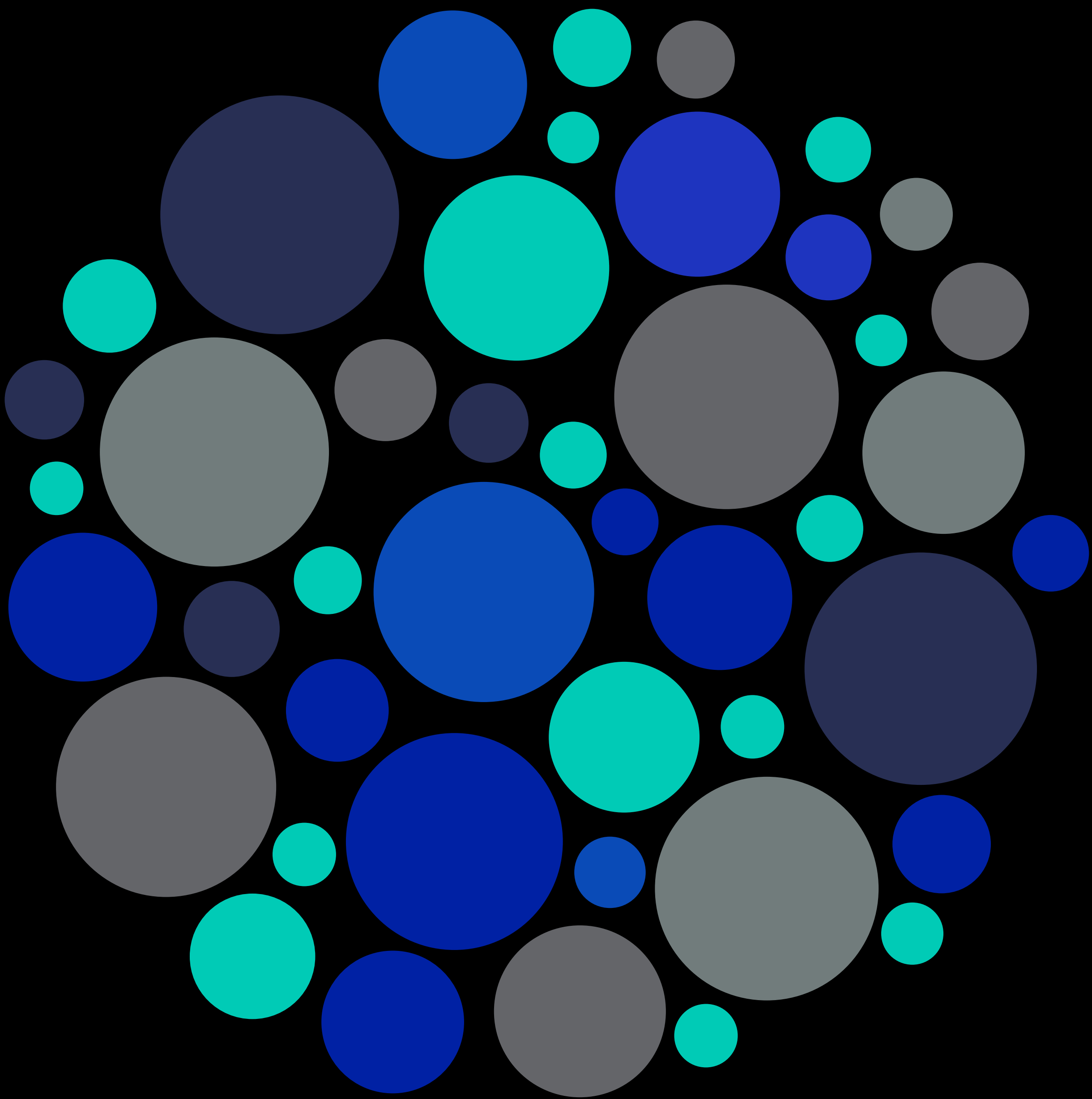
LLOYD'S

Building simpler insurance products to better protect customers

The insurance industry response to COVID-19



Sharing risk to create a braver world

Contents

Foreword 03

1. Overview 06

2. The drivers of complexity and benefits of simplification 09

3. Existing leading practice 13

4. Insurance design innovations 19

5. Recommendations 24

6. Taking action in the Lloyd's market 27

Appendix 1: Worked example of simplification levers applied in cyber 31

Appendix 2: How simplification levers could be applied to business interruption parametric and outcome-based products 36

Foreword

The ongoing catastrophic societal and economic impact of the COVID-19 pandemic continues to demonstrate the significant challenges ahead, as governments around the world grapple with the consequences of this devastating health crisis.

While the global insurance industry's response and recovery efforts continue to expand through claims payments, charitable donations, and product innovation, there have been distinct complications that have arisen from pandemic insurance coverage uncertainty and resulting court disputes between insurers and their customers.

Although insurers have been actively exploring ways in which they can remove complexity and improve clarity, these complications have highlighted an urgent need for the global insurance industry to accelerate and further extend its efforts to simplify products and promote greater understanding of the cover it is providing to its customers.

Product complexity is an enduring challenge faced by the global insurance industry and its customers – from multi-national corporations, through to entrepreneurs and small business owners; as insurance products have evolved over time, they have become more complex in their design and the way in which they are delivered to customers.

This complexity can lead to a lack of customer engagement with the product they are purchasing, alongside a coverage expectation gap between the insured, and the insurer. This is a result of a number of influencing and interdependent factors which are described in this report and that remain front of mind for the industry as it continues to improve the way it protects and supports its customers, including through leading practice and product innovation.

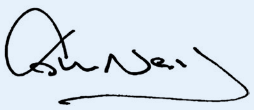
This report has been published to support the global insurance industry's efforts to better serve its customers through simpler products that promote enhanced understanding of coverages. It provides three important recommendations that the industry should implement to respond to the challenges that COVID-19 has presented, together with several actions that the Lloyd's market will itself deliver to improve the way in which it provides products and support to its customers.

Foreword

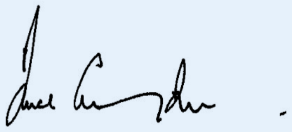
While product complexity presents a challenge for all customers, small to medium-sized businesses, who often lack access to risk mitigation advice, are particularly impacted where there is coverage uncertainty. For this reason, the report focuses first on how the industry and Lloyd's can further extend leading practice and product innovation to these customers, and in time implement them across more complex specialty products bought by larger firms.

The fundamental purpose of insurance is to provide comfort and confidence to customers in a world full of changing risks that could threaten their livelihoods. We sell a promise to pay when the worst happens, based on a trusted relationship and shared understanding between the customer and their insurer.

While the societal and economic impacts of the pandemic are of a scale that has never before been experienced, it has reinforced the global industry imperative to accelerate our efforts to build simpler insurance products that are more easily understood by our customers. In doing so, Lloyd's and the global insurance industry will remain relevant and trusted by customers, creating a braver, more resilient world.



John Neal
CEO, Lloyd's



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1. Overview

The COVID-19 pandemic has set in motion irreversible societal change, calling for new insurance solutions and greater protection for customers' short, medium, and long-term needs, as outlined in Lloyd's *Supporting global recovery and resilience for customers* report.

As countries and businesses cautiously reopen and start recovering from the immediate economic and societal impacts, the insurance industry must take this opportunity to improve the way it protects its customers.

Insurance plays an essential role globally for society – by providing financial relief to customers during challenging times, it helps people, businesses and economies recover from unexpected disasters. For many, this worked as intended during the COVID-19 pandemic, and we expect that the global insurance pay-out will be over $100bn, of which the Lloyd's market will pay in the range of $3bn to $4.3bn.

However, in some instances there has been confusion. While many insurers around the world believed coverage under business interruption policies did not extend to pandemics, there were a number of cases where customers did not agree. This is a frustrating and disappointing outcome for all. If insurers pay disputed claims where pandemics were not intended to be included under the coverage, they will be paying claims for which they have neither received premium nor reserved capital. If customers' claims are not paid when they believe they have cover, they may not receive compensation that they were relying on and may over time choose to insure less risk – putting them in a more vulnerable position for when the next disaster strikes.

Earlier this year Lloyd's interviewed executives and experts across key global industries to understand their priorities as a result of COVID-19. The research found that some attitudes to insurance had deteriorated, with the perception that some policies have not performed as expected. An insurance contract is a promise to pay valid claims as they arise, and all customers – whatever their risk needs and sophistication – want clarity about what they are and aren't protected against.

