suggestions are unsuitable. This inexperience calls for the advice of a professional or brand and product education tools that an online channel cannot provide adequately.

REFUNDABILITY

Refundability heavily influences online purchases. Purchasers, unable to experience the product beforehand, seek comfort in the ability to return the product if it does not meet their purchasing expectations. For example, if you purchase clothing online and it isn't your size, you can return the product, often without penalty.

When there is an absence of a penalty for returning a product, consumers will more likely purchase a product. Coverage, being intangible and contractual, means that refunds without penalties are usually not available. Insurance can only be canceled. Currently, most markets practice 'short-rating,' meaning instead of pro-rating the policy refund for the unused days, the policy fees are front-loaded into the policy.

PRODUCT KNOWLEDGE

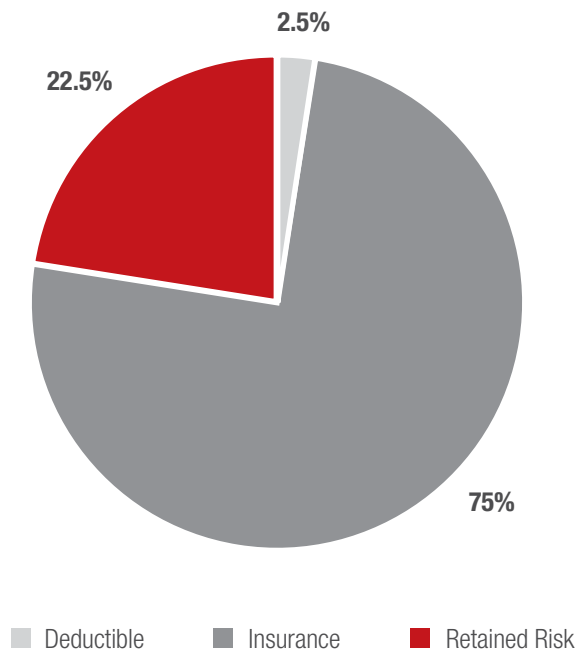
Consumers are more likely to purchase online when they have a full understanding of its value. Insurance is often a complex product customized to each consumer's needs. Insurers can use different strategies to protect customers from diverse events. The general consumer does not fully understand their assets, liabilities, and ability to self-insure (accept the risk). Beyond understanding their coverage needs, consumers then need to fully grasp the implications of different policies on their own and validate that they are purchasing the protection levels that are right for them. Licensed advisors liaison between insurance carriers and clients, correctly assessing the client's risk tolerance, and selecting a policy the best suited for them.

Consider some uses cases:

Deductibles: Deductibles are amounts paid by the policyholder before the insurance carrier begins to cover expenses. When determining a deductible, a customer may choose a higher value to keep their monthly premium low or lower values to offer better protection against smaller losses. It is the amount the purchaser must be able and willing to self-insure. Consumers may not understand the impact of their choice on their financial security at the time of a loss.

Limits: Consumers may select a limit that is too low to maintain their current lifestyle to save money on their premiums. Advisors are more likely to understand the full price attached to a purchaser's lifestyle and help them purchase the appropriate limit. Again, consumers may elect to self-insure for some coverages, but it is not best to find this out after a loss occurs.

Risk Strategy - Insurance



DIGITAL ADVANTAGE

Online tools do provide the ability to research and compare, allowing shoppers to consider various options and leverage online aggregators to help them decide which brands and products they should start to consider.

A study by LIMRA found that customers from all generations use online tools as a method for researching life insurance information. Sixty-one percent of boomers, 58 percent of Millennials, and 54 percent of Gen X participants making insurance purchasing decisions found online research findings to be useful⁴.

Online packages offer protection for generalized groups effectively. If the product is straightforward, and the customers' risk appetite is the same, online packages could be an effective method of providing insurance. For example, when looking at product insurance, Apple Care caters to a very specific need, uniform across a particular audience—as such, purchasing this type of insurance online would be suitable.

