The Competitive Advantage

The Declining Value of Insurance

By Chris Burand

Value is a relative term often specific to a given asset. For example, if the price of gold declines from $1,800 per ounce to $1,250 per ounce, as it has, then gold is less valuable. The price of insurance is set to decline materially over the next 10 years. In fact, one reason insurance companies have been so profitable over the last decade is that premiums increased materially faster than claims. If premiums were even softer, matching claims, insurance would already be less valuable. I know some readers are doubting these first few sentences, so here are facts based on A.M. Best's databases and simple calculations.

The 20-year average combined ratio is only 102.4 percent with a median of 101.3 percent. These are phenomenal results. The unweighted long-term average is 104.2 percent, and prior to the past 10 years, it was 105.1 percent. The past 10 years was 100.7 percent. A 4.5 point long-term improvement is worth approximately $25 billion per year.

Keep in mind that over the past 20 years, we've incurred Hurricane Katrina, Superstorm Sandy, the credit crisis, numerous other catastrophes and yet, these are still the most profitable years.

Also keep in mind that the nation has grown by 40 million people per the U.S. Census Bureau, with millions more cars, millions more houses, millions more assets and yet, the number of claims submitted annually has remained roughly between 51 million and 53 million per year. All of those extra exposures are not resulting in a commensurate increase in claims filed.

Earned premiums increased so much faster than claims during the first 15 years of the last 20 years that it took the softest market in history and the large 2017 catastrophes for loss increases to finally match premium increases over the past 10 years.

When people have fewer claims, insurance becomes less important and therefore, less valuable. Severity still plays a clear role for everyone jumping to this point. However, selling insurance where frequency exists in the forebrain is quite different than selling insurance when frequency declines and severity is all that really matters because human beings do not process severity well. People can conceive they may be impacted by claims that often occur, but humans tend to always think the rare but severe claim will never happen to them. The way in which insurance is sold, just on this point alone, will have to change.

Less Insurance Going Forward

Going forward, relative to GDP, less insurance will be required to finance and protect people and the economy. A major reason is that everyday life, already safer than maybe ever, is about to become more safe and the more safe an environment, the less important insurance becomes. The reasons the world will be safer include:

- Vehicles will become even safer. For those that always argue "but bumpers are more expensive" please consider that if fewer accidents occur, fewer bumpers will

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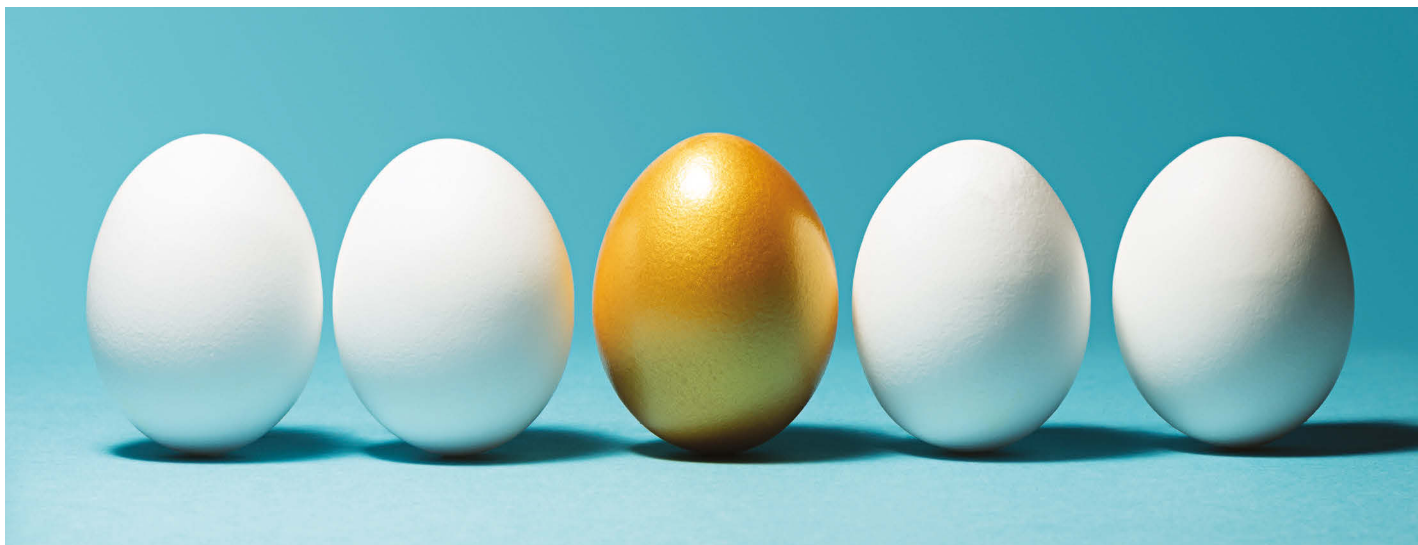

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need repair, and a lot of bumpers can be repaired for the price of one major injury. These safety features include: braking mechanisms, smart mirrors, lane identifiers and smart technology to reduce fraud.

- Auto technology alone is expected to decrease auto premiums by 20 percent.

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- Water leak detection and prevention technology will likely, over time, decrease non-cat property claims by 30 to 40 percent. Insurance simply will not be required, or be nearly as expensive, if the probability of water damage claims decrease by 80 percent.
- New technology coming to the blue collar workplace will absolutely decrease injuries and the fewer injuries, the less valuable insurance becomes.

Consolidation

These are just some of the major forces that will create a much safer world, but at the cost of decreasing the price and need for insurance. The result will be a consolidation of insurance companies. Approximately 900 property/casualty carriers exist, but the top 90 carriers by market share write 88 percent of all premiums, and the top 11 carriers write 50 percent per A.M. Best and my calculations. The remaining carriers, excluding those with special niches, just really do not matter.

If hundreds of carriers are immaterial and the other carriers know the market is going to shrink, consolidation is about the only possible outcome.

An interesting wrinkle though has to do with all of the acquisitions of insurance agencies and brokers at record prices. At those prices, the acquisitions do not pay for themselves on a cash flow basis before the deflation takes hold, making the debt used for the acquisitions more dear. This is a timing issue, but one likely to catch some players without a chair in the game of musical chairs, especially with rising interest rates and less deductibility of interest expense under the new tax law.

Insurtech distributors are mostly funded by equity. While the public face of these companies is all about the customer experience, I suspect that some see a strategic play where they do not have debt loads. However, major serial acquirer distributors do. Furthermore, if they can create a better customer experience while legacy players cannot adjust their balance sheets or afford the transition to the customer experience versus selling less valuable insurance, then these distributors will achieve fast growth and profit even more quickly.

Growing Value

The less valuable insurance, the more the sales focus truly has to be on something other than insurance that does have growing value. At this point, as insurtech is making everyone aware, it is about the consumer experience. Exactly what "the consumer experience" means is up for debate, with many different strategies and ideas and some snake oil thrown in by some.

But I'll put it succinctly: No one has ever wanted to buy insurance and therefore, the better consumer experience has to include some service, product or both that consumers actually want. This may be risk management, it may be web portals that practically cook dinner for you, it may be apps that provide extremely addictive games (a key element of good apps is that they contain a game), or it may be some other consumer experience, but it cannot be insurance.

No one ever wanted to buy insurance when it was far more valuable and just because it becomes, relatively, less expensive, people will not be motivated to buy more of it.

What will you be selling that people actually want to buy? IJ

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