

PAYD - a new era in car insurance pricing

By Joseph Weinstock ❖

PAYD provides a much more immediate feedback loop to the driver, by changing the cost of insurance dynamically with a change of risk

"Pay As You Drive" is a trade mark of **Norwich Union** UK. They were among the first insurers to launch a usage based car insurance program.

It started at 2003. Since then, the term PAYD has become more of a generic expression, rather than a



Joseph Weinstock

brand name to a specific program.

It was justified by Wikipedia to define PAYD as a concept: "The simplest form of Pay As You Drive bases the insurance costs simply on the number of miles driven. However, the general concept of Pay As You Drive includes any scheme where the insurance costs may depend not just on how much you drive but how, where and when you drive.

Pay As You Drive means that the insurance premium is calculated dynamically, typically according to the amount you drive. Driving is monitored using a secure black-box device in the vehicle, linked to a national network of satellites and data recorders.

The formula can be a simple function of the number of miles you drive, or can vary according to the type of driving or the identity of the driver. Once the basic scheme is in place, it is possible to add further details, such as an extra risk premium if someone

drives too long without a break, uses their mobile phone while driving, or travels at an excessive speed.

Insurance companies have always tried to differentiate and reward "safe" drivers, giving them lower premiums and/or a no-claims bonus. However, conventional differentiation is a reflection of past history rather than present patterns of behavior. This means that it may take a long time before safer (or more reckless) patterns of driving and lifestyle feed through into premiums.

PAYD provides a much more immediate feedback loop to the driver, by changing the cost of insurance dynamically with a change of risk, and this means drivers have a stronger incentive to adopt safer practices. For example if a commuter switches to public transport or working at home, this immediately reduces the risk of rush-hour accidents. With PAYD, this reduction would be immediately reflected in

the cost of car insurance for that month".

Apparently, using PAYD programs, could

lead to more just and fair system of insurance pricing, to the individual responsible driver and in addition to reduce motor related problems at a nationwide level.

Against those two advantages, there are two main objections:

The first concerns the exposure of personal data to the operators of the scheme. Some people might not be so enthusiastic with satellites technologies interfering with their private life and habits.

The second argument, against PAYD, is that insurance for young drivers will become expensive, a fact that eventually will lead to "unsocial

driving".

This objection is rather weak because "safe" young drivers will not be priced higher.

To my opinion, the first objection is a matter of a public debate. Society should decide how to settle between the important value of the "right to privacy" on one hand and the privilege of safer roads and "greener" environment on the other hand. This issue will be solved one way or another; (a NON GPS PAYD programs can suggest kind of a compromise).

Does it already work somewhere?

The answer is yes. There are several institutions as well as insurance companies that are offering various forms of PAYD programs, either as a full commercial products or as a "trial version" programs. That

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**Call us:
Economic Communication
14 Nachshon St. Ramat Hasharon 47301 Israel
Tel 972-3-5407884
Fax 972-3-5493622
E-mail edit@tikshoret.co.il**

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PAYD - a new era

includes: Norwich Union in the UK, **Hollard Insurance** in South Africa, **AIOI Insurance Company** in Japan, **Progressive Insurance** in the USA and **Aviva** in Canada. **Aryeh Insurance co.** in Israel has its trial with "per kilometer" program which has stopped after a short period, **General Motors** with its "On Star" program and others. I hope one more Israeli insurance company will soon join this distinguished list.

What are the challenges for the new concept?

First, "telematics" (information and communication technology) is a fairly new science. For instance - in early days of the concept, the main parameter measured was distance. Nowadays technology can gather and

process some more important factors which altogether may produce a "driver profile" which is transformed to a precise system of insurance pricing. But, and it is quite a big "but", as with every new technology, so is this one which characterized with "childhood illnesses"; i.e: some technical problems.

The ability of operators to collect, process and deliver a risk influence data, has yet a way to do until it could be regarded as reliable.

A second challenge this concept is facing, lies in the frequent "gap" between a "good idea" and a "good working product".

This means; finding the right insured segment which can become a true PAYD "believer" and then, supply a SIMPLE product. This task could be a fascinating project in terms of design,

as well as, marketing.

The future

PAYD is a concept of many benefits: for responsible individual drivers of all ages, for society as an improving roads safety tool and for insurance companies. It is a triple winner, and I believe that in 5-15 years, a large share of car insurance market will use this pricing method. Until then, the concept has some technical "maturity" process to go through. Then, like any other new concept, some kind of public recognition and acceptance is required.

This article is one more step in this evolutionary process.

❖ **Joseph Weinstock, CEO Shomera Insurance Company Ltd**

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The honesty of the policy

their policyholder, for a financial loss that was caused by a lack of information.

The spectrum of details that the insurance agent is required to reveal and expose to its potential policyholder, during the contractual proposal, is getting wider and wider, as far as the eye can see.

Despite the fact that the contractual relations takes place in the field of

private commercial market, it seems that the Israeli judge is a strong-minded player in the game known as "freedom of contracts".

According to the tendency above, a possible assumption shall lead to the conclusion that the "duty to disclose" refers to insurance companies, is drawn near the "duty of bona fides".

As a result of this process, a

realistic insurance agent should be aware of the burden of disclose, and should try and give its "product" a perceptible form facing the crowd of future clients.

❖ **Ronel Fisher & co** – Israel and Hungary Branch's

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The changing role

the reinsurer is as well informed as possible about the risks in the treaty and it is also its duty to fully understand the reinsurers thinking process and profit drivers in order to be able to create an agreement zone.

The issue of counterparty risk is an integral one as well. While the cedant transfers insurance risk, it assumes the credit risk of the reinsurer. That risk needs to be analyzed and monitored in order to protect the reinsurance recoverable asset on the balance sheet.

This will sometimes entail, from efficient capital perspective, accepting less than 100% placement rather than

Too often reinsurance treaties are based on the information gap that exists between cedants and reinsurers - not the best recipe for a long-term relationship

assuming a high counterparty risk.

To sum, in this limited article I have tried to touch on the need for different, broader, concept of reinsurance in Israeli insurance companies, and the challenges to reinsurance departments

as a result. In an environment with shrinking profit margins from one end, and increased risk on the other, reinsurance departments need to understand that they are responsible for an asset that can and needs to be managed in a manner that will create surplus value to the shareholder.

❖ **Elad Shelef, Reinsurance and Planning Manager, Menora Mivtachim Insurance**