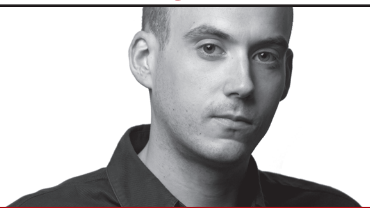
The road to Solvency II is paved with … headaches
Markets&Risks, page 18



WEBLOG Danny Walkinshaw on the latest stories online

As the online world develops, and in response to the rapid growth of insurancetimes.co.uk, we've introduced some exciting additions to the website.

You may have noticed a number of changes in recent weeks, including the introduction of our new subscriber-only features. This exclusive content is split into six online channels dedicated to various sectors of the market, and will be updated regularly with web-first content, giving our subscribers even more reasons to enjoy the site.

One of the first examples was our piece on insurer NIG, titled: 'NIG: A victim of 2008-2009 claims farming'. The story hit the right notes with our subscribers and features prominently in this week's top 10.

As always, you can enjoy our up-to-the minute breaking news, regular blogs, special photo galleries and other online content that make insurancetimes.co.uk such a valuable tool.

Top of the pile this week was our breaking news story on RBS Insurance's latest figures. The bank-owned insurer suffered heavy losses and was the most clicked-on story, but it was closely followed by news about staff resignations at the FSA. Our online exclusives about a team leaving Kerry London and a new managing director at Oval also performed well.

Over on Twitter, our popular account @InsTimesNews reached a major milestone after hitting 700 followers – and it is still growing. Some brokers have also been using social networking to support our Fair Fees campaign. One broker, @insurance_jon, tweeted: "Just signed up to Insurance Times Fair Fees petition. Sign up here and make a difference: bit.ly/buCAYG #fairfees."

You can also send me a tweet to @InsTimesDanny for any insurance or online-related topics.

Insurancetimes.co.uk is the number one site for breaking insurance news, analysis, blogs, photos and much more. Follow on Twitter @InsTimesNews

ONLINE TOP 10 The most-read stories this week

1 INJURY CLAIMS LOSE RBSI £253M
H1 loss bigger than H1 2009 profit; bodily injury claims rise

2 RESIGNATIONS MORE THAN DOUBLE AT FSA
128% rise in FSA staff exits linked to proposed abolition

3 SPORT AND LEISURE TEAM EXITS KERRY LONDON
Team of five, including managing director Chris Wright, believed to be joining rival CCV

4 OVAL UNVEILS NEW BOSS
Oval's Patrick O'Connell is one of two boardroom promotions

5 QBE IN EXECUTIVE RESTRUCTURE
New heads appointed at QBE in bid to reflect growth

6 NIG: A VICTIM OF 2008-2009 CLAIMS FARMING S
The cleaning-up of NIG has paved the way for an early sale

7 GYMNAST SUES FOR BROKEN NECK
China's Sang Lan wants US lawyer to sue Goodwill Games

8 SEAN QUINN'S ALLIES OUSTED
Friends and family of Sean Quinn removed from boards

9 CHAUCER TAKES ON TIM CARROLL
Strengthening board continues at Lloyd's insurer

10 GROUPAMA COMBINED UK PROFIT UP 30%
'Bad old days' have returned in commercial motor, says chief Boisseau

You too can earn more money from your customers, says Tim Ham. First, though, run them through a computer

Price optimisation can boost profits by half

IT IS WELL known that the competitive pressure induced by web-based aggregators has driven down first-year commissions in personal lines insurance.

This has spurred some brokers to optimise pricing structures – which has led to a boost in profits and volumes. The benefits can be dramatic: creating a simple though well-developed algorithm can increase customer value by up to half, depending on current pricing, the diversity of business and elasticity of customers.

Also key to profitability is product holding, payment type, renewal rates, cancellation rates, acquisition channel and claims ratio.

The value of customers will vary enormously. It is not untypical for a third of customers to create all of the profits, another third to have little effect and the remainder to be loss-making. In one company I worked, about 20% of customers contributed virtually all the profits.

The customer's lifetime value must be modelled with consideration to cost categories. The biggest error is to model gross margin, which results in under-pricing.

Price elasticity must be measured by how customers are grouped. Customers should be defined by channel and stage in life cycle, as well as by parameters relating to what and how they are transacting with you.

Measuring price elasticities can be complex. You need to understand the effect of price on volume, and it is often difficult to disentangle this from other factors.

Be careful not to use sophisticated so-called price optimisation software that is based on conversion rates rather than price elasticity. This results in underpricing in areas of poor performance (and vice versa) without volume returns.

Price optimisation should lead to important decisions. A good model should be versatile, transparent and flexible. But over-simple models do not provide all the information to make good decisions. They may, for instance, show the effect on the coming 12 months but not on the lifetime of the customer. Over-complex models can be more dangerous; they can be opaque and lead to over-confidence. Pricing then becomes an act of faith in the model.

More often than not, 90% of the potential benefits can be achieved with simple solutions.

Behavioural economist Richard Thaler described the "winners' curse" – where the winner in an auction offers the most money but ultimately lose out because they have over-valued the item.

> *An auction winner is the one who offers most, but often because they have over-valued an item*

Equally, when underwriters find they are writing too much of a certain type of business they increase prices, and rightly so. In a competitive environment, it is more than likely that the underwriter has under-estimated the risk.

The industry standard price optimisation software has been developed against this backdrop.

However, while the underwriter is right to reduce prices if they find they are getting too little business, the broker is not. This can lead to over-investing in consumers they will never attract or hold.

Accordingly, some brokers are using what appears to very sophisticated price optimisation tools but to the wrong effect. **IT**

Tim Ham is managing director of Pearson Ham, a price optimisation consultancy