Association of British Insurers

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INSURANCE AND AGE-BASED DIFFERENTIATION

THE IMPACT OF POTENTIAL AGE DISCRIMINATION LEGISLATION ON THE MOTOR AND TRAVEL INSURANCE MARKETS

Report from CRA International
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EXECUTIVE SUMMARY

Key findings

- More than 99% of customers aged 65 and over are able to obtain motor insurance and more than 98% of customers aged 65 and over are able to obtain travel insurance.
- The evidence for any form of age-related intervention on the grounds of market failure is weak.
- In the motor insurance market, upper age limits have been increasing over time, but concerns about adverse selection means that some insurance companies are unwilling to unilaterally remove them.
- In the travel insurance market, informational problems mean that some older consumers are required to take time searching for a provider who will offer them a quote.
- A range of policy options have been considered (removal of age limits, narrowing of age bands, signposting and referrals). The net benefits of these policies vary but are small in all cases.

CRA International (CRA) was asked by the Association of British Insurers (ABI) to conduct research into the impact of potential age discrimination legislation on insurance markets. The debate on age discrimination legislation and its application to financial services has been going for some time. An expert working group including insurance industry and age lobby representatives was formed by the Government in April 2008 to review commercial practices in the financial services industry that relate to the age of the customer, and to consider the implications, costs and benefits of legislation making age discrimination unlawful in certain circumstances. This report seeks to build on the conclusions of that working group, which identified key areas for further discussion, including age-based pricing; the use of age bands; and the use of maximum and minimum age limits.

Policies under consideration

We have considered four policy options:

- Removal of age limits: we have examined the removal of all age limits and the removal of only upper age limits;
- Narrowing of age bands: in particular, the requirement to base pricing on integer ages rather than age bands. In practice, age bands are rarely used in the motor insurance market so this is only relevant for the travel market;
- Signposting: a requirement that insurance companies who are unwilling to provide a quote to an individual because of their age must provide details of a "signpost" which would give contact details of insurance companies who would be willing to offer insurance to people of that age;

- Referral: a requirement that insurance companies who are unwilling to provide a quote to an individual because of their age must find a partner who would be willing to offer insurance to people of that age and then refer the customer on.

An important issue that could affect each of these policy options is the extent to which the terms that consumers are offered must be "objectively justified" and how this would be defined and upheld. Although there is general agreement that it is reasonable for the price of insurance to change with age to the degree that this reflects risk, there is uncertainty regarding how pricing could be justified when insurance companies have little or no experience or data for customers of this type.

Approach

The policy options were developed jointly by CRA and the ABI and were informed by discussions with other interested parties including HM Treasury, the Government Equalities Office, Age Concern, and Help the Aged. We have undertaken 24 interviews with insurers regarding the use of age-related pricing in the market today, collected public data on how the market works and on recent changes in the market, and undertaken a consumer survey of 600 older insurance customers to understand the buying process and impact of different policy alternatives. We have also collected compliance cost data through a compliance questionnaire sent to 32 different companies.

Our approach has been to use a conventional market impact assessment in line with the Financial Services Authority's economic-based approach to cost benefit analysis. This focuses on identifying the extent of any market failure and whether policy options result in net benefits after taking into account the costs of the policy.

We focus on the motor and travel markets and do not consider the potential unintended consequences of the policy options on other insurance markets. We have not been able to fully examine the potential impact of the policy options on all types of distributors.

Motor insurance

Overall, only a very small number of older customers have difficulty getting access to motor insurance: less than one-percent. In our customer survey of 300 customers over the age of 65, not one had failed to get motor insurance and only three respondents (all aged 75 and over) had been turned down for a quote at all during their search. Furthermore, customers in our survey did not think it difficult to find a company that would provide cover for them.

Removal of age limits

Nearly all insurers do not apply an upper age limit for existing customers. For new customers, insurers commonly have age limits in the 80s. There are also a number of providers who do not have any upper age limit for new customers. Furthermore, over recent years insurance companies have significantly increased their age limits so any difficulties which older customers face are being reduced by market trends.

Minimum age limits are less common, although age restrictions for certain vehicles are prevalent across the whole market.

There are a number of reasons why insurers do not serve all ages. These include:

- Concerns regarding adverse selection if an individual firm removes its maximum age limit and others do not;
- The preference for the current approach of gradually increasing limits so that data on new customers can be captured rather than using sudden jumps;
- The reputational consequences of high, albeit risk-reflective, prices for older customers, particularly where existing older customers are cross-subsidised by other drivers; and
- A reluctance to take on more than a certain level of risk which is particularly associated with the youngest drivers who are 10 times more risky than 35 year-olds. In addition, their level of risk changes rapidly at young ages which brings additional uncertainty for insurers.

Removing all age limits would cause particular difficulties associated with serving younger customers. It is likely that insurers would redesign their existing products to avoid the risks associated with serving the youngest drivers, with the result that the quality of the products offered to other age groups may fall.

Firms focusing on serving older customers could see their brand diluted by serving younger customers and barriers to new entrants seeking to target older customers could be created. Such firms would be required to invest in systems and underwriting processes to be able to offer insurance quotes to a large group of younger people whose risk is substantially different from their current or targeted customers.

Removing maximum age limits (but not minimum) would avoid the problems associated with insuring the younger ages, and could bring the benefit of increased competition for older drivers.

The compliance costs associated with objective justification are not large – often this reflects the need to employ an additional actuary. However, if, because of a lack of actuarially robust data relating to new customers, insurers were required to set prices at the same level as existing customers based on existing data (which experience indicates is not representative of new customers), the potential costs for the insurance industry could be very significant.

Signposting

If signposting is to be effective, it would require a phone or postal-based system as older customers strongly prefer this to websites and most do not currently use comparison websites. It could reduce barriers to entry for providers seeking to serve older customers, but its success depends on older customers searching on the basis of this information. Evidence from our survey suggests consumers would use the information to conduct large numbers of searches but this is likely to be an overestimate since in practice they conduct relatively few searches today.

Referrals

Customers prefer the idea of signposting to referrals, but realistically a referral system may lead to a higher likelihood of gaining quotes. Indeed, there is experience in the market of referrals working effectively, and where these do not have age limits in place they should be seen as acceptable under the scenario where maximum age limits are removed since this is a market-based solution to widening age limits. However, for the market as a whole the need for all companies to use referrals has the highest compliance costs of the policies examined.

Table 1 sets out the net benefits for each of the different policy scenarios under consideration. It should be noted that while the benefits will accrue to older customers, it is unclear whether the costs will ultimately be incurred by older customers or spread across a larger number of customers of all ages.

Table 1 Total net annual benefits by scenario: motor insurance

	No maximum limits	No age limits	No age limits and objective justification	Signposting	Referral
Quantity	£3.3m	£3.3m	£3.3m	£2.0m	£2.4m
Quality	+	--	--	++	+
Variety	+	--	--	++	++
Efficiency	£3.0m	£3.0m	£3.0m	£1.8m	£2.4m
Total quantified benefits	£6.4m	£6.4m	£6.4m	£3.8m	£4.5m
Total quantified costs	£1.1m	£2.2m	£2.4m	£3.5m	£4.4m
Net quantified benefits	**£5.3m**	**£4.2m**	**£4.0m**	**£0.3m**	**£0.1m**
Net quantified benefits per policy	**21p**	**16p**	**16p**	**1p**	**0p**

Source: CRA calculations. -- negative; - slightly negative; + slightly positive; ++ positive.

It is clear from Table 1 that the net benefits in all scenarios are extremely small. Even where the largest net benefit arises, annual benefits represent only £5.3 million – around 0.06% of the value of gross written premiums in this market. The trivial nature of the net benefits reflects the evidence that there is no significant market failure.

Travel insurance

More than 98% of older customers are able to access travel insurance. However, a significant proportion (25%) is turned down by at least one insurer. Hence information problems where customers do not know who would be willing to offer them a quote lead to unproductive search costs.

Removal of age limits

The typical insurer provides single-trip cover up to around age 85. In addition, specialists and some of the mass-market insurers provide single-trip insurance with unlimited ages. For annual insurance, the typical insurer provides cover up to around age 73. Again, specialists offer annual insurance policies without age limits. There is little evidence that these limits are being increased; some firms have reduced age limits in recent years for certain schemes.

There are a variety of reasons why some insurers may be unwilling to provide travel insurance to older customers, including:

- The increased level of risk and uncertainty posed by these customers;
- The reputational damage from high, yet risk-reflective pricing;
- The increased sales costs from pricing quotes which are not converted into sales;
- The lack of expertise in meeting the specific requirements of older customers; and,
- The lack of expertise in dealing with medical risk.

Removing age limits would remove concerns about access to insurance, although insurers would incur costs in adjusting their actuarial models and IT systems, and changing sales processes.

The removal of age limits may also lead to a reduction in the quality of insurance cover as more restrictions are applied in order to limit the risk exposure for insurance companies. In addition, it raises barriers to entry to firms wishing to serve the older age group alone since they would also have to serve younger customers.

Removing age limits may not significantly increase access to insurance for older people as those customers currently turned away on the basis of age may be declined on the basis of health – 80-90% of older customers fail initial medical screening questions.

As with motor insurance, under certain definitions of objective justification, insurers are concerned that they may incur losses by having to serve customers based on existing data which they know to be unrepresentative of new customers.

Removal of age bands

In the travel market, insurers commonly use wide age bands. Typical age bands are 0-17, 18-59/64, and then five year age bands until any upper age limit is reached. Explanations for the use of a large age band which covers the great majority of the market include:

- The limited change in risk for a large section of the population. Since risk is very similar it is appropriate that price would be similar; and
- A simple rate structure is important for distribution, particularly in retail outlets such as travel agents.

There do not appear to be any large economic benefits from the forced removal of age bands although this could reduce some cross-subsidies within bands and improve economic efficiency. However, more complex selling processes and systems changes will mean higher prices for everyone. It will also result in smaller jumps in price although the economic benefits of this are unclear. In addition, costs will be imposed on retail outlets including travel agents who currently use age bands in their systems.

Signposting

There does appear to be an informational problem which may be leading older customers to undertake unproductive search activities because they are not aware of which firms would be willing to offer insurance to customers of particular ages. Setting up a signpost would enable customers to quickly identify a list of companies who would be willing to serve them and avoid this unproductive search activity.

Signposting would therefore bring benefits in terms of assisting customers in obtaining a quote and reducing the amount of unproductive search that arises when consumers are unable to obtain quotes.

Referrals

The use of referral arrangements would be expected to increase the number of times customers successfully receive a quote when they contact any given provider. As such, shopping-around would involve searching between different quotes rather than searching for a quote and this could lead to increased competition and better outcomes for customers.

Table 2 gives the net benefits we estimate for each of the policy scenarios under consideration. As with motor insurance, it should be noted that while the benefits will accrue to older customers, it is unclear whether the costs will ultimately be incurred by older customers or spread across a larger number of customers of all ages.

Table 2 Total net annual benefits by scenario: travel insurance

	No maximum limits	No age limits	No age limits and integer age bands	No age limits and objective justification	Signposting	Referral
Quantity	£4.8m	£4.8m	£4.8m	£4.8m	£3.0m	£4.0m
Quality	--	--	--	--	++	+
Variety	-	--	---	---	+	+
Efficiency	£9.4m	£9.4m	£9.4m	£9.4m	£5.9m	£7.7m
Total quantified benefits	£14.2m	£14.2m	£14.2m	£14.2m	£8.9m	£11.6m
Total quantified costs	£10.8m	£10.8m	£10.9m	£11.1m	£2.9m	£3.0m
Net quantified benefits	**£3.4m**	**£3.4m**	**£3.3m**	**£3.1m**	**£6.0m**	**£8.7m**
Net quantified benefits per policy	**£0.16**	**£0.16**	**£0.16**	**£0.15**	**£0.29**	**£0.41**

Source: CRA calculations. -- negative; - slightly negative; + slightly positive; ++ positive.

It is clear from Table 2 that the net benefits in all scenarios are extremely small. The largest net benefit arises in the scenario where signposting or referrals are applied where at most £8.7 million net quantified benefits arise each year, although even this represents only 1.3% of the value of gross written premiums in this market. The trivial nature of the net benefits implies that there is no significant market failure.

Conclusion

We do not find significant market failures in the provision of insurance to the motor or the travel market. Consequently, we find the net benefits of the policy options to be small in both markets. Given the limited evidence regarding significant market failures, a proportionate policy response must avoid the potential for unintended consequences and take into account the differences between insurance markets.

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INTRODUCTION

CRA International (CRA) was asked by the Association of British Insurers (ABI) to conduct research into the impact of potential age discrimination legislation on insurance markets. As part of the Government's proposed Equality Bill, various policy options are being considered to respond to problems cited in this market. The ABI is interested in:

- Understanding the use of age related practices in insurance;
- Considering whether there is evidence of any market failures associated to these age related practices; and
- Assessing different policy options designed to address concerns identified.

Background

The debate on age discrimination legislation and its application to financial services has been going for some time. An expert working group including insurance industry and age lobby representatives was formed by the Government in April 2008 to review commercial practices in the financial services industry that relate to the age of the customer, and to consider the implications, costs and benefits of legislation making age discrimination unlawful in certain circumstances. The findings of this group were published in October 2008. [1]

The report set out broad product categories, the size of the market for each category, and set out tentative estimates of the benefits and costs of three options:

- doing nothing;
- introducing a system to signpost customers to firms who can meet their needs; or
- making unjustified age discrimination unlawful, given certain assumptions.

Our report seeks to build on the expert report which set out key areas for further discussion including examining: age based pricing; the use of age bands; and the use of minimum and maximum age limits.

We also draw on some of the analysis that fed into this process including research by Age Concern and Help the Aged which set out areas where they had concerns including: [2]

- Access to insurance beyond a certain age. For example they found that 29% of quotation attempts by those aged 75 and over were unsuccessful compared with 3% by those aged 30-49;
- Perceptions regarding poor value products increasing with age. For motor insurance this appears to be limited to a small sample of consumers aged over 80. For travel

[1] Age discrimination in financial services: final report of the Experts' Working Group, HM Treasury, October 2008.

[2] Insurance and Age: Exploring behaviour, attitudes and discrimination. A summary report from Age Concern and Help the Aged, March 2007.

insurance, those aged 65-74 appear to view policy value similarly to younger adults although those aged 75 and over were twice as likely to consider their policy poor value compared with those aged 30-49; and

- The impact of specific age thresholds. For example, some providers offer travel insurance with very wide age bands at younger ages such as covering customers aged 19-59 or 19-64 within the same band, and then often using five-year bands beyond those ages. They expressed concern that this led to jumps in pricing as consumers move into the next band.

There is also a concern regarding banking products where travel insurance is bundled with current accounts and the travel insurance is not always accessible to older consumers. In addition to concerns being expressed regarding older people, it is also clear that for motor insurance, the premiums offered can be high for younger drivers reflecting the higher level of claims among very young drivers.

The current proposals in the Equality Bill do not question the use of age to price insurance to the extent that it reflects the differences in risk. Indeed, to the extent that age increases risk there is little disagreement that this should be reflected in the price of the product. Age sector organisations have made clear that they are not seeking mathematical proportionality of risk and premiums, but rather that differences in premium are shown to be a proportionate response to increased risks as evidenced by data.

However, there remain significant questions regarding current market practices in using age, whether differences in risk explain the current difference in pricing, the way that pricing is currently applied, the existence or size of any market failure and how different policy proposals might work in practice.

Approach

In order to investigate these issues we have undertaken the following tasks:

- Discussion on the policy alternatives. These were developed jointly by CRA and the ABI but were informed by discussions with other interested parties such as HM Treasury, the Government Equalities Office, Age Concern and Help the Aged.

- Interviews with industry participants regarding the use of age-related pricing in the market today. We have interviewed insurance providers in motor and travel markets, specialist insurers focusing on older age groups, brokers and distributors of insurance and service providers to insurers. [3] In all we have undertaken 24 interviews.

- Collected data on the changes in the market. We have assessed industry data on how these markets are evolving, the fragmentation of the industry and whether there is evidence of entry and exit or changing distribution channels. This has included

[3] We have not been able to interview travel agents or retailers such as supermarkets.

collecting information from a wider group of insurers about the use of age limits and age bands today and how this has changed.

- A consumer survey to understand the buying process and the impact of different policy alternatives. A telephone based survey of 300 travel and 300 motor insurance customers over the age of 65 has been undertaken.[4] This focused on their experience of purchasing insurance, any difficulties they have faced and how they would react to different policy options.
- A compliance survey focusing on the different policy options. In order to understand the cost of changing systems, sales process and documentation we have undertaken a survey of insurers. This was sent out to 32 different companies, with separate surveys sent on motor and travel insurance to each of these companies. [5]

Assessment criteria

The approach and conclusions need to take into account the objective of age discrimination legislation. It is clear that age discrimination legislation seeks to prohibit rules or practices that unjustly penalise people on the basis of their age.

The approach taken in this report has been to use a conventional market impact assessment in line with the FSA's economic-based approach to cost benefit analysis. This focuses on identifying the extent of any market failure that explains why there are access issues for older consumers and whether the policy options considered result in net benefits after taking into account the costs of the policy.[6] As such it identified whether any policy proposal is "proportionate" given the market failures.

However, it is possible that age discrimination legislation may seek to go further than this. In particular, such legislation may seek to prohibit rules or practices that differentiate between people on the basis of age (without regard to the associated costs or benefits). Thus age discrimination legislation may represent a "standard" that Government or society believes should not be breached.

It is clear that the objectives of age discrimination legislation and proportionality may therefore conflict. For example, it is possible that the policy that addresses any market failure and best meets the "proportionality" test does not mean that all insurers offer cover to all consumers irrespective of age. Yet this outcome might be considered to break the "standard" of age discrimination legislation. This research does not opine on the

[4] The field work was conducted by Continental Research and took place in November and December 2008. The sample was constructed so that there were 100 consumers aged 65-69, 100 aged 70-74 and 100 aged 75 and over for each product.

[5] As such it should be noted that our compliance survey is more extensive than the figures relied on in the report by HMT. The figures estimated from our survey are considerably lower than those estimated by HMT reflecting information being gathered from a wider group, whereas those providing information to HMT appear to have been likely to incur more costs than most respondents to our survey.

[6] It should be noted that this does not represent a full cost-benefit analysis as we do not estimate the direct costs (the costs to the relevant regulators) associated with the introduction of the different policy options.

appropriate trade off between these objectives. Instead it focuses on the purely economic issues regarding the appropriate proportionate response to any market failures. Therefore this represents a contribution to the policy debate based on the economics of the issue.

Structure of the report

The rest of the report is structured as follows.

In the next chapter, we summarise the policy debate and the different policy options considered in this report.

In the following chapter, we consider how the motor insurance market works today, the way that age is used to determine pricing and access to insurance and why some parts of the market are not served by all insurers; we then consider the different policy alternatives.

In the final chapter, we consider how the travel insurance market works today, the way that age is used to determine pricing and access to insurance and why some parts of the market are not served by all insurers or face banded pricing; we then consider the different policy alternatives.

POLICY OPTIONS

There are a number of different policy options which have been proposed in order to address the concerns expressed regarding age discrimination in the provision of insurance. In this chapter we set out the particular scenarios that we have investigated. These build on the policy options investigated by the Expert committee summarised in the previous chapter.[7]

In order to undertake a more formal market impact assessment and narrow down the range of potential costs and benefits it is necessary to be as specific as possible. To the extent possible we have provided details on different possible policy options that we have considered and which have been tested in this research. In a number of cases, there are a range of ways that policies could be implemented and we have tested a number of permutations. These were developed jointly by CRA and the ABI but were informed by discussions with other interested parties.

Each of these is compared to a counterfactual case that assumes no change in policy – effectively a do nothing scenario.[8] The policy options are set out to test the practical implications of the policy proposal rather than the precise form of words used in the Equality Bill. So for example, we consider a policy that would result in the removal of age limits. An area that seems particularly contentious is the interpretation of "objective justification". To test this, we have discussed with insurers how they would interpret objective justification and collected compliance data with, and without, this condition.

Finally, these policy options may involve legislative approaches (making price differentials that cannot be objectively justified unlawful) or, alternatively, some approaches are more likely to involve voluntary action by the industry rather than being done through legislation (such as the use of signposting or referrals).

Removal of age limits

Concerns have been expressed that older customers find it difficult to obtain insurance because insurance companies or distributors have age limits in place where they refuse to serve customers outside a certain range.

Therefore, the first policy option under consideration is that insurance companies and distributors are required to remove any age limits which they have in place whereby they refuse to offer cover for individuals who are either above or below a particular age. It should be noted that age discrimination legislation will apply only to adults i.e. those who are 18 and older and so we do not consider any policy relating to the provision of insurance for those aged below 18.

[7] Age discrimination in financial services: final report of the Experts' Working Group, HM Treasury, October 2008.

[8] We understand that this would be achieved by giving an exemption for financial services from the Equality Bill.

This would not only apply to maximum or minimum age limits but would also apply to any products where there are differences in cover by age. For example, companies would be unable to impose a different amount of excess for customers of different ages, exclude the youngest drivers from driving the most powerful cars, and they would be unable to have Permanent and Total Disablement limited to those who are under a particular age.

It would, however, be possible to refuse to cover people for reasons that are not covered by discrimination legislation, as is the case today, such as:

- Medical conditions;
- Claims history; and
- Destination of holidays.

It is assumed that for travel insurance the removal of age limits would apply to both single-trip and annual travel insurance policies.

Removal of maximum age limits

We have also considered an alternative policy where insurance companies and distributors are required to remove maximum age limits but would not be required to remove minimum age limits. The reason for including this option is that concerns have been expressed regarding serving customers of older ages but none have been identified regarding serving younger customers. The debate, to date, has largely focused on the problems faced by older customers and this option therefore seems consistent with the concerns in the market. As will be discussed in the next chapter, from an economic perspective the issues related to younger and older drivers also differ significantly.

This would mean that companies would no longer be allowed to refuse to offer insurance to older customers, although they would be able to refuse to offer insurance to younger customers.

As with the removal of all age limits, this would imply that there could be no differences in cover for older ages, but that companies could refuse to cover people on other grounds. It is also assumed that for travel insurance this would apply to both single-trip and annual travel insurance policies.

Objective justification

Where insurers offer insurance to older drivers there is a concern that it would not reflect the associated risk and hence insurers should be required to objectively justify the terms they offer. However, there is considerable variation in how objective justification may be interpreted. In particular, based on the interviews undertaken this could take a number of forms:

(a) A purely actuarial approach based on the information that is available to insurers about existing customers;

(b) Allowance for the uncertainty that exists where there is little data or expertise – as is the case when insurers raise limits voluntarily; or

(c) Allowance for the competitive position that an insurer wishes to take. [9]

Depending on the wording of the Equality Bill and the interpretation of insurers the different approaches could affect pricing and costs associated with collecting information to prevent legal or regulatory challenge.

In order to examine the impact of this we asked insurers about the implications of different interpretations of objective justification both for their pricing and for any compliance costs. The compliance costs captured in our survey effectively assume that both (b) and (c) would be allowed. Thus firms would be able to adjust prices to reflect the uncertainty of their data and would be able to take other competitive decisions relating to pricing for different risks.

We do not believe that (a) is a sustainable position. As the Actuarial Profession points out, actuarial techniques used in general insurance are statistical in nature and require a large volume of data to make statistically robust analysis. It would be difficult for insurers to estimate the effect of age on claims experience over and above other rating factors where firms do not have sufficient data to derive credible estimates due to their small size or because of specialisation in niche markets. Therefore, the Actuarial Profession raises concerns on whether objective justification of price using actuarial data from existing customers is workable. [10] A scenario based on requiring insurers to use existing data (which they know is not representative of new customers) under these different policy scenarios would not use the evidence drawn from past experience of raising age limits and would clearly be economically inefficient.

Narrowing age bands

The third scenario is that companies are required to objectively justify any differential in price by age and cannot use age bands as they have done in the past.

There has been some concern that the use of age bands for travel insurance leads to large jumps in prices as customers move from one band to the next and that the jump in price does not reflect a jump in the riskiness of insuring someone as they change from one age to the next.

9 It is also possible that objective justification could be designed in a similar manner to that applied for gender discrimination where the ABI collects data from insurers and presents aggregate information regarding the average cost of claims for women compared with men.

10 Actuarial Profession, The Equality Bill – Age Discrimination in General Insurance Commentary from the Actuarial Profession, August 2008.

In particular, we test the scenario in which insurance companies are required to use integer ages.[11] Due to the lack of age banding for motor insurance, this scenario is only considered for travel insurance.

Signposting

As noted in the introduction, one of the concerns expressed is that older customers find it difficult to obtain insurance because insurance companies or distributors have age limits in place.

An alternative to requiring companies to offer quotes to all customers is that if insurance companies are unwilling to provide a quote to an individual because of age, the insurance company would be required to provide details of a "signpost" which would give contact details of insurance companies who *would* be willing to offer insurance for people of that age. An alternative scenario would be a website that presents quotes for older customers in the same way as a comparison website, however insufficient data was provided on this possibility. We have examined how the information is presented to the customer, for example, whether it is on a website or over the phone.