These challenges highlight the urgency with which the global insurance industry must invest and focus on clarifying and simplifying its products. Doing so will mean customers have improved understanding of the cover they have in place and the most relevant protection for the risks they face.

Whilst we have heard the challenge clearly from customers at all levels, the need is particularly pressing for small to medium-size enterprise (SME) customers, who make up a substantial proportion of insurance policies sold globally but who typically have significantly less access and resource dedicated to risk management than larger corporate firms. By providing greater clarity of coverage, insurers and brokers can reduce prudential and conduct risk and, most importantly, better protect customers – helping us to offer customers greater value and fulfil our purpose as an industry.

Reinsurers also have a key role to play. As the industry develops new and enhanced ways of providing insurance products to its customers, insurers need confidence that reinsurance capital will respond to claims. Availability of reinsurance capital may also inform what risk transfer innovations insurers are able to offer customers.

1. Overview

Much progress has already been made in developing regulation, guidance and codes of conduct to provide greater clarity of coverage for customers, with the global insurance industry committed to this goal. Although the core principles already exist and are actively being applied, we have taken the opportunity to restate them, as well as to consider new ways to apply them in practice. These principles focus on how insurance products are worded and distributed today, as well as providing more innovative options which challenge and reconsider traditional insurance wordings, contract structure and delivery. They are particularly relevant to insurance products bought by 'individuals' – such as consumers or micro and small businesses – but over time should be extended to more complex specialty products which are often bought by professional buyers on behalf of larger businesses.

Whilst this report is not a comprehensive set of answers and cannot ensure that customers will always understand and buy the right cover, it sets out three key recommendations (see Chapter 5) that the global insurance industry should implement across all customer segments to respond to the challenges that COVID-19 has presented:

1. **Leverage and build on the application** of existing leading practice, including a linguistics review of customer documentation – for both simple and more complex products.

2. **Invest in continuous product design and delivery innovations,** including data-led policies and digital contracts, as well as exploring more radical options like parametric or outcome-based insurance.

3. **Involve customers directly in product design** to build simpler, more relevant products for their changing needs and post-pandemic risk profiles.

Alongside these global industry recommendations, Lloyd's is taking its own affirmative action. This includes reviewing how products are developed, designed and distributed, as well as reaching out to trading partners, risk managers and customers, so it can proactively implement changes across its global marketplace to enhance customer outcomes and more effectively meet their needs (see Chapter 6).

As many businesses around the world evolve to withstand the continued impacts of the COVID-19 pandemic, including radically changing their business models, the insurance industry must urgently reassess how it can better serve and support its customers. By simplifying insurance product design and delivery, Lloyd's and the global insurance industry will ensure it remains relevant and trusted by customers, creating a braver, more resilient world.

2. The drivers of complexity and benefits of simplification

Insurers sell a promise to pay valid claims as they arise. This provides peace of mind and allows buyers to take measured and well managed risks to achieve their ambitions.

The more complex a product is, the less likely it is to provide peace of mind to customers. Worse, it may be the case that if customers do not fully understand the terms of their product, they either breach those terms or believe they have cover when they do not.

COVID-19 provides an inflection point for the insurance industry to take stock and reconsider how it can better serve its customers, and in doing so reinforce its critical societal role. Simplifying insurance products and enhancing customer understanding have significant benefits for all:

- **Customers** will have the confidence of knowing that they are protected, with clarity resulting in faster claims payment, shorter negotiation time, and fewer costly disputes.
- **Intermediaries** need to be able to fully understand a policy in order to communicate it to their customers. Simpler products make it easier for them to communicate and for customers to understand the coverage.
- **Insurers** will be able to provide more relevant, trusted products to customers, ensuring that they have the right pricing for the risk they are taking on, and the right amount of capital put aside should the customer need to call on it.

While these and the broad societal benefits are clear, complexity still remains in insurance contracts, which can lead to an expectation gap between the coverage insurers believe they have sold, and the coverage customers believe they have bought.

The reasons for this are interdependent and must be addressed holistically.

The way products evolve

Insurance contracts are legal documents which have evolved over time, often building on existing structures to maintain legal precedent, whilst adjusting to an ever-changing societal and risk landscape. This can lead to challenges when the scope of a policy extension does not fit easily into the structure of the original policy. Legacy technology systems and regulatory constraints can also be additional factors in creating complexity.

A prime example of this expansion of scope is business interruption cover, which is commonly offered to customers as an extension of a commercial property policy. As a result, conventional business interruption policies typically focus on damage to the physical premises and the denial of access that may result, rather than offering protection against other events which could disrupt operations without causing physical damage.

How products are sold and discussed with customers

Although one party is ultimately responsible for the product, some customers may purchase their insurance through an extended distribution chain of multiple intermediaries, which can increase the chance of a misunderstanding of the cover if the documentation itself is not clear enough.

Many personal lines products, for example, can be white-labelled and sold under a retail brand, with separate product administrators and underwriters. In addition, many retail and SME customers buy their cover online, and so receive less support, guidance or advice around the differences between policies or their suitability for their unique operations or risk profile.

2. The drivers of complexity and benefits of simplification

A relative lack of societal engagement around insurance is also a challenge. Many customers may not review their policy wordings in detail or have the expertise to know what cover they need until the worst happens – particularly in the case of more remote and extreme risks. In the wake of COVID-19, many businesses are having to rapidly adapt their operating models, so understanding how their risk exposures have changed and the resulting insurance implications may not be a priority.

How the policy is documented

Insurance documents often contain complex technical and legalistic language. While this may make it easier to comprehensively codify the cover provided, it can make documents difficult to understand, particularly for customers without a dedicated risk management function. It is also important to recognise an inherent conflict, in that what might seem a clear and simple contract to a customer might not necessarily be clear and simple from a legal perspective.

The design and format of documentation is also key, with factors such as the use of white space on the page, font size, paragraph layout and use of colour which affect the readability of a contract. Many traditional policy documents can also be hard for customers to read and digest on their preferred devices, for example on tablets or mobile phones.

Scope of coverage

Even when the language and structure of a policy document is clear and comprehensible, uncertainty may remain, particularly if the writer is aiming to reduce the contract's length. This can create a situation where the language is clear, but the intent does not match the implied scope. Focusing on the specific perils or the outcomes that will be most relevant to customers and seeking to find a balance between brevity and clarity can help. Not to do so can have significant consequences. Silent cyber, which arises when policies are not clear on whether coverage is provided for losses caused by a cyber event, is a prime example of this. Not providing affirmative coverage, or clearly excluding coverage, can lead to insurers under reserving, customers either under or over insuring, and potentially to costly claims disputes.

Customer insurance buying needs and behaviours

This report highlights the opportunity for the entire global commercial insurance market to reduce complexity and provide customers with greater certainty over their cover. All customers, irrespective of their size or sophistication, are undergoing significant changes and need products and industry approaches that respond clearly to their changing needs.

Initial efforts, however, should be focused on smaller commercial customers. These customers often have little to no expert resource dedicated to managing their risks, and less access to advice and support compared to mid-market and large corporates. SME insurance buyers account for a significant proportion of insurance policies sold globally and are also the group for whom COVID-19 has highlighted a notable expectation gap around how some insurance products have responded to.

	Consumer or micro enterprise	SME	Mid-market	Large corporate
Size	No employees	Up to 250 employees	250-5,000 employees	5,000+ employees
Insurance needs	Typically single location with non-complex risks	Typically single location with less complex risks	Typically located in a single country with less complex but larger risks	Larger and more complex risks, potentially spread across multiple countries
Insurance buyer	Individual	Owner or Finance Director	CFO	Specialist risk managers
Served by	Direct to insurer, local brokers or online	Direct to insurer, local brokers or online	Local or regional brokers	Regional or global brokers

Low → **High**

- Typical complexity of insurance needs
- Typical availability of advice and support
- Typical sophistication and risk literacy

Although known as the world's specialist insurance market, almost half of the risks traded through Lloyd's today are relatively simple, high volume and low premium.

A substantial number of these risk transfer products are purchased by retail and SME customers and through delegated authority insurance providers.

