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TRAVEL INSURANCE PRICING
MORE COMPLEX THAN IT LOOKS

By
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WHY IS TRAVEL INSURANCE SUCH A VOLATILE CLASS OF BUSINESS?

Travel insurance is complex, with many different underlying covers. As a result, pricing is subject to a variety of risk drivers.

Every travel policy is unique, driven by differing risk factors specific to the individual travellers and the nature of their trips. Each policy has a different ratio of coverage pre-trip which is exposed to cancelation risk versus on trip medical and other benefits. This results in complexity, even extending to how the premium is earned in the accounts.

Because travel insurance is generally a single trip purchase product in Australia, with only a very small proportion of policies that are annually renewable, the results of portfolio actions are seen very quickly. You can't rely on a lazy renewal book.

People are at the heart of travel insurance – helping them in often desperate health situations, managing their treatment, and then bringing them home. It can be a life saver which results in amazing stories and a positive feeling about the product. The challenge though, is that health events can result in very large claims especially with older people with existing medical conditions in high cost jurisdictions like the USA.

Unlike other classes which are exposed to catastrophes domestically, travel insurance is exposed to catastrophes from all over the world. Past examples include volcano ash clouds, pandemics, tsunamis, hurricanes and cyclones. Pricing can therefore be a real challenge for providers.

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WHAT DRIVES PRICING IN TRAVEL INSURANCE?

Type of coverage
The type of coverage has a big effect on premium. Purchasing a policy that covers trip cancellation, interruption and medical expenses will cost more than a basic policy which just covers medical expenses.

Destination
Some destinations, such as those considered high-risk, result in a higher premium.

The cost of healthcare in the United States is generally higher than in many other countries, which can make medical claims more expensive. Countries which have reciprocal health agreements with Australia like the UK mean that claims costs will be lower for travellers there.

Some countries are riskier due to the level of personal safety, hygiene, and sanitation. Trekking in Nepal may result in altitude sickness or a trip to Bali a bad case of gastro.

Age
As people get older, their likelihood of having a health problem, such as a chronic illness or injury, increases. They are more likely to have an incident, and their recovery is slower. This means that there is a higher chance that they will need to make a claim for medical treatment while traveling. And the claims cost is likely to be higher.

For example, an older person with heart disease might need medical attention while traveling, which would be more expensive than the same service for a healthy person.

Therefore, insurers charge higher premiums for older travellers to offset the potential costs of their claims.

There is also the indirect impact of age on a policyholder. The adverse health episodes of older relatives, especially parents, may impact the travel plans of the policholder, resulting in claim.

Length of trip
The longer the trip is, the higher the premium will likely be. There is a logical link here, the more travelling you do the more time you are exposed to something happening, so hence the price is higher.

Lead time
The lead time before a trip can affect the cost of a travel insurance premium because the further in advance a policy is purchased, the greater the potential that one's personal situation could change and something could happen to disrupt a trip, such as the emergence of a medical issue.

Excess
In most classes of business, excesses are used to reduce the number or size of claims. Travel insurance is a relatively low claim size business with an average claim size of around $1,000 to $2,000. Excesses help reduce the number of smaller claims. Excesses can vary from $0 to $500 with most excesses ranging from around the $200 to $300 level. The higher the excess the cheaper the premium.

Cruise

Cruise vacations can be more expensive to insure than other types of travel because there are additional risks associated with taking a cruise. The close proximity of many people on a cruise ship increases the risk of illnesses such as norovirus.

In the case of an emergency or if a passenger falls ill, evacuation from a cruise ship can be more difficult and expensive than it would be from a land-based location. Inclement weather or technical issues can cause a cruise ship to be delayed or rerouted, which can result in additional costs as many policies provide benefits for missed ports.

If you need to cancel your trip, cruise cancelation terms are generally not very favourable returning little in terms of refunds.

Cruising by its nature is subject to the swells of the seas and is more exposed to risk of accidents such as slip and falls.

Activities

Participation in adventure activities increases an individual's risk. This includes such things as skiing, snowboarding, motorcycling, scuba diving, bungy jumping, sky diving and mountaineering.

Different policies will include certain adventure activities and either exclude activities or charge tiered pricing for select activities.

Motorcycling is a risky activity even in Australia. A collision on a motorised vehicle at velocity will be more significant than a normal slip and fall. The following can all make it difficult to navigate and increase the risk of accidents:

- road conditions in some foreign countries being vastly different to those in Australia
- poorly maintained roads
- lack of road signs
- different driving habits

Winter sports are popular activities and has a prevalence of claims in relation to knee and ligament issues. Coverage for riskier activities like heliskiing can generally be purchased at a higher premium.

Existing medical conditions

Past and current medical conditions, if covered, will have an impact on the premium. Individuals with pre-existing medical conditions are at a higher risk of experiencing a health problem or requiring medical treatment. The insurer will charge a higher premium to cover the potential costs of a claim.

People with pre-existing conditions are more likely to need medical treatment while traveling, which can increase the costs associated with a claim and the risk of the claim being made. People with pre-existing conditions may need to be evacuated in case of an emergency, which can be more difficult and more expensive than for healthy individuals. People with pre-existing conditions may need to cancel their trip due to their condition, which can result in additional costs for the insurer.

Some medical conditions may be more difficult to get travel insurance coverage for, as they are considered to be higher-risk conditions by insurers. These include cancer, heart conditions, neurological disorders, respiratory conditions and autoimmune disorders.

Generally most players in the market have some sort of medical rater to assist in pricing risk - backed up by the experience of medical practitioners - though their risk appetite will place limits on the risks they will cover.

EMERGING PRICING CHALLENGES FOR INSURERS?

- Customer value – Commission rates can be high, with some over 50%. This poses a potential customer value issue with the implied loss ratios being below 50%. This raises the question, what is a reasonable loss ratio?
- Optimisation – Is it fair to simply increase and decrease premiums in response to demand?
- Rise of Aggregators – The market is not very competitive due to the disparate places where travel insurance can be purchased. Aggregators have operated in this space for many years and over time may increase market share.
- Medical discrimination – A space where there is limited data and the dangers of discriminating with the inability to prove to a regulator that the level of discrimination is justified particularly in relation to disabilities.
- Having less questions driven by the desire to keep the purchase path simple may lead to customer understanding issues.

CASE STUDY

ANTI-SELECTION

With single-trip policies, a strong book of business can change fairly quickly to a loss making book if it is not monitored.

Travel insurance generally requires only a few questions to obtain a quote. The scope for new rating factors is huge. Insurer A implemented a new rating factor that differentiated pricing based on the lead time until travel, reflecting the increased chance that individual circumstances can change the further into the future a trip is booked. Insurer B noticed a change in the mix of policies sold with more longer lead time policies compared to shorter lead time policies. Their hypothesis was that buyer behaviour had changed. Claims costs were increasing and this was initially assumed to be a claim management problem. The reality was that it was a selection issue. Insurer B with its flat pricing was cheaper on long lead time policies and relatively more expensive on shorter lead time policies. A recalibration of the pricing led to not only improved profitability but increased revenue growth leading to an increase in profitability of around $12m p.a.

ABOUT PFS

PFS Consulting is an actuarial and risk consultancy. It provides insight, foresight and oversight and always seeks to leave its clients better placed after engagement than they were before. One of the keys to PFS's success is that its approach embodies some of the core actuarial perspectives and attributes outlined above.

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