If firms have a referral process in place to which customers are transferred when the original firm is unwilling to offer a quote, it is assumed that the requirement to provide details of the signpost would apply at the end of the referral process if a quote was not provided because of age.

We have further assumed that such a signpost would only be used for older customers and not for younger customers. For travel insurance it is assumed that this requirement would apply to both single-trip and annual travel insurance policies.

Referral

The final scenario also seeks to address the concern arising because insurance companies have age limits in place. In this scenario, if insurance companies are unwilling to provide a quote to an individual because of age, they would be required to find a partner who *would* be willing to offer insurance to people of that age and then refer the customer on. Again it is assumed that such a requirement would only be used for older customers and not for younger customers. However, for travel insurance it is assumed that this would apply for single-trip insurance only and that there would not be a requirement to have a referral in place for annual travel insurance since there are few insurers currently willing to offer annual travel insurance without an upper age limit.

[11] It is possible that insurers could charge the same price for everyone in an age band but we assume objective justification will require differential rates by age. It is still possible that prices would be flat if the assessment of risk meant that this is the same for all customers.

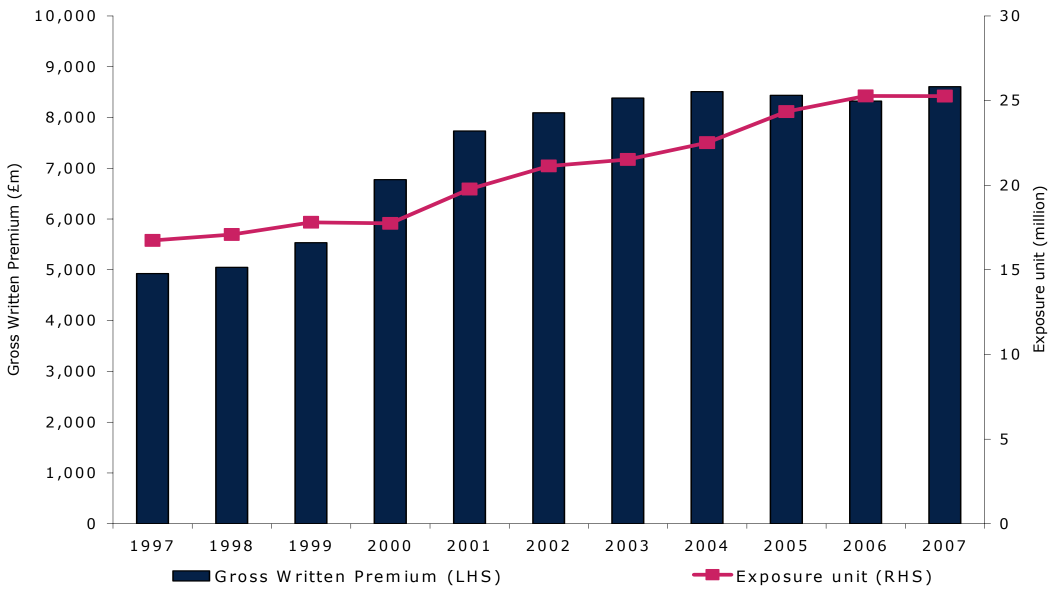
MOTOR INSURANCE

Competition in the market for motor insurance

Motor insurance market size and competitiveness

Motor insurance is the single biggest insurance product in the UK general insurance market representing around 22% of all business written.[12] Figure 1 shows that the private motor insurance market has been growing in terms of Gross Written Premium (GWP) from around £5 billion in 1997 to about £8.6 billion in 2007. In terms of the number of vehicles insured, this has increased from 16.3 million in 1997 to 25.3 million in 2007.

Figure 1 UK motor insurance market size – Gross Written Premium and Exposure unit 1997 - 2007



Source: ABI (2008), Exposure and total Claims for all vehicles, and personal lines breakdown.

In the last five years, GWP has been fairly flat even though exposure units (number of vehicle years insured) have increased, leading to a decline in premium per vehicle insured. In addition, the average value of claims has been increasing steadily over the last few years. In particular, the average cost of an injury claim was 37% higher in 2007 than in 2002 and average claims for theft have increased by around 70%.[13] This partly reflects trends such as the increased use of portable in-car satellite navigation devices. Combined, this information suggests that there has been increasing pressure on profit margins consistent with the widely accepted claim that the UK motor insurance market is highly competitive.

[12] ABI, Rankings by Class based on UK Gross Written Premiums in 2007.

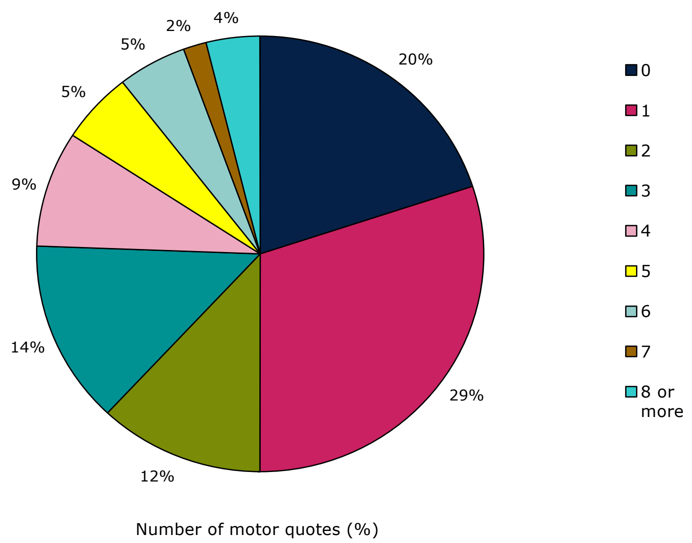
[13] ABI Motor market 2007, Data Bulletin August 2008.

Turning to the structure of the market, there are around 60 ABI members serving the motor insurance market, suggesting relatively low barriers to entry. The market is not especially concentrated as the largest five companies had around 60% of the market in 2007. This was a slight decline from 2006 which is again consistent with increased competition.

Previous examinations of insurance markets have also concluded that the characteristics of motor insurance, that it is a relatively simple product for customers to understand and purchased regularly with reasonably high switching rates, support the conclusion of a competitive market. [14]

Our consumer survey conducted in December 2008 found that among 300 respondents, 80% of older consumers contacted more than one insurer to get quotes for their motor insurance policy.

Figure 2 Other than the company you bought through, how many insurance companies in total did you contact yourself to get quotes for your renewal/new policy?



Source: CRA survey of 300 older consumers who have taken out or attempted to take out motor insurance.

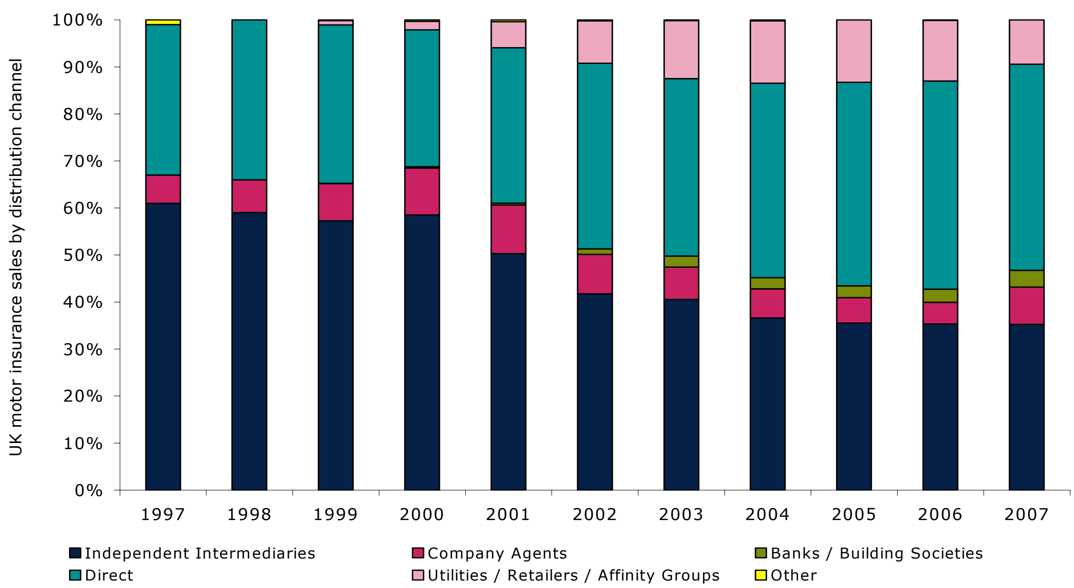
On average, respondents to the survey contacted 2.7 other providers in addition to the provider that they bought through i.e. they contact a total of 3.7 providers. Since most customers receive a quote from the first provider that they contact, this indicates that searching takes place in order to compare between quotes rather than in order to obtain any quote.

[14] See for example: "An assessment of the extent of an identified need for simplified, standard financial services products" for the European Commission, CRA International, December 2004.

Distribution channel and market differentiation

The distribution of UK motor insurance has experienced significant changes in the past decade. A clear trend is the shrinkage of the independent intermediary channel. At the same time, direct sales have become more and more prevalent. This reflects the increasing number of consumers using the telephone and internet to search for and purchase their insurance direct from insurers. The increased role of affinity groups since 2000 is also clear from Figure 3 although this channel has declined slightly in the last two years.

Figure 3 Distribution channels for UK motor insurance



Source: ABI (2008), General insurance business split by distribution channels – personal lines breakdown

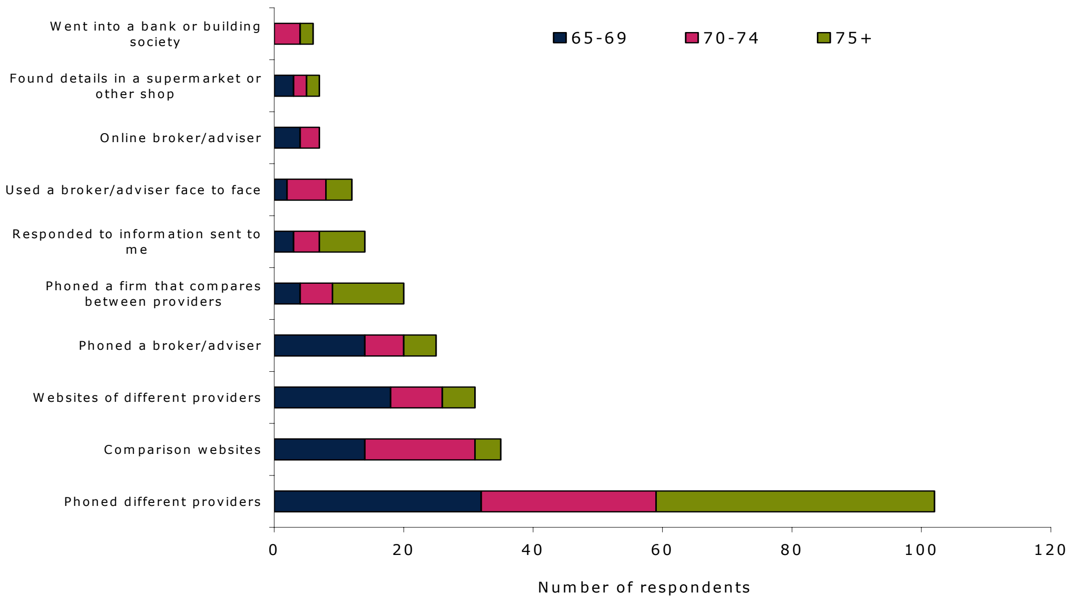
As well as mainstream insurers targeting the mass market, there are various specialists covering different niches. For instance:

- Sheilas' Wheels targets female motorists; and
- Insurers such as Saga target the older end of the market. In addition, distributors such as Rias, Age Concern and Help the Aged are active in this market.

Purchasing behaviour

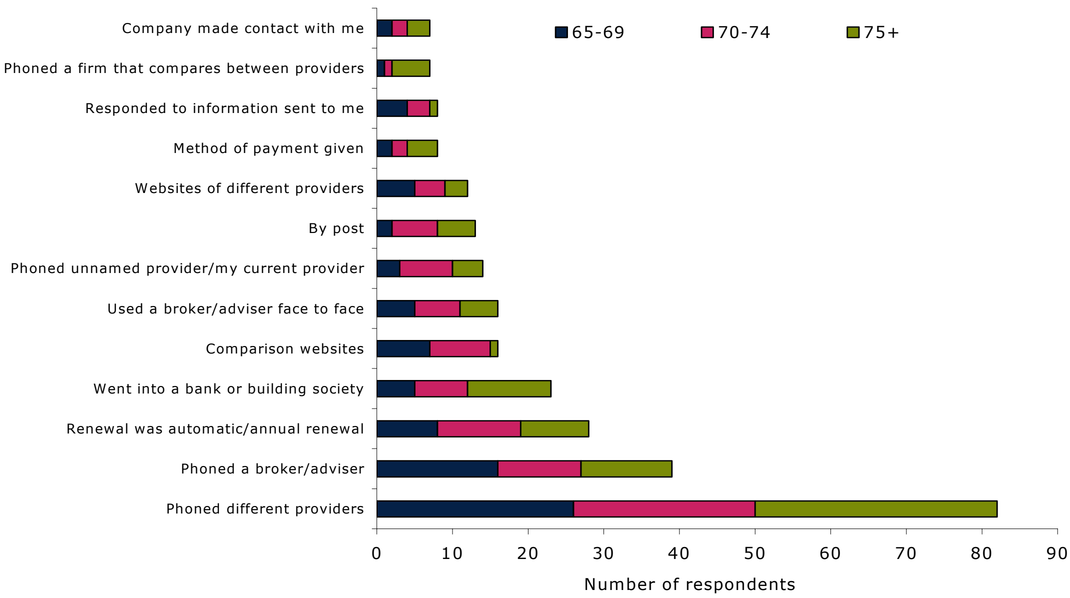
Our survey finds that the vast majority of older consumers use the phone to both shop-around and purchase their motor insurance across all three age groups i.e. 65 – 69, 70 – 74, and 75+. When consumers shop-around, they tend to use both the phone and internet, which are used in the top five choices stated in our survey. When they actually purchased the insurance, telephone becomes the single most important channel.

Figure 4 Which of the following methods did you use to search for different motor insurance quotes?



Source: CRA survey of 300 older consumers who have taken out or attempted to take out motor insurance. This is based on a sample size of 234 consumers who have obtained more than one insurance quote.

Figure 5 Which method did you actually use to purchase your motor insurance?



Source: CRA survey of 300 older consumers who have taken out or attempted to take out motor insurance.

These results are broadly consistent with the findings of Age Concern and Help the Aged that respondents are more likely to use the internet to get information about products than to purchase through this channel, and that older people prefer to use the telephone when it comes to actually purchasing motor insurance. [15]

The use of age in underwriting process and age limits

There are a large number of different rating factors used in setting the price for motor insurance. Some of these include factors to do with the vehicle (its make and level of security, value, engine size), where the vehicle is kept (on the road, off road, in a garage), and factors to do with the customer (years of driving experience, claims history, age).

Age is an important indicator of risk that is used in the pricing of motor insurance. The use of age in the assessment of risk allows insurers to make more accurate decisions about pricing and cover. This has been recognised by HM Treasury since age can materially influence both the likelihood of policyholders making a claim and the size of such claims when they occur.[16]

All insurers use age in assessing risk in the motor insurance market and all insurers use integer ages (as a minimum, indeed more disaggregation is possible). The impact of age is especially important at both younger and older ages. In general, risk declines rapidly from 17 to 21 and continues to decline through to the late 50s or early 60s before starting to increase again.

Young drivers are higher risk than other drivers and are around four times more likely to be killed or seriously injured than those in their 60s.[17] It is common practice for insurers to put age restrictions on covering young drivers for certain types of car. In particular, insurance companies will commonly have age limits at 25 or 30 for high performance cars. Thus many providers (although not all as described below) will offer insurance to 17 and 18 year olds with a small engine size car but may refuse to do so for a high performance car. Some insurance companies will also apply different accident and conviction terms to young drivers e.g. they would be willing to offer insurance to 30 year olds with three points on their licence but not to 18 year olds.

In addition, the change in risk is fastest at the youngest ages as young drivers begin to gain experience of driving over time. Indeed a small number of insurance companies have indicated that they use age information on a monthly or half-yearly basis rather than simply relying on the integer age for writing risks in this part of the age spectrum – further evidence of a very rapidly changing level of risk for these drivers.

Other policy conditions where there are differences in age include:

- The level of excess may be higher for young drivers (usually below the age of 25);

15 Age Concern and Help the Aged, Insurance and Age – Exploring behaviour, attitudes and discrimination, March 2007.

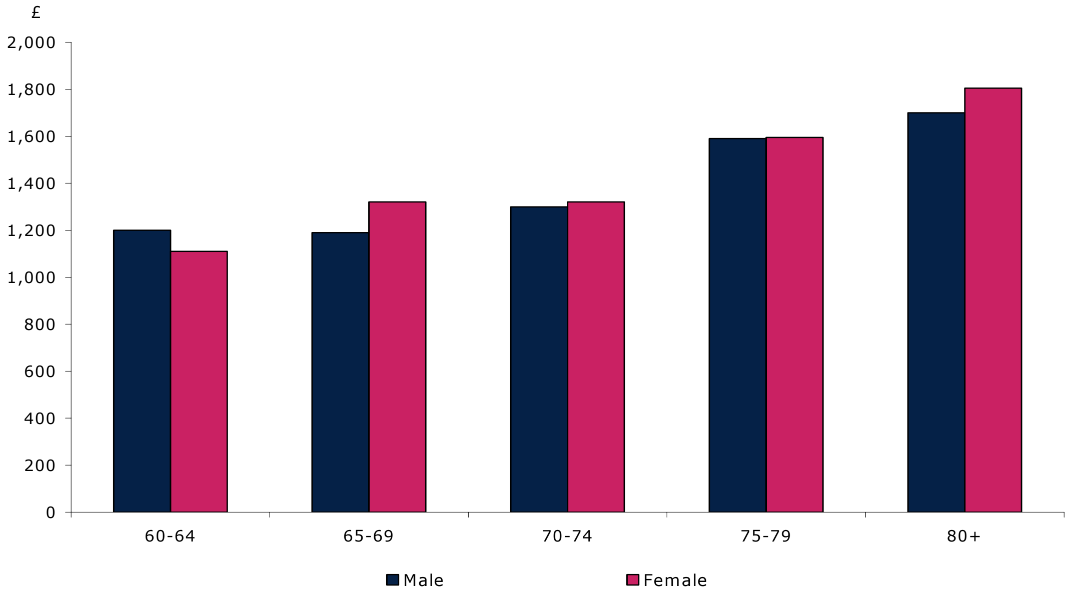
16 Age discrimination in financial services: final report of the Experts' Working Group. October 2008.

17 ABI, Older drivers and the insurance market, May 2006.

- Some firms will not provide cover for driving other cars (DOC) for young drivers. The age limits that apply vary from 21 to 30 with most insurance companies applying limits at 25. This requirement is in place because of concerns about the young driving unspecified vehicles and fraud from providing this cover to younger drivers;[18] and
- Benefits relating to permanent total disablement and personal accident typically end at 65 or 70 although some insurers have no age limit; and
- At the older end of the spectrum, risk begins to increase again in the 60s although the change in risk for older customers is not as rapid as the sharp decline in risk for younger customers. Drivers who are 70 or over are twice as likely to be killed or seriously injured compared to those in their 60s and the casualty rates per mile are around 3 times greater.

In addition, as seen in Figure 6, the average value of an individual claim increases with age so average claims made by the over 80s are 50% greater than claims for those aged 60-64.[19]

Figure 6 Average value of an individual claim



Source: ABI member survey (2004).

Some insurance companies will have both minimum and maximum age limits in place. Minimum age limits are less common although age restrictions for certain vehicles are prevalent across the whole market.

[18] Fraud is thought to be more prevalent among young drivers because of the higher cost of insuring certain vehicles for younger drivers and thus the gains from fraudulent behaviour are greater for younger than for older drivers.

[19] ABI, Older drivers and the insurance market, May 2006.

Nearly all insurers do not apply an upper age limit for existing customers.[20] However, for new customers, insurers commonly have age limits in the 80s. In addition, there are a large number of providers or distributors who do not have any upper age limit for new customers including: Age Concern, Intune, Saga and Sabre.

Table 3 Use of age limits

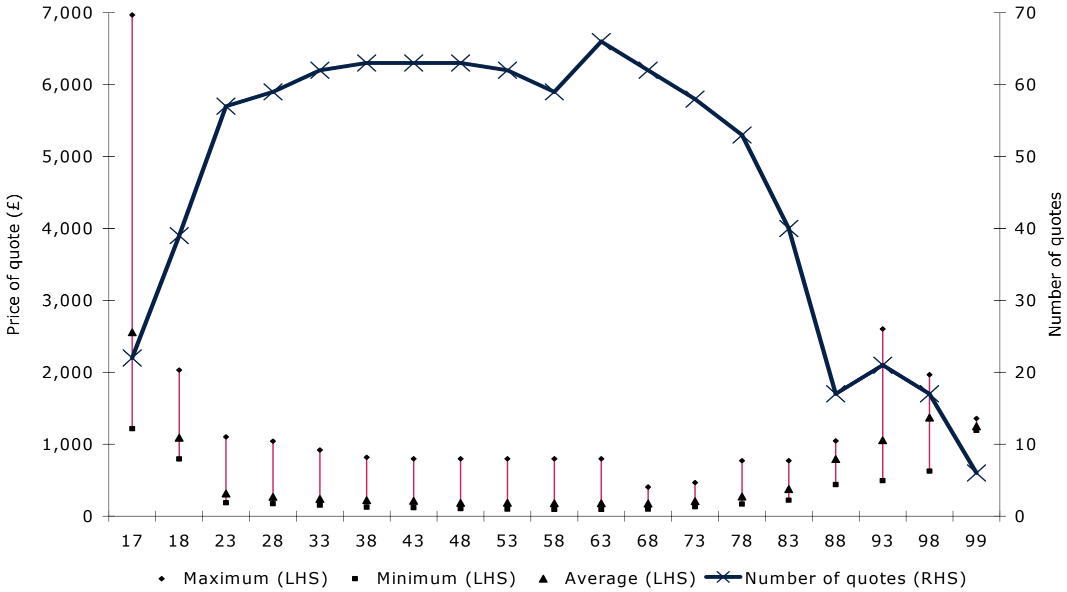
	2008
Average minimum age limit	Only one insurer responding to our survey (with a market share of less than 5%) applied a minimum age limit above the legal minimum age.
Market share of insurers with minimum age and car type restrictions	All insurers who responded (market share of around 70%) stated that they applied minimum age restrictions for different car types
Average maximum age limit for new customers	83 (among those who apply a limit which is over 90% of the market)

Source: CRA survey

We have also gathered information on the quotes available for drivers of different ages. It should be noted that this is based on information taken from a single comparison website and as such will not cover all of the available offers in the market since some insurance companies do not distribute through comparison websites or do not distribute all of their products through such a website. This shows that the price of motor insurance does depend on age. It also demonstrates that there are a smaller number of providers who are willing to offer quotes for both young and old drivers.

20 During the course of our work only one insurer indicated that they applied an upper age limit for existing customers and this insurer underwrites less than 2% of the market. A small number of insurers indicated that their systems have limits of 99 in them because their systems contain two digit fields. These insurers indicated that they would renew policies of someone who turned 100 but as far as they were aware they had never had such a customer.

Figure 7 Number of quotes and prices for different ages



Source: CRA analysis based on data from a leading comparison website. The quotes are based on applications for comprehensive motor insurance cover for a Ford Focus car registered in 2006 with a voluntary excess of £500 for a driver who holds a full UK driving licence and has no claims or convictions. All information was kept constant other than age.

Figure 7 shows that the average prices charged are higher for young drivers than for all other drivers; this reflects the pattern of claims which arise. There is variation in prices across all ages. There is no suggestion that this variation of prices is an indication of any market failure for those customers who are middle aged and for whom there are a very large number of companies willing to provide insurance. Instead this variation is likely to reflect different companies seeking to focus their efforts on attracting customers from some parts of the market and not in other parts, with other companies focusing on different areas of the market at any given point in time. We find that the variation in prices is slightly lower for both older and younger ages than for those of middle age.[21]

It is also clear that there are fewer providers willing to offer quotes through a comparison website at both younger and older ages. The number of quotes declines substantially in the 80s although even in the early 90s around 20 quotes are available.

Some providers who are unwilling to serve older customers themselves have found an alternative market based solution to serving these customers through putting referral arrangements in place. They have generally done this because they wish to ensure that as wide a group of customers as possible receive a quote when they call.