Consumer products at Lloyd's

21.5 million[1]
Consumers and micro enterprise customers

2,070
Consumers and micro enterprise products

79%
of products sold through coverholders

[1] Based on a snapshot view taken from Lloyd's December 2018 'Eligible Complaints Return'

The top five products represent 72% of consumer products being sold

Home & property	27%
Accident & health	21%
Travel	10%
Specie	9%
Motor	5%

Where consumer products are sold

UK & Europe	54%
US & Canada	19%
Australia & NZ	5%
Rest of the World	22%

Stand alone products	81%
Package policies and employee benefit or group policies	15%
'Add-ons' or secondary sales	4%

3. Existing leading practice

The industry and regulators have already taken steps towards addressing issues around insurance product complexity and clarity of coverage, including regulation, guidance and codes of conduct.

This has created leading practice, much of which is summarised below. Effectively adopting leading practice for all insurance products can be a challenge as many insurers operate globally and there are significant differences between jurisdictions. However, the principles at the core of simplifying insurance products can be applied consistently across the world, and include to:

- Provide clear and simple product documentation.
- Summarise key components of the contract up front.
- Review and rationalise product wordings.
- Enhance customer risk literacy and understanding of their cover.
- Improve customers' experience by monitoring and analysing the product journey.

Lloyd's operates to a set of Fair Value Principles which encapsulate what we consider to be fair value in consumer business and how we expect all customers to be treated. These Fair Value Principles, which form part of our oversight of the Lloyd's market, ask the seller to ensure that:

1. Products meet a genuine need of the customer.
2. Products are reasonably priced, reflecting the level of cover provided.
3. The acquisition costs, fees and charges are transparent and commensurate with the services that each party provides.
4. The terms and conditions of a product and the sales process ensure that customers understand what they are buying.
5. Products respond fairly and promptly in the event of a claim or complaint.

The most relevant principle in terms of reducing any expectation gap between customers and their insurers is principle 4 – ensuring that customers understand what they are buying.

We have outlined below different examples of existing leading practice to demonstrate how this principle is being applied effectively. Many have been developed in personal lines, but can also be applied to SME businesses, and potentially to larger corporate and specialist risks.

3. Existing leading practice

Clear and simple product documentation

Increasing the clarity and simplicity of documentation has been a consistent theme in personal lines guidance. Recommendations stress the importance of increasing the comprehensibility of policies (and all supporting pre- and post-sale documentation) by:

- Improving structure.
- Reducing the length of documents and the complexity of sentences (for example setting a target reading age of 13 or less).
- Removing jargon (or briefly explaining any complex terms which can't be replaced).
- Clearly signposting any exclusions.
- Using clear design to aid navigation and comprehension.

The Lloyd's Market Association (LMA) provides practitioners in the Lloyd's market with Consumer Wordings Guidance to assist with the drafting of new consumer products and the adaptation of existing commercial wordings for consumers.

The LMA has also begun a project to overhaul their model Home Insurance Policy to ensure that the coverage is as clear as possible. This involves not only simplifying the content but also producing a navigable document framework that will lend itself more easily to electronic trading. The aim is to produce an interactive contract, presented digitally, which includes icons and graphics that a customer can navigate around easily, using bookmarks and hyperlinks. Once this framework is in place, the same structure will be extended to other existing model wordings for consumer products as well as in the future development of new model wordings.

The demand for simplicity and clarity in document wordings can be seen through the increased adoption of seals such as the Crystal Mark, which was introduced to encourage firms to communicate more clearly with its customers and is now being used by over 2,000 member organisations[1]. The Fairer Finance Clear & Simple Mark was introduced in 2015 and looks at both the clarity of language as well as the simplicity of design. It sets a challengingly high bar, and so far only around ten policy documents have met the criteria[2].

The balancing requirement is that policy wordings also need to make sense in relation to their jurisdiction in law, which can be difficult to achieve. For complex risks it may be more challenging to simplify products and by necessity the focus may be on clarity rather than simplicity; though this should not preclude considering how leading practice might apply for customers with multifaceted risk requirements.

The Chartered Insurance Institute (CII) has launched *The Chartered Transparency Forum* to drive leading practice across the UK insurance industry. This group of senior practitioners; trade, consumer, and legal representatives has been established to:

- Assess the current gap in customer expectation around their insurance.
- Publish and promote guidance, outlining the principles by which all insurance professionals should take accountability for improving transparency, engagement and comprehension of communications relating to policy coverage.
- Identify existing materials and prioritise the development of future learning materials to improve the sector's broad expertise in how policy wordings work, and how their drafting can better match brand promises and consumer expectations.
- Lead a campaign to promote these standards and learning, with the objective of collectively improving public trust by reducing the expectation gap.

Impact score	Customer value	Implementation complexity
(for proposal described above)	**Medium**	**Medium**

[1] Plain English Campaign
[2] Fairer Finance

3. Existing leading practice

Summarise key components of a contract up front

The EU Insurance Distribution Directive[3] (IDD) introduced standardised product information documents for non-life consumer insurance products. These documents outline the key coverage, excesses, limits and exclusions – as well as common areas of misunderstanding. This is done in a consistent fashion to help improve customers' understanding and ability to compare different products.

Similar standardised summary documents could be used more widely for commercial insurance to provide the same benefits. If they also link to the different sections of the contract where further detail is available, this could provide an easy reference point to help customers quickly navigate the key contract components. Where products are purchased online, the summary should be shown prominently on screen, or where via a broker, it should be explained verbally and provided in writing to customers.

It is important to note that simply providing a product summary document will not fully realise the potential benefits for customers and the industry. The underlying policy documentation must also be reviewed to ensure it is clear, simple and reflects the intended coverage, so that it too can reduce any misalignment of expectation and provide clarity to customers.

An example of how a product summary could be written to give customers greater clarity around silent cyber coverage is included in *Appendix 1: Worked example of simplification levers applied in cyber.*

Impact score	Customer value	Implementation complexity
	High	Low

Review and rationalise product wordings

Many insurers operate in a large number of markets, across many lines of business and reach their customers through a variety of distribution channels. As a result they often offer a wide range of products, wordings and exclusions which have all been developed at different times to meet specific customer segments, and can be difficult to maintain.

Increasingly, many SME products are being sold and managed digitally, where the cover and limits selected will result in the insurer issuing tailored contracts using standard clauses. Accelerating this approach will enable insurers to move towards a modular approach built around common standards – which will drive tighter control on the wordings used, while also limiting alterations which do not add value.

Following this approach will help ensure that leading practice is consistently applied and supports the comparability of products, without limiting genuinely valued points of differentiation between insurers.

Impact score	Customer value	Implementation complexity
	High	High

[3] European Commission

3. Existing leading practice

Enhance customer risk literacy and understanding of coverage

Ensuring that contracts are easy to read and interpret so that customers can more easily understand their policies is integral to closing any expectation gap. Highlighting which risks aren't covered is also critical, as is providing support to customers around how to mitigate or protect against those risks.

Further support can be provided to customers through supporting materials or educational tools, such as videos or gamification techniques, that actively engage them around their risk profile, the value of insurance, and how their policy will respond to different events. These should not focus just on the 'point of sale' but should support the customer at all times to keep their insurance coverage at front of mind.

Industry associations are working together to find new and engaging ways to educate consumers and SMEs about insurance.

The British Insurance Brokers' Association (BIBA), the Confederation of British Industry (CBI) and the Association of British Insurers (ABI) have recently published an SME Insurance Guide to help small businesses understand the importance of managing risks, the role insurance can play, and how to choose the right cover for their business.[4]

The ABI has also launched a retail consumer education initiative, The Insurance Experiments, which aims to improve consumers' understanding of general insurance products through a series of engaging and colourful animations and practical use cases.[5] These are supported by a social media promotional campaign to engage consumers who might not otherwise seek out insurance education.

These supporting materials should help make the products clearer for both customers and distributors. Customers often buy cover through an extended distribution chain, relying on the broker or agent closest to them to communicate the cover and, in some instances, advise on its appropriateness. Therefore it is important distributors are encouraged to adopt fair value principles and these are applied consistently, together with explaining what risks are and are not covered, so that the customer can have certainty in the cover they are purchasing.

Layr is a US-based commercial insurance platform redefining the way small businesses purchase and manage their commercial liability insurance by giving control back to the business owner.

