General Insurance Pricing Practices Market Study Team
Competition Division
Financial Conduct Authority
12 Endeavour Square
London E20 1JN

Dear Sir/Madam,

22 January 2021

Practitioner Panel Response to FCA General Insurance Pricing Practices Market Study Final Report (MS18/1.3) and Consultation Paper (CP20/19)

Overall, we believe this is an ambitious change to the pricing environment for Motor and Home insurance, which has at its core a very straightforward aim. The interventions that the FCA propose will substantially address an area of concern that the industry has recognised and been tackling.

This is a bold intervention which is far reaching, affecting every policyholder's price, not just those in the pricing tails. Rather than tempering the specific issue of price walking, it will potentially transform how the market operates.

We believe the proposed remedies will substantially address differential pricing in motor and home insurance and improve product governance and oversight across the market. However, they will also create 'winners' and 'losers' amongst different groups of customers. Accordingly, it is a new direction which overall is welcomed by the Practitioner Panel noting concerns regarding the following:

- **Implementation Timescales:** The proposals are complex, and come at a time when industry is tackling many issues, including ongoing Covid-19 impacts on firms and consumers, and the end of Brexit transition arrangements. Full consideration needs to be given to the timing of implementation to ensure an orderly market transition.

- **Post-Implementation Vision:** Clarity of the desired outcomes is critical. The papers lay out the FCA's desires in relation to the elimination of price walking and fairness but, given the scale of the intervention, it is important the FCA lays out its vision of the market post-implementation from a broader perspective and provides additional clarity in relation to a number of aspects of its proposals. We expect this to include:

    - **Creating a 'level playing field':** There are a number of areas where we feel further clarification is required to ensure consistency of interpretation of the new rules, so we have an effective transition first time, and one free from practices that aim to frustrate the intended outcome of the central pricing remedy. The clarity of the FCA's proposals and vision is essential to ensure there is a 'level playing field' and that the general insurance market remains sustainably investable. This should include both principles and rules to frustrate unintended consequences and make supervision and interpretation of the remedy simpler for all market participants.

- **Customer Impacts:** The FCA needs to be mindful of the need to mitigate the disproportionate financial impact these changes may have on customer segments e.g. younger purchasers, who are currently experiencing the most significant impacts from the Covid-19-related economic issues, while also achieving a balance between rewarding price seeking and eliminating punitive pricing penalties
- **Delivering choice and fair value for customers:** The proposed remedies will have consequences in the home and motor markets that will lead to negative premium outcomes for some consumers in the short to medium term. This will also impact consumers' views of the sector. How the FCA communicates the remedies to consumers during transition requires thoughtful consideration and the potentially negative reputational impact on the industry will need to be carefully managed. We also think that it is important to promote consumer choice and high-quality products.

- **Additional Costs:** We are concerned that the business case is not fully reflective of the economic reality of implementing the remedies proposed. This concern is from the perspective of both the absolute financial impacts on the sector versus benefits to consumers during a period of significant economic challenges and the increased ongoing costs of compliance, particularly centred on the proposed reporting requirements, which will be imposed the year following a global pandemic. We note the likelihood that these frictional costs for the market will ultimately be passed on to consumers through pricing, and note the potential impact that this will have on competition and innovation in the long term. This is a market feature that has been seen in banking over the last couple of years.

Overall, whilst supportive of the bold and ambitious changes proposed by the FCA to the pricing environment for Motor and Home insurance, we believe more time is required for implementation than currently proposed. Engagement with industry participants has been strong and we suggest this continues to protect against unintended consequences and to avoid implementation that has the effect of distorting the FCA's operational objective to promote effective competition in consumers' interests.

We have addressed the specific questions in the consultation in the attached appendix.

Yours faithfully,

[signed}

Paul Feeney
Chair, FCA Practitioner Panel

Appendix – Answers to specific questions

Q1: Do you have any comments on the proposed implementation period?

Implementation Timescales: The FCA has stated a desire to implement the proposals four months after the report is finalised. We believe this is an unrealistic timetable given the nature of the proposed package of remedies, notwithstanding that there could be substantive changes as a result of the current consultation exercise.

The proposals come at a time when industry is tackling many challenges, including ongoing Covid-19 impacts on firms and consumers, the end of Brexit transition arrangements, and other industry issues such as whiplash reform. All market participants are operating largely through home working, and while this has not stopped change programmes in businesses, it has, in the experience of a number of firms represented on the Practitioner Panel, made them more difficult to deliver. Co-ordination is more difficult with remote working. Market participants are also seeing challenges with the availability of key staff, some of whom are being affected by Covid-19. And finally, during the period up to implementation, we are also looking at further disruption caused by Brexit, in whatever form that may take.

The remedies are complex in nature and will require far-reaching business change including wholesale changes to pricing models, operating model restructures, significant IT changes, customer communications, etc.

Specific examples include the negotiation of contracts with intermediaries and corporate partners where commission or profit share arrangements will need to be amended, and the capacity of software houses (which serve the broker market) to process the high volume of pricing changes for each of their insurers and each of their products/schemes.

The FCA will want market participants to ensure they are delivering the right outcomes in their pricing, aligned to the new rules. A rushed implementation risks poor outcomes for customers and an increased supervisory workload (for example, the FCA will have to be dealing with any fallout from customers, mitigation plans etc).