These arrangements typically work such that if customers are ineligible for a quote with the insurer, customers would be referred to either a broker with a panel of insurers or to one particular insurer. This arrangement is usually available irrespective of channel such

[21] This is based on three different measures of variation of the price: maximum price/minimum price; maximum price/average price; and (maximum price minus minimum price)/average price. In all cases these ratios are higher for ages 23-63 than they are for ages 17, 18 and above 68.

as the telephone and the internet. The insurance product may be sold under a different brand or under the same insurer's brand. If the customer who is referred purchases the insurance, the original insurer receives a commission for introducing the customer. The partner in the referral arrangement faces the regulatory compliance responsibilities, and customers are only referred if they agree to this where it is made clear that they are being referred to a different provider or broker as appropriate.

The extent of any market failure

Access to motor insurance

As noted above, there are few insurers who impose absolute limits on young drivers suggesting that most young drivers should be able to identify insurance companies who would be willing to provide insurance for them. Although we have not focused on gathering evidence regarding search behaviour for young drivers, insurance companies have indicated that these drivers are highly likely to search using the internet and comparison websites and that they would have no difficulty in locating insurance companies who would be willing to offer them insurance which include some of the largest companies with well known brands. Furthermore, during the debate on age discrimination no evidence has been provided that there is a problem for young drivers in finding insurance. [22]

However, there are restrictions for young drivers for specific high performance car groups. Indeed, it is common for there to be restrictions on younger drivers depending on the size of the engine of the car they wish to insure. Younger drivers are seen as higher risk due to the greater probability of a claim but also the potential size of the claim since they are more likely to have passengers who are typically young and therefore personal injury claims may be significant for young drivers.

At older ages, all insurance companies will offer renewal terms to their existing customers irrespective of age. Hence unless individuals start driving in their 80s (DVLA figures suggest no provisional licences were issued to individuals beyond the age of 72[23]) or return to driving after a period of not having a car, it appears as though there would be no difficulty for older consumers to obtain motor insurance from their existing insurer. Furthermore, most insurance companies have indicated that they would continue to do this even if the customer makes a claim, although if there are a very large number of claims (interviewees suggested four or more) then insurance companies may refuse to offer renewal terms.

This is also supported by evidence from Saga which found that only 3% of respondents who are over 65 have ever been refused insurance because of age, while no respondents aged between 50 and 64 had been refused insurance because of age.

[22] It was noted that this may be because there is no group specifically representing the interests of young drivers.

[23] Driving Licence Holders by Age & Gender, DVLA.

Table 4 Have you ever been refused motor insurance because of your age?

	50-54	55-59	60-64	65+
No	100%	100%	100%	97%
Yes	0%	0%	0%	3%

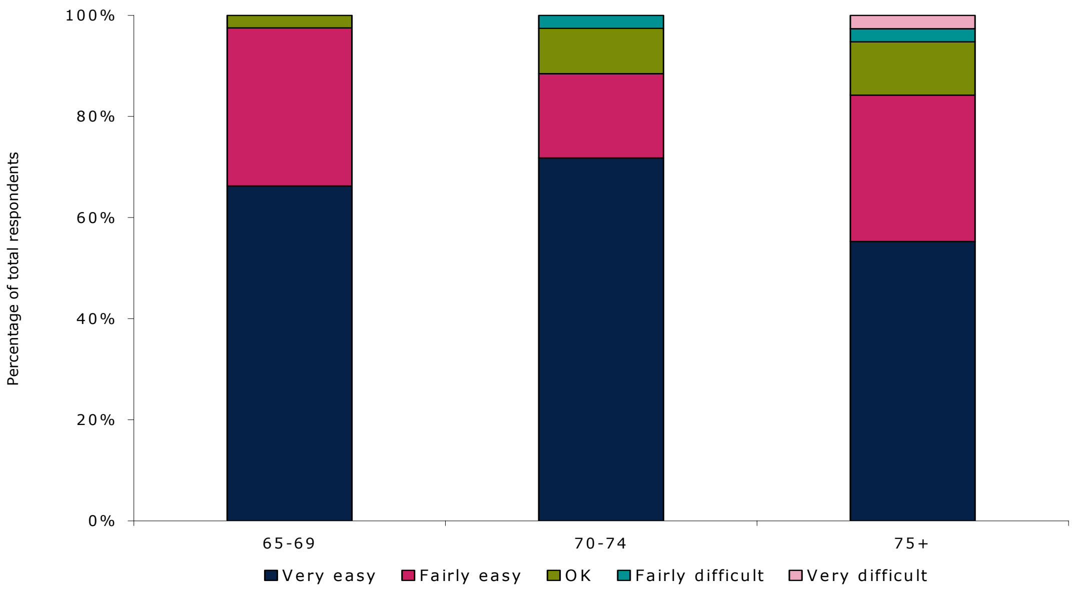
Source: SAGA Populus survey based on sample of 10,613 respondents aged over 50.

Among those who were refused insurance, 93% were able to find another insurer who would provide a quote with only 7% unable to do so.[24] In total therefore, less than 1% (3%*7%) of customers over the age of 65 were unable to obtain motor insurance. It is likely that these customers will be among the older set of customers rather than those in their late 60s.

Our survey is consistent with the result that there is only a very small proportion of customers who are unable to obtain insurance. Not one of the 300 respondents over 65 failed to get motor insurance; and only 3 respondents (all aged 75 or over) had been turned down for a quote at all during their search.

Furthermore, customers in our survey did not think it difficult to find a company that would provide cover for them.

Figure 8 How easy or difficult was it to find a company that would provide cover?



Source: CRA survey of 300 older consumers who have taken out or attempted to take out motor insurance. This is based on a sample size of 234 consumers who have obtained more than one insurance quote.

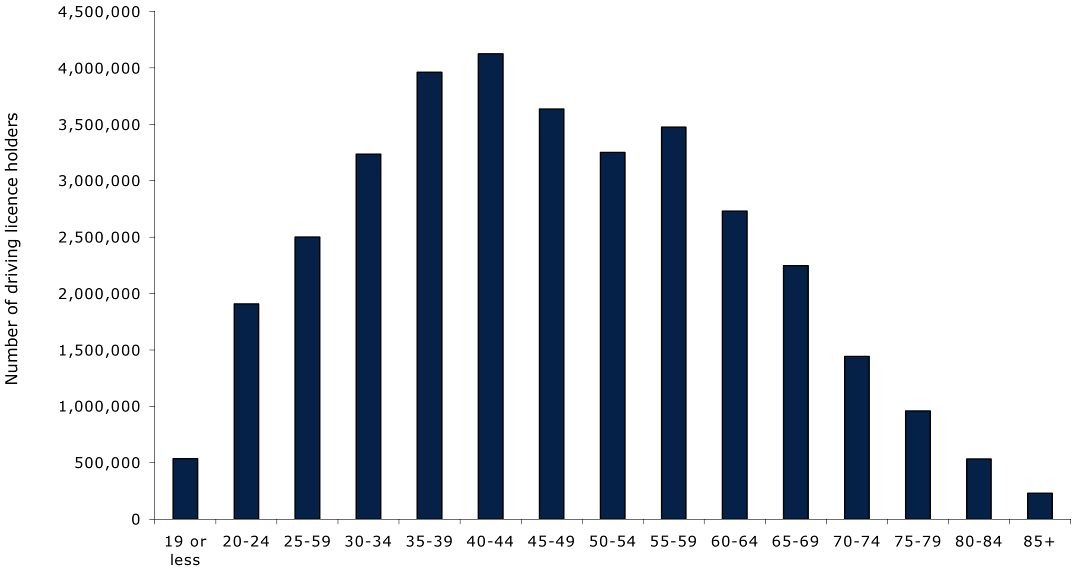
24 It should be noted that the 7% figure is an average for both motor insurance and travel insurance. Given that a much larger proportion of over 65s have difficulty in finding travel insurance it is likely that the 7% estimate is too high for motor insurance and too low for travel insurance.

Only 6% of respondents aged 75 and over thought that the process of finding a company that would provide cover was difficult. In terms of a description of the sales process, only 9% of respondents aged 75 and over found the search process "troublesome" as opposed to "agreeable" (74%) or "neutral" (24%).[25]

This result is as expected given the evidence that insurers are all wiling to offer renewal quotes to existing customers and they typically have very high age limits in place for new customers.

It is also clear that there are relatively few customers seeking insurance at older ages. Figure 9 shows the number of people in different age bands who hold a driving licence.

Figure 9 Number of driving licence holders by age



Source: DVLA and CRA calculations.

The age profile of driving licence holders partly reflects the overall structure of the population especially at the older end of the spectrum. Indeed, the baby boom generation can be seen in the increase in the 55-59 age group with licences. However, Figure 9 also serves to demonstrate that the number of people over the age of 83 (the average age limit for new customers) who have driving licences is a very small fraction of the population – around 1.2% of all licence holders.

Overall therefore, with insurers wiling to offer renewal quotes to existing customers, relatively high age limits in place for new customers and a very small number of licence holders over the age of 85, there is no evidence of a significant market failure in providing motor insurance for older customers.

25 Customers in the survey were asked, "How would you describe your experience of the searching process? Was it…agreeable, neutral or troublesome?"

However, a small proportion of older customers (3%) have stated that they have been turned down for motor insurance because of age. This may indicate that there is some unproductive search being undertaken.

A further concern regarding older customers is that customers may only be able to obtain insurance from their existing insurer (although as we have shown this is most likely to be for the highest age groups as there are quite high age limits). In practice, only 6% of respondents to our survey aged 75 or over indicated that it was difficult to find a company that would provide cover.[26] However, if customers can only obtain cover from their existing insurer, the insurer may be able to raise prices above the competitive level since the customer has no alternative but to take out the insurance from their existing provider (or not take it out at all).

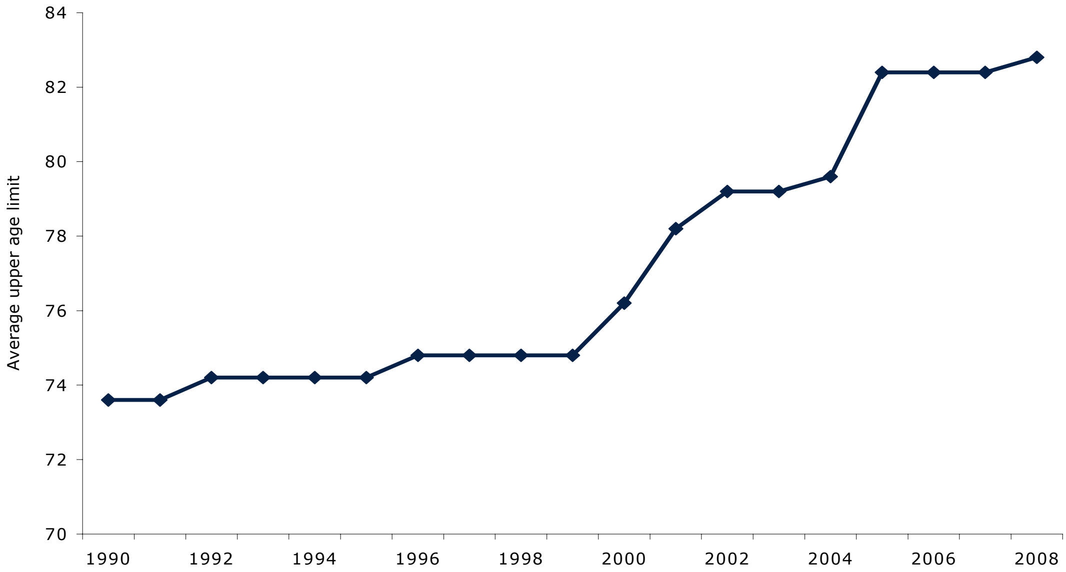
In practice, however, a number of insurance companies offer prices to these customers at levels which are *below* the risk-reflective price, although others price at the risk-reflective price without cross-subsidies. CRA has been shown confidential data from one of the top five motor insurance companies which demonstrates the presence of cross-subsidies for customers in their 80s and older. Insurance companies which cross-subsidise older customers state that they do so for loyalty reasons and, given the maximum age limits in place, these cross-subsidies are primarily limited to existing customers.

Is this likely to change in the future?

Over the past few years, the size of the older driver market has been increasing, reflecting increased life expectancy. In response to this increased market opportunity, insurers have been increasing their upper age limits on accepting new customers. Indeed, as is clear from Figure 10, since 1999 the average maximum age limit has increased by approximately one year every year.

[26] These were all customers who obtained more than one quote and therefore this relates to the search process generally and not only to the availability of a renewal quote.

Figure 10 Average upper age limits for new customers (1990 – 2008)



Source: CRA compliance survey 2008 and ABI, Older drivers and the insurance market, May 2006. Note that 2007 data has been assumed to be the same as 2006.

It is clear therefore that insurers have been reacting to the increased demand to continue driving into older ages by continually increasing their age limits. Indeed many insurance companies have explained that they review their age limits and have gradually increased them over time. They are able to use both their experience of customers who are at, or just below, existing age limits, as well as the experience of existing customers for whom they offer renewal terms, to assess the likely risk of new customers when they increase age limits. In general, however, firms have sought to do this by moving in five-year increases so that they are able to gradually assess the increased risk of new customers and gain confidence in their pricing for those five years before increasing the age limit again later.

There is therefore clear evidence that insurers are increasing their age limits. In as far as there is any market failure regarding access to motor insurance at older ages, market trends will continue to limit or reduce this market failure over time.

Why insurers do not provide access to all ages

We also consider why insurers are not willing to offer motor insurance to customers of all ages or to cover all age and car type combinations. It should be noted that the reasons that insurers do not serve all ages differ between young and old drivers.

For younger drivers, insurance companies provide the following arguments why they are unwilling to serve them (or serve them for particular car types):

- Young drivers are very high risk – there is clear evidence from an overall market perspective that young drivers are much riskier than other drivers and some firms appear to take the view that they do not want to take on more than a certain level of risk and so do not offer insurance to these customers.

- Young drivers have risk which changes rapidly – the riskiness of young drivers changes rapidly at very young ages (17-22) which gives considerable uncertainty to firms. Some firms have indicated that they have attempted to offer insurance to these customers but because they were unable to price sufficiently accurately they made significant losses and so withdrew from focusing on this part of the market.

In order to overcome some of the riskiness associated to young drivers, some insurance companies have developed telematics based products aimed at this part of the market so that pricing can be more finely adjusted to the driving habits of the particular drivers. These products tend to charge more for driving at night, and hence provide incentives for avoiding driving at this time which is when most accidents involving young drivers occur.

For older drivers, however, firms have not suggested that their unwillingness to offer motor insurance to new customers beyond a certain age is because of the high absolute level of risk of these customers. Instead the following arguments have been made:

- Uncertainty from sudden jumps in limits. A number of insurance companies have noted that they have been increasing their age limits, but they have not been willing to remove these limits because to do so would lead to a large increase in the age range which they would be serving and, because of not serving these customers in the past, they would be uncertain about the behaviour of these customers. A gradual increase in limits, by contrast, enables them to do this in a more controlled manner.
- Adverse selection. Many insurance companies are concerned that if they remove their maximum age limits and other firms do not, then they would attract a large share of older customers and the risks of new customers, about whom they have less information, will be different to those of existing customers. Firms noted that this concern is reduced if all insurers remove maximum age limits.
- Cross-subsidies. Those insurance companies who currently cross-subsidise older customers are reluctant to attract new customers at older ages because then they would increase the total cross-subsidy or they would need to change their pricing approach to existing older customers. The removal of such a cross-subsidy would make prices more risk-reflective, although firms currently provide this subsidy because of concerns that the risk-reflective price might be perceived as too high and therefore damage their reputation – in this case such pricing might continue.

As well as these concerns, some insurers have noted that there would be systems costs associated with any changes and hence this may not be worthwhile from a commercial perspective.

Summary on market failure

There is little evidence of a significant market failure in the motor insurance market, however, it is possible that there is a small co-ordination problem meaning that the oldest customer groups will only be served gradually over time.

Policy options

In this section we consider the likely market impacts of the various different policy options. We seek to determine whether the different policy options would result in economic benefits that exceed the costs. This requires comparing the market outcomes following each of the policy options with what would happen in the absence of these scenarios. In line with the FSA's approach to cost benefit analysis we examine the impact of each of the policy options on:

- The quantity of insurance and associated products purchased;
- Quality of insurance provision;
- The variety of insurance propositions and products on the market;
- The efficiency of competition; and
- Compliance costs.

We consider four policy options: the removal of all age limits including those applying to older and younger drivers; removal of age limits applying to older drivers, the use of sign-posting; and requiring referrals. We do not consider narrowing age bands as, based on the interviews undertaken for this project, the use of age bands in motor insurance is exceedingly rare.[27]

Information on compliance costs is based on a survey which was sent to 33 insurers. Eleven responses were received with detailed cost information. These companies represent approximately 72% of the motor insurance market.

Removal of age limits

As described above, age limits are commonly applied in the motor insurance market for new customers, although the exact age varies from company to company and all will accept renewals for existing customers of any age. There is a group of customers who have been unable to obtain motor insurance, although this group is very small and estimated at less than 1% of drivers over 65. Over time insurers have been raising their maximum age limits and this is expected to carry on in the future.

Quantity

In order to understand the potential impact on quantity we need to consider how insurers will react to being obliged to offer insurance irrespective of the age of the customer.

Insurers would obviously need to react to the removal of age limits by reviewing their pricing policies. As age limits have been increasing over the last 15 years, insurers have experience of doing this at older ages. This has conventionally involved a small increase,

[27] We understand that age bands are still used in a small number of cases. For example, there are motor dealerships that offer motor insurance on the basis of age bands. Often the insurance will be offered for free, so although banding is used to determine the commercial relationship between car companies and the insurer this does not directly affect the consumer. In addition, the size of the market where this applies is small. Therefore we do not investigate this in any detail.

by say five years, and they have priced this by extrapolating data from existing customers. Over time the insurer has generated sufficient data on the age of new customers such that this could be priced as for other ages. The uncertainty from removing limits completely is much reduced now compared to the past simply because insurers have increased their existing age limits over time and therefore the number of customers who are above their current maximums is very small. As such there is little difference between making further gradual changes and removing limits altogether.

Nonetheless, in this case for many companies coverage would be extended by more than five years so a different approach to setting the price may be required. The sample of customers affected is unlikely to ever be large. Indeed given there are only around 30,000 people over the age of 90 who have driving licences, even if a company had a 10% share of the market they would only have a few hundred observations for each integer age. While this makes it difficult to estimate the appropriate price accurately, the downside risk of getting the price wrong is also limited by the small number of new customers who would be brought into the market.

One possibility is to use the experience and information which insurers already have from their existing customers who are offered renewal terms. However, insurers have consistently stated that experience has shown that new customers are more risky than existing customers. At present older customers who are seeking to switch insurance providers are more likely to be those whose characteristics mean that they are a worse risk for example because of making a large number of claims. Under this scenario where maximum age limits are removed, the customers who are seeking to switch are more likely simply to be those who are shopping-around rather than those who are more risky. Hence differences between existing customers and new customers at older ages would be likely to reduce.

In addition, the removal of maximum age limits would mean that different insurance companies would be able to use rate monitoring software to see what other people are charging. At present this cannot be used for all ages and all insurance companies since insurance quotes are only offered to existing customers beyond certain ages for many companies.

The impact this has on quantity will depend on the price that insurers ultimately offer. Based on the interviews insurers are following different strategies today:

- Some appear to be cross-subsidising existing older customers as (1) a reward for loyalty and (2) due to a concern that the high risk-reflective price would damage their reputation; and
- Others are pricing all drivers to reflect their assessment of risk.

Given that these insurers are not targeting older segments today it seems unlikely that they will offer new older drivers the cross-subsidised rates. Indeed, some insurers are worried about attracting too many new older customers (in a segment they do not see as economic to serve), so it is likely that new drivers will be offered higher rates than currently available for renewals.

Some insurers have argued that each insurer would endeavour to avoid being at the lower end of the pricing spectrum as this would attract a larger number of older customers that they perceive as risky. In theory this could therefore become a game of overpricing as they chase each other upwards. However, since specialists are likely to be more willing to attract such customers, and given concerns regarding reputation, this is unlikely to be a problem. Furthermore, customers would retain the ability to stay at their existing provider. The impact on prices for these existing customers is unclear, with some insurers likely to raise their price as cross subsidies for older customers are removed and prices more accurately reflect risk. Other firms would continue to offer bonuses and rewards for loyalty to their existing drivers as they do today. Those firms who already set prices at risk-reflective levels are expected to continue to do so.

Although insurers will not be able to refuse to quote for a customer because of their age, and will not be able to offer different products to customers of different ages, they will be able to tailor the distribution of products in different ways. Indeed, the appropriate distribution channel is likely to be different for older customers:

- Insurers prefer to serve these customers over the phone. They are able to ask more questions regarding medical situations that are more important for this demographic; and
- Older customers prefer to deal with insurance companies over the phone compared to searching or purchasing through the internet.

Unlike with travel insurance, distribution through supermarkets or other retailers does not cause a problem, since only information is provided in-store, but the product is sold over the phone or through the internet. This is because there are a large number of rating factors which are taken into account when selling motor insurance and hence the simple approach that is used in travel insurance cannot be used in-store for motor insurance. Insurance companies could choose to offer different prices over the phone and over the internet to reflect the difference in the cost of these distribution channels.

The main concern regarding this scenario is not older drivers (where most believe that the market is evolving to serve the majority of these customers anyway) but younger drivers. As seen above insurers commonly have age limits that affect drivers below 25 or 30. This can take a number of forms:

- They may simply choose not to serve some young drivers – only one provider in our survey has done this although others have changed their pricing strategy so that they are less likely to attract young drivers because of making losses on this business in the past;
- They commonly put limits on the cars that young drivers can insure; and
- The policies may be different in terms of the excess and ability to insure drivers on other cars.

As described above, the main reason for this is the much higher risks of these drivers (with young drivers being ten times more risky than 35 year olds in terms of claims costs), that the risk changes quickly – with some insurers pricing in terms of months since the driver gained their licence - and insurance companies have no data on past driving as a basis to assess the risk. There is also a concern regarding road safety as the youngest drivers are the most dangerous. Insurers argue that to remove minimum age limits for certain car types would go against the road safety aim that the Government has. They therefore note that in the absence of alternative Government intervention through preventing young drivers from driving certain car types, there would be an expectation of increased young driver deaths and injuries.

Whereas most insurers would serve older customers, and a coordinated approach would make this considerably easier, they were very concerned about serving younger customers.[28] It therefore seems possible that insurers would consider changing their product or market position to prevent attracting these customers. As described above, it is common for insurers in all markets to determine the types of risk that they wish to cover. Although it may be possible to price for the risk associated to more risk segments many large insurers have chosen to exit high risk segments that produce volatile returns as high individual risks are combined with relatively small samples and large potential claims. It is therefore credible that insurers would try to avoid these segments for commercial reasons.

However, it is reasonable to expect that the impact of this policy would be to result in an increase in the size of the motor market, but this will be small due to the very small number of older customers being provided with insurance that they were not previously able to find.

Quality

The quality of insurance provision depends on terms and the way that claims are dealt with if they arise. Currently products are designed to reflect the needs of different types of consumer but also to address concerns regarding moral hazard. Given the concerns above it seems likely that some insurers will continue to try to avoid younger drivers, particularly for certain car types. It seems likely that this would lead to the following:

- Not offering to cover some car types at all;
- Applying high excesses to all drivers – this would lead excesses to increase for most drivers, but they would be expected to decrease from their currently high levels for young drivers. Since high excesses for young drivers are aimed at keeping premiums down, this would be expected to lead to higher premiums for young drivers; and
- Removing some add-ons such as cover for driving other cars to avoid having to offer this to younger customers.

This will reduce the quality of products to the population at large who were previously able to have these product features.

[28] Based on the policy assumptions, they would not need to change the rules concerning 17 year olds as these would not be affected by the age discrimination legislation, but firms would need to change any limits for those aged 18 and above.

Variety

The motor insurance market is currently served by a mixture of specialists and mainstream insurers who are willing to quote for most types of risk, including all ages and different types of car. Some specialists are conventionally accessed through brokers. It is possible that increasing the age limit will result in consumers choosing to stay with large insurers and lead to specialists losing market share and possibly pulling out of the market. Given the small number of customers who fail to gain a quote from large insurers, purely age related risks must only represent a small part of the specialist motor insurers' business model today and thus this seems a minor concern.

However, there are also specialists in the market that focus on older drivers. For example, some specialists require the main driver to be over 50. This scenario will require such specialists to offer provision to all drivers. This will cause difficulties for them since they do not currently have data to understand risks associated to young drivers. Data which they have regarding young named drivers (such as on a parent's policy) is not a true reflection of risk when young people are the primary driver and thus existing information would not help insurance companies to be able to price risk in this part of the market. Furthermore, for these insurers, the part of the market that they do not currently serve represents a large group of the driving population (i.e. 17-49) with considerable variation in risk and significant differences compared with the part of the market they currently do serve.