They have streamlined, standardized, and re-written the questions found on applications for insurance which allows business owners to quickly and accurately apply for coverage through a responsive proposal generator. Not only are the questions asked written in plain English, but the proposal generator also includes an integrated educational layer providing customers with detailed explanations of what the questions mean, why they are asked, and how the answers may impact their cover and premiums.

Layr is assisting agents and brokers during the COVID-19 pandemic by deploying a white labelled version of its platform directly to the clients of broker partners.

[4] SME Insurance Guide
[5] The Insurance Experiments

3. Existing leading practice

Furthermore, many customers can underestimate the likelihood and impact of the potential risks they face. The COVID-19 pandemic has highlighted that even risks that seem extreme and unlikely do occur. Where business is intermediated, it is the role of the broker to help customers understand the impact of remote risks and help them to determine whether these are risks for which they should obtain insurance or retain themselves – but insurers have a role in supporting these conversations.

Lloyd's will be piloting components of a Centre of Excellence to further explore systemic and remote risks.

The initial outputs will offer customers and their brokers a consumable, commercial and practical view of the types of systemic risks they might be exposed to – including their likelihood, possible economic impact and potential insurability – and will help to promote a broader societal discussion around the need for stronger mitigation and protection.

Impact score	Customer value	Implementation complexity
	Medium	**Medium**

Improve customers' experience by monitoring and analysing the product journey

The insurance industry must constantly and consistently find ways to improve the customer experience throughout the insurance lifecycle – from when they look to buy coverage, through to their moment of need. To do that, brokers and insurers must employ dynamic and responsive measurement tools, using appropriate metrics to track against fair value principles.

By improving the way that customer experience is monitored and analysed, insurers and brokers can more easily identify pain points and quickly take actions – especially when there are significant numbers of complaints, cancellations, lapses, queries or rejected claims. For example, coverage consistently cancelled within a 14-day cooling period may indicate that a product isn't suitable for the customer base to which it is being sold.

There are also many ways that the industry can better measure customers' experience and the success of its actions to build simpler products to better protect its customers. These include:

- **Customer surveys:** gauging customers' experience at key interaction points, the fit of a product to their need and their level of understanding of the coverage provided.
- **Customer engagement tools:** understanding how engaged customers are in the purchase process and how they will manage dynamic changes to their risk profile.
- **Net Promoter Scores (NPS):** understanding customers' willingness to recommend a company's products or services.
- **Rejected claims analysis:** providing a thematic indication of any expectation gap between customers and their insurer.
- **Complaints analysis:** providing insight into customers' understanding and interpretation of their cover.
- **Cancellation of cover:** indicating where products have not met customers' expectation.
- **Cover 'Not Taken Up':** identifying products that may not be not appropriate for their target customer segment.

Impact score	Customer value	Implementation complexity
	High	**Low**

4. Insurance design innovations

While effectively applying existing good practice would significantly improve outcomes for customers, carriers and distributors, there are more innovative ways to make the cover provided clearer.

These include:

– Digital contracts.
– Modular contracts.
– Dynamic customer comparison tools.
– Parametric insurance products.
– Outcome-based insurance products.

Digital contracts driven by data-led policies
Today's insurance contracts are document-led, meaning that the record of cover is often a long, difficult-to-read contract. Moving from traditional documents to digital contracts – data objects with inbuilt structure and logic, supported by common data standards and digital connectivity – could ultimately offer a single interrogable source of information on the coverage for all parties.

The use of digital contracts would provide a more sophisticated alternative to traditional document-based contracts and enable new ways of presenting a contract that offer greater opportunities for customers to engage and understand their policy. This could include the ability to visualise a contract and test how it would respond in different scenarios, applying a layer of Artificial Intelligence (AI) allowing customers to compare underlying clauses or ask questions about their coverage, or to present the contract in new, more engaging media such as videos, images or apps.

Digital contracts are already evolving to be app-based, making them easy to use, purchase and interrogate. This is particularly true in emerging markets, such as Brazil and South Africa, where personal lines insurers often use images of objects covered, uploaded via mobile phone app, as the basis for a contract, and as a way to help people understand what they are insuring.

Digital contracts can also improve customer service by automating some processes according to the terms of the cover. For example, if they detect that the customer, the nature of the claim, the type of cover and the cover limit can all be reconciled, then a claim could be paid automatically. This type of automated responsive digital contract (often described as a "smart contract") relies on external and customer data and would typically be delivered through a purpose-built online platform.

Through the Future at Lloyd's, we are moving from a document-first to a data-first world that would enable digital contracts.

The ambition for Lloyd's complex risk platform and risk exchange is to develop a data-first technology platform to enable efficient sourcing and placing of risks, using common data sets and standards to improve the negotiation process. For complex risks the future insurance contract will be digital, drawing on submission data, quote details, a rules engine and selections from clause libraries to build the contract digitally, ensuring that the contract is right first time and consistently for all parties.

Impact score	Customer value	Implementation complexity
	High	**High**

4. Insurance design innovations

Enhance customers' ownership of their cover through modular contracts

One application from personal lines cover that has been making its way into commercial contracts is a 'modular' approach – with individual covers sitting beneath a master policy.

Encouraging the customer and broker to go through their risk choices and build and update their cover on a modular basis provides the customer with greater ownership and opportunity to input into their policy. It also promotes a greater understanding of what is and is not covered, as well as the relative costs of each module of cover.

This approach still ultimately relies on the underlying contract generated being clear and simple, but can increase customer understanding by prompting customers to engage with the details of the insurance cover they have chosen.

Impact score	Customer value	Implementation complexity
	Medium	**Medium**

Dynamic customer comparison tools

As insurance contracts become clearer, customers will have a better view of the different types of cover provided, under what conditions, and with what exclusions.

To help build their understanding and inform their choices, further support could be provided by distributors offering interactive comparison tools. These tools could highlight the extent of cover that each policy would provide under different scenarios, or even a check the comprehensiveness of a customer's cover across all of their policies.

Developing these tools and services alongside risk educator tools would help customers to think about the risks they face and how different covers would respond to different events. This could include "what if" functionality, showing how contracts are expected to respond under different or unexpected circumstances.

New technologies could be used to support these tools and truly revolutionise the way customers engage with their contracts and compare the products on offer to them. For example, technologies such as Optical Character Recognition, Machine Learning or Natural Language Processing could be used to analyse and compare the underlying wording in different contracts – highlighting key terms, exclusions and feeding a comparison tool to support customer decision making.

Impact score	Customer value	Implementation complexity
	High	**Medium**

4. Insurance design innovations

Parametric insurance products with clearly defined trigger events

Traditional indemnity insurance reimburses a customer for actual losses that they have incurred. A parametric product, on the other hand, links the payment under the policy to a pre-agreed and independently verifiable trigger (the 'parameter').

A parameter could be defined around the magnitude of a single event (such as a pre-defined rainfall or windspeed), an index (such as commodity price indices), or a specific customer outcome (such as the explosion of an engine). The level of indemnity that is provided is pre-determined and established based on the chosen parameter being triggered, and should be strictly correlated with a loss outcome for the policyholder

Parametric products offer several potential benefits to customers and insurers, including reducing claims-adjusting costs and enabling prompt claims settlement. By reducing complexity in the claim's adjustment process, parametric products also offer customers greater certainty around what payment they will receive and greater confidence around their liquidity in times of crisis. This might be particularly relevant where a customer is very exposed to a high level of natural peril or catastrophic risk, for example where a customer's property is located in regions with seismic activity, windstorm activity or other adverse weather. A number of parametric products are already available in the Lloyd's market for areas prone to natural disasters.

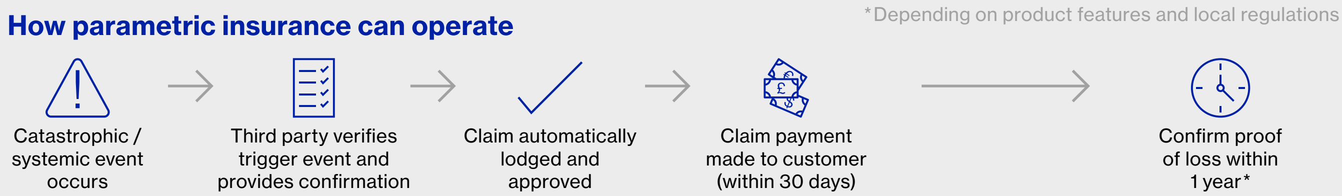
However, as the pay-out and trigger is pre-defined, if they do not perfectly correlate with the underlying risk exposure, a customer could suffer a loss without the parametric insurance being triggered – or the pay-out that they receive may not meet the full cost of their loss. The management of this basis risk, as well as data quality, model enhancement and consumer education, remains critical for the further development of parametric products.