Insurers can use online packages to offer clients with a particular need, packages defined by their peers. Consider professional errors and omissions policies for professional

engineers, medical practitioners, and even insurance advisors who can buy specific policies based on group defined criteria. Many directors and officers' packages are also similar.

The question becomes, are you the correct consumer for that product or group? Advisors are more likely to consider all a customer's factors:

- Assets: cars, housing, rental properties, equipment, income, lifestyle, etc.
- Liabilities: pets, children, businesses, etc.
- Items for professional or commercial use and the potential limitation or exclusion implications.
- High-risk exposures and the required policies or coverages to protect their customers.

Advisors mix and match policies according to the client's needs and offer discounts that online channels will not be able to provide.

IMPACT

Although online packages make the policies easier to sell, they can subject the client to risk mismatching. If a customer chooses the wrong policy, limit, or deductible, it can be catastrophic to the purchaser, leaving the client vulnerable if they suffer a loss or an injury. Decisions to purchase online are almost always fueled by saving dollars and time. However, the move to direct distribution and online sales cause the concepts of risk management and risk transfer to get lost in financial planning.

Customers aren't the only victims of online package purchases. Carriers also are being exposed to more risk due to product mismatching. This forces insurers to become more risk-averse, causing them to modify coverage limits (i.e., capping water claims) or by including coverages that increase complexity but reduce errors and omissions (i.e., overland water coverage).