If insurers focused on older drivers were obliged to serve younger drivers, they would not be able to price accurately since they do not know the risk. It is likely that this would lead them to follow the market price (probably adding on additional premiums because of both the uncertainty in whether they have set the price correctly and also because their brand focus is not to seek to attract these customers) or use an actuarial consultant who specialises in motor insurance. It would probably take around two years to set up their own database covering the younger customers (even before any requirements regarding objective justification are taken into account - see below) and insurers are concerned that they may lose money during this period. However, as is the case for insurers with upper age limits this largely reflect a transitory cost and specialists would still be able to target customers in line with their brand and marketing as today.

It should be noted that where firms already have referral arrangements in place to offer insurance to older customers through this mechanism, since this represents a market solution to the delivery of insurance for older customers, it has been assumed that these referrals would continue to function as they do today.

Efficiency of competition

In this scenario, it seems likely that insurance will be offered to all older drivers, but that competition would not be based aggressively on price. Indeed, it is likely that insurers will seek to avoid getting too many customers in this category.

Drivers older than the typical maximum age limit currently only have the option of taking out insurance with their existing provider. However, this scenario would enable them to search between different providers. In as far as older customers search the market, this would be expected to bring benefits to competition. There is some evidence that older customers conduct fewer searches than younger customers, with our survey finding that those who are 75 and over contact 2.2 providers as well as the provider that they took their insurance out with in contrast to those aged 65-75 who contact three additional providers. Hence there would be some, but only relatively small, benefits accruing to older aged customers from increased shopping-around. (It should be noted that this level of shopping-around is not due to difficulties in finding an insurer.)

It is also possible that the removal of age limits might result in higher premiums across the board due to a slightly higher number of claims from older customers able to obtain insurance as well as increases in compliance costs. Given that the number of additional older drivers is likely to be small, it is possible that this will be passed on through a higher cost to all drivers.

Firms which currently offer insurance only to older customers would be required to invest in systems and underwriting processes to be able to offer insurance quotes to younger people. It is unlikely that they would be aggressively pricing to younger drivers and so this is likely to lead to higher costs of sales processes which do not lead to sales. Such costs would need to be spread over the base of customers who do purchase insurance from them i.e. older customers – hence it is possible that prices to older customers could increase (although this would only be a relatively modest increase).

Compliance costs

The compliance costs associated with removing the maximum limit are not large. In some cases the maximum limit is hard-coded into systems and costs will be incurred in updating these systems. In many companies offering insurance to those aged over 99 would impose a compliance cost as this would involve a change to systems based on two digits. The way that insurers would deal with this issue varied from insurer to insurer:

- Given the relatively low number of customers involved some said they would use manual processes and this would not involve a significant system change; but
- Others argued that they have a systems-based approach and they would therefore need to do this in an automated fashion. This would therefore involve a bigger systems cost.

Costs will also be incurred because of the need to have a process of deciding the appropriate prices for older customers. Specialist insurers who already serve this market have stated that the cost of such a process is not especially high and would not be significantly different compared to assessing risks elsewhere in the market. Furthermore, firms will be able to monitor the rates which others charge (as commonly occurs today).

Other insurers have indicated that they may need to employ an additional actuary or underwriter to advise on price. However, costs are not high which is consistent with the evidence that insurers have increased their age limits in the past. Furthermore, a number of providers are in the process of improving their software behind the underwriting process in order to widen the characteristics (including age) for which quotes will be available. In some cases it is anticipated that limits could be increased by up to 10 years (although these tend to be providers who have relatively low limits at present).

Table 5 Compliance cost – Removal of age limits

	Scaled up costs (£)	£ per million premium	£ per average policy
Additional one-off costs	£10.6 million	£1,200	£0.42
Additional ongoing costs	£0.1 million	£13	£0.00
Average annual costs	£2.2 million	£260	£0.09

Source: CRA survey. One-off costs have been spread over five years to obtain the average annual costs.

As expected the compliance cost of serving all customers is not especially high with the costs for the whole market estimated as around £2.2 million per year. Changing IT systems make up the overwhelming majority of one-off costs with the cost of moving to three digit ages imposing a significant proportion of these costs. Most importantly, the costs are particularly high for those insurers who do not currently operate in the *younger* age range.

Objective justification

We also requested information on the implications of a requirement to objectively justify prices in combination with the removal of all age limits. Some insurers have indicated that this would impose little additional cost since they currently set risk-reflective prices and, if challenged through the courts, they would simply provide details of their internal pricing approaches.

However, a number of insurers (including many large providers) have indicated that objective justification would impose costs because of the burden of *proving* the prices were objectively justified. Insurers have particularly highlighted the difficulty of objectively justifying prices when they have little data on a group of customers (because they have not served them before) and when the group itself is very small (such as customers over a certain age, or particular age and car type combinations for young drivers).

Firms indicated that they may be forced to use actuaries and underwriters not for the benefit of their pricing, but simply in order to be able to bolster the evidence to demonstrate the objectivity of their pricing. As such this would simply represent a deadweight cost. In practice, the compliance costs involved in objective justification appear to be small indicating that firms are likely to switch actuaries from other activities rather than employ many new ones. There is a slight increase in one-off costs due to changing systems to provide reporting information for the purpose of objective justification.

Table 6 Compliance cost – Objective justification

	Scaled up costs (£)	£ per million premium	£ per average policy
Additional one-off costs	£11.1 million	£1,300	£0.44
Additional ongoing costs	£0.1 million	£14	£0.00
Average annual costs	£2.4 million	£270	£0.09

Source: CRA survey. One-off costs have been spread over five years to obtain the average annual costs.

It should also be noted that in as far as some insurance companies are cross-subsidising older customers at present, insurance companies have indicated that they would be likely to remove these cross-subsidies because of concerns that they would not be objectively justifiable. (However, this does depend on whether rewarding loyalty is seen as an objective justification.) The more significant concern from insurers is in terms of potential losses incurred by having to serve customers, with a requirement that they objectivity justifying the prices based on existing customers. Without sufficient data to allow them to differentiate the risk that new customers represent, this could result in large losses. Some individual firms have estimated that this could be as high as £40 million.

Overall, this scenario would be expected to lead to a small increase in the quantity of insurance sold. However, reductions in the quality of insurance would be expected as policy terms are altered because of concerns about younger drivers for example by having higher excesses and not insuring drivers to drive other cars. There would be a reduction in variety from firms being unable to focus on older customers alone and modest compliance costs incurred.

Removal of maximum age limits

This scenario would remove the age limit for older drivers but allow insurers to continue to be selective regarding younger drivers. Given the analysis for the scenario above this would be superior across most of the dimensions of the market impact assessment:

- Quantity: This would increase provision to older segments where there is a concern regarding access but would not change access for younger drivers (where no concerns have been expressed during the course of the age discrimination debate). Hence there is no difference between this scenario and the previous scenario regarding the quantity of policies sold.
- Quality: Unlike the previous scenario where there was a danger that policy conditions could be removed for the majority of customers in order to prevent them being required for younger customers, existing policy conditions would be expected to remain. Hence most drivers would continue to gain from the ability to access these policy conditions such as insurance for driving other cars.
- Variety: There is a danger that firms which have historically focused on serving older customers would have their brand diluted by being obliged to offer insurance to younger drivers. This danger is removed in this scenario. In addition, barriers to entry for firms which wish to focus on older customers would be lower in this scenario

compared to the previous scenario. Overall, this scenario would therefore be expected to have a wider variety of specialists compared with the previous scenario.

- Efficiency of competition: Firms which currently offer insurance only to older customers would not be required to invest in systems to offer quotes to younger people which they would in the previous scenario. Hence the increase in prices to older customers suffered due to increased quotes without sales would not arise in this scenario.
- Compliance costs: Given that there would be less need to re-design products across the board the compliance cost of this scenario would be smaller compared to the previous scenario.

Table 7 Compliance cost – Removal of maximum age limits

	Scaled up costs (£)	£ per million premium	£ per average policy
Additional one-off costs	£5.3 million	£620	£0.21
Additional ongoing costs	£0.02 million	£3	£0.00
Average annual costs	£1.1 million	£130	£0.04

Source: CRA survey. One-off costs have been spread over five years to obtain the average annual costs.

As expected the compliance cost of serving older customers is not especially high with average costs for the whole market at just over £1 million per year which is just under half the level of compliance costs associated with removing all age limits. The costs apply disproportionately on those insurers with systems-based approaches who would need to alter their systems to take account of moving to ages with three digits. Changing IT systems generally make up the overwhelming majority of one-off costs.

In terms of market impacts, the benefits of this scenario are greater and the costs are smaller in comparison to a scenario where all limits are removed, though overall the net benefits remain low.

Signposting

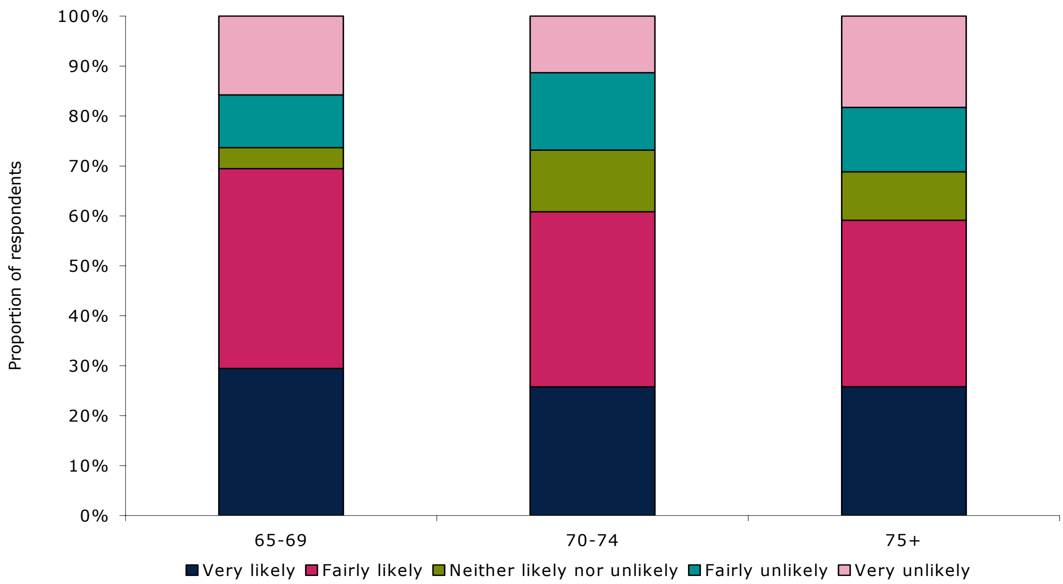
In the signposting scenario, insurers who are unwilling to provide a quote would have to inform customers where they could find insurers who were willing to provide them with a quote. The signpost could take a number of different forms:

- In terms of the information provided through the signpost - which could range from contact details of different providers to information on the prices charged akin to a comparison website or broker; and
- In terms of the delivery mechanism of that information - such as whether information is provided by phone, post or internet channels.

Quantity

Based on the consumer research undertaken for this project, most older customers would be willing to use a signpost as shown in the Figure 11.

Figure 11 How likely would you be to use a signpost?



Source: CRA survey of 300 older consumers who have taken out or attempted to take out motor insurance. Note that the chart does not include those who responded "don't know". This is based on the question, "If the company who wasn't willing to quote provided details of a website or phone number which listed multiple providers who would be willing to give you a quote, how likely would you be to use that information?"

Overall, 60% of customers would be likely to use a signpost although this falls from 66% of customers in their late 60s to 55% of customers who are aged 75 and over. The latter category is the most relevant since it is only customers in this category who face any danger of being turned down for insurance because of their age.

Whether they would use the signpost in practice is partly based on how the signpost delivers information. For example while 41% of drivers in their late 60s would prefer to use a website, this drops to 25% for those aged 75 and over with the remaining 75% preferring to use the phone. To some extent these results reflect a cohort effect since people currently aged 65-69 will have had more internet experience in their lives than those aged 75 and over, hence in ten years time the proportion of the over 75s who might be willing to use an internet based signpost would be expected to be higher. However, it is also possible that there is simply a generational effect where older people prefer to speak to someone on the phone.

It is also notable that 19% of drivers aged 75 and over have ever used a comparison website to compare insurance products in the past. This figure compares to 37% of those aged 65-69. This suggested that providing information on quotes through a website may be less appropriate under this scenario.

If signposting could be organised over the phone, it seems likely that at least some older consumers would find this useful. This appears likely to result in an increase in quantity.

However, since the group of consumers currently not served is very small, this increase in quantity would also be very small.

It is also possible that insurers would re-assess their provision if they would otherwise need to incur the time in directing people to a signpost. Some insurers have suggested that they would consider referring customers to their own broker. The advantage of this over signposting for the insurer is that their broking arm would receive a commission on the sale of a policy and it is also possible that the original insurance arm may receive a fee from their broking arm for the introduction of the customer.

Some commentators have suggested that having a signpost could lead to frustrations for older customers who believe that a firm will offer them insurance but who in practice does not for other reasons. However, unlike in travel insurance where increased medical conditions may mean that there are firms who are willing to serve older customers, but unwilling to serve older customers in poor health, in motor insurance there do not appear to be other factors which are likely to be highly correlated to age which would frustrate the search process. [29]

Quality

As signposting directs consumers to specialists in the market, this could result in better quality products for older customers with little unintended consequences for other segments.

Variety

The variety of competition could increase in this manner since the signpost has the effect of reducing barriers to entry for new entrants who wish to enter the market focused on serving older customers. This is because, even without strong brand recognition, they would have customers directed to a location where the contact details of the new entrant are made available. As such the signpost could encourage more entry into the market.

Efficiency of competition

Signposting appears to reduce the cost of search and increase the potential for shopping-around. By reducing the cost of accessing specialists it also increases specialisation which would be expected to encourage competition. However, there are a number of concerns:

- Competition will only increase from having a signpost if older customers actually use it (around 55% of those aged 75 and over state that they would use the information provided by the signpost) and obtain a quote from the insurance companies on the signpost; and
- Insurers may be reluctant to pass consumers onto competitors with the result that they offer their own product.

[29] It is possible that insurance companies would reject some older customers who have a large number of previous claims or recent convictions. Some insurance companies have indicated that very large numbers of claims for older customers may be indicative of them no longer being safe drivers.

The first of these objections could be significantly mitigated by making the signpost telephone based since older customers have expressed a strong preference for this channel compared to a website. A telephone based channel would probably require only a small number of contact details to be given since customers are unlikely to want to write down a large list of possible firms to contact and a long call would be unattractive for both customers and the provider of the signpost.

Alternatively, information could be sent to consumers by post so that they have a list of insurance companies to contact, rather than expecting them to write down contact details of multiple providers over the telephone. If this is the case it seems likely that this could more easily be done by the original insurance company contacted rather than through requiring a signpost to be set up. This would, however, require coordinated action by the industry to ensure that all companies were sending out the same information which may in practice therefore necessitate some form of signpost organisation to facilitate this. It would also introduce a delay into the process as customers await delivery of the information which may be of concern if customers leave their search process to only a few days before renewal.

The second objection does not seem particularly significant. If insurers are sufficiently reluctant to pass a customer on to a competitor and decide to serve the customer instead then customers will have improved access compared with today. It is unlikely that they would worry about passing them onto a competitor since they are unconcerned about not serving these customers today, although some firms may be concerned about their brand.

Respondents to our survey who state that they would be likely to use information regarding a signposting system state that they will use this information to contact 5.5 providers on average. This compares to current practice where they only contact a total of 3.7 providers. It is well recognised that consumers tend to overstate their shopping-around habits in surveys and thus each of these estimates is likely to be an overestimate of the amount of shopping-around that they would conduct.[30]

Compliance costs

The compliance cost associated to signposting depends on how it works in practice. Table 8 provides details of the estimated costs to insurers of directing older customers to a signpost such as through the provision of a phone number or website address.

Table 8 Compliance cost – Signpost

	Scaled up costs (£)	£ per million premium	£ per average policy
Additional one-off costs	£1.3 million	£150	£0.05
Additional ongoing costs	£330 million	£380	£0.13
Average annual costs	£3.5 million	£410	£0.14

Source: CRA survey. One-off costs have been spread over five years to obtain the average annual costs.

[30] Due to the concern about overestimating shopping-around, we base our benefits calculation on information regarding changes to the amount of time spent searching rather than the estimate of increased search from the survey.

This scenario has higher ongoing costs than the previous scenarios reflecting the fact that increased call times would be required in order to provide information to customers regarding the signpost. If information was sent by post instead of over the phone, the main difference compared with this scenario would be the addition of postal and printing costs although insurers did not estimate these as being substantial.

These costs do not include the cost associated with constructing the signpost itself. It should be noted that practical issues such as who would operate such a signpost, and how it would be funded, as well as how much this would cost, remain unresolved. Thus the costs provided in Table 8 do not represent all of the costs associated with this scenario which may explain the relatively low up front costs. Estimates made by HM Treasury indicate that BIBA operates a helpline to signpost or refer enquiries to BIBA members. While this is not a perfect comparison, the cost of this operation is less than £250,000 per year.[31]

If the signpost provides a comparison of quotes, this would impose more costs on insurance companies which would have to provide IT links to the signpost on an ongoing basis much as they do with other comparison websites. While companies that participate in such websites clearly have technology in place to do this, interviews indicated that adding a further link would be costly and not all companies currently distribute through comparison websites. It has not been possible to estimate this cost from the compliance survey due to a lack of data provided.

Referral

The final scenario would be that insurers would be encouraged to develop referral systems so that where they will not serve particular customers, they put in place arrangements where the customer is referred to someone who *will* serve the customer. As set out above there are already a small number of insurers who have such systems in place (although these do not necessarily cover all ages). The referral is sometimes to a specialist insurer and sometimes to a broker panel.

Quantity

Although consumers in our survey state that they prefer the signpost to a referral, more of them stated that they would use the referral compared with using the signpost. Around 71% of respondents to our survey stated that they would consider purchasing from the company that they were referred to. There was no clear difference by different age groups within our sample.[32]

There are a number of reasons to believe that referrals could be effective in practice:

- Customers appear to be currently satisfied with existing referral systems with the percentage of completions high and firms providing clarity as to the underwriter and

[31] Age discrimination in financial services: final report of the Experts' Working Group, HM Treasury, October 2008.

[32] This is surprising since it is higher than the proportion of customers who would use a signpost despite consumers stating that they prefer a signpost to referral.

the method of making claims. No evidence has been provided that customers are confused by the referral process; and

- Customers commonly overestimate the amount of search that they would conduct in practice. Indeed customers in our survey typically only spent 15 minutes searching the market. Hence a referral system that provides a quote to the customer without an additional need to search the market could be effective. By contrast, the large number of searches that consumers state they will conduct under the signposting scenario may not materialise in reality.

However, even if referrals are attractive from consumers' perspectives they need to work commercially. If they were currently profitable we would expect them to occur today. In practice, there are only a small number of referral systems in place. Furthermore, a number of specialist insurers have stated that they would not want to be the recipient of large numbers of referrals because of an adverse selection problem since they are concerned that the quality of their book of business would deteriorate.

Efficiency of competition

The argument regarding the efficiency of competition mirrors that of quantity. Around 67% of the whole sample state that a referral system would make them more likely to shop-around (although surveys are likely to exaggerate this result in practice). Importantly, very few customers (12% of respondents aged 75 and over, and only 8% for the full sample) state that a referral system would make them less likely to shop-around.

If consumers are unwilling to search in practice, then the referral system may lead to companies competing to be the provider to the insurer.

Compliance costs

To the extent that insurers have referrals in place, the cost of using this is clearly low. However, for those insurers who need to make new commercial arrangements these costs are relatively significant.

Table 9 Compliance cost – Referral

	Scaled up costs (£)	£ per million premium	£ per average policy
Additional one-off costs	£1.6 million	£190	£0.06
Additional ongoing costs	£4.1 million	£470	£0.16
Average annual costs	£4.4 million	£510	£0.17

Source: CRA survey. One-off costs have been spread over five years to obtain the average annual costs.

It is clear from Table 9 that these costs are higher than those associated with signposting. One-off costs are higher than signposting because of the need to arrange for transfer of the customer and as with other scenarios, the bulk of these costs are IT related. The ongoing costs are higher because of the time taken to affect the transfer and the need to explain compliance related information that the individual is being transferred.

However, it should be noted that since insurers could always choose to offer the product themselves if referral became too expensive, under this scenario, we would expect firms would start to offer the product themselves if introducing a referral process would be expensive. In practice this will depend on a trade-off between the costs of setting up a referral process and the expected profitability of writing the business themselves compared with commission received through a referral.

Benefits from policy scenarios

There are a number of different types of benefits which potentially arise from the policy options. In this section we quantify the benefits which arise from the following areas:

- Benefits from customers obtaining insurance who could not previously get insurance;
- Benefits from continuing to drive; and
- Benefits from improved search.

We examine each of these in turn below and then consider which of these benefits would arise, and to what extent, from the different policy options examined. Other benefits also arise which have not been quantified but are based on the discussion in each of the policy scenarios described above.

Benefits from obtaining insurance

There are a small number of consumers who currently do not manage to obtain motor insurance, but who would be able to obtain motor insurance under certain policy scenarios.

Table 10 Benefits from obtaining insurance

Proportion of licence holders aged 65 and over [a]	15.6%
Proportion of respondents aged 65 and over who have ever been refused insurance due to age [b]	3%
Proportion of these respondents who did not subsequently obtain cover [c]	7%
Premiums for older customers compared with average [d]	106%
Gross written premiums for motor insurance [e]	£8,605 million
Value of premiums to those who previously were unable to obtain insurance [f]=[a]*[b]*[c]*[d]*[e]	**£2.99 million**

Source: [a] from DVLA. [b] and [c] from Saga Populus survey. [d] based on quoting information from comparison website and taking a weighted average of quotes by age to obtain both the overall average and the weighted average for those 65 and over, weights are based on DVLA information. [e] from ABI figures.

Benefits from continuing to drive

As well as benefits arising through obtaining insurance, additional benefits could arise because older people can continue driving. In order to assess the value of this, our consumer survey examined how much more older drivers would be hypothetically willing to pay for their motor insurance to ensure that they could continue driving. The benefits are therefore calculated from the same sample of customers who are newly able to obtain insurance.

Table 11 Benefits from continuing to drive

Value of premiums to those previously unable to obtain insurance [f]	£2.99 million
Willingness to pay above existing premium [g]	12%
Benefits from continuing to drive [h]=[f]*[g]	**£0.35 million**

Source: [g] from CRA survey. Respondents were asked to consider the situation where insurance companies would not offer insurance to them and then based on the question "If, when you next need to purchase insurance, there was one insurance company willing to provide a quote, how much more would you be willing to pay to have the insurance in order to continue being offered cover".

Benefits from improved search

At present a number of older drivers conduct search activities but do not receive quotes because they are above the maximum age limits applied by individual insurance companies. One of the impacts from policy intervention could be that customers no longer engage in this unproductive search activity. An alternative is that older drivers may continue to use the same amount of time to search, but they will receive more quotes during this searching time and will therefore be able to choose better value products.

We therefore conduct two alternative calculations to estimate the benefits of these two alternatives. It should be noted, however, that they are mutually exclusive calculations. Customers can either use the time for other activities or continue to search but gain from lower prices but not both. When considering policy interventions, it is appropriate to be conservative regarding the level of benefits which would imply that the lower of these two measures should be used. Unusually, given the circumstances of this case however, we take the higher of these two measures. This is because legislation will be arising regarding issues to do with equality and a key question is whether insurance should have an opt out from it which indicates that we need to be conservative in assumptions leading to an opt out.

Table 12 provides details of the approach where consumers use less time to search.

Table 12 Benefits from improved search – less search time

Number of drivers aged 65 and over [j]	5,415,610
Proportion of respondents aged 65 and over who have ever been refused insurance due to age [b]	3%
Cost of time based on minimum income in receipt of Pension Credit [k] [33]	£3.10
Average amount of time spent before obtaining a quote [m]	5 minutes
Benefits from less search time [n]=[j]*[b]*[k]*[m]/60	**£0.04 million**

Source: [j] from DVLA. [b] from Saga Populus survey. [k] based on information from The Pensions Service on Pension Credit of £124 per week and 40 hour working week. [m] based on CRA consumer survey taking time spent to obtain the first quote for those who do not get a quote from the first provider they contact minus time spent to obtain the first quote for those who do get a quote from the first provider they contact in order to reflect the sales process i.e. it does take some time to obtain a quote.

Table 13 shows the benefits from improved search on the basis that individuals continue to spend the same amount of time searching but have an increased number of quotes from which to choose.