The complexities of developing and managing parametric products - particularly for retail and SME customers - and potential good practice to overcome them - are outlined in our recent report *Triggering innovation*[6]. Notwithstanding this, a growing number of parametric products are being developed, particularly for retail and SME customers.

Impact score	Customer value	Implementation complexity
	Medium	**High**

How traditional indemnity insurance operates

How parametric insurance can operate



[6] Lloyd's

4. Insurance design innovations

Parametrix: A new parametric business interruption product for SMEs' IT downtime.

This is a new "first-of-its-kind" business interruption policy for small and medium sized enterprises (SMEs) using third-party cloud services, specifically designed to protect them against IT downtime or disruption. Parametrix Insurance offers simple and reliable coverage by removing the traditional indemnity trigger that most insurance policies use today. Instead, the new solution uses a parametric trigger, meaning that the policy aims to automatically pay out if a customer's critical IT services – such as cloud, e-commerce or payment systems – are disrupted. This significantly reduces the time needed by an insurer to assess a loss or adjust a claim.

This new Lloyd's product is led by Tokio Marine Kiln (TMK) and supported by other members of Lloyd's Product Innovation Facility (PIF), including RenaissanceRe, through the Lloyd's PIF BETA which is designed to accelerate product development for technology driven insurance solutions.

Outcome-based insurance contracts that insure against tangible customer outcomes

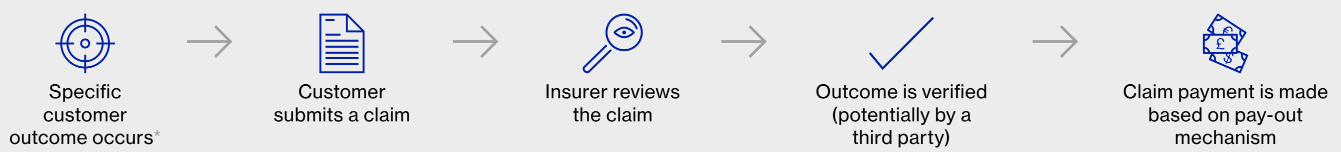
Insurance contracts are often focused on the cause of a loss (a peril), rather than what the customer cares most about – the loss itself. All-risk policies, that automatically cover any risk which the policy has not explicitly omitted, already exist. However, they typically include a number of exclusions that are often required to protect insurers against potentially significant exposures which would be hard to reserve for – for example systemic risks. This can lead to confusion for customers.

Structuring insurance policies around the outcomes that customers would be protected against, for example a loss of revenue, rather than the perils which cause those outcomes could help give customers greater clarity over the cover that their policy offers.

Insurers could protect themselves against large aggregations of risk by applying specific limits to the cover, provided these are visible and clearly worded. These products might also require reinsurance support or backing from industry pooled capacity, with a government backstop, depending on the outcome being insured.

How outcome-based insurance can operate

*In the event of an applicable peril occurring as defined in the policy



In *Supporting global recovery and resilience for customers* we outlined a framework, Black Swan Re, which could protect customers from the devastating and long-term impacts of systemic catastrophic events, and also offers a mechanism through which outcome-based cover could be provided. The framework would provide reinsurance for commercial business interruption cover for black swan events through industry pooled capital, backed by a government guarantee to pay out if ever the pool had insufficient funds.

Impact score	Customer value	Implementation complexity
	High	High

5. Recommendations

As businesses around the world evolve to withstand the continued impacts of the COVID-19 pandemic, including radically changing their business models, and grappling with the challenges that lockdown restrictions around the world have brought, the global insurance industry must urgently reassess how it can best serve its customers.

Importantly, it must work to further simplify its products for all customer segments and promote greater understanding of the cover it is providing. The benefits are significant. If the industry does not take the opportunity to respond to customer needs and evolve, it will lose relevance over time.

Whilst this paper is not a comprehensive set of answers that will ensure that customers will always understand and buy the right cover, there are three key recommendations that the global insurance industry should implement to respond to the challenges that COVID-19 has presented:

1. Leverage and build on the application of existing leading practice including a linguistics review of customer documentation – for both simple and more complex products

Reflecting the lessons learnt from personal lines and effectively and consistently applying the existing leading practice summarised in Chapter 3 would considerably improve outcomes for customers, brokers and insurers and strengthen trust in the insurance industry.

This is likely to be easier and have the most impact in the short term for more standardised SME insurance products, where many of the existing requirements are closer to personal lines products. Increasingly looking for ways to leverage best practice for products aimed at more sophisticated buyers could also deliver similar benefits, though they are more complex to implement.

To illustrate the potential benefit, we have looked at how existing good practice could be applied to improve clarity around silent cyber cover (*Appendix 1*).

2. Invest in continuous product design and delivery innovations including through data-led policies and digital contracts, as well as exploring more radical options like parametric or outcome-based insurance

While insurance innovation to improve customer outcomes is already happening, as an industry we need to accelerate the pace of change – not just in product design, but also in how we provide cover to better protect customers.

The industry will need to focus on product design and delivery innovations, to ensure a consistent approach that enables customers to more easily understand the cover available to purchase, and its scope.

This could build towards a framework in which all wordings (selected by customers) can be underpinned by common universal standards, tailored or differentiated through clear endorsements where necessary.

As outlined in Chapter 4, there are a number of routes the industry can take to more radically transform and simplify its products. The key recommendations include:

- Investing in developing data-led policies through digital contracts.
- Enhancing customer ownership and understanding of their policies through modular contracts.
- Building dynamic comparison tools to explore how policies respond in different scenarios.
- Providing parametric insurance products with clearly defined trigger events.
- Designing outcome-based insurance contracts that insure against tangible customer outcomes.

5. Recommendations

Appendix 2 outlines how business interruption cover could be provided through parametric or outcome-based products, and highlights some key design considerations for the insurance industry.

3. Involve customers directly in product design to build simpler, more relevant products for their changing needs and post pandemic risk profiles
COVID-19 has highlighted the need for the industry to involve customers more in the design of insurance products, in order to provide greater value and to respond more dynamically to changing risk profiles. The changing needs and expectations of customers will ultimately determine which approaches to designing simpler products are successful in future.

The more feedback brokers and insurers can get from their customers, the more quickly they can respond and the more successful they are likely to be. This can either be by making better use of the existing customer information they have in complaints, queries and claims, or by finding new ways to engage them.

The London Market Group is establishing a Client Advisory Panel to put customers at the heart of the market's strategic decisions

Through its Client Lens programme, the London Market Group is engaging with customers to understand how their business models are changing, and how the London Market can best meet their needs.

The research programme started in September 2020, and detailed sector reports on critical risk developments, insurance implications and associated service needs will be published in 2021 to stimulate innovation and best practices in both the supply and demand sides of the London Market.

The programme will also establish a Client Advisory Community and a London Market Client Advisory Panel to bring a customer voice to the London Market's strategic initiatives.

Involving customers directly in product design can help ensure policies are easy to understand and better meet customer needs. Some insurers are looking to include customer champions within their boards to make sure they are represented at the highest levels.

Lloyd's Reputation Pulse Survey

We monitor our reputation and performance with all of our global stakeholders, to ensure we are getting customer feedback to help us better understand our key audiences.

As part of the Future at Lloyd's, we have implemented a new benchmark to measure our Net Promoter Score (NPS), so we can measure our success of the changes we are delivering and improvements in customer experience and perceptions.

