An update to how insurance premiums are calculated

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At a glance

- Customers may not appreciate the wide range of factors that insurers must consider when calculating premiums
- This can cause frustration if premiums change and do not meet a customer's expectations
- To help you in discussions with your customers, we update some of the key factors that can influence their insurance premiums

A wide variety of factors affect how insurance premiums are calculated. A large proportion relate to customers' specific risk profiles, whereas others will be out of their control and determined by a range of other influences.

Many of these are not widely understood by customers, which can lead to surprise and frustration if insurance premiums go up.

To help your discussion with customers, we look at a number key factors that affect how insurers determine premiums.

Global politics and economics

Political change and its economic consequences can have a significant influence on individual insurance premiums.

One example is the current uncertainty over Britain's exit from the EU, which has already reduced the strength of the pound. This is affecting, among other things, the cost of motor parts manufactured outside of the UK, which in turn increases the cost of repairing a vehicle and therefore the premiums needed to cover future motor claims.

Recent rises to insurance premium tax (IPT) are another example. The UK Government has announced a number of successive increases to IPT over recent years, directly impacting the amount customers pay for their insurance. While this tax is collected by insurers, it passes straight to the government.

Cost of doing business

Insurance companies face the same sorts of changes to the cost of doing business as their customers. For example:

- Exchange rate fluctuations
- Reductions in investment returns
- Salary inflation
- Energy cost rises

Insurer business models

In addition to typical business outgoings, insurers' business models also feature a number of unique factors that will influence insurance premiums. These include:

- **Solvency requirements** – Insurers are legally required to set aside a significant proportion of earned premiums to ensure there is always enough money to pay future claims. This includes large and catastrophic losses, such as extreme weather events
- **Future claims trends** – Insurers must adjust premiums over time to cover the cost of future claims. If, for example, a type of workplace injury becomes prevalent, this is likely to affect future claims experiences due to the increasing trend of Periodic Payment Order (PPO) awards for serious personal injury claims
- **Investment income** – Many lines of business, such as Employers Liability (EL) and Public Liability (PL) have historically run at an underwriting loss, with insurers relying on investment income to generate an overall profit. Global interest rates have fallen significantly over recent

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years (the Bank of England base rate, for example, recently dropped to an all-time low of 0.25%), putting more pressure on insurers to make an underwriting profit, putting upward pressure on premiums

The following are examples of specific factors that have recently affected particular lines of insurance business:

Public/products' liability

- Rise in activity from claims management companies following the introduction of regulatory restrictions to other, previously more lucrative, lines of business such as motor
- High claims inflation for bodily injuries, particularly for catastrophic losses

Property

- Following the recession, many businesses were forced to cut back on risk management expenditure, leading to increased losses and larger claims. Property is also still commonly being underinsured, despite the significant risks this poses for customers
- Increase in number of unoccupied buildings, leading to rise in metal thefts, arson and fly tipping
- Catastrophic losses from extreme weather events

Motor

- Currency fluctuations – the drop in the value of the pound is increasing repair costs, as everything from parts to paint becomes more expensive
- Although better technology in vehicles is reducing the number of collisions, this technology costs more to replace or repair if it is damaged, with much of it featuring in high impact areas such as bumpers
- Fraud – 70,000 dishonest motor claims were detected in 2015
- Growth in periodic payment orders (PPOs) for personal injury claims, increasing insurers' long-term costs

Employers' liability (EL)

- Latency – insurers must price for the fact that decades can pass between an employers' liability policy being underwritten and a claim being made, e.g. for asbestos-related illnesses
- High claims inflation for bodily injuries and growth in PPOs
- Impact of low interest rates on investment income

How can customers manage premium changes?

The information above should offer your customers some insight into the wide range of factors that can influence their insurance premiums. This can be used in discussions if, for example, they do not automatically experience a significant reduction in premium following an improvement in claims experience.

Despite the importance of these factors in determining premium levels, we will always look at each customer on an individual basis, and try to limit the impact of factors outside of their control.

To help your customers better manage some of the risks discussed in this article, please explore the range of content on Zurich Insider, including:

How to keep empty properties safe

An interactive guide to spotting motor fraud

Quick guide to risk assessments

Identifying and dealing with flood risk

To find out more, or to discuss how you can help your customers improve their risk profile, please speak to your usual Zurich contact.

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