Table 13 Benefits from improved search – increased number of quotes

Number of drivers aged 65 and over [j]	5,415,610
Proportion of respondents aged 65 and over who have ever been refused insurance due to age [b]	3%
Reduced price through additional quotes [p]	£18.77
Benefits from number of increased quotes [q]=[j]*[b]*[p]	**£3.05 million**

Source: [j] from DVLA. [b] from Saga Populus survey. [p] based on CRA consumer survey which assumes an increase from 3.7 quotes to 4.8 quotes on the basis of an average of 1.1 unproductive searches before obtaining a first quote; a maximum price of £406.44 and a minimum price of £99.07 for a 68 year old from comparison website; we then assume that there is a uniform distribution of prices; the price reduction is therefore calculated as the difference in (maximum price minus minimum price)/number of quotes; this is consistent with the approach used in 'Market impacts of regulating general insurance', CRA International for the ABI, March 2006.

Benefits by policy scenario

Table 14 sets out which of these benefits would arise in each of the different policy scenarios under consideration or the degree to which they would arise.

[33] An alternative value of time is available from the Department for Transport, Values of Time and Operating Costs, February 2007. They state that the cost of non-working, non-commuting time is £4.46 in 2002 prices which, when updated according to their growth rates for the value of time, would be £5.11 in 2008 prices. Using this value would increase the benefits calculation to £0.07 million.

Table 14 Total benefits by scenario

		No age limits	No maximum limits	Signposting	Referral
Quantity	Obtaining insurance	100%	100%	60%	71%
	Continuing to drive	100%	100%	60%	71%
Quality		--	+	++	+
Variety		--	+	++	++
Efficiency of competition	Improved search	100%	100%	60%	71%
	Total benefits	**£6.4 million**	**£6.4 million**	**£3.8 million**	**£4.5 million**

Source: Based on the proportion of respondents to survey who would use signposting or referrals. Note that the scenario regarding maximum no age limits applies for objective justification as well.

Conclusion

Overall, only a very small number of older customers in the motor insurance market have difficulty getting access to insurance. Insurance companies commonly have age limits in place but they apply only for new customers and not for existing customers and are set at high levels beyond which there are relatively few customers. We estimate that less than 1% of customers over the age of 65 are unable to obtain motor insurance. Furthermore, over recent years insurance companies have significantly increased their age limits so any difficulties which older customers face are being reduced by market trends.

There is some evidence of a coordination problem regarding widening access to older customer groups - given the small commercial opportunity, the market would only offer to provide this wider access to all customers after a period of time. However, given the number of consumers affected, the evidence for any form of intervention on the grounds of market failure is weak.

Of the policy options considered, removing maximum (but not minimum) limits has the highest net benefits although even in this case they are very low. Co-ordinated action would reduce the concern that insurers have regarding adverse selection which prevents some insurance companies from removing their limits in the absence of action from others. This will provide access for the small number of drivers who cannot get a quote due to age. Drivers older than the typical maximum age limit, who currently only have the option of taking out insurance with their existing provider, will be able to shop-around, and this may bring benefits from increased competition. Finally, compliance costs are estimated at around £1 million per year for the whole market. This is consistent with the evidence that firms have increased their maximum limits in the past.

By contrast, removing all age limits would cause difficulties associated with serving younger customers. It is likely that insurers will re-design their existing products to avoid the risks associated with serving the youngest drivers, with the result that the quality of the products offered to other ages may fall. Firms focusing on serving older customers could see their brand diluted by serving younger customers and barriers to new entrants seeking to serve older customers would be increased. Such firms would be required to invest in systems and underwriting processes to be able to offer insurance quotes to a large group of younger people whose risk is substantially different from their current customers. The cost of changing systems and of sales processes which do not lead to sales are likely to lead to costs which would need to be spread over the base of their existing customers leading to higher prices for older customers at these specialists. This would more than double compliance costs compared to removing maximum age limits, with no corresponding benefits.

The compliance costs associated with objective justification reflect the need to employ an additional actuary. However, if, because of a lack of actuarially robust data, companies were required to set prices for new customers at the same level as existing customers (who are not representative of new customers), the potential costs for the insurance industry would be very significant.

If signposting is to be effective it would require a phone or postal based system as older customers strongly prefer this to websites and most do not currently use comparison websites. It could reduce barriers to entry for providers seeking to serve older customers, but its success depends on older customers searching on the basis of this information. Evidence from our survey suggests consumers would use the information to conduct a large numbers of searches but this is likely to be an over-estimate since in practice they conduct relatively few searches today.

Finally we consider a system based on referrals. Customers prefer the idea of signposting to referrals, but realistically a referral system may lead to a higher likelihood of gaining quotes. Indeed, there is experience in the market of referrals working effectively, and where these do not have age limits in place they should be seen as acceptable under the scenario where maximum age limits are removed since this is a market-based solution to widening age limits. However, for the market as a whole the need for all companies to use referrals has the highest compliance costs of the policies examined.

Table 15 sets out the net benefits for each of the different policy scenarios under consideration. It should be noted that while the benefits will accrue to older customers, it is unclear whether the costs will ultimately be incurred by older customers or spread across a larger number of customers of all ages. A concern expressed by insurers is that, under certain definitions of objective justification, they may incur losses by having to serve customers based on existing data which they know to be unrepresentative of new customers. This is not quantified in Table 15.

Table 15 Total net annual benefits by scenario

	No maximum limits	No age limits	No age limits and objective justification	Signposting	Referral
Quantity	£3.3 million	£3.3 million	£3.3 million	£2 million	£2.4 million
Quality	+	--	+	++	+
Variety	+	--	+	++	++
Efficiency	£3.0 million	£3.0 million	£3.0 million	£1.8 million	£2.2 million
Total quantified benefits	£6.4 million	£6.4 million	£6.4 million	£3.8 million	£4.5 million
Total quantified costs	£1.1 million	£2.2 million	£2.4 million	£3.5 million	£4.4 million
Net quantified benefits	**£5.3 million**	**£4.2 million**	**£4.0 million**	**£0.3 million**	**£0.1 million**
Net quantified benefits per policy	**21p**	**16p**	**16p**	**1p**	**0p**

Source: CRA calculations. -- negative; - slightly negative; + slightly positive; ++ positive. [34]

It is clear from Table 15 that the net benefits in all scenarios are extremely small. Even where the largest net benefit arises, annual benefits represent only £5.3 million – around 0.06% of the value of gross written premiums in this market. Given the uncertainties that attach to cost-benefit analyses and the potential for unforeseen unintended consequences, it is difficult to know whether this small net benefit is significantly different to zero. In addition, the trivial nature of the net benefits reflects the evidence that there is no significant market failure.

[34] An alternative to spreading the one-off costs over five years would be to calculate the net present value of the costs and benefits. Based on using a 10% discount rate we find that the five year NPV calculations are: £21.2 million, £15.6 million, £15.0 million, £1.1 million and £0.34 million in order of the scenarios in the table.

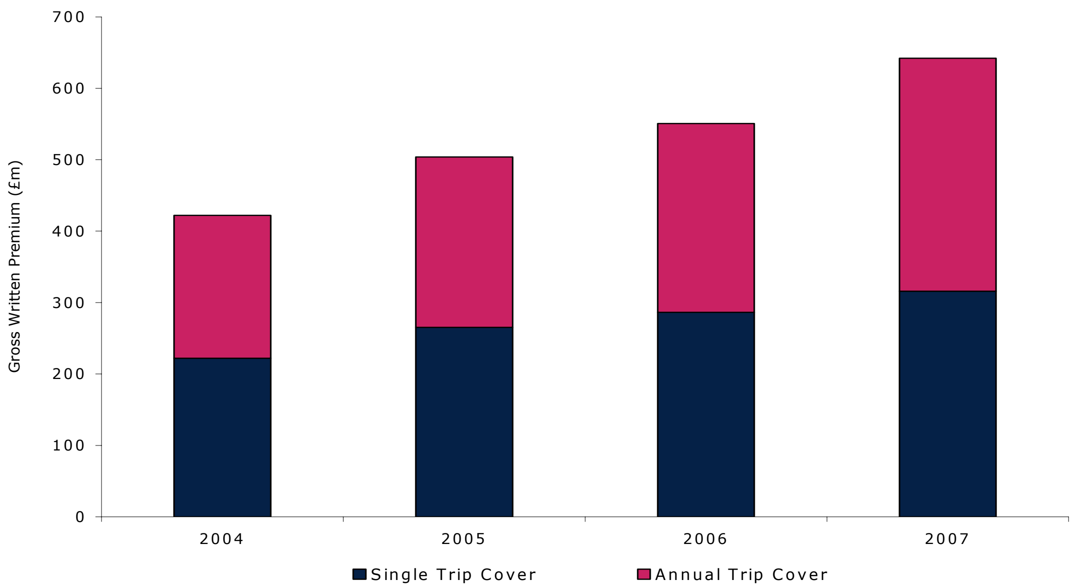
TRAVEL INSURANCE

Competition in the market for travel insurance

Market size and growth

The UK travel insurance market is less than a tenth of the size of the motor insurance market, with GWP of £642 million in 2007. Travel insurance policies typically cover either a single-trip or provide annual cover for multiple trips taken within the year (these typically have limits on the length of any given trip and the total time spent travelling in the year).[35] Such policies are likely to be close substitutes for each other for many customers.

Figure 12 UK travel insurance market size – Gross Written Premium 2004 - 2007



Source: ABI, Travel insurance income, August 2008.

In terms of premiums, the market splits fairly evenly between annual policies and single-trip policies and in terms of the number of policies around 45% are annual and 55% single-trip.

The total value of GWP has been growing over time reflecting the increase in the number of holidays taken. The number of visits abroad by UK residents has increased from 51 million in 1998 to 70 million in 2007 and this has also been combined with travel to a wider set of destinations with the number of trips to destinations outside of Europe and North America doubling over this period. [36]

[35] Backpacker policies also exist that provide insurance for extended times of travelling.

[36] National Statistics, Overseas Travel and Tourism, MQ6, Q1 2008, Table 2.

Some travellers do choose to go on holiday without travel insurance. The FSA quotes data suggesting that around 13-15% of travellers go abroad without travel insurance. [37] GfK/NOP data finds that around 11% of people go on holiday without travel insurance and there is little clear difference between age groups.[38]

Claims

As shown in the Figure 13, the cost of claims has increased at a slightly faster rate (75% from 2004-2007) than the increase in premiums (52% from 2004-2007).[39]

Figure 13 Cost of claims of travel insurance 2004 - 2007

Source: ABI, Travel insurance outgoings, August 2008.

Baggage and money claims, which are relatively flat across age ranges, represent a small proportion of claims. By contrast, the biggest component of claims costs are medical costs which have grown particularly rapidly over the period shown. In addition, medical reasons are one of the primary reasons for cancellations of holidays. This is an important issue to recognise given the high correlation between medical claims and age i.e. the largest component of claims is driven by a factor that is highly correlated to age.

This is demonstrated by Figure 14, which shows the average value of claims by different age groups. The data is from one provider although the pattern of data has been

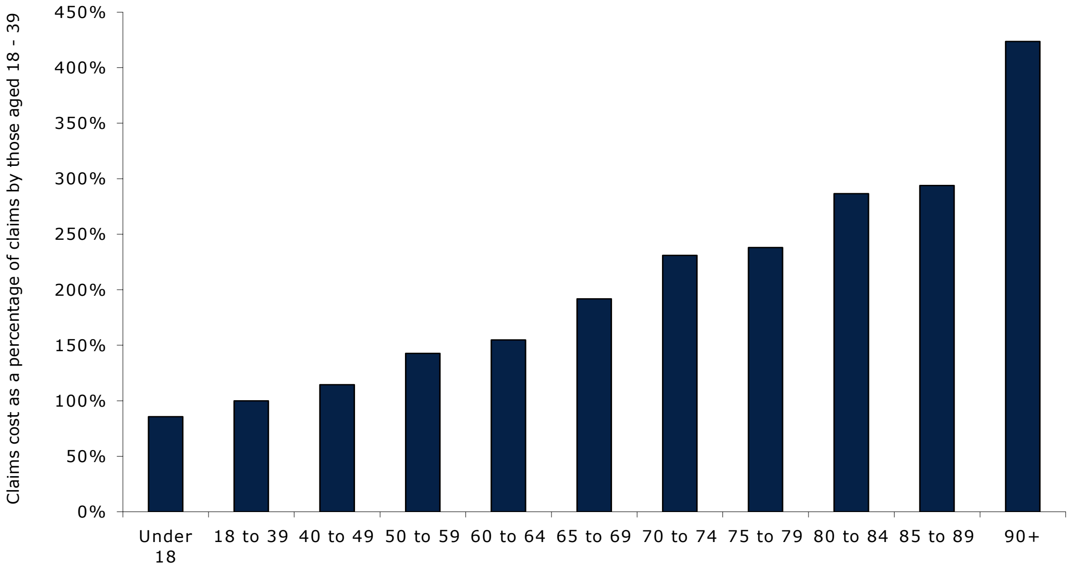
[37] Based on information from Datamonitor UK Travel Insurance 2007, An in-depth look at the travel insurance industry in the UK, and Treasury Select Committee – are you covered? Travel insurance and its regulation, February 2007.

[38] Based on the FRS as cited in Insurance and Age: Exploring behaviour, attitudes and discrimination. A report from Age Concern and Help the Aged. Research undertaken by CM Insight and Andrew Smith Research. Note that Datamonitor suggests that the numbers travelling uninsured may fall by age.

[39] It should be noted that the difference between premiums and claims does not represent profit since insurers will need to incur other expenses such as the cost of distribution and administration in addition to the cost of claims.

supported in all of the interviews with travel insurers; a small number of other insurance companies have shown similar data to CRA on a confidential basis.

Figure 14 Average claim costs as a percentage of those aged 18 to 39



Source: Data from travel insurance provider.

Figure 14 shows clearly that the average cost of claims increase with age. In addition to the increase in the *size* of claims which are made, the *frequency* of claims also increases with age which means that the total average risk of different age bands will accelerate faster than is shown in Figure 14. Previous evidence collected on behalf of the ABI found that the likelihood those aged 85 making a claim was nine times that of those aged 25. [40]

Interviewees have indicated that the combination of increased claims and increased frequency of claims means that customers in their 80s are around 8-12 times more risky than customers under 65. CRA has been provided with data on a confidential basis showing that the increase in the total claims cost per traveller (the "burn cost") increases particularly rapidly in the 80s.

An increase in the frequency of claims is consistent with other evidence that shows that for those older consumers who do go on holiday, they are likely to take more holidays per year than younger cohorts. For example, the proportion of individuals taking three or more holidays per year is:

- 18% for those aged 30-49;
- 23% for those aged 65-74; and
- 28% for those over 75.[41]

[40] ABI, Insuring Older People.

[41] Based on a sample of 229 people aged over 65 and 115 aged 30-49. Insurance and Age: Exploring behaviour, attitudes and discrimination. A report from Age Concern and Help the Aged. Research undertaken by CM Insight and Andrew Smith Research.

This is of particular relevance for selling annual travel policies since older customers, once they are retired, are more likely to be in a position to take multiple holidays and therefore a greater proportion of the year will be "on risk" for the insurers.

Older people are also less likely to go on holiday at all.[42] Evidence from GfK/NOP finds that the proportion of individuals aged 60-64 who did not go on holiday over a year was 38% whereas this increased to 51% for those aged 70-74 and 67% for those aged 80-84.[43]

Structure of the travel insurance market

There are 36 companies which are currently offering travel insurance in the UK.[44] Travel insurance is a small market and few providers have premiums of over £100 million. There are a relatively large number of providers with relatively low premiums. For example, 12 providers have GWP of less than £10 million. We estimate that the top five providers have around 80% of the market and the top ten providers have around 95%.

The significantly smaller size of the travel insurance market is potentially an important backdrop to the analysis since any fixed costs associated to policy changes would be expected to represent a larger proportion of premiums in travel insurance than they would for motor insurance.

Search

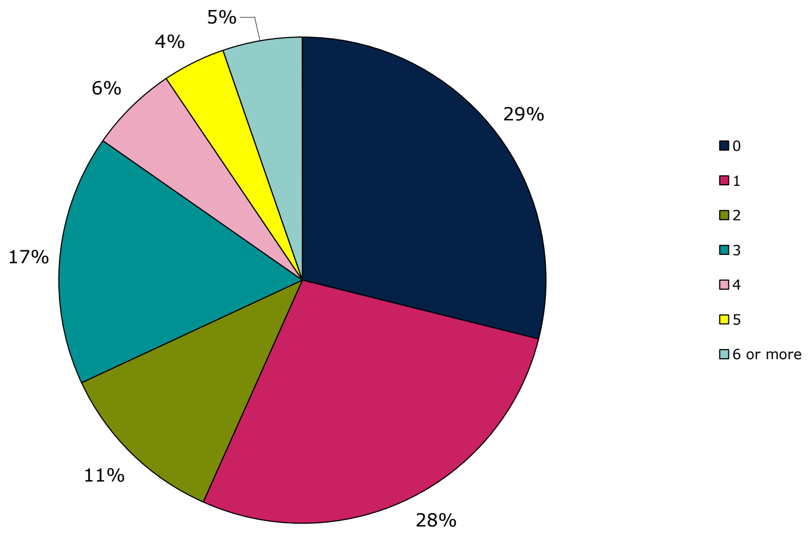
Considering shopping-around, approximately 70% of consumers shop-around when seeking travel insurance and on average consumers seek 1.9 quotes other than the company through which they purchase travel insurance.

[42] That is, a higher proportion of older people took no holiday compared with the proportion of people at other ages who took no holiday. It was also the case that a higher proportion of older people took three or more holidays compared with the proportion of people at other ages who took three or more holidays. Older people were less likely than other ages to take one or two holidays in a year.

[43] As cited in Insurance and Age: Exploring behaviour, attitudes and discrimination. A report from Age Concern and Help the Aged. Research undertaken by CM Insight and Andrew Smith Research. Data for 2004.

[44] Based on Syn Thesis analysis of FSA returns.

Figure 15 Other than the company you bought through, how many insurance companies in total did you contact yourself to get quotes for your renewal/new policy?



Number of travel insurance providers contacted (%)

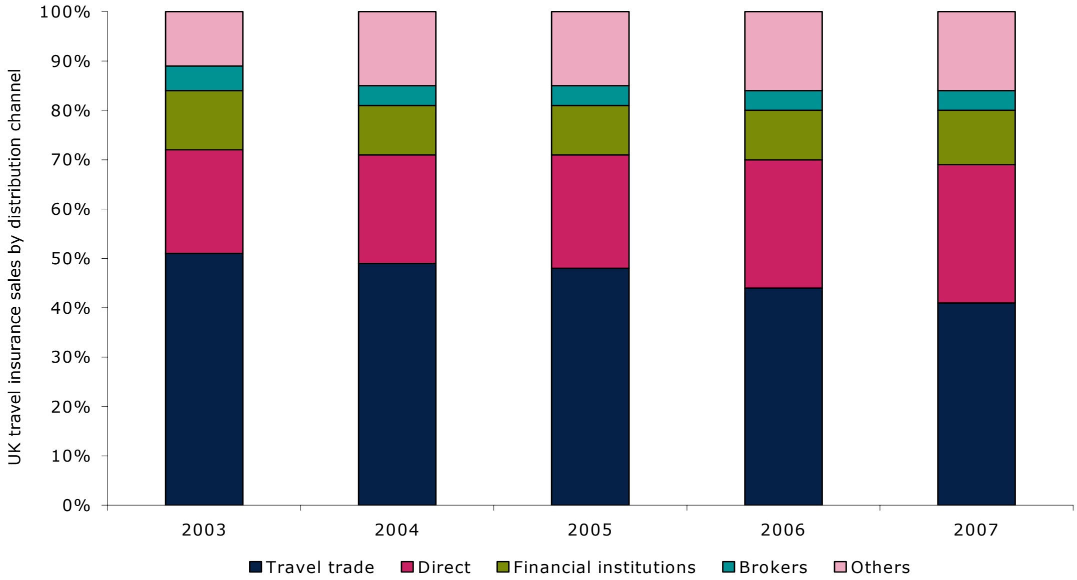
Source: CRA survey of 300 older consumers who have taken out or attempted to take out travel insurance. This is based on a sample size of 296 consumers who have taken out travel insurance.

As with motor insurance, most customers receive a quote from the first provider that they contact, indicating that for most customers the purpose of searching is to compare between quotes rather than obtain a quote.

Distribution channel and market differentiation

The different distribution channels used to sell travel insurance are quite distinct since they are regularly sold alongside the holiday which people are taking and therefore arranged with the travel agent from whom the holiday is purchased.

Figure 16 Distribution channel of UK travel insurance market



Source: Datamonitor analysis of Ipsos MORI statistics and industry interviews.

Historically the travel trade would have represented the overwhelming majority of travel insurance sales. Over the last five years the use of the travel trade channel has declined from around 50% of the market to around 40% in 2007 as measured by GWP although it remains the single most important distribution channel. The travel trade represents a smaller proportion of the number of policies at around 23% of all policies sold.[45] In contrast to the declining trend in the travel trade, the direct channel has been expanding over this period reflecting the growth of distribution through remote channels such as the telephone and internet.

Purchasing behaviour

Looking at consumer behaviour it is again useful to contrast travel insurance with motor insurance. Travel insurance has a significantly smaller premium with an average premium of £31 (including both annual and single) compared with £340 for motor insurance.[46] However, for customers over the age of 65, the differences between the premiums charged are somewhat smaller. Within our survey of customers over the age of 65 we find that the average premium for motor insurance is £241 whereas for travel insurance it is £131.[47]

As we might expect when premiums are smaller, consumers are less likely to shop-around for travel insurance than for motor insurance (in addition to the insurance

[45] Estimate of number of policies from Mintel travel insurance report 2007 and GWP from Datamonitor UK Travel Insurance 2007, An in-depth look at the travel insurance industry in the UK as quoted in Regulating connected travel insurance, FSA, CP07/22 December 2007.

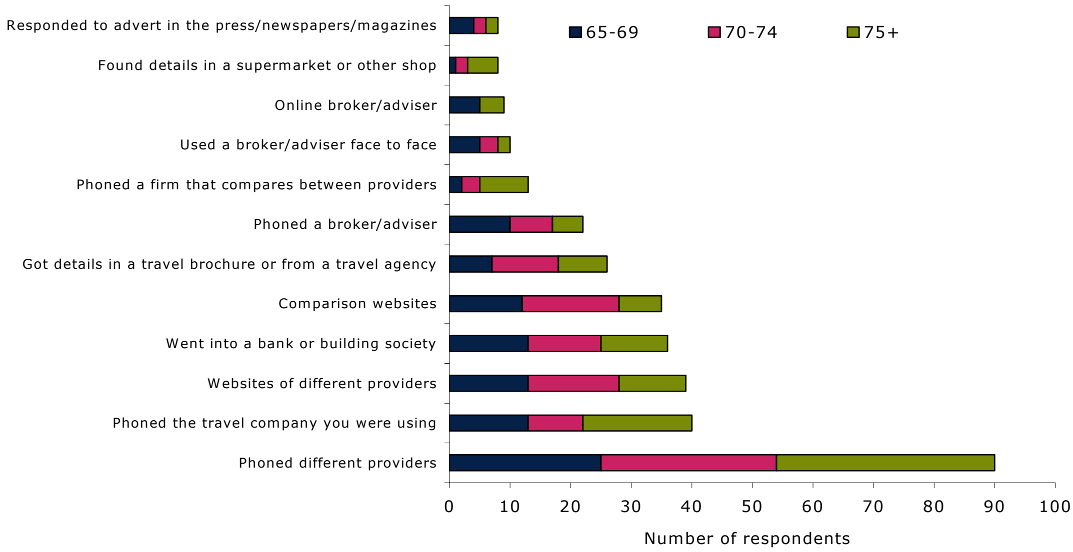
[46] This is based on the total premiums and total number of policies.

[47] Clearly differences in premium between customers will reflect different circumstances such as what type of car they have (motor) and where they end to travel and for how long (travel).

company from which consumers bought, they approached an average of 1.9 different companies for travel insurance compared to 2.7 for motor in our survey). We do not find any evidence from our survey that the amount of shopping-around decreases with age above the age of 65.

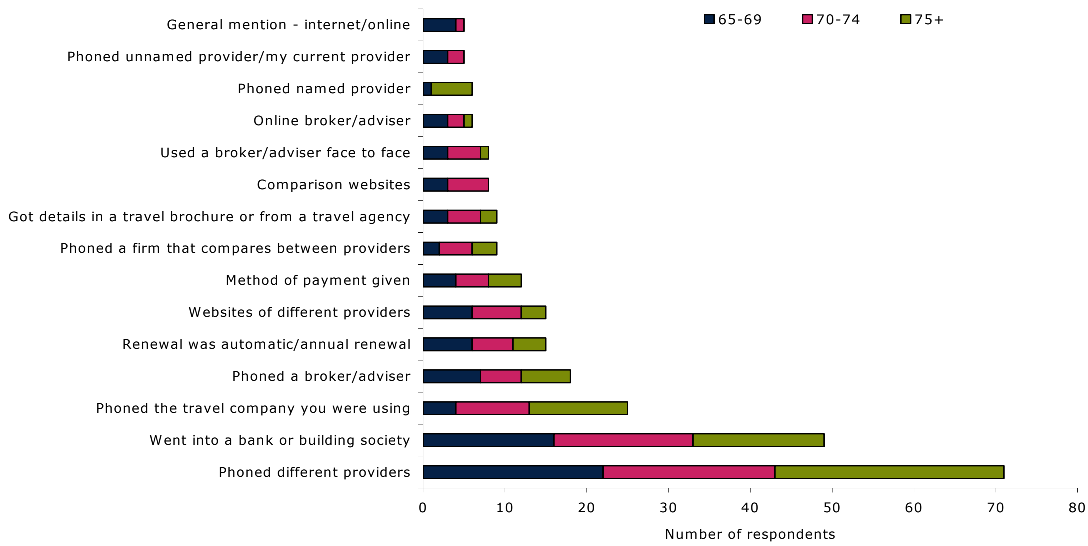
In terms of the methods by which consumers choose to shop-around and purchase, there is a clear preference for phone based channels although face to face in either a bank or building society is also an important channel for both shopping-around and purchasing. The preference for using the phone also increases for older customers.