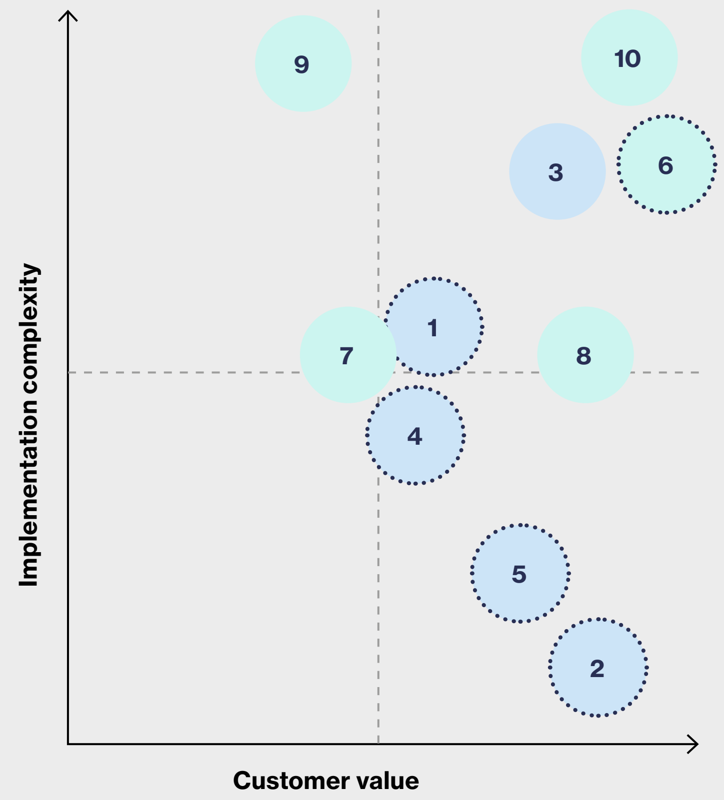
Next steps for implementation of recommendations
Lloyd's will continue to use its position as a convener to support progress across the global insurance industry. We have discussed these recommendations with a number of trade associations within the UK and with insurers and brokers in our Global and UK Advisory Committees. In parallel, we will continue to develop best practice and product design innovation within the Lloyd's market, including how these proposals might be applied, as well as testing product design innovations through the Lloyd's Lab.

Nevertheless, the global insurance industry must work together to find consistent ways to simplify its products to support enhanced customer understanding of the cover they have in place, and ensure they have the most relevant protection for the risks they face. Lloyd's will continue to support collaboration across the industry as it works to improve customer experience and product understanding.

6. Taking action in the Lloyd's market

To deliver better outcomes for customers in line with our Fair Value Principles, Lloyd's will take action in five key areas set out in the diagram below.

Lloyd's proposes to initially work with market participants to develop initiatives in five of the areas outlined



Existing leading practice

1. Clear and simple product documentation.
2. Summarise key components of a contract up front.
3. Review and rationalise product wordings.
4. Enhance customer risk literacy and customer understanding of coverage.
5. Improve customers' experience by monitoring and analysing the product journey.

Insurance evolution

6. Digital contracts driven by data-led policies.
7. Enhance customer ownership of their cover through modular contracts.
8. Dynamic comparison tools.
9. Parametric insurance products with clearly defined trigger events.
10. Outcome based contracts that insure against tangible customer outcomes.

Lloyd's will take action in five of the areas – with an initial focus on personal lines and SME.

This action will deliver increased customer value in the short to medium-term, with relative ease of implementation, and will provide the foundation to progress the other solutions over time. We will continue to engage with our key stakeholders, customers and the global insurance industry to prioritise further action.

6. Taking action in the Lloyd's market

Short term (2021)
During 2021, Lloyd's will take action in the following areas, to provide immediate benefit to our customers:

- Set up a working group to explore more innovative ways we can contract with customers and evolve product wordings, drawing on the applications and lessons learnt from personal lines.

- Enhance the effectiveness of **product documents by making them clearer and simpler (solution 1),** complemented by introducing a standardised Lloyd's **upfront contract summary document (solution 2).** This work will include:

  - Conducting an active review of wordings in priority classes of business to identify leading practice learnings and agree – with direction from market stakeholders and the legal profession – if we should expand this approach more widely.
  - Exploring, beyond existing regulatory requirements, opportunities to introduce a Lloyd's standardised product summary document, initially for retail and SME customers.
  - Sourcing expert support and embedding consumer linguist principles into product design.
  - Conducting a thematic review on clear and simple product wordings.

- These actions can be further supported with additional materials such as videos, diagrams and other support content for distributors to use through various channels in order to **improve customers' risk literacy and understanding of their cover (solution 4).** This will include:

  - Seeking opportunities to partner with trade associations to develop additional materials and approaches.
  - Introducing additional requirements as part of Lloyd's coverholder onboarding processes to understand supporting information which would be helpful to the end customer.

- We will continue our approach to **improving customers' experience by monitoring and analysing the product journey** by constantly identifying good metrics to track against the principles, collecting relevant data and taking actions.

  - Existing activities to deliver this include:

    - Continuing our work to develop and implement risk appetites around our Fair Value Principles. We will establish core metrics that act as indicators of low value in products and develop product performance monitoring, using existing data received by Lloyd's where possible. Insights from this data will help us provide further guidance to the market and greater clarity on what is meant by fair value.
    - The recent launch of Lloyd's Delegated Oversight Manager, a new system to manage delegated authority approvals, registrations and compliance. This will provide greater information about the type of customer for delegated authority and line slip business, and potentially also consortium business and master policies in time.
    - Driving increased adoption of Lloyd's new delegated authority systems, Coverholder Workbench and Delegated Oversight Manager, will continue to improve data quality and help the market more effectively monitor their performance against these principles.

- We will also explore further work through Lloyd's market oversight activities, including:

  - Publishing KPIs and requesting market compliance, which is already a requirement for high risk groups.
  - Introducing a more structured approach to reviewing and monitoring product value at Lloyd's.

6. Taking action in the Lloyd's market

Medium to long term

Digital contracts (solution 6) offer a more radical way to close the customer expectation gap, providing differentiated benefits to customers, enhancing the relationship between insurers and customers and radically changing the way insurance is purchased and managed. However they will be more complex to implement than the short-term solutions because of the fact that there are no regulatory frameworks in place around purely digital contracts (where the data object is the only form of contract), as well as the significant investment in technology infrastructure that will be required.

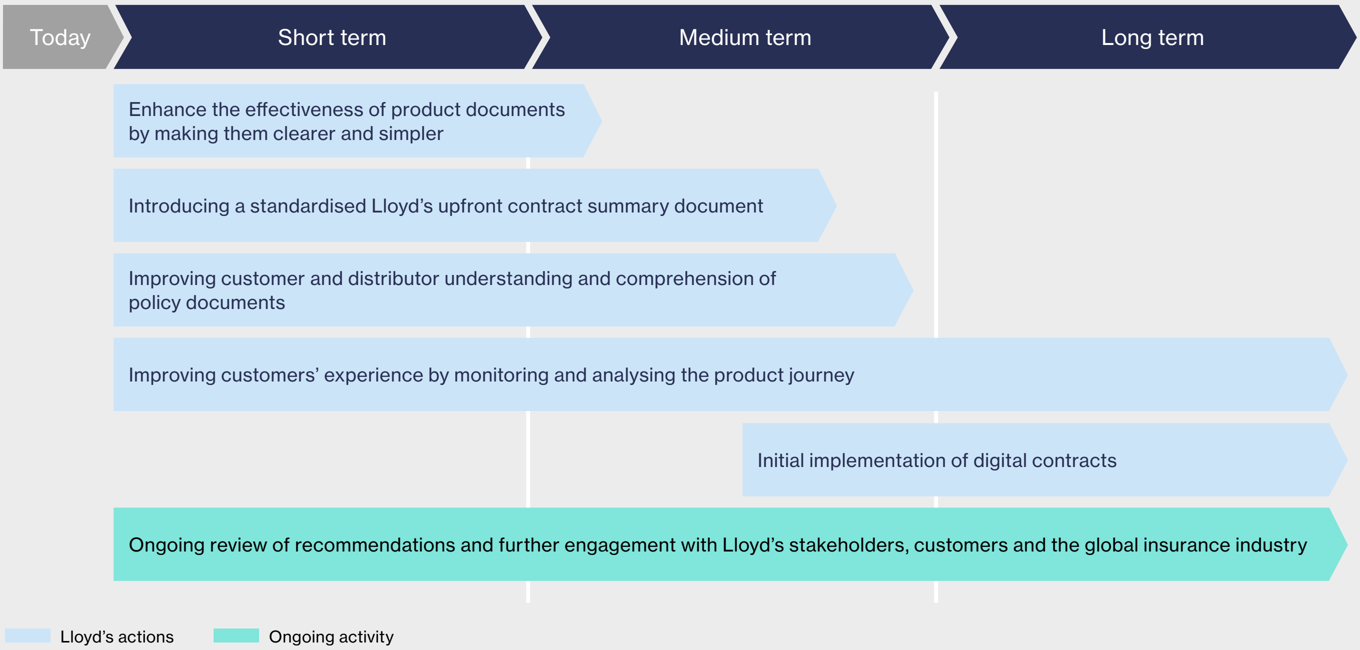
At Lloyd's we are already planning to make digital contracts a reality through the Future at Lloyd's. The ambition for the complex risk platform is to move from a document-first to a data-first technology platform that enables the efficient sourcing and placing of complex risks, using common data sets and standards to improve the negotiation and claims processes.

