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INSURANCE ISSUES

Motor Insurance in the Post-Pandemic Era

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No event in recent decades has had such a significant impact on society as the COVID-19 pandemic. While the effects of lockdowns and working from home threatened the existence of various industries and business sectors, the situation in motor insurance was completely different: the serious restrictions on people's lives, especially mobility, led to record results for German motor insurers.

The first COVID-19 year – 2020 – alone generated underwriting income amounting to 13.5% of premium income, a remarkable almost EUR 4 billion. In addition, more than EUR 2 billion from the past year (2021) remained as surplus despite very high natural hazards losses.

Are these impressive figures a reason to sit back and relax? Not at all, because a look at upcoming challenges and emerging developments reveals the fragility of the recent positive figures.

How will mobility develop after COVID-19?

Before the pandemic, traffic volume and loss frequency could be reliably assessed. Loss frequency decreased almost linearly by about 40% over the past 30 years, corresponding to an average decline of 1.3% per year.

This long-term trend was interrupted by the pandemic: in 2020 alone, motor liability claims fell by 18% compared to 2019, and in 2021 there were 22% fewer motor liability claims than in 2019. It should be evident that a renewed pandemic surge, combined with the reintroduction of restrictive measures, is likely to lead to further reductions of similar magnitude. It is already known that the current year – 2022 – will also be significantly influenced by COVID-19 in the first quarter and moderately in the second quarter.

Contents

About This Newsletter

Insurance Issues® provides an in-depth look at timely and important topics on property/casualty insurance industry issues.

How can we assess future loss frequency without another pandemic relapse? The prevailing opinion is that there will be no complete return to the “old world before 2020”. Home working and virtual business meetings could permanently remove the need for every “old world” trip and thus lead to permanent claims relief for motor insurance.

In addition, there are ecological and political imponderables that entail significant increases in the price of fuel – here, too, the signs point to a decline in the total number of kilometres travelled. This does not include the imminent electrification of the vehicle fleet (with an expected increase in insured risks) and the technological progress of the vehicles (with accident-preventing systems). Although “Vision Zero” will certainly remain a goal, the path towards it continues unabated – and probably at a higher speed than in the last 30 years.

What impact does inflation have on car insurance?

Discussions on the pandemic and the ensuing debate on societal change are primarily aimed at forecasting future claims frequencies. The inflation rate of claims payments, on the other hand, was relatively immune to the pandemic and societal changes. Although claims payments have always been higher than the inflation rate in recent years, they were manageable – at 3% to 4% per year.

In recent years, this robustness of claims inflation has been repeatedly challenged by chip shortages, lack of vehicle availability and massive disruptions in supply chains but following Russia’s invasion of Ukraine and the associated uncertainties, prices are rising sharply in almost all areas.

For the first time since the 1970s, consumer inflation is above 7%. This increasingly raises the question of which components of this strong price increase will be transferred to the settlement of motor insurance claims. It should be clear that an increase above 4% directly leads to a reduction in underwriting results, as no market participant could have foreseen this development at the beginning of the year and incorporated it into pricing. By its very nature, an insurance industry that promises “in advance” to pay benefits for at least one year is very susceptible to short-term changes in inflationary conditions.

Some scenario calculations demonstrate how quickly high inflation could have a drastic impact on results. If, for example, the claims frequency in 2022 were to be based on the pre-pandemic level of 2019 and a claims inflation of +6% were assumed for 2022, the profit of over EUR 2 billion from 2021 would immediately be mirrored by a loss of the same amount (calculated combined ratio 107.5%).

Even a half-year pandemic effect calculated for 2022, analogous to the years 2020 and 2021, would not compensate for 6% claims inflation; in this model calculation, a loss of approximately EUR 400 million would remain (combined ratio 101.5%).

In summary, the future earnings situation in motor insurance can currently be forecast only vaguely using actuarial expertise alone. Rather, it requires the inclusion of virological, economic and even political science expertise in order to be able to generate a holistic picture of social development processes. A close-meshed, real-time-oriented controlling of business developments should be very helpful in order to be able to anticipate necessary changes in business orientation as quickly as possible.

Is telematics the future of motor insurance?

Telematics has accompanied motor insurance for quite some time, be it in theory, in research and development fields, or in operational product approaches. The emergence of the COVID-19 pandemic has brought this product approach back into the focus of media coverage, as telematic components can be used to automatically adjust the insurance price to changes in vehicle use. Some even predict that the pandemic could help telematics achieve its final breakthrough.

The pros and cons of telematics have been discussed extensively in numerous publications.[1] Objectively, it should be noted that the breakthrough of telematic insurance solutions has so far failed to materialise. Both market leaders have been offering their customers corresponding products since 2016, i.e. for six years. Although they function technically and offer the customer considerable savings potential, the penetration rate in the respective portfolios is barely 4%.