Figure 17 Which of the following methods did you use to search for different travel insurance quotes?



Source: CRA survey of 300 older consumers who have taken out or attempted to take out travel insurance. This is based on a sample size of 204 consumers who obtained more than one insurance quote.

Figure 18 Which method did you actually use to purchase your travel insurance?



Source: CRA survey of 300 older consumers who have taken out or attempted to take out travel insurance. This is based on a sample size of 296 consumers who have taken out travel insurance.

In fact the evidence that older customers purchase through going into a bank or building society is a little surprising since a number of banks and building societies do not sell travel insurance through the branch network. Instead many of them would provide marketing information regarding the products which direct consumers to the telephone or internet channels. It is possible that some of these responses relate to the provision of travel insurance with added value bank accounts.

The use of age in the underwriting process, age limits and age bands

There are relatively few rating factors used in setting the price for travel insurance. In general these are limited to factors regarding the travel itself (the destination, length of the trip) and factors regarding the customer (age, medical history). As such the number of rating factors for travel insurance is considerably smaller than the number used for motor insurance.

All insurance firms use age in their underwriting process although the method through which they do this varies substantially. The majority of underwriters use age bands in their underwriting process although some insurers will use integer ages in the underwriting but then use age bands in their consumer pricing.

The use of age in the assessment of risk is seen by insurers as very important since the main component of travel insurance claims is medical related claims which is highly correlated to age. Most insurance companies have stated that there is limited change in risk between customers aged between 18 and 50, with a moderate increase in risk from the 50s to early 60s at which point risk begins to increase more rapidly with age. CRA has been provided with confidential information from insurers which demonstrates that there is almost no discernible change in risk for consumers aged 18-40, with only a very small increase in this risk for those aged 40-50. The data also supports the statements of insurance companies that risk increases and accelerates from the 60s onwards. [48]

There are a variety of policy conditions which are based on age including:

- Limits on death benefits and Permanent Total Disability are typically reduced at 65 or 70;
- Cover for winter sports or hazardous activities is often limited to those under 65; and
- Trip limits (i.e. the maximum time a given holiday can last under the terms of the insurance policy) may be less for those over 65.

In the case of the latter condition it was indicated that shorter trip limits may apply for the over 65s in order to prevent travel insurance being used as a medical insurance product for ex-pats who choose to spend most of their time abroad after retirement.

Age bands

All insurance companies participating in this research use age bands, at least to some extent, with the majority relying on the use of age bands for the sale of travel insurance for all of the schemes which they underwrite. For many insurers the precise bands used vary according to the scheme being underwritten reflecting the different profile of customers in different schemes.

Age bands apply for both annual multi-trip and single-trip travel insurance products. Typical bands which are in place across the majority of insurers are 0 – 17, 18 – 59/64, and then five-year bands until any age limit is reached. In practice, insurers have made it clear that within a band of 18-64, those aged 50-64 are being cross-subsidised by those aged 18-30. A number of firms apply slightly different age bands including:

- A single band for customers above 64 and below any upper age limit;
- Ten-year age bands within the range 18-59 followed by five-year age bands;
- A split of 18-30 and 31-59 followed by five-year age bands; and
- A split of 18-49 and 50-64 followed by five-year age bands.

One of the characteristics of travel insurance is that there is a large band which covers the great majority of the market (in terms of premium). The result of this is that for a given type of insurance (e.g. single-trip to Europe) customers aged between 18 and 59/64 will commonly face the same prices. Insurers offer a number of explanations for this:

- Risk profile: The limited change in risk for a large section of the population links to why insurance companies use age bands for selling travel insurance. Since risk is very similar it is appropriate that price would be similar.

[48] This information is additional to that presented in Figure 14.

- Low premiums: Given the relatively low premiums firms have focused on selling products to as many customers as possible when selling to the mass market.
- Distribution: The use of bands also reflects the common use of rate cards by travel agents 10-15 years ago. Simple structures were necessary in order that prices could be displayed on an A4 piece of paper or in holiday brochures. Despite significant changes in technology over time, simple structures remain today. Indeed even policies which are sold over the internet frequently use age bands rather than integer ages. A simple rate structure is also seen as important for sale of travel insurance in retail outlets.[49]

Age limits

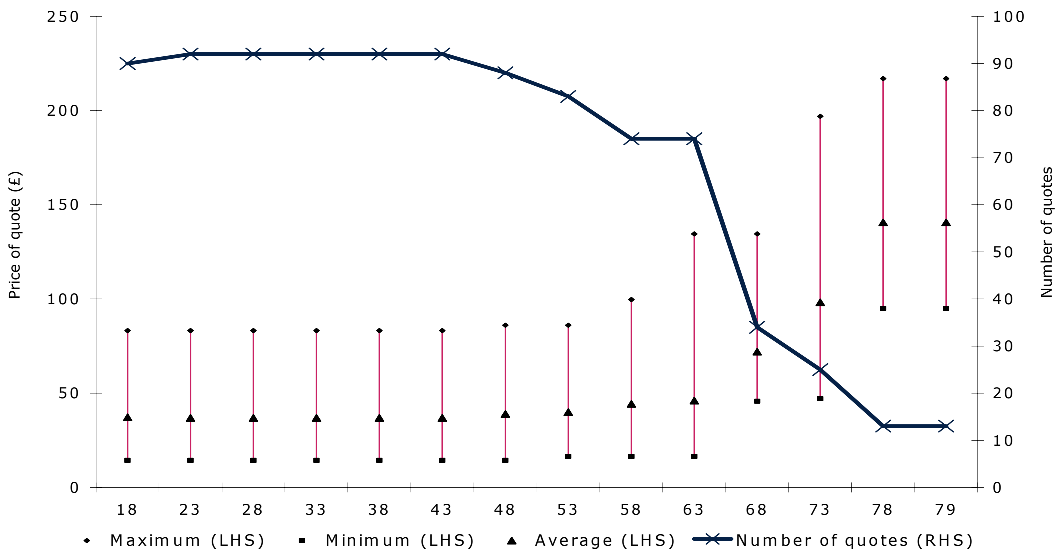
Age limits are also common and these limits vary by the type of insurance that is required. Most commonly the limits vary according to whether single-trip or annual cover is required, although some limits vary according to the destination of the trip with lower limits applied for travel to the US compared with the limits that apply for travel to Europe. Responses to our survey indicate that there is considerable variation in the limits which are applied both between insurance companies and also between different schemes for a given insurance company. On average, however, the age limit for single-trip insurance was found to be 85 and that for annual insurance was found to be 73.

In addition, specialists and some of the mass market insurers provide single-trip insurance with unlimited ages. These include: Age Concern (underwritten by Fortis), Churchill and Direct Line (RBS Group), Post Office (underwritten by Fortis), Professional Travel Insurance and Intune (underwritten by LV). Those who offer annual policies to all destinations without an age limit appear to be limited to Age Concern and Intune (owned by Help The Aged).

We have also gathered information on the quotes available for travellers of different ages. It should be noted that this is based on information taken from a single comparison website and as such will not cover all of the available offers in the market since some insurance companies do not distribute through comparison websites or do not distribute all of their products through such a website. This shows that the price does depend on age. It also demonstrates that there are a smaller number of providers who are willing to offer quotes for older travellers.

[49] This contrasts to the situation in motor insurance where risks vary by a wide range of factors (age, car type, no claims bonus, where the car is kept) and it is therefore not possible to provide quotes in store – hence retailers advertise motor insurance in store but actually provide quotes through other channels.

Figure 19 Number of quotes and prices for different ages (annual travel insurance)



Source: CRA analysis based on data from a leading comparison website. The quotes are based on applications for an individual annual multi-trip travel insurance policy for Europe including the UK starting from 1st February 2009.

Figure 19 shows that the average prices charged are higher for older travellers than for other travellers.[50] As with motor insurance, there is variation in prices across all ages, which is likely to reflect different companies seeking to focus their efforts on attracting customers from some parts of the market and not in other parts. We find that the variation in prices is actually slightly lower for those of older ages than for those of middle age.[51]

It is also clear that there are fewer providers willing to offer quotes through a comparison website at older ages. The number of quotes declines substantially in the late 60s although even in the late 70s over a dozen are available for annual travel insurance.

A small number of insurers have referral systems in place where customers who fall outside certain criteria are referred onto another provider or to a broker panel. Where such referral arrangements are in place they will typically involve referrals for both age related reasons and medical reasons.

In some cases insurance companies have a panel only for travel insurance and not for other insurance products. For these companies maximum age limits are lower for travel insurance policies (for both single and annual) than they are for motor insurance policies. Some customers will hit the limit for travel insurance while still being within the limits for motor insurance. Firms have therefore sought to provide a solution to older customers in

50 A similar pattern was observed for single-trip insurance although this had lower prices and a higher number of quotes at any given age.

51 This is based on three different measures of variation of the price: maximum price/minimum price; maximum price/average price; and (maximum price minus minimum price)/average price. These ratios are lower for those in their 70s or above than for those who are middle aged.

order to maintain customer loyalty so that they can retain the relationship with the customer on other insurance products. This suggests, as we discuss further below, that limits and bands are driven by the market opportunity. Although insurers do not see offering travel themselves above these limits as economic, it makes sense from a commercial perspective to refer the client (with the result that the insurer “solves” the customers problem, makes a commission from the referral, and maintains customer loyalty for other products).

The extent of the market failure

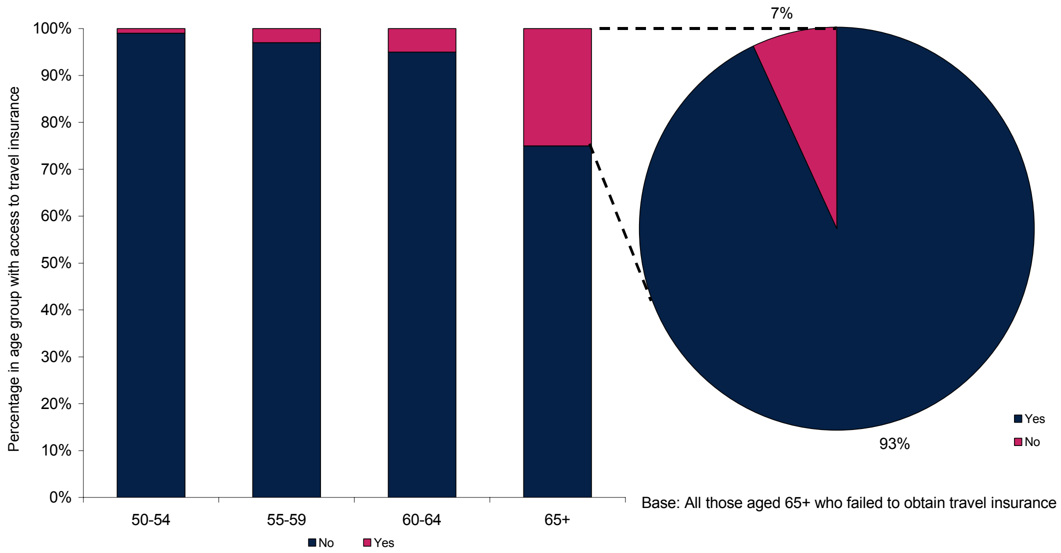
Access to travel insurance

As noted earlier, the typical insurer provides single-trip cover up to around age 85. In addition, specialists and some of the mass market insurers provide single-trip insurance with unlimited ages. For annual insurance, the typical insurer provides cover up to around age 73. Again, specialists offer annual insurance policies without age limits although the list appears to be limited to Age Concern and Intune / Help the Aged. As described above these limits typically vary by destination.

As with motor insurance, therefore, it is not the case that insurance is unavailable for customers although the number of insurers who provide such insurance does decline for customers in the 70s and reduces substantially for those in the 80s. In addition, it is clear that it is more difficult to obtain annual insurance than single-trip insurance.

It is therefore possible that there is a group of customers who are failing to get travel insurance which they wish to obtain. Figure 20 provides evidence on the extent of this.

Figure 20 Access to travel insurance for customers aged over 65



Source: SAGA Populus survey based on sample of 10,613 respondents aged over 50.[52]

Overall, 25% of customers aged 65 and over have been refused insurance because of age. However, of these 25% of customers, 93% were able to find another insurer who would provide cover. In total this implies that less than 2% (25%*7%) of customers aged 65 and over were unable to find insurance.

A low proportion of customers who were unable to find insurance is consistent with the results from our consumer survey, which found that there were only four consumers out of 300 (less than 2%) asked who tried to obtain travel insurance but failed to do so.

Given that age limits are typically applied for people in their 70s, it is to be expected that this percentage would be lower for people in their late 60s and would increase for those in their 70s and 80s. Overall, however, the size of the market failure is limited.

Search

There are also a group of customers who do find cover but for whom the current situation imposes search costs. Many more consumers are experiencing being turned down for travel insurance compared with motor insurance, although they would get a quote from a specialist. There does therefore seem to be an informational problem which is potentially resulting in unproductive search activity. This is mitigated by those firms who have entered into referral arrangements but there are clearly some consumers who have to take additional time and effort to search out the providers who will cover them.

The Saga survey indicates that 25% of consumers aged 65 and over experience being turned down for age reasons. This number is higher than that suggested by Age Concern and Help the Aged who found that 20% of those aged 75 and over had been declined

[52] It should be noted that the 7% figure is an average for both motor insurance and travel insurance.

travel insurance or had health related restrictions imposed.[53] Of this 20%, specifically age-related declines represented around half of these cases with medical declines representing the majority of the remaining reasons. This suggests that unproductive search activity because of informational problems for age-related reasons is in the range 10% (20%*50% from Age Concern and Help the Aged) to 25% (Saga).

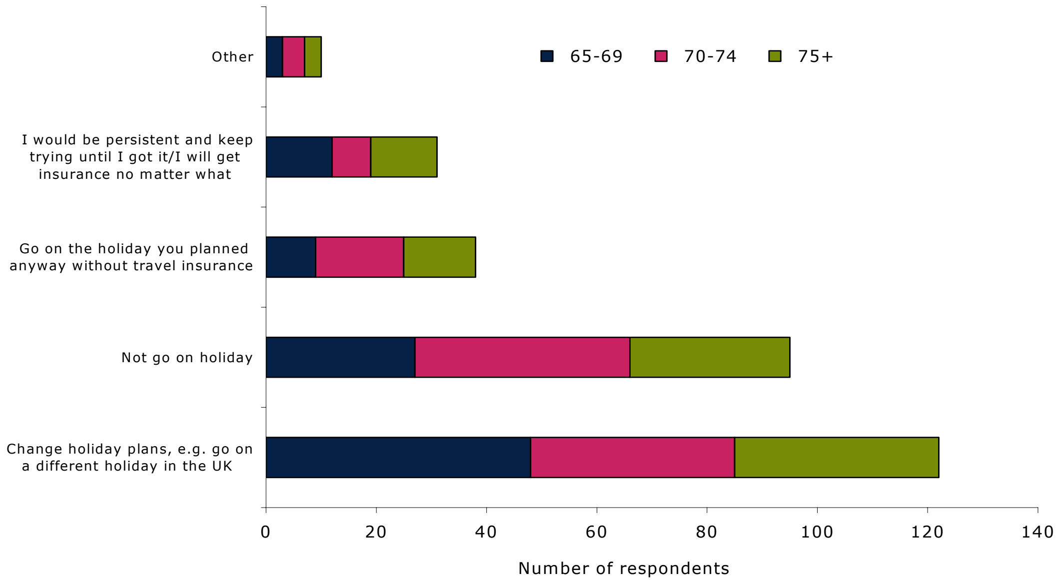
Cover

We found little evidence that consumers were not getting the type of cover they were looking for. Only five respondents in our survey (all over 70) did not get the cover that they wanted. Only one respondent stated that they had to take a single-trip policy rather than an annual travel policy (medical and age reasons were given). Of the remaining four respondents, medical conditions were cited by three of them (and two also cited age).

Implications for holidays

Given the very small number of customers who fail to obtain the travel insurance that they want it is difficult to determine with any precision what the follow on consequences are. Indicative evidence for this is provided by our survey when people were asked hypothetically what they would do if they were not able to get cover.

Figure 21 If after trying a number of different providers you were unable to purchase travel insurance would you…?



Source: CRA survey of 300 older consumers who have taken out or attempted to take out travel insurance. This is based on a sample size of 282 consumers who have not had difficulty finding a travel insurance provider in the last 6 months. Note that the question only offered the options, "change holiday plans e.g. go on a different holiday in the UK, not go on holiday, and go on the holiday you planed anyway without travel insurance". Alternative answers were therefore unprompted responses in the survey.

[53] Based on those taking at least one trip of 2+ nights in the last year from a sample of 229 people aged over 65 and 115 aged 30-49. Insurance and Age: Exploring behaviour, attitudes and discrimination. A report from Age Concern and Help the Aged. Research undertaken by CM Insight and Andrew Smith Research.

Around 50% of older customers would change their holiday plans but would still go on holiday if they could not get insurance and around 34% would not go on holiday. Thus it is possible that there is a reduction in older people taking holidays because they are unable to obtain travel insurance although the size of this is limited by the small proportion of customers who are unable to obtain travel insurance.

Age bands

The issue of whether age bands reflect a market failure is complex. Age bands have the effect of grouping together a range of customers and charging them the same price. As risk changes with age this represents a cross-subsidy from one group of customers to another within the age band.

In addition, since risk increases with age, this has the unintended consequence of leading to larger changes in price as individuals move from one age band to another. Although this is unattractive to those just above a threshold, it works in the favour of those just below a threshold. Where there is a band of 18-64 those in their 50s and early 60s are gaining at the expense of those at younger ages (18-30). Similarly within older five-year age bands, those aged 73/74 and 78/79 gain compared with those aged 70/71 and 75/76 respectively. Considering this over time, for any given older customer who continues to take out travel insurance they will spend some time (aged 63/64) gaining from the cross-subsidy and then some time (65/66) providing the cross-subsidy.

In theory cross subsidisation can result in inefficiencies, as those getting a better deal will over consume and those providing the cross subsidy will under consume. However, there are counter arguments why cross subsidisation may be efficient in this case including that:

- Simpler products might be cheaper to produce meaning that all consumers face a lower average price than would otherwise occur; and
- Consumers may prefer simpler products that offer certainty regarding price.

Hence market failures associated with age bands are limited.

Is this likely to change in the future?

Unlike in motor insurance where there has been a clear trend to increasing age limits in the last 10 years, there is no clear trend in travel insurance. Despite an ageing population with an increasing desire by older people to travel since they are healthier than previous generations at the same age, there is little evidence of across-the-board increases in age limits in recent years.

While a small number of insurance companies indicated that they have increased their age limits over the last few years, only a few insurers indicated that they were planning to increase their age limits in the short term future.

By contrast other insurance companies have indicated that they had reduced age limits on particular schemes over the last few years because of increasing costs and a lack of profitability associated with serving older customers. This was commonly the case when entering into arrangements with third-party distributors who wanted to achieve lower prices for other customers through having lower age limits. That insurance companies are currently acting in this way gives credence to the suggestion that they do not believe that they can offer risk-reflective prices to older customers that will be taken up by those consumers (see next section). [54]

Different companies are therefore taking different strategies on this issue i.e. some expanding their age bands and some contracting, which is consistent with the hypothesis that specialists have a comparative advantage in this market and are able to serve older customers where more mainstream insurers may not be able to serve this segment profitably.

There is also little change in the use of age bands, although some change in the actual bands used. Again it is useful to contrast this with the motor situation where age bands were used historically in order to simplify the sales process (rates were significantly higher for those younger than 25). However, over time, systems have become more sophisticated and they have moved to integer based pricing. A trend of integer based pricing does not currently seem to be occurring in travel (or is only occurring slowly).

However, there is some evidence that age bands have become smaller over time. For example, historically firms would have had only two bands: 18- 64 and 65-upper age limit. Now, nearly all insurance companies apply five-year bands above 65, and a number have introduced a band for 50-64. Both of these changes suggest that the market has moved slightly towards eliminating cross-subsidies where these are significant. Yet in the main, the market has focused on greater commoditisation, with competition focusing on offering polices with a single or small number of prices for the majority of the market.

Overall, given trends in the travel insurance market, there is little evidence that any market failure that is caused by the use of age limits or age bands is likely to be reduced through market trends. However, as noted earlier, the market failure in travel insurance is limited.

Why insurers do not provide access to older ages

There are a variety of reasons explaining why insurers are not willing to provide travel insurance to customers at older ages including:

- The level of risk imposed by these customers;
- The reputational damage from high, yet risk-reflective, pricing;
- The increased sales costs from pricing quotes which are not converted into sales;
- The lack of expertise in meeting the specific requirements of older customers;

[54] Otherwise they could simply keep the prices to younger customers the same and become profitable by increasing their prices to older customers.

- The lack of expertise in dealing with medical risk; and
- The low margins for insurers in travel insurance reducing the willingness to incur systems costs to change current approaches.

Level of risk

Insurers who impose age limits for travel insurance have consistently stated that they do not offer insurance to older customers because such customers are "too high-risk". There are a number of elements associated to this:

- Risk increases with age because travel insurance risk is mainly driven by medical risks. This has a number of aspects – the likelihood of having medical conditions increases with age, the likelihood of developing medical conditions increases with age (this makes offering annual policies significantly more difficult[55]), hence medical related claims increase and the size of these claims increase due to the increased severity of medical problems and the likelihood of spending longer recovering in hospitals at older ages. Evidence is clear that risk increases at an accelerating pace especially beyond 70; and
- The uncertainty in determining the level of risk increases with age since older people travel less especially beyond the mid 70s. With a smaller sample of customers it is harder to accurately assess the appropriate level of risk at older ages. There is considerable volatility in claims which imposes volatility in the profitability of the travel book for insurers.

An analogy could be made between offering motor insurance for younger drivers and offering travel insurance for older travellers where in both cases risk changes rapidly, it is difficult to observe how this risk changes on an individual basis and some firms are unwilling to offer insurance because of the high risk. However, in the case of travel insurance for older travellers, the risk continues to increase as the customers get older.

Since insurance companies focus on understanding risk, it is surprising that many firms are unwilling to set a price which reflects this risk and therefore to make insurance available. Since some specialist insurers *are* willing to insure all types of risk it is a legitimate issue to examine why many insurers do not. Some insurance companies therefore appear to apply a "hurdle" approach to travel insurance where they are willing to offer insurance until the risk associated with a particular type of customer exceeds some form of hurdle. The level of this hurdle is set according to the "risk appetite" of the firm.

If this was the explanation we would expect insurers to behave in the same fashion for other groups of consumers that offer higher risks, and this is indeed the case. For

[55] A number of insurance companies have also noted that in the past they could have requested that individuals make them aware of any changes in medical conditions throughout the year but the Financial Ombudsman has recently ruled against this which has the effect of increasing the risk associated to offering annual policies for older customers.

example, nearly all firms set limits on the medical risks which they are willing to cover (rather than simply setting higher prices for higher risks). Mainstream insurance companies typically refuse to cover medical risks which would be considered to be more than four or five times more risky than someone who is of “clean health”. A similar logic is used to justify offering insurance in some regions of the world but not in others.

In practice, however, in each of these cases it appears as though insurance companies do not offer insurance beyond a certain level, not primarily because they are unwilling to bear the risk per se, but rather because they do not believe that they can do this profitably.

Some commentators have suggested that since particular insurers are willing to underwrite schemes where there are no limits this implies that they are unfairly discriminating against older people when these same insurers apply limits on other schemes.

Insurance providers have explained that they may be willing to have no limits on a particular scheme if they believe that the whole book of business within that scheme would be profitable. A number of providers who have operated schemes without limits in the past have suggested that they are willing to do this because they receive a large amount of business (often including other types of insurance such as home and motor). They are therefore willing to take risks or even make losses on some parts of the travel book in order that they underwrite the whole scheme of business which is profitable overall. CRA has been shown evidence from various providers supporting the contention that prices to older customers are generally set below the risk-reflective level.