Into the future

As many businesses around the world evolve to withstand the continued impacts of the COVID-19 pandemic, including radically changing their business models, we as an industry must urgently reassess how we can best serve our customers and work at pace to ensure we are providing them with the best service and support.

Whilst this report is not a comprehensive set of answers, it highlights the need for a new starting premise, one that recognises that if we ensure that customer needs remain at the heart of our industry and simplify our products, Lloyd's and the global insurance industry will remain relevant and trusted by customers, creating a braver, more resilient world.

Lloyd's key actions to better protect and support customers: delivery timeline



Appendix 1:
Worked example of simplification levers applied in cyber

COVID-19 is changing the way we live and how businesses operate, and some of these changes, such as increased remote working, have the potential to increase customers' exposure to cyber risks.

Historically, property and liability policies have been "silent" on cyber. Therefore, one challenge for traditional insurance products in recent years has been a lack of clarity about whether cyber was covered or not within existing property and liability policies. This has created uncertainty, resulting in possible claims disputes, the risk of insurers under reserving, and potentially customers under insuring or over insuring.

The discipline of summarising key components of a contract upfront (i.e. either specifically affirming or excluding cover for cyber), and bearing them in mind while designing the cover, could resolve this challenge by helping prospective customers see clearly what is and what is not included in their policy.

The summary could take the form of an Insurance Product Information Document (IPID) a two-page summary of the key information about a product, originally designed for consumer products, or a Policy Summary, frequently used by the direct-to-customer market for commercial products.

Illustrative contract summary document for commercial insurance policy, highlighting the exclusion of cyber

We have provided an illustrative example of how such a summary document could more clearly highlight to business customers the key terms and exclusions in commercial business cover, such as to clearly exclude cyber cover.

Business Insurance

Insurance Product Information Document

Company: ABC Insurance Company **Product: Business Plus Policy**

This document is intended to provide a summary of the main cover and exclusions and is not personalised to your specific individual needs in any way. Full information on the product is provided in your policy documentation.

What is insured?

We will pay you up to these amounts, following a valid claim:

Property and buildings up to $2 million for:
- ✓ Physical damage to property and buildings, including architects, surveyors, legal and consulting engineers' fees
- ✓ Fire damage (for causes specified in detailed policy wordings)
- ✓ Accidental damage
- ✓ Cables and underground pipes as a result of insured damage

Business interruption up to $2 million for:
- ✓ Loss of business income following a claim under the property and buildings cover
- ✓ Cover for outstanding debit balances where records are lost following physical damage (up to a maximum of $50,000 for any one occurrence and $250,000 in total during any one period of insurance)
- ✓ Failure of public utilities (up to a maximum of $1 million for any one occurrence)

Public and products liability up to $5 million for:
- ✓ Compensation payments and any associated legal costs if you're held responsible for causing injury or property damage to a member of the public, including:
  - Injury to working partners
  - Accidental damage to employees' and visitors' vehicles and personal belongings in your custody and control
  - Payment for court attendance expenses in connection with a claim you are covered for (up to $500 per day)
  - Personal liability of employees and directors working temporarily overseas
  - Legal costs and expenses for defending prosecutions under health and safety legislation
  - Corporate manslaughter and corporate homicide act
  - Acts of terrorism

Employer's liability up to $10 million for any one occurrence for:
- ✓ Costs of compensating an employee and any associated legal fees if they are injured or become ill as a result of their work for:
  - Employees on work experience and government schemes
  - Cover for employees who are temporarily working overseas
  - Legal costs defending prosecutions under all relevant health and safety legislation
  - Court attendance expenses in connection with a claim you are covered for (up to $500 per day)
  - Acts of terrorism

What is not insured?

- ✗ Your policy excess of $1000 which will be deducted from each claim
- ✗ Your policy does not cover you for loss or physical damage arising directly or indirectly however so caused by War, Terrorism, Chemical, Biological, Nuclear, Radioactive or Chemical Contamination
- ✗ Your policy does not cover you from loss arising out of Pollution or Contamination

For all sections other than Employer's liability
- ✗ This policy excludes any cover for:
  - Cyber losses, as defined in your detailed policy wording
  - Losses of any nature resulting from any loss of use or reduction in quality of business data, including the cost of replacing the data

Business interruption
- ✗ We will not cover loss of business income for any reason other than those specified in your property and buildings cover
- ✗ We will not cover failure of electricity, gas or water supply cover due to:

- your wilful act or neglect
- a deliberate act of the supply undertaking in restricting or withholding supplies
- weather conditions or drought
- any industrial action
- any failure of supply lasting for less than four hours

✗ We will not cover any accounts receivable losses under this cover resulting from:

- misplacing or misfiling of information
- a public supply company deliberately restricting or withholding your electricity supply
- deliberate erasure, loss, distortion or corruption of information

Public and products liability

✗ Injury to an employee travelling in or on, or getting into or out of, a vehicle where any Road Traffic Act legislation applies.
✗ Physical damage to property in your custody or control other than employees' and visitors' personal belongings
✗ Liquidated damages, penalty clauses, fines or punitive damages
✗ Products supplied that could affect the navigation, or safety of any aircraft or other aerial device
✗ Pollution or contamination
✗ Products supplied to or work on, or travel to/from any offshore installation or support vessel
✗ Claims arising from asbestos
✗ Physical damage during the fixing/correcting of defective products supplied, or the cost of recalling them
✗ Any advice, instruction, consultancy, design, inspection, certification or testing which you provide under a specific contract or for which you're paid separately

Employers liability

✗ Work in or on or travel to or from any offshore installation or support vessel
✗ Injury to an employee travelling in or on, or getting into or out of, a vehicle where any Road Traffic Act legislation applies.
✗ Liquidated damages, penalty clauses, or fines

Are there any restrictions on cover?

! We will not pay any costs we consider are not reasonably and necessarily incurred
! We will not pay more than the specified $2 million policy limit towards any one loss
! We will only pay for losses incurred from 01/01/2020 to 31/12/2020
! You will pay the policy excess of $1000 towards any claim
! We will not pay a claim against a loss that is insured elsewhere
! We may not make any payment if you have contracts in place with third parties which restrict our rights of recovery
! Additional conditions apply, as specified in your detailed policy wording, for:

- Security conditions
- Special terms for empty buildings

What must I do?

- You must provide us with honest, complete and accurate information
- You must tell us as soon as possible of any changes:
  - to the business
  - in the persons or organisations listed as the insureds
  - to the information you provided to us previously or any new information that
  - increases the risk of loss as insured under any section of your policy
- You must comply with all applicable laws and regulations in all relevant jurisdictions, as set out in your policy documentation
- Timely payment of outstanding premiums

When and how do I pay?

- You can pay your premium annually or monthly by Direct Debit or debit/credit card. Alternatively, call us us on 01234 567 890, 9.00am 5.30pm, Monday to Friday to discuss other payment options
- If you fail to make your monthly payment(s) in full by the due date on more than 3 occasions in any period of insurance, we will cancel your policy immediately

When does the cover start and end?

- A period of 12 months from 01/01/2020 to 31/12/2020

How do I cancel the contract?

- If you wish to cancel and the insurance cover has not yet commenced, you are entitled to a full refund of any premium paid
- If the cover has commenced, you can cancel your policy at any time during the period of insurance by advising us. Provided you have not made a claim, you will be entitled to a refund of any premium paid, subject to a deduction for any time for which you have been covered

How do I make a claim?

- If you need to make a claim, please email us at claims@ABCinsurance.com with the following information:
    - Your name and policy details
    - Details of the injury, loss or damage incurred
    - Any relevant evidence to help us pay your claim
- Alternatively, please call us on 01234 567 890, 9.00am – 5.30pm, Monday to Friday

Appendix 2: How simplification levers could be applied to business interruption parametric and outcome-based products

Parametric insurance
Parametric insurance pays out a pre-determined sum to customers in the case of a qualifying 'trigger' event, with claims paid as soon as the trigger is verified - regardless of whether the policyholder sustains an actual loss.

