Usage-Based Insurance: Navigating Challenges and Opportunities

Introduction

Usage-based insurance (UBI) is not a new concept, but thus far has not been a widely adopted automobile insurance option in the United States. By many accounts, this is set to change in the coming years. Previous technological barriers are falling. New, more accurate, devices are being developed. Costs for the technology are also declining. Ideological barriers, such as loss of privacy, are becoming less of an issue for consumers as they become more comfortable with sharing and engaging personally and professionally through technology.

Emergence and Background

Telematics and the advent of user-based insurance have grown from a single pilot program by Progressive in Houston, Texas, in 1998, to a $160 million dollar market that is estimated to produce $1.6 billion in revenue by 2020. Progressive was an early leading contender as the first company to begin offering a user-based insurance scheme in which consumers had the opportunity to have a device professionally installed and then removed every six months for the data to be downloaded, analyzed, and then have the effects applied to their insurance premium (Deveau, 2012).

At this point, existing telematics systems offered both rewards and penalties; good drivers received discounts, and those deemed to be driving with poor skills or risky behaviors actually saw increases in their insurance rates. However, evolving technology and a keener understanding of consumers’ desires and needs has led to non-punitive user-based insurance pilots that are becoming increasingly prevalent in insurance packages.

Now, UBI has become an opportunity for insurance companies to change the perceptions of consumers through personalized premiums and high levels of innovative engagement. Changing technological advances have raised consumer expectations as well as the number of chances that insurers have to meet and exceed these needs. Telematics can provide a strong foundation for insurers to create organized business models that satisfy a robust array of consumers (Stross, 2012).

The Market

Insurance industry consultant, Towers Watson, conducted a survey in 2013 that found 79% of participants would be willing to try UBI. Of these 79%, 89% would try it if they were guaranteed that their premiums would not increase (Gusman, 2013). Drivers between the ages of 18 and 34 showed the highest interest in UBI as compared to other age groups. Many of the
participants also noted that they would be willing to change their driving habits if it meant they would have a lower premium.

Specifically, these adjustments involved habits such as driving below the speed limit and maintaining a safer distance between themselves and other cars, which would create safer driving conditions. Of these 79%, however, 30% said they would need more information before they would decide to switch to UBI (Gusman, 2013). Consumer awareness and understanding then emerges as one of the obstacles that companies interesting in UBI would have to navigate.

As UBI telematics evolve, industry standards are developed, and consumers become more informed, the market for these devices and services will demonstrate more clarity than it currently displays. The fact that different insurers employ different insurance models makes it difficult to gauge the forecast as well, but the prevalence of successful pilots and innovative technology makes this increasingly more likely. Drivers who live in smaller cities with lower speed limits and fewer stop signs may receive a higher discount. Those who are the least likely to receive a large discount are those who drive significant distances, usually drive during rush hour, and brake often and/or hard (Walsh, 2012). These factors demonstrate the importance of promoting customer awareness, the sophistication necessary for a successfully tailored insurance program, and the different ways in which personalized telematics analysis can enable individuals who simply consider themselves safe drivers to potentially become future consumers.

Developments, Major Suppliers, and Current Pilot Statistics

The significance of a providing a strong and nuanced telematics program to consumers offers insurance companies a competitive advantage amongst their peers. Notably, Progressive, State Farm, and Allstate are leading suppliers, offering programming entitled Snapshot, Drive Safe and Save, and Drivewise, respectively.

However, the barriers to entering the telematics market are twofold; not only does state by state legislation hinder the ability of companies to create all-encompassing policies, but the sheer amount of data collected can be overwhelming, difficult to maintain and organize, and brings up issues of privacy that merit significant consideration (Stross, 2012).

According to each company’s most current website information, Progressive’s Snapshot is available in 43 states, while State Farm’s Drive Safe and Save is offered in 48. Allstate’s Drivewise follows with coverage in 39 states, but each company is taking steps to increase availability to consumers.

Market Advantages and Challenges

In the United States, all cars manufactured since 1996 are legally required to have diagnostic ports which have aided in the prevalence of telematics by simplifying accessibility and opening the telematics markets to devices that are cheaper and more convenient, such as the utilization of smart phones, and do not necessarily have to be professionally installed.

Additionally, the visibility of the pilots, programming, and the companies figures who promote them, such as Flo from Progressive and the easily recognizable Allstate spokesperson,
Dennis Haysbert, has led to not only more consumer interest but also assisted in making insurance policies, premium rates, and charges more transparent and understandable to consumers, which has in turn augmented consumer interest and willingness to try these programs (Phelan, 2013).

Ultimately, growing interest means companies that are invested in telematics and UBI services cannot underscore the importance of having organized data collection and analysis programming within the production and enforcement of policies as well as clear regulation for the dissemination or protection of that information (Swartz, 2012).

Value Propositions to the Market

Currently, the primary selling points in the U.S. for UBI are cheaper premiums and driver discounts. Consumers interested in such policies are attracted by the prospect of saving money through the reception of both immediate and long-term discounts on their auto insurance based on their good driving habits. In a UBI policy, consumers are given independence and control over their own premiums, and many find it appealing to know that their premium is determined solely on their own behaviors and not those of other drivers. They are drawn by the knowledge that they will no longer suffer financially as a result of other insurees’ reckless driving behaviors.