Reputational damage

Some firms have indicated that they are unwilling to provide insurance to customers at older ages because the risk-reflective price would lead to very high premiums. These insurance companies state that there would be considerable damage to their brand if the media reported high premiums which may exceed the cost of the holiday in some circumstances. Implicitly they believe that the brand damage from refusing to serve older customers is less than the brand damage arising from charging high, yet risk-reflective, premiums.

An argument could be made that firms would not suffer reputational damage if all insurance companies also charged risk-reflective prices since then many other companies would have relatively high prices. However, in practice specialists are able to reduce both the uncertainty factor regarding the expected risk and have specific advantages enabling them to reduce the costs of insuring older people (see below) implying that specialists may be able to set lower prices than others and therefore that mainstream firms still face a possible reputational issue.

Increased sales costs from lower conversions

Insurers have stated that given the high risk-reflective prices, offering such prices to older customers would mean that fewer of them actually decide to take out the insurance cover compared to customers at a younger age. As such, conversion rates would fall and the average cost of a sale would increase leading to price increases for all customers. [56] Most companies do not believe that this represents a profitable strategy and any change in systems costs would therefore be difficult to recover.

Lack of expertise in the specific requirements of older customers

Insurers who are providing cover to older customers have indicated that there are a number of areas where offering insurance to older customers differs from the provision of such services to younger customers. Some of these are generic to all insurance products, but many are specific to travel and medical related issues. For example, the sales process for older customers tends to be longer and phone-based. Some schemes focused on older customers will not use automated telephony and messaging because older customers do not like this (clearly it is not possible at this stage to tell the age of the caller).[57]

Older customers are more likely to fail medical screening questions and therefore require a longer process to discuss medical issues. Based on information from interviews, it would be typical for only around 7% of people to go through detailed medical screening, whereas for schemes focused on older customers this is around 80-90%.[58]

Older customers will often want time to consider the information that they are given and therefore frequently request information to be sent by post (increasing costs) and will call a second time to make the purchase (increasing costs compared with younger customers who are more likely to decide to purchase at the time of the quote).[59] More generally, older customers prefer information to be sent by post and not by email, and also prefer to make payments by cheque through the post rather than by providing credit or debit card details over the telephone.

In addition, companies or schemes that specialise in older people are able to adapt policy conditions to the needs of older customers such as covering specialist medical equipment like wheelchairs or walking frames, or including cancellation expenses related to a carer not being able to travel. They may also use larger print policy documents (implying that they will be longer and therefore more costly to produce and post).

Some of these capabilities may be present in “specialists” more generally i.e. those who specialise in unusual risks rather than necessarily in older customers. These firms are likely to have a more flexible underwriting system. In particular they may use individual underwriting approaches. Such an approach is both more expensive than a call centre

[56] This is because firms would need to go through the whole sales process for older customers that they now provide quotes to rather than ending the sales process quickly by stating that they do not offer insurance to older customers.

[57] For example, there will be no messages saying something similar to “press 1 if you are travelling to Europe, press 2 if you are travelling to the US” etc.

[58] That is, these customers will fail initial trigger questions regarding medical conditions and will have to go through a more detailed process in order to establish whether or not the insurance company would be willing to write the business and if so, at what price.

[59] Note that this is not driven by a difference in shopping-around, but rather a difference in deciding to purchase the best policy once a search process has been undertaken.

environment but also not possible within a standard call centre which is designed for mass market risks and relies on automated not individual underwriting.

Many of these differences imply that a different sales process may be appropriate for older customers. For many insurers, this would be inconsistent with their focus on mass market simple risks. Specialists by contrast, may be able to adapt their systems for an older audience.

Lack of expertise in dealing with medical risk

As noted above, the largest component of claims for travel insurance is represented by costs related to medical issues. Understanding medical risk requires certain specialist skills. Indeed specialist firms such as Healix exist that focus on understanding the risk associated with age and medical conditions and providing services to insurance companies to help them understand this risk. Specialists may also have a developed network for dealing with particular types of risk, which other insurers would need to replicate in order to offer comparable products. Not all insurers will have this capability although as we discuss below, many insurers have already invested in these systems.

Low margins for insurers

The insurers interviewed consistently reported that travel was a relatively small market, with low margins, so it was difficult to justify large costs associated to changing systems. This is consistent with competition occurring on relatively simple commoditised products. Low margins reduce the willingness to incur systems costs in order to change current approaches.

In order to understand this it is useful to consider the scale of premiums and possible claims. We consider a hypothetical insurer with GWP of £30 million. Based on evidence from interviews, underwriting margins of 5% would be considered a good year in travel insurance and thus for our insurer this would lead to profit of around £1.5 million. If the insurer served the whole market, they would attract a small number of customers in their 80s and 90s. Insurance companies have indicated that claims for US medical risks in particular could easily reach levels of £250,000 for older customers who are likely to spend considerable lengths of time in hospital. Only six such claims would eliminate the profit of this company supporting the suggestion that it is commercially unattractive to serve this part of the market. Clearly, the concern about loss making is increased when considering whether to underwrite a particular scheme or what conditions to apply on an individual scheme since the premiums associated to any given scheme will be substantially lower whereas the size of the potential claim remains the same. Thus concerns about the volatility of returns are especially credible in an environment of low margins where volatility may imply that schemes are loss-making in some years.

Summary on market failure

Overall, there is a very limited market failure associated with a lack of access to travel insurance for less than 2% of the population aged 65 and over, with an associated implication for a smaller proportion who will not take holidays because of a lack of insurance. In addition, informational problems mean that many older consumers are required to take time searching for a provider who will offer them a quote. However, the evidence does not suggest that these very limited market failures will be reduced quickly.

Policy options

In this section we consider the likely market impacts of the various different policy options. We seek to determine whether the different policy options would result in economic benefits that exceed the costs of implementation. This requires comparing the market outcomes following each of the policy options with what would happen in the absence of these scenarios. In line with the FSA's approach to cost benefit analysis we examine the impact of each of the policy options on:

- The quantity of insurance and associated products purchased;
- Quality of insurance provision;
- The variety of insurance propositions and products on the market;
- The efficiency of competition; and
- Compliance costs.

Information on compliance costs is based on a survey which was sent to 33 insurers. Ten responses were received and these companies represent approximately 50% of the travel insurance market. It should be noted that we have not been able to interview representatives of the travel agent industry or collect compliance information from this sector. Hence figures regarding compliance costs do not take into account any potential impacts on distribution costs faced by travel agents.

Removal of age limits

Quantity

Other things being equal, the removal of age limits should lead to a higher number of older customers being able to find the insurance that they are seeking. This will be modest since less than 2% of customers aged 65 and over are currently unable to find insurance.

Furthermore, it would not necessarily lead to all of these customers being converted into additional sales since it is expected that this scenario would result in high risk-reflective prices which insurers believe many customers will be unwilling to accept.

Many interviewees have indicated that there are currently cross-subsidies to older customers (and some firms have shown confidential data to CRA supporting this point). Prices charged by companies required to serve this market are unlikely to include cross-subsidies and therefore would be higher than current market prices. These high prices result both from high medical risk, but also from increased uncertainty of risk – because these customers are different from existing customers (although this concern would reduce over time) and also because there are only a small number of customers and so there is uncertainty in the estimation of risk. The impact of the latter is unclear – while any uncertainty will reduce over time for individual companies now serving this market, it is possible that specialists currently serving the market receive fewer customers than before and are therefore less able to determine the appropriate price potentially leading to higher prices and lower sales for specialists due to a margin for uncertainty being applied.

Nonetheless, it is all customers who would pay for the additional costs of the sales process that does not lead to a sale and so these additional costs would be passed on to all customers through higher prices.

In addition, insurers have all indicated that the risk of having very high claims also increases substantially with age. Even large providers of insurance have suggested that a single claim of £250,000 could cause a particular scheme of travel business to be unprofitable. Most insurers would be reluctant to charge the risks of such claims to only older customers and therefore state that these costs would lead to higher prices for all customers. (It is unclear whether a requirement for objective justification would oblige firms to charge the costs of these risks only to older customers.)

However, since some big insurers have sufficient data to price the risks of older customers and there are specialist insurers who are servicing the older end of the market, insurers are able to follow the competitive market price in the short run and establish their own database and pricing strategy in the long run. So we do not expect the prices for all ages to deviate too much from the competitive level in the long run, as competition will prevent any excessive mark-up, especially for the good risks.

Quality

One of the reasons that insurers are unwilling to provide insurance cover to older customers is because medical risks increase with age. Since these are highly correlated, firms could choose to limit their risk exposures by placing limits on the medical risks rather than placing limits on age.

This would lead to a reduction in the quality of cover (since certain medical risks would no longer be covered). Furthermore, it may limit any increase in quantity since customers who would previously have been refused insurance because of age are refused insurance because of medical reasons. Based on evidence from interviews, around 80-90% of older customers fail initial medical screening questions, indicating that in a large proportion of cases (although not all cases) it will be the same customers who are refused whether for age or medical reasons.

In a small number of cases, insurers indicated that they are willing to cover pre-existing medical conditions with a low age limit but that they may have to change policies so as not to cover pre-existing medical conditions if age limits are removed since a much higher proportion of older customers have such conditions. Furthermore, insurers may increase medical excess levels which would have to apply across all travellers.

In as far as insurance companies lower limits for medical risk to compensate for higher risk faced through no limits on age, this may leave the overall level of insurance policies sold unchanged from today, but the quality of cover would be lower.

Variety

We are unaware of any providers who focus on younger customers through the use of a very low age limit – we do not have any evidence of providers with an age limit which is below 60.[60] There are, however, a few providers, such as Saga, who impose minimum age limits. These providers would no longer be able to impose minimum age limits on the customers who they are willing to serve. This is therefore likely to reduce the variety of competition as specialists would no longer be able to impose these limits, although they could continue to market only to older customers.

There are a number of areas where the variety of products might decline if age limits are removed:

- **Travel insurance with bank accounts**: Age limits are commonly applied where travel insurance is offered in added value bank accounts. The removal of age limits would lead to an increase in the premium per customer insured since higher risk customers would now be covered. The cost of this insurance is shared across all customers who pay for it through the (same) monthly account management charge. Hence either all customers would pay higher account charges, or the level of cover would be reduced for all customers in order to keep the premium per customer to the current level, or travel insurance would be removed from added value accounts. It is estimated that such accounts may represent around 10% of the travel insurance market.[61]
- **Family travel policies**: Some family travel policies will cover children who are under 23 and in full time education. Preventing the use of age limits would mean such policies would be redesigned, probably to cover children under the age of 18 (since age discrimination legislation only covers adults). While this could mean that families with children aged 18-23 and in full time education have to purchase two (or more) policies, impacts will be limited since there is no suggestion of any difficulty in finding insurance for young adults.
- **Backpacker policies**: Many insurance companies offer backpacker policies which are aimed at gap year students or young adults who wish to take an extended period of travel and these policies typically have low age limits. These policies might be removed because insurance companies do not want policies designed around the needs and claims of young students being used by older customers taking extended travel (or simply living abroad) following retirement.

Alternative reductions in variety that a small number of insurance companies have suggested include:

[60] The exception to this is with backpacker policies – see below.

[61] This is based on Figure 16 taking the proportion of the market distributed through financial institutions. In addition, one major bank has indicated that they have over 1 million customers with added value accounts that include travel insurance cover. If the five major banks had similar numbers of customers, these could represent five million out of 25 million (i.e. 20%) of travel policies. It should be noted that in terms of the number of policies in the market it is unclear whether added value accounts would be captured as separate policies or whether the overall scheme would count as a single policy.

- **Limits on destinations**: Medical costs in the US are especially high in comparison to other countries. Since older people are more likely to have medical related claims, one way to reduce this risk would be to no longer offer insurance to customers of any age travelling to the US.
- **Annual policies**: Many insurance companies have indicated that the uncertainty of the risk of insuring older customers for annual policies is much greater than that for younger customers because of the increased likelihood of health deteriorating in advance of any travel. In order to limit this risk, some insurance companies suggest that they may have to withdraw annual travel policies.

If either of these occurred there would be a significant reduction in the variety of policies available. However, given the importance of both elements in the current market there is limited credible evidence that significant proportions of the market would choose to withdraw these products from sale. We therefore do not take this into account.

Removal of age limits may also impact distribution channels. In particular, travel agents are believed to have systems which are designed around a small number of age bands with limits in order to keep the sales process simple. The costs of changing these systems may lead to some travel agents no longer being willing to sell travel insurance. This is likely to impact small travel agents where the fixed cost is above the revenues that they make from selling insurance. Interviews with insurers have indicated that systems costs have thwarted previous attempts to persuade travel agents to make changes to travel insurance sales – this lends credibility to the suggestion that some of them will exit the market if forced to incur significant costs. It is possible that the exit of travel agents from the insurance market could lead to reduced availability of travel insurance and the need for more search activity by consumers.

In addition, it should be noted that the advent of FSA regulation for travel agents selling travel insurance is believed to have already triggered a reduction in the number of travel agents willing to sell insurance. Some interviewees have suggested that around 10% of travel agents (small firms) have decided to cease selling insurance themselves. If systems costs are significant further withdrawal of small travel agents from selling travel insurance would be expected. However, as we have not been able to collect compliance information on this, we do not take this into account in the market impact assessment below.

Efficiency of competition

Older customers currently undertake unproductive search activity as they seek to find insurers who will provide them with a quote. This scenario would enable them to search between different providers. Hence there would be some benefits accruing to older aged customers from increased shopping-around.

However, all insurers who have age limits in place have indicated that the main impacts of removing age limits will be:

- Longer sales processes because of dealing with older people;
- A reduction in the conversion ratio; and
- An increase in prices to all customers.

Insurers are consistent in arguing that offering insurance to older customers beyond the limits that they currently apply will involve longer sales processes because older people are more likely to have to go through a detailed medical screening process. In addition, as discussed above, high risk-reflective prices are likely to lead to a reduction in the conversion ratio and the costs of this will be borne by all customers. As such additional costs are added into the system for little additional gain and the market would be less efficient.

If insurance companies apply a “hurdle” approach to travel insurance, then requiring them to serve customers of all ages could lead them to offer insurance beyond their risk appetite. Alternatively firms could take other steps to limit risk such as refusing to insure pre-existing medical conditions as described above in order to limit their overall level of risk.

Compliance costs

There are two main areas of cost which have been highlighted by interviewees:

- Systems costs from removing age limits and requiring new prices for such customers; and
- Increased sales process costs arising both from longer telephone calls and also from a reduction in conversion rates due to the risk-reflective prices being higher than some customers might be willing to pay.

Additional costs also arise because of the need to conduct increased medical screening where the risk of medical conditions increases with age. Firms that are not currently serving older ages may choose to have fairly minimal requirements regarding medical screening today. However, if firms are required to serve customers of all ages they may need to invest in new technologies in order to have additional medical screening criteria (unless they choose to simply reject all customers with any medical conditions which would be an effective way of limiting the number of high risk customers).

Firms such as Healix specialise in providing such medical technology solutions in order to inform insurance customers about the risks involved in certain medical conditions as well as understanding the risks of travelling to particular countries. A requirement to serve all ages may therefore require investment in this additional technology. However, as we understand it, the fixed costs of purchasing this technology would be considerably less than £100,000 per year (additional costs would be incurred on a monthly basis for the ongoing screening) although insurance companies would need to incur costs in providing the IT solutions to accommodate the new technology.

Our compliance cost survey has provided approximate figures for the costs of removing age limits.

Table 16 Compliance cost – Removal of age limits

	Total scaled up costs (£)	£ per million premium	£ per average policy
Additional one-off costs	£1.3 million	£2,100	£0.06
Additional ongoing costs	£10.5 million	£16,400	£0.50
Average annual costs	£10.8 million	£16,800	£0.52

Source: CRA survey. One-off costs have been spread over five years to obtain the average annual costs. An average premium of £31 has been used to calculate the cost per premium.

The main one-off costs which arise are from changing IT systems and actuarial models. Ongoing costs relate to increases in the cost of the sales process from increased quotes that do not convert into sales and increases in the length of call times.

Objective justification

Our compliance cost survey has provided approximate figures for the costs of removing age limits and combining this with a requirement to objectively justify this. Insurers have indicated that objective justification would impose costs because of the burden to *prove* prices are objectively justified rather than to set the prices and as such this would represent a deadweight cost. This is especially problematic when they have little data on a group of customers (because they have not served them before) and when the group itself is very small (such as customers over a certain age).

Table 17 Compliance cost – Removal of age limits and objective justification

	Total scaled up costs (£)	£ per million premium	£ per average policy
Additional one-off costs	£1.7 million	£2,600	£0.08
Additional ongoing costs	£10.6 million	£16,600	£0.51
Average annual costs	£11.0 million	£17,200	£0.53

Source: CRA survey. One-off costs have been spread over five years to obtain the average annual costs. An average premium of £31 has been used to calculate the cost per average policy.

It is clear that there are relatively modest differences in costs which arise from objective justification. There are slight increases in one-off costs as insurance companies require additional IT resources to be used in designing new reports to capture information for the purpose of objective justification. Firms also indicated that a small amount of additional actuary time would be required on an ongoing basis.

The more significant concern from insurers is that, under certain definitions of objective justification, they may incur potential losses by having to serve customers based on existing data which they know to be unrepresentative of new customers. Some firms have estimated that this could be as high as £2 million.

Removal of maximum age limits

There are very few providers who impose minimum age limits for travel insurance. For the great majority of providers there will therefore be no difference between this scenario and the previous scenario. In particular, we conclude that the impacts on quantity and quality of insurance products will be the same as those examined in the previous scenario.

However, there are a small number of providers who do have minimum age limits for travel insurance. In contrast to the previous scenario, applying only a maximum age limit would retain the variety of competition that is seen in the market currently.

Removing age limits and narrowing age bands

Preventing the use of age bands and requiring integer ages to be used would have a differential impact across both insurance companies and distributors. Those insurance companies who use integer ages already for their underwriting would not incur costs on the underwriting side although many would still incur costs due to changing their quoting system for distributors which are often based on bands even where underwriting can be calculated for integer ages.

We focus in this section on some of the additional issues related to narrowing age bands although many of the implications described in the previous section where age limits are removed will still apply.

Quantity

Most insurers agree that the use of age bands leads to cross-subsidies arising within those age bands. The widest age band commonly in use is between 18 and either 59 or 64. Insurers agree that this means that customers from around 18-30 are providing a cross-subsidy for customers aged around 50-59/64. Other things being equal, the removal of this cross-subsidy would therefore lead to a decrease in prices for those aged 18-30 but an increase in price for those aged 50-59/64.

As noted earlier, cross subsidisation can result in inefficiencies, as those getting a better deal will over consume and those providing the cross subsidy will under consume. However, age bands are in place partly to reduce the size of cross-subsidies i.e. the market has moved from a single band for 65 and above to a series of five-year bands in order to reduce the degree to which some customers are being cross-subsidised by others. Hence it is expected that remaining cross-subsidies are relatively small.

In addition, given the compliance costs provided for this scenario (and additional costs for distributors which have not been captured), it is likely that price increases will arise for all consumers (including those previously providing the cross-subsidy). This would be expected to lead to a decline in the amount of travel insurance purchased.

Quality

It is not clear that the removal of age bands per se would lead to a change in the quality of insurance products.

Variety

Most interviewees have indicated that travel agents have simple systems for selling insurance and the cost of changing these could lead to small travel agents exiting the market. This is thought to be more significant than removing age limits (since the latter would be equivalent to making the upper age band much bigger) because some travel agents only have a small number of fields in systems in which differentiation can arise e.g. they may only be able to offer four bands at present, and moving to integer ages would require over 100. However, we have not been able to test whether this concern in significant due to a lack of information on travel agents.

Efficiency

Removing cross subsidies may increase efficiency as consumers face risk-reflective pricing. However, there are also some arguments to support the retention of age bands because it may enable simple distribution models to be used, which would not be possible for more complex pricing structures. Moreover, simple pricing structures save transaction costs and make the market prices more transparent which facilitates competition. Hence the removal of age bands may remove these existing benefits.

Compliance costs

Our compliance cost survey finds that narrowing age bands in addition to removing age limits slightly increases one-off costs compared to the scenario of removing age limits but does not substantially change the on-going costs.

Table 18 Compliance cost – Removal of age limits and age bands

	Total scaled up costs (£)	£ per million premium	£ per average policy
Additional one-off costs	£1.8 million	£2,800	£0.09
Additional ongoing costs	£10.5 million	£16,400	£0.50
Average annual costs	£10.9 million	£17,000	£0.52

Source: CRA survey. One-off costs have been spread over five years to obtain the average annual costs. An average premium of £31 has been used to calculate the cost per average policy..

It should be noted that these costs do not include the costs of changes for distribution through travel agents since such firms did not participate in the study. Insurance companies have indicated that the one-off costs for travel agents may be greater than the costs for insurers because the former currently have relatively simple systems in place.

Objective justification

Our compliance cost survey has provided approximate figures for the costs of removing both age limits and age bands combining this with a requirement to objectively justify prices.

Table 19 Compliance cost – Removal of age limits and age bands and objective justification

	Total scaled up costs (£)	£ per million premium	£ per average policy
Additional one-off costs	£2.1 million	£3,300	£0.10
Additional ongoing costs	£10.7 million	£16,700	£0.51
Average annual costs	£11.1 million	£17,300	£0.53

Source: CRA survey. One-off costs have been spread over five years to obtain the average annual costs. An average premium of £31 has been used to calculate the cost per average policy.

Again there are modest differences in costs which arise from objective justification since firms will generally rely on existing information if challenged to provide an objective justification for their prices. However, as noted above, any costs that do arise will represent deadweight costs.

Signposting

As indicated earlier, there does appear to be an informational problem which may be leading older customers to undertake unproductive search activities because they are not aware of which firms would be willing to offer insurance to customers of particular ages. Setting up a signpost will enable customers to quickly identify a list of companies who would be willing to serve them and avoid this unproductive search activity.

Quantity

Given the willingness of some insurance companies to offer travel insurance to all ages, it is assumed that some companies would be willing to be on the signpost. Indeed for some companies this would be a valuable source of additional custom. Thus a signposting system should lead to a higher number of older customers being able to find the insurance that they are seeking. Given the relatively low number that cannot find insurance (2%) this will be small and would also depend on the proportion of customers who would actually use the signpost (63% - see Figure 22).

However, it should be noted that not all firms who are currently serving, or have previously served, the market for all ages for some of their schemes would be willing to do so for their whole book of business. It is understood that on particular schemes, losses from serving older customers for travel insurance are cross-subsidised with profits made elsewhere. The availability of other business which makes the overall offering profitable would be less likely to arise through the signpost.

Quality

As signposting directs consumers to specialists in the market, this could result in better quality products for older customers with little unintended consequences for other segments.

Variety

This scenario would maintain specialists in the market and allow insurers to focus on the product where they had a competitive advantage. By increasing access to specialists this may marginally improve variety in the market.

Efficiency of competition

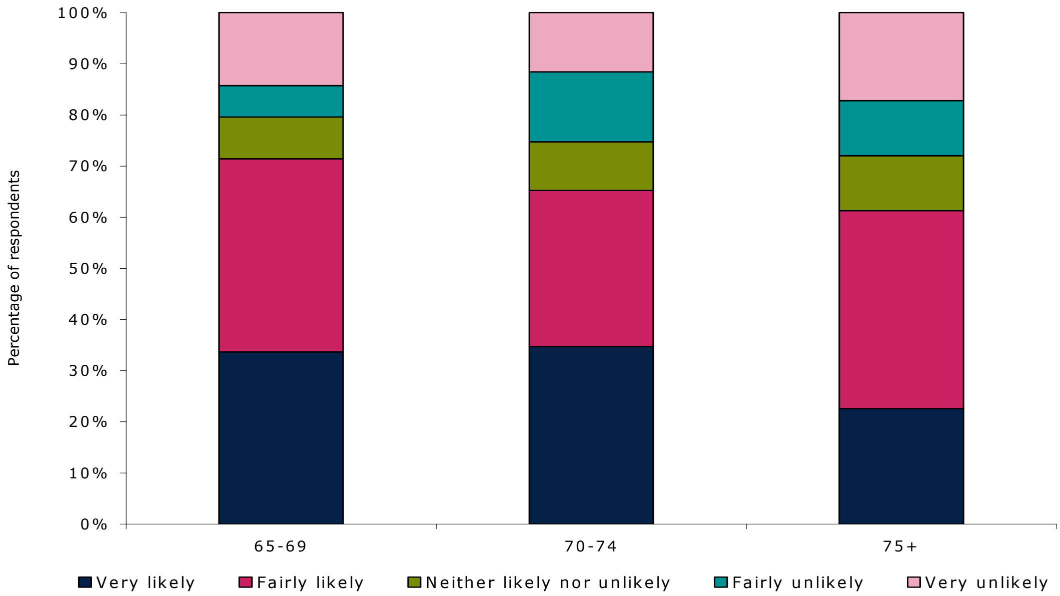
The availability of the signpost could also represent a useful tool for new entrants who wish to specialise in serving older customers because, even without strong brand recognition, they would have customers directed to a location where the contact details of the new entrant are made available. This may reduce the entry barriers for new firms seeking to serve this segment of the market.