The amount to be paid out is calculated by reference to an agreed index or 'parameter', although some policies fix the amount to be paid out in the policy. This amount is calculated to attempt to indemnify the insured for the loss the insured will have suffered on the occurrence of the trigger event.

The causes of loss that parametric insurance can cover are potentially much broader than those covered by traditional indemnity insurance. Although all pure risks – that is, risks with only a loss outcome – can theoretically be considered for the construction of parametric insurance, in practice there is much complexity in bringing these products to market, especially when the complexity of these risks implies multiple possible loss outcomes.

Parametric products are not a new concept, in fact parametric cover is offered in the Lloyd's market for areas prone to natural catastrophes and in many other areas. Parametric cover has potential applications to business interruption because it focuses on the trigger event, not the cause of the trigger. Parametric products may also be outcome based.

Parametric contracts are based on clearly defining a trigger event (or events) which the customer is covered for and a mechanism to determine the claim payment:

– **Trigger event:** One or more clearly defined and measurable event(s) or occurrence which is anticipated to cause a loss or disruption for the customer. A trigger event could be a natural catastrophe of a certain severity, such as an earthquake or flood, power or internet failure or government triggers, such as declaring a pandemic or enforcing a national lockdown.

  Parametric products rely on using agreed, independent data sources, e.g. measurement of the location and magnitude of earthquakes, which means there is the potential for parametric contracts to operate as smart contracts, paying out automatically, without the usual requirements for the loss to be adjusted.

  Example 1: Government-mandated lockdown and closure of all non-essential businesses for 2 or more weeks (resulting in closure and loss of sales for a retail store).

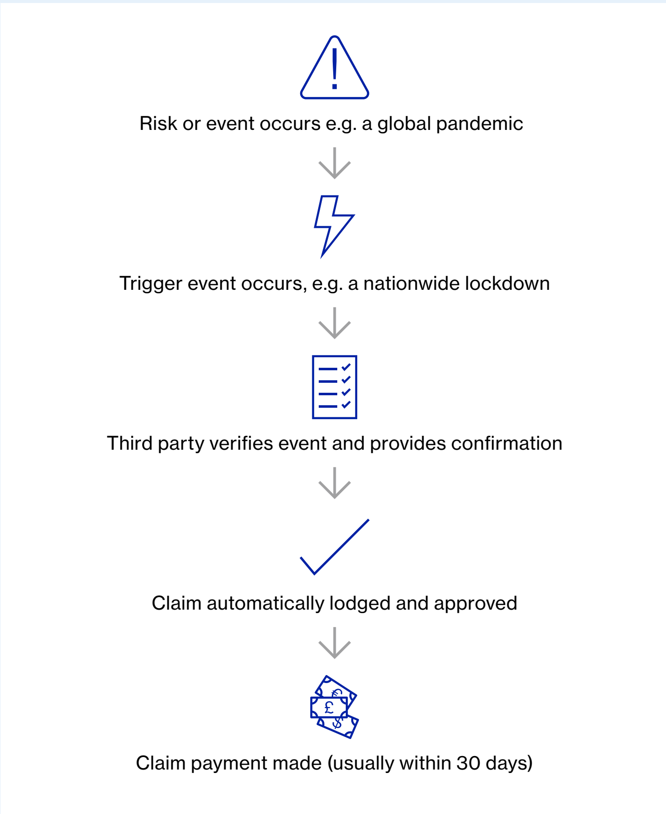
  Example 2: A significant power outage lasting over 1 week (halting production in a factory).

Appendix 2: How simplification levers could be applied to Business Interruption Parametric and Outcome Products

- **Pay-out mechanism:** The (often tiered) approach to calculating the customer pay-out once the trigger event has been verified as occurring, or exceeding a certain threshold. The pay-out level is typically aligned with a customer's business continuity plan and risk tolerance.

  Example 1: 50% of average weekly turnover paid for each week that a retail store is closed due to lockdown, up to a maximum of 12 weeks.

  Example 2: 50% of average weekly turnover paid power outage lasting up to 1 week or more, reducing to 25% if the outage lasts for over 3 weeks.

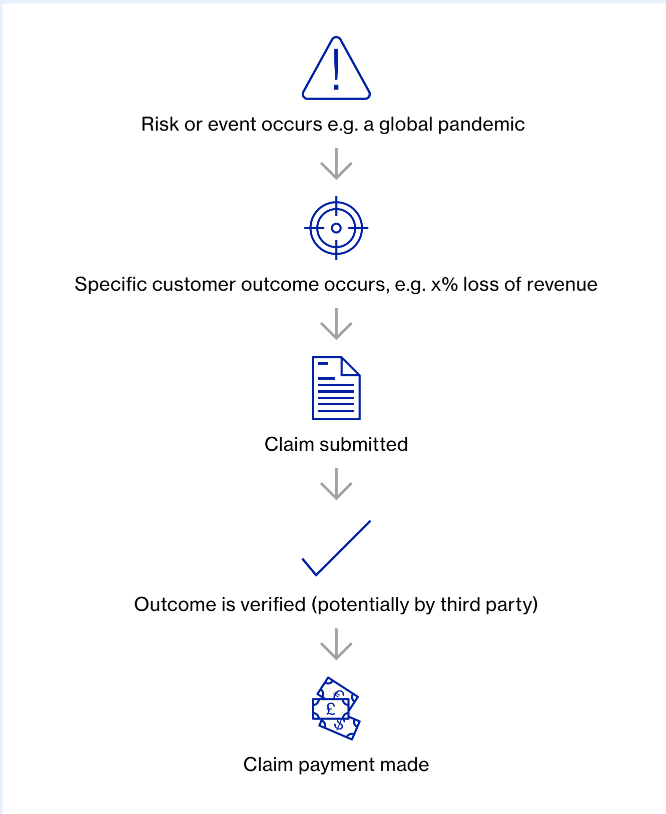


Outcome-based insurance

Outcome-based insurance contracts are defined around the impact of a risk or event on customers rather than the cause of loss.

Customer centricity is at the heart of outcome-based insurance, with the pay-outs resulting from specific, measurable outcomes which would be defined by customers in collaboration with their brokers and insurers. This represents an opportunity for the industry to engage with customers around what their most significant concerns are, and to design products which respond to these.

However, outcome-based products can be difficult to price using traditional underwriting approaches, which typically focus on the expected likelihood and impact of specific perils. In addition, insurers could be exposed to large aggregations of risk – for example from systemic events causing large economic and societal losses. Insurers could protect themselves against such aggregations of risk by applying specific limits to the cover, provided these are visible and clearly worded. Alternatively, these products could be supported by industry pooled capacity, with a government backstop, depending on the outcome being insured, due to the potential.



Appendix 2: How simplification levers could be applied to Business Interruption Parametric and Outcome Products

Outcome-based products insure against a clearly defined outcome with a pay-out mechanism to determine the amount paid out. They would typically be structured around three key elements:

- **Customer outcome:** A clearly defined and measurable outcome which would impact the performance or viability of a business, potentially including loss of turnover, a reduction in asset values or loss of key contracts or accounts.

  The outcomes and associated targets will vary based on the risk appetite of individual businesses and would likely require some sort of independent verification in the event of a claim. A suitable organisation to independently verify the outcome would need to be agreed to by parties.

  Example 1: X% loss in revenue for 1 month or more.

  Example 2: X% loss in property rental income in a calendar year.

- **Pay-out mechanism:** The payment made to the insured once the outcome and severity have been verified. The pay-out level is typically aligned with a customer's business continuity plan and risk tolerance.

  Example 1: Reduction in gross profit during the indemnity period, for a maximum period of 12 weeks.

  Example 2: 50% of average rental income for each week that a rental property is empty.

- **Applicable perils:** It is unlikely that the insurance industry could design an attractive outcome-based product to cover all potential causes (or perils) leading to the defined customer outcome without government support.

  For example, a reduction in revenue for a retail store following an earthquake or terrorist attack might be covered by an outcome-based product, whereas a reduction in revenue due to less demand for the product would not. Any applicable perils should be clearly highlighted in the contract and explained to the customer.

Sharing risk to create a braver world

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