Telematics has the potential to allow insurers to include many value-added services, which would enhance the appeal of UBI to all drivers. For instance, UBI devices can facilitate vehicle recovery in the event of theft by making it easier to locate the vehicle. Further, they can be programmed with automated emergency response systems that can assist drivers and passengers in the event of an accident, and they can provide drivers with notifications for scheduled maintenance, such as oil changes (Reddy, 2012). Additionally, geo-fencing is a service that could be marketed to parents of young drivers as a means of monitoring their children’s driving habits to determine if they are driving irresponsibly or taking the car without permission (Hutchins, 2014). Insurers are moving away from product-focused business models to more consumer-oriented models, and UBI can help them in their efforts (TELEMATICS A HARD SELL, 2013).

Consumer Acceptance Issues

Consumer apprehension towards UBI is rooted in concerns about privacy and trust. Many consumers are uncomfortable with the idea of being under constant surveillance, despite the existence and popularity of companies such as Google that already collect information on the consumers who use their products and services (Baumann, 2013). There are also concerns about how insurers will keep the information they collect secure.

A major concern amongst consumers is that the data collected by UBI devices will actually lead to an increase in their premiums, because it may not accurately reflect their driving risks. An example would be a highway driver who must accelerate to get onto the on-ramp or brake hard in order to avoid a collision with a reckless driver (Gusman, 2013).

Another concern is that the data collected will be sold to other providers, which would lead to unwanted emails, phones calls, or other forms of advertisements and solicitation.
Consumers also worry that the data collected on their driving habits could potentially be used to invalidate their insurance claims (Gusman, 2013). The fact that it is not clear how insurers will raise premiums under UBI policies adds another level of concern. As consumers become increasingly “connected” and more comfortable with sharing information, they may also become more accepting of UBI telematics.

**Regulatory Standards**

Telematics data poses a great obstacle for insurers because the insurance industry is not accustomed to collecting and analyzing telematics data. It has not been something they have traditionally done, and regulated organization and analysis will be necessary in order for a company to successfully engage with its consumers.

In January of this year, the insurance industry group ACORD, (Association for Cooperative Operation Research and Development), released a report on open data standards for insurance telematics technology. ACORD said that they chose to focus on what data is collected in UBI and how that data is organized, rather than dictate how insurers should use that data (McMahon, 2014).

Additionally, all states in the U.S. have their own laws on UBI, which can complicate operations for cross-state insurers (Lucker, 2012). Unclear criteria for raising premiums under UBI complicates competition between insurers, as consumers would use this information when selecting their insurance policies.

Most importantly, and amongst the highest concerns to consumers, is the lack of standards on protecting personally identifiable information; this is especially important for UBI models that use mobile devices to transmit data as they are more susceptible to hacking than other devices.

**Potential Social & Environmental Impact**

The adoption of UBI by consumers could have a greater impact on society and the environment than expected. The incentive to drive safer in order to save on insurance premiums could lead to fewer accidents occurring, or less severe accidents as a result of fewer drivers speeding and more drivers keeping safer distances between vehicles (Lucker, 2012). There may be less traffic on the roads if drivers leave with sufficient time to arrive at their final destinations. Drivers may also opt to walk or ride bicycles if travelling short distances to reduce the number of miles they drive. This would in turn lead to fewer gas emissions, less pollution, and a cleaner environment.

**Insurance Models**

Three main insurance models have emerged in UBI. The main insurance models are: Pay-as-you-drive (PAYD), Pay-how-you-drive (PHYD), and Manage-how-you-drive (MHYD). In the PAYD model, insurance premiums are charged based on the number of miles driven. For PHYD, driving style is incorporated (sudden braking or acceleration, etc.). MHYD will utilize driver
feedback in order to stem risky driving behaviors (Ocken, 2013). In order to ensure the safest drivers and therefore the highest profits, insurance companies will want to move their customers to different insurance models.

Technology

Technologies associated with UBI have evolved over time. A white paper report by Deloitte outlines the history of UBI technology (Baumann, 2013). At the start of UBI offerings, aftermarket professionally-installed black boxes were used to gather driving information. These were expensive and required professional installation. With newer technology, these are becoming obsolete.

The next evolution in UBI were self-installed onboard diagnostics devices (OBD2), which are easily installed as well as at a lower cost. The smartphone is another data collection tool, which is attractive to drivers who do not need to purchase additional equipment, but there are questions about the reliability of the data gathered.

The latest device to capture driving data is the embedded OEM (original equipment manufacturer) device. Examples of these include GM’s OnStar or Ford’s SYNC. These solutions are becoming more common as car manufacturers install them to provide additional benefits such as navigation or theft prevention. An increasingly common UBI solution combines both smartphone and OEM devices.

A shift in the technology used for UBI is underway. According to a survey of industry experts by Telematics Update, the demand for OEM devices for use in UBI will increase dramatically in the next 2-5 years while Black Boxes and OBD2 dongles decrease (Telematics, 2014). This is due to the emergence of OEM installations factory installed in new vehicles. According to a report published by Cognizant Research, by 2018 the percentage of cars sold in the U.S. with embedded telematics devices will reach 80% (Reddy, 2012).

Conclusion

An increasing number of insurance companies are adopting UBI programs to attract safe drivers, and as a result of positive reinforcement through tailored insurance policies, creating more safe drivers. For these reasons, the number of drivers in the U.S. who take advantage of UBI is projected to grow significantly in the near future, and it is clear that usage-based insurance is an opportunity for insurers to not only restructure the current automobile industry but also create stronger, more personal relationships with their consumers through technological advances in telematics. Navigating the falling barriers of organization, technology, and regulation will aid insurers in turning these obstacles into opportunities for safer drivers as well as a developing environment that is conducive to a novel take on automobile insurance.
Works Cited