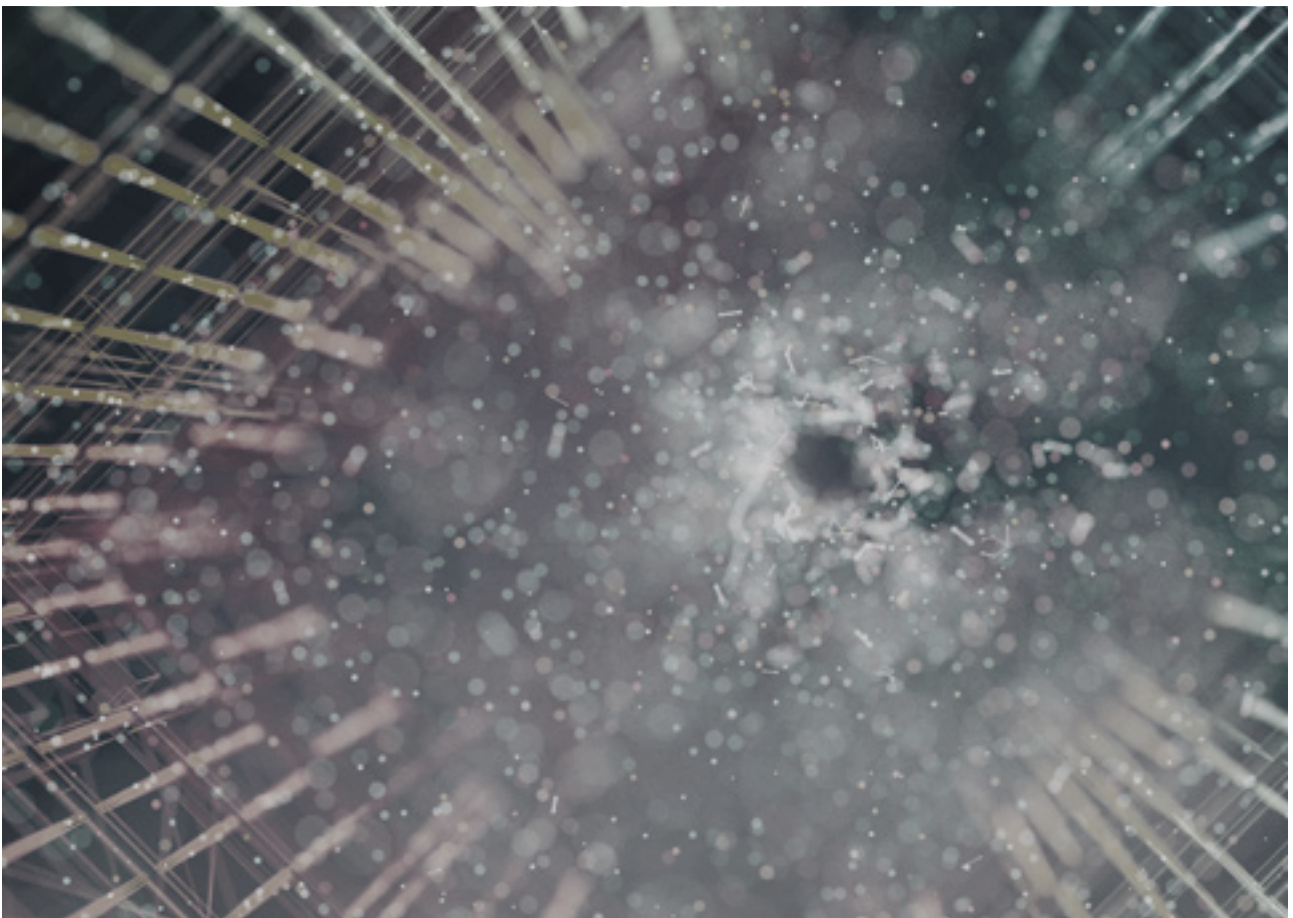
COMMODITY APPROACH

A good is a commodity if there is no difference between the products, regardless of who made them. This would mean insurance policies would remain the same irrespective of the purchaser, the location and the length of purchase⁵. Insurers often struggle to differentiate their products, given that industry regulators and market conditions force them to offer similar coverages and definitions.

However, carriers still work with a large degree of freedom in their ratings, market experiences and packages. Advisors can

attest to a dizzying set of combinations of coverages, policy forms and rating criteria.

Even if we concede that insurers could streamline these variations into more commoditized type offerings, carriers have spent years distinguishing their service and claims experiences targeting different market segments. Consider the marketing strategies of Progressive Flo with packages and price comparison services or the Geico Gecko promoting online ease of doing business.



RESULT

Insurance policies and coverage, while similar across various markets aren't necessarily commodities due to sophisticated risk attributes, pricing and servicing models.

Insurance policies, even if we still consider them commodities, don't meet the qualifications for the types of commodities typically purchased online: brand familiarity, returnable and easily understood.

Yet, online insurance is becoming a primary distribution channel. **With this in mind, how can we ensure clients are purchasing the right insurance policies?**

Three things to consider for insurance digital offerings:

1) Redesign products to be more intuitive to consumers. Simplify packages and options that are easier to understand. Remove complicated discount and rating considerations wherever possible leveraging third-party data sources.

2) Add risk appetite options to the buying process. Work with the consumers to align your products to their needs. Consider situations such as:

- **Financial Independence:** Can you afford a \$500 deductible if a loss happens tomorrow? How about \$1000?

- **Risk Appetite (self-insuring):** If a total loss happens, does the cover limit meet your needs to maintain your lifestyle?

- **Risk Adversity:** If a loss of type 'X' occurs, are you willing to assume the risk?

3) Build a hybrid digital model

Consider leveraging the benefits of both. Using online platforms for self-education is very powerful for consumers. This hybrid digital approach would help guide the user experience to educate the customer while engaging an advisor to ensure purchasing success. The movement towards this model has already begun with digital research.

The hybrid digital approach can go through continuous improvement by leveraging artificial intelligence (AI). Collecting feedback from both consumers and advisors will enhance recommendation engines by creating risk profiles⁶ and, in turn, will help advisors provide more tailored solutions to their consumers, decrease purchasing times and improve the client experience with recommendation engines ('Next Best Action' or 'Customers Like You' options).

Selling insurance online is inevitable. Proper due diligence in product design and client experience will ultimately ensure the success of the industry in maintaining its mission-critical: providing financial protection to those in need at the time of loss.

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