One of the difficulties for signposting for older people is that some firms may be willing to be on the signpost because they will serve people at older ages, but may be unwilling to provide cover for various medical conditions which are highly correlated with age. As such, older customers directed to the signpost who have medical conditions may find themselves searching between providers who they think will offer them insurance, but who in practice will not. However, this represents the difficulty of finding cover associated to different medical conditions rather than age.

In addition, the efficiency of competition would be expected to increase because of changes to the search process for older customers. At present, around 25% of customers over the age of 65 have been turned down by an insurance company. Although the great majority of these do end up finding insurance, they have to spend time searching for providers who would be willing to serve them. For those who would use the signpost, it would eliminate some of this unproductive search activity. This could allow more shopping-around between providers who offer quotes.

Our consumer survey finds that about 65 – 70% of consumers across age groups would be likely to use the information provided by signposting, suggesting a potential reduction in search costs.

Figure 22 Willingness of consumers to use information provided by signposting



Source: CRA survey of 300 older consumers who have taken out or attempted to take out travel insurance. The survey question asks: "If the company who wasn't willing to quote provided details of a website or phone number which listed multiple providers who would be willing to give you a quote, how likely would you be to use that information?"

Overall around 63% of consumers would be willing to use the information provided by the signpost.

Respondents to our survey who state that they would be likely to use information regarding a signposting system state that they will use this information to contact around 4.9 providers on average. This compares to current practice where they only contact a total of 2.9 providers on average. It is well recognised that consumers tend to overstate their shopping-around habits in surveys and thus this estimate is likely to be an overestimate of the amount of shopping-around that they would conduct.

Compliance costs

Our compliance cost survey has confirmed that the cost of firms sending customers to a signpost is relatively modest. Compared to the previous scenarios, the one-off and ongoing costs of signposting are both much smaller reflecting the relative ease of setting up the system and maintaining it. The ongoing costs of signposting are much higher than the one-off costs because of longer call times.

Table 20 Compliance cost – signposting

	Total scaled up costs (£)	£ per million premium	£ per average policy
Additional one-off costs	£0.5 million	£800	£0.03
Additional ongoing costs	£2.8 million	£4,400	£0.13
Average annual costs	£2.9 million	£4,500	£0.14

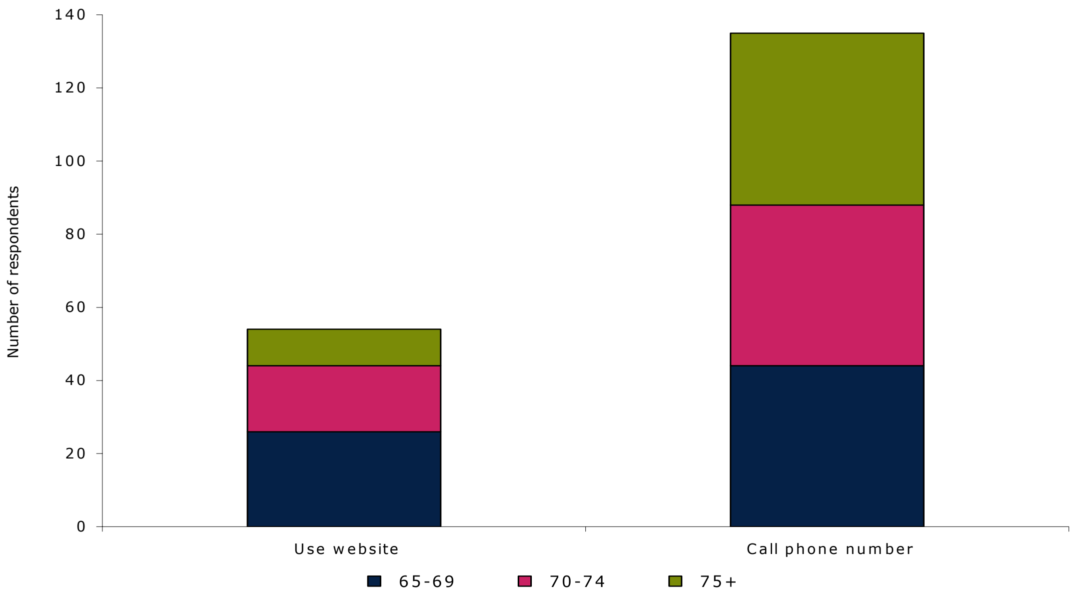
Source: CRA survey. One-off costs have been spread over five years to obtain the average annual costs. An average premium of £31 has been used to calculate the cost per average policy..

In terms of setting up the signpost it does not seem as though this would entail significant costs. Macmillan Cancer Support provides a list of insurance companies who offer insurance to customers who have had cancer. Companies on the list are ones which have been recommended by customers although we understand that they are seeking to improve the way that they manage this list. Discussions have indicated that setting up the list in the first place was not a particularly costly activity. Ongoing costs are incurred through checking of both contact details and that the companies do in fact offer cover for cancer.

Estimates made by HM Treasury indicate that BIBA operates a helpline to signpost or refer enquiries to BIBA members. While this is not a perfect comparison, the cost of this operation is less than £250,000 per year.[62]

Our consumer survey also finds that consumers across all older age groups would prefer the signpost to be phone based (68%) rather than a website (32%) and this preference increases for older groups.

Figure 23 Would you prefer to use a website or to call the phone number?



Source: CRA survey of 300 older consumers who have taken out or attempted to take out travel insurance. This is based on a sample size of 189 consumers who are likely to use the information provided by signposting in travel insurance.

Referral

It has been assumed that the referral requirement for travel insurance would apply only to single-trip insurance. This is because there are only a very small number of firms currently willing to offer annual travel insurance to customers irrespective of age and thus it is not clear that a referral scenario applied to annual travel insurance would be sustainable.

[62] Age discrimination in financial services: final report of the Experts' Working Group, HM Treasury, October 2008.

Quantity

Bringing in referral arrangements would be expected to have a slight increase in the number of travel insurance policies sold although this would be minimal given the small number of people who fail to obtain travel insurance today. Based on our survey we find that 82% of older customers would be willing to consider purchasing through the new company that they were referred to.

Quality

Concerns have been expressed regarding the impact of referrals on customers and in particular whether the customers would be confused about who is providing the insurance for them and what the claims process would be. However, there is no evidence that this is the case for customers who currently go through a referral process.

Interviews with those insurance companies which operate referral systems currently suggests that customers are clearly told that they are being referred, who the underwriter is and how to make claims. Indeed in cases where referrals involve providing a branded solution to the customer, the brand owner has every incentive to ensure that customers have clarity regarding their insurance and that the referrals process does not lead to increased complaints.

Since age limits are currently lower for travel insurance than for other insurance products, this is where customers are most likely to hit a limit first. The main reason given for arranging referrals for travel insurance is that of customer service and to engender loyalty so that older customers in the 60s and 70s consider purchasing other forms of insurance from the same firm such as home insurance and motor insurance (where limits are much higher). Similar incentives to prevent damage to the brand in other parts of their book would also apply to companies required to refer customers under this scenario and therefore quality would not be expected to reduce.

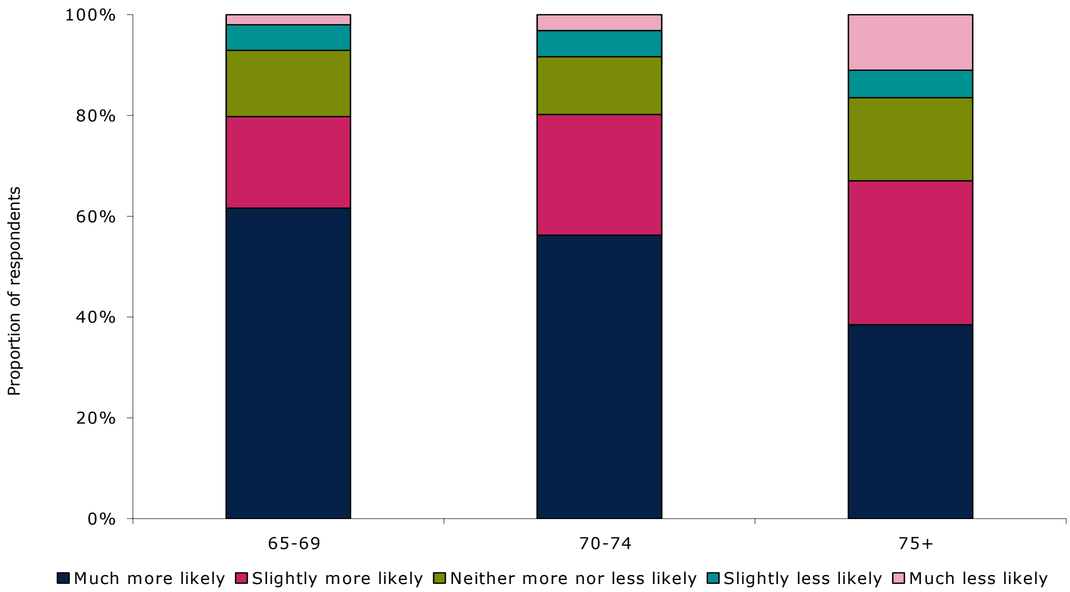
Variety and efficiency of competition

The use of referral arrangements would be expected to increase the number of times customers successfully receive a quote when they search any given provider. As such shopping-around would involve searching *between* different quotes rather than searching *for* a quote and this would be expected to lead to increased competition and better outcomes for customers.

There are possible concerns regarding referrals that only a small number of providers or in the extreme only one provider would be willing to be the companies which are referred to. Some have argued that this would lead to a reduction in competition as all customers would end up being referred to the same provider. In practice, however, if firms are willing to serve older customers now there is no reason to suppose that they would bring in a referral arrangement for anyone but a group of customers that they do not currently serve. Thus the referral of customers would happen only for those customers who would not previously have been given a quote. It is not clear that this can lead to a reduction in competition compared with today. Further, if being the company referred to is highly profitable we would expect competition between firms to be this company which would in turn place pressure on pricing. Nonetheless discussions with interviewees indicate that few firms have referrals in place for travel insurance because there are few providers who are willing to take on large numbers of these high risk customers.

Turning to the behaviour of consumers, our survey finds that customers who are referred would still choose to shop-around. Although reassuring, customer often over state their willingness to shop-around in such surveys.

Figure 24 Would the referral make you more or less likely to shop-around than would otherwise have been the case?



Source: CRA survey of 300 older consumers who have taken out or attempted to take out travel insurance.

Around 72% of consumers state that the referral would make them more likely to shop-around. Importantly, only 10% state that it would make them less likely to shop-around.

Compliance costs

As with signposting, referral requires much smaller compliance costs compared to removing age limits or narrowing age bands. Most insurance companies struggled to provide compliance costs for the referral that were different to those provided for signposting since they indicated that the costs would depend on exactly how the referral arrangement worked. Conceptually it could be very similar to signposting if it involved simply providing details of the partner.

Interviews with insurers have indicated that a referral system where customers and their information are transferred would be more costly, but these costs have not been captured by insurance companies. Hence the costs presented in Table 21 should be treated with particular caution since the actual costs of referral could vary significantly from those shown.

Table 21 Compliance cost – referral

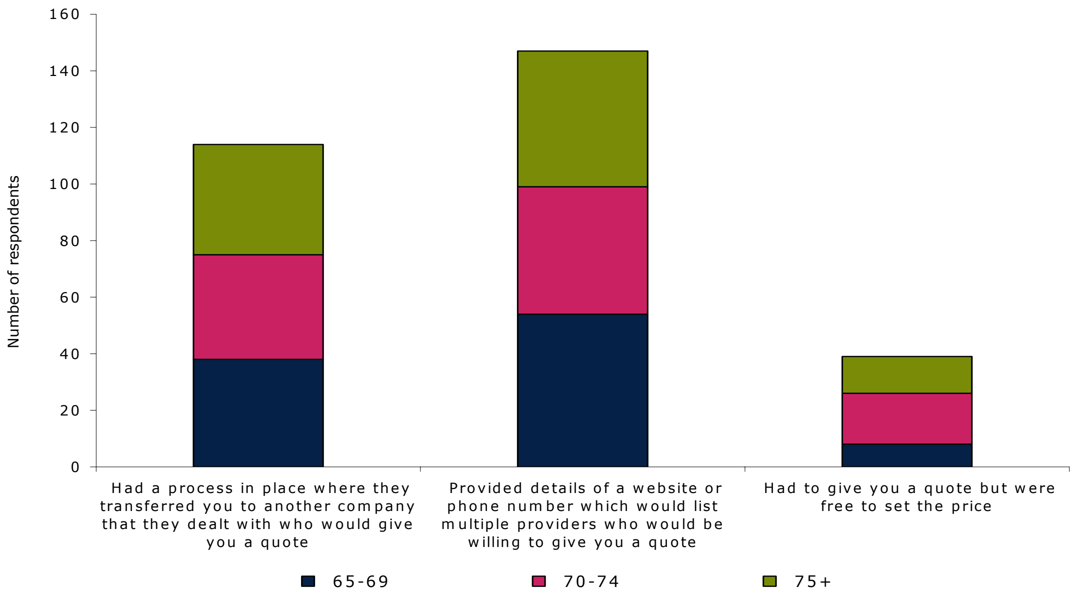
	Total scaled up costs (£)	£ per million premium	£ per average policy
Additional one-off costs	£0.7 million	£1,200	£0.04
Additional ongoing costs	£2.8 million	£4,400	£0.14
Average annual costs	£3.00 million	£4,700	£0.14

Source: CRA survey. One-off costs have been spread over five years to obtain the average annual costs. An average premium of £31 has been used to calculate the cost per average policy.

Signposting v referral

Our consumer survey finds that slightly more consumers prefer signposting to referral. However, our survey shows that referral leads to consumers being at least as likely to shop-around as signposting. Furthermore, given the relatively small number of insurers who have no age limits on both annual multi-trip and single-trip travel insurance products (and hence the low number that might appear on a signpost), the difference in enhancing competition is rather minor between signposting and referral.

Figure 25 If a company was not willing to provide a quote do you think it would be better if they...?



Source: CRA survey of 300 older consumers who have taken out or attempted to take out travel insurance.

Benefits from policy scenarios

There are a number of different types of benefits which potentially arise from the policy options. In this section we quantify the benefits which arise from the following areas:

- Benefits from customers obtaining insurance who could not previously get insurance;
- Benefits from being able to go on holiday with travel insurance; and
- Benefits from improved search.

We examine each of these in turn below and then consider which of these benefits would arise, and to what extent, from the different policy options examined. Other benefits also arise which have not been quantified but are based on the discussion in each of the policy scenarios described above.

Benefits from obtaining insurance

Consumers above 65 account for 17% of the travel insurance market. Among them, 25% had difficulty in finding insurance and 7% of them could not get any cover in the end. Were they all able to get cover, the value of premiums would increase as shown in Table 22. To the extent that some customers are unable to obtain insurance because of medical reasons rather than age, this represents an over estimate of the benefits.

Table 22 Benefits from obtaining insurance

Proportion of population aged 65 and over who go on holiday [a]	17%
Proportion of respondents aged 65 and over who had difficulty in getting travel insurance [b]	25%
Proportion of these respondents who did not subsequently obtain cover [c]	7%
Premiums for older customers compared with average [d]	214%
Gross written premiums for travel insurance [e]	£642 million
Value of premiums to those who previously were unable to obtain insurance [f]=[a]*[b]*[c]*[d]*[e]	**£4.08 million**

Source: [a] from National Statistics population numbers weighted by GfK/NOP data on the proportion of people who do not go on holiday from Insurance and Age: Exploring behaviour, attitudes and discrimination. A report from Age Concern and Help the Aged. Research undertaken by CM Insight and Andrew Smith Research. [b] and [c] from Saga Populus survey. [d] based on quoting information comparison website for single and annual trip insurance and taking a weighted average of quotes by age to obtain both the overall average and the weighted average for those 65 and over, weights are based on National Statistics population numbers and GfK data noted in [a]. [e] from ABI figures.

Benefits from being able to go on holiday with travel insurance

As well as benefits arising through obtaining insurance, additional benefits arise because older people can now go on holiday with travel insurance. In order to assess the value of this, we asked consumers, hypothetically, how much they would be willing to pay as an extra premium to enable them to go on holiday with travel insurance. The benefits are therefore calculated from the same sample of customers who are newly able to obtain insurance.

Table 23 Benefits from being able to go on holiday with insurance

Value of premiums to those previously unable to obtain insurance [f]	£4.08 million
Willingness to pay above existing premium [g]	18.17%
Benefits from continuing to drive [h]=[f]*[g]	**£0.74 million**

Source: [f] from CRA survey.

Benefits from improved search

We use the same approach to estimate the benefits from improved search as in the motor insurance chapter. Consumers can benefit either from reduced search time or improved quotes, which are estimated in Tables 24 and 25 respectively. Again, we take the higher of the two figures. This is an upper-limit estimate as in practice we do not know if customers would use all the time they save in getting their first quote to search for further quotes.

Table 24 Benefits from improved search – less search time

Number of population aged 65 and over and go on holiday [j]	4,481,289
Population who can now go on holiday [k]=[j]/(1-[b]-[c])	4,561,109
Proportion of population aged 65 and over who now go on holiday who take travel insurance [m]	85%
Proportion of respondents aged 65 and over who had difficulty in getting insurance when go on holiday [b]	25%
Cost of hour based on minimum income in receipt of Pension Credit [n] [63]	£3.10
Average amount of time spent before obtaining a quote [p]	26 minutes
Benefits from less search time [q]=[k]*[m]*[b]*[n]*[p]/60	**£1.30 million**

Source: [j] from National Statistics and Age Concern estimate on who goes on holiday. [m] from FSA estimates. [b] and [c] from Saga Populus survey. [n] based on information from The Pensions Service on Pension Credit of £124 per week and 40 hour working week. [p] based on CRA consumer survey taking time spent to obtain the first quote for those who do not get a quote from the first provider they contact minus time spent to obtain the first quote for those who do get a quote from the first provider they contact.

Table 25 shows the benefits from improved search on the basis that individuals continue to spend the same amount of time searching but have an increased number of quotes from which to choose.

[63] An alternative value of time is available from the Department for Transport, Values of Time and Operating Costs, February 2007. They state that the cost of non-working, non-commuting time is £4.46 in 2002 prices which, when updated according to their growth rates for the value of time, would be £5.11 in 2008 prices. Using this value would increase the benefits calculation to £2.15 million.

Table 25 Benefits from improved search – increased number of quotes

Population who can now go on holiday [k]	4,561,109
Proportion of population aged 65 and over who now go on holiday who take travel insurance [m]	85%
Proportion of respondents aged 65 and over who had difficulty in getting insurance when go on holiday [b]	25%
Reduced price through additional quotes – Annual [r]	£8.63
Reduced price through additional quotes – Single [s]	£10.68
Benefits from increased number of quotes [t]=[k]*[m]*[b]*([r]+[s])/2	**£9.36 million**

Source: [k] calculated as above. [m] from FSA estimates. [b] from Saga Populus survey. [r] and [s] based on CRA consumer survey; This assumes an increase from 2.9 quotes to 4 quotes on the basis of an average of 1.1 unproductive searches before obtaining a first quote; a maximum price of £134.52 and £125.86 and a minimum price of £45.7 and £15.9 for Annual and Single respectively for a 68 year old from a comparison website; We then assume that there is a uniform distribution of prices; The price reduction is therefore calculated as the difference in (maximum price minus minimum price)/number of quotes; This is consistent with the approach used in Market impacts of regulating general insurance, CRA International for the ABI, March 2006; a simple average of the price reduction for annual and single policies is then used – this is a simplifying assumption but a weighted average would have limited impact since annual policies represent 51% of GWP and single policies represent 49% of GWP.

Benefits by policy scenario

Table 26 sets out which of these benefits would arise in each of the different policy scenarios under consideration or the degree to which they would arise.

Table 26 Total benefits by scenario

		No maximum limits	No age limits	No age limits and integer age band	Signposting	Referral
Quantity	Obtaining insurance	100%	100%	100%	63%	82%
	Going on holiday	100%	100%	100%	63%	82%
Quality		--	--	--	+	+
Variety		-	--	---	+	+
	Improved search	100%	100%	100%	63%	82%
	Total benefits	**£14.2 million**	**£14.2 million**	**£14.2 million**	**£8.9 million**	**£11.6 million**

Source: Based on the proportion of respondents to survey who would use signposting or referrals. Note that the scenarios regarding no age limits and no age limits and integer age band apply for objective justification as well.

Conclusion

In the travel market, insurers commonly use wide age bands and apply age limits. The application of these limits varies between providers with lower limits applying to annual policies (73 on average) than to single policies (85 on average). The group of potential customers who are not able to find an insurer is again small (less than 2%) but a large group are turned down by at least one insurer (25%) increasing the search cost associated with obtaining a quote. Hence information problems where customers do not know who would be willing to offer them a quote leads to unproductive searches arising.

Unlike in the motor market there is little evidence that the use of limits or bands is diminishing and there is little evidence of entry into the market to serve older customers. However, some providers offer referrals to other providers, and specialists are willing to quote for the entire market.

Of the policy scenarios considered, there is a trade-off between the alternative policies. Removing maximum age limits brings the greatest gross quantifiable benefits, but once costs are taken into account, referrals and signposting have the highest net benefits.

Both referrals and signposting would bring benefits in terms of assisting customers in obtaining a quote and reducing the amount of unproductive search that arises due to failure to obtain quotes. Both referrals and signposting would therefore enable older people to shop-around more productively and bring about better value products. While benefits for referrals dominate those for signposting because more people would use the referral than the signpost, the cost numbers calculated for referrals are less robust and are based on minimal differences between referral arrangements and signposting arrangements. The actual costs of more complex referral arrangements where data and people are transferred during the same phone call could be somewhat greater. It is also unclear whether there will be a large number of companies willing to act as the company to which customers are referred.

Removing age limits would remove any concerns about access to insurance, although insurers would incur costs on adjusting their actuarial models and IT systems, and changing sales processes. It may, however, lead to a reduction in the quality of insurance cover as more restrictions are applied on pre-existing medical conditions and higher excesses are applied in order to limit the risk exposure for insurance companies. In addition, it raises barriers to entry to firms wishing to serve the older age group alone since they would also have to serve younger customers.

There do not appear to be any large economic benefits from the forced removal of age bands although this could reduce some cross-subsidies within bands and improve economic efficiency. However, more complex selling processes and systems changes will mean higher prices for everyone. It will also result in smaller jumps in price although the economic benefits of this are unclear. In addition, costs will be imposed on travel agents who currently use age bands in their systems – although it has not been possible to capture these costs during this project.

Table 27 gives the net benefits we estimate for each of the policy scenarios under consideration. As with motor insurance, it should be noted that while the benefits will accrue to older customers, it is unclear whether the costs will ultimately be incurred by older customers or spread across a larger number of customers of all ages.

Table 27 Total net annual benefits by scenario

	No maximum limits	No age limits	No age limits and integer age band	No age limits, integer ages objective justification	Signposting	Referral
Quantity	£4.8 million	£4.8 million	£4.8 million	£4.8 million	£3.0 million	£4.0 million
Quality	--	--	--	--	++	+
Variety	-	--	---	---	+	+
Efficiency	£9.4 million	£9.4 million	£9.4 million	£9.4 million	£5.9 million	£7.7 million
Total quantified benefits	£14.2 million	£14.2 million	£14.2 million	£14.2 million	£8.9 million	£11.6 million
Total quantified costs	£10.8 million	£10.8 million	£10.9 million	£11.1 million	£2.9 million	£3.0 million
Net quantified benefits	**£3.4 million**	**£3.4 million**	**£3.3 million**	**£3.1 million**	**£6.0 million**	**£8.7 million**
Net quantified benefits per policy	**£0.16**	**£0.16**	**£0.16**	**£0.15**	**£0.29**	**£0.41**

Source: CRA calculations. --- strongly negative; -- negative; - slightly negative; + slightly positive; ++ positive. [64]

It is clear from Table 27 that the net benefits in all scenarios are small. The largest net benefit arises in the scenario where signposting or referrals are applied where at most £8.7 million net quantified benefits arise each year, although even this represents only 1.3% of the value of gross written premiums in this market. Given the uncertainties that attach to cost-benefit analyses and the potential for unforeseen unintended consequences, it is difficult to know whether this small net benefit is significantly different to zero. In addition, the trivial nature of the net benefits reflects the fact that there is no significant market failure.

[64] An alternative to spreading the one-off costs over five years would be to calculate the net present value of the costs and benefits. Based on using a 10% discount rate we find that the five year NPV calculations are: £14.0 million, £14.0 million, £13.5 million, £12.6 million and £36.0 million in order of the scenarios in the table.

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