Not even every 20th customer could be won over for the telematics solution within the six-year offer phase. Other market providers, some of which have been on the market with this offer for less than six years, have a portfolio penetration far below the 4% mentioned. The product offerings to date seem to appeal more to target group-specific customers and less to the totality of all customers.

Small- and medium-sized companies, in particular, should take this selective customer acceptance into

account when making their business decisions regarding telematics – otherwise they run the risk of setting up a costly infrastructure for just a few thousand customers.

Another aggravating factor is that (almost) all protagonists agree that the current app and beacon solutions are only a transitional technology. Many market participants do not expect the big breakthrough until data is obtained directly from the vehicle. However, this thesis is associated with further challenges (and leads directly to the next topic).

Will the car insurance of the future become an add-on or annex of the vehicle?

This question has occupied the insurance market for a long time, because collaborations between vehicle manufacturers and insurers with regard to an "integrated insurance solution" have existed for decades – with balanced market shares. This is why many market participants smile at the threat of a significant decline in the "free and independent" motor insurance business; after all, the sword of Damocles has been hanging over it for a long time.

However, the insurance industry itself is in the process of undermining the balance between vehicle manufacturers and insurance cover by declaring driving data to be a future key feature of insurance technology. Until now, insurance cover could be offered without the "assistance" of manufacturers, but this independence is overturned when telematic driving parameters are used.

Even if all insurers were granted non-discriminatory access to data in order to ensure free competition, the key would remain in the hands of the manufacturers because they are the generators of the data. They, as data generators, would therefore have better, more accurate and more comprehensive data at their disposal. Furthermore, it seems difficult to imagine that monetary product solutions generated from vehicle systems will completely bypass the original manufacturer value chain. At the very least, the possibility of a so-called "embedded" insurance solution is likely to increase significantly.

Another important reason to look at integrated insurance solutions is the technological development of vehicles. Even if the fully autonomous vehicle is not yet imminent, the spread of semi-autonomous systems is gradually increasing. This is accompanied by the significant insurance-related questions of which of these systems are used or activated by the driver, when, where, and in which driving situation?

In general, the question arises whether the increasing spread of semi-autonomous driving functions is not much more relevant from an insurance point of view than the assessment of the driver. If vehicles are increasingly capable of correcting alleged driver errors and actively intervening in accidents, previous telematic insurance concepts would become obsolete.

In the future, the insurance key to risk assessment will lie in vehicle technology rather than in the hands of the driver.

Does electromobility only change the type of drive technology?

Both politically and socially, there seems to be no dispute: the vehicle fleet of the future will be electric. In Germany, the number of vehicles with electric drives is doubling year by year and will clearly exceed the one million mark this year. Many manufacturers have decided to phase out their combustion engine model series between 2030 and 2035, so motor insurance for zero-emission vehicles will become standard in the future.

Initial experience with this new automotive technology shows significant underwriting losses, especially in motor own-damage insurance. On one hand, this is due to the discount policy of many companies that want to improve the "sustainability" of their insured fleet, but on the other hand, it is also due to the lack of surcharges for increased battery damage. The latter component especially could transform into a bigger problem for motor insurers, as the replacement of battery components costs up to 50% of the total vehicle value.

As electric vehicles become more widespread, battery damage will also gradually find its way into the liability insurance component, as the probability of collision with an electric vehicle increases.

Battery damage is not only about spectacular fire damage that causes costly extinguishing, storage and disposal procedures – this component is still the most insurable due to a low probability of occurrence. Rather, it is about the multitude of "normal" collision damages, in which the question arises in each case of whether the battery was affected.

At present, only the manufacturer can make a reliable statement on this and thus occupies a key position in the entire settlement process. Should the manufacturer be able unilaterally to determine when a battery has to be replaced, this could put both the independent workshop market and the concept of insurance-authorised workshops developed by the insurance industry to the test.

Ultimately, such a scenario for battery damage provides another element for promoting holistic solutions for vehicles, including their insurance. Independent motor insurers, on the other hand, run the risk of unilaterally paying dearly for the ageing and refurbishment process of vehicle batteries at the expense of their insurance community.

Conclusion: there is a lot to do, so get it done!

Of course, there are numerous other tasks beyond these five challenges to ensure successful motor insurance business in the future, but these challenges alone are enough to show the considerable need for action.

As good as the most recent business figures look, if the already foreseeable developments are not countered with a great deal of effort, the German motor insurance industry will face difficult times.

Endnotes

1 Morawetz, Der telematische Irrweg, 2016, ZfV 2016, 68 ff. and https://www.genre.com/knowledge/publications/2016/april/kfz1603-de; Morawetz, Die Zukunft der Kfz-Versicherung: Schöne neue Welt?! ZfV 2016, 766 ff. and https://www.genre.com/knowledge/publications/2017/december/kfz1712-de.

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