The FCA should also consider how it will supervise firms that have not completed the necessary changes in their pricing by the implementation date. Will they be asked to close to new business, or will they be allowed to continue trading?

- The FCA should be looking at a more prudent timescale for implementation of the new guidelines.
- The FCA should clearly establish the rules around non-compliance with the pricing remedy in the event that any market participants have not completed the necessary adjustments to their pricing algorithms in line with the timetable.

Q4: Do you have any comments on our proposal to ban price walking?
Q6: Do you have any comments on our proposals to address practices that aim to frustrate the intended outcomes of the pricing remedy?

'Level playing field' considerations: Given the scale of the intervention it is vital that market participants understand the shape of industry that the FCA is looking for. There are several areas where more clarity upfront from the FCA would assist the industry in interpreting the proposed remedies, and in avoiding some of the confusion which has been observed from other recent regulatory changes, such as implementation of the Insurance Distribution Directive.

In particular, there are several gaps in the FCA's proposals, plus aspects where more clarity is required to ensure the 'level playing field' that all market participants seek once the regulation is live and that unintended consequences are minimised. Notable among these are:

- Constitution of Price - Administration and Other Fees: The guidance needs to be clear on how to treat administration and other fees e.g. policy set-up fees, renewal fees, so as not to create a mechanism through which the price to consumers can be manipulated to deliver more value to the insurer or broker whilst ostensibly still complying with the new rules. As an example, a renewal set-up fee that was higher than a similar fee for setting up a new business policy would have the same effect as price-walking, but in a way which fell outside the current definition of 'premiums'. We think this area needs to be tightened up considerably.
- Constitution of Price - understanding the value and risk in the provision of advice: The areas of additional costs already noted, and their application through "levelling the playing field" across distributions, make sense. However, there are advised consumer household and motor solutions that will be captured by the changes, with very different pricing dynamics to non-advised products. Pricing for advised customers may include the lifecycle of the customer's needs (not always transactional), advice through complex claims and the inherent E&O risk in the provision of advice.
- Distributors and 'Narrow' Most Favoured Nation (MFN) Clauses: 'Narrow' MFN clauses prevent all participants on a Price Comparison Websites (PCWs) offering customers a price for a product bought directly which is lower for the same product offered through that PCW. We believe this is no longer in the spirit of the rules, where explicit differences in price by channel are permitted, and therefore MFN clauses should be expressly disallowed. Further, to leave them in place would potentially place further upward pressure on premiums for customers and reduce competitive forces in the market. In the FCA explanations for how it expects the market to adapt to the new rules, there is an expectation of lower levels of shopping around. More clarity is required in respect of the role of distributors in an industry where the FCA anticipates a reduction in levels of 'shopping around' in order to ensure that distribution costs do not simply rise to compensate for lower shopping levels. Specifically, if MFNs remain in place, any increase in commission levels introduced by PCWs would require participants to increase their prices through all their channels-to-market to reflect the higher input costs of the PCW channel.
- Affinity Market and Solus Arrangements: The proposals will adversely affect the affinity market and other solus arrangements where it will become almost impossible for these groups to change insurer and potentially limit the volumes of new transactions. This is because a new insurer will have a different view of risk at a customer level. Whereas today an insurer would migrate a book to its own view of risk over time, deploying the use of 'caps and collars' to limit the impact of 'price shocks' to the transferring business, under the FCA's proposals it would be unable to do this because it will need its renewal prices to match its new business rates at next renewal. The overall impact would be to reduce customer numbers and income for the distributor, making a change of underwriter an unattractive prospect notwithstanding that this might be in its customers' best interest. A set of 'transitional rules' may assist in mitigating the unintended impact of the remedy on these types of arrangements.
- Add-On Products: Further clarification is required around the intent in relation to add-on products potentially captured by the proposals, but which are also available as standalone products. It is unclear whether the FCA's intention is that the new pricing intervention applies to such products, and hence is creating a different pricing environment for products sold alongside insurance than those sold independently. Or are the proposed remedies intended to apply more broadly to these products distributed independently of insurance?
- Closed Books: The proposals around closed books have a couple of challenges. First, the proposed definition of a closed book in ICOBS 6B and SUP 16.28 would appear too restrictive and result in some of the largest and most heavily marketed books with some of the biggest new business market shares meeting the ICOBS definition of 'closed' simply due to their scale. Second, the definition of the remedy for a closed book to use a 'market benchmark' price is difficult to implement in practice since the 'market benchmark' does not exist. Further consideration is required to improve the clarity of this aspect of the remedy.

- Other 'Level Playing Field' Considerations: Further consideration of the market transition is required by the FCA to ensure a 'level playing field' through this period. There is a risk that the transition period penalises incumbent players relative to new players who have more flexibility in their pricing. Further clarity is also required to ensure that that there is a 'level playing field' applied to distributors (Direct, PCW, Brokers) and underwriters (particularly by domicile, e.g. Gibraltar).

In addition, there are areas where the Panel believe that further clarification is required in order that consumers can have a clear understanding of the market for general insurance products which the FCA envisions through these proposals. This is addressed further in the following section, but two specific aspects are highlighted here:

- Constitution of Price - Incentivisation: Further to earlier comments in relation to fees, further clarification is considered necessary in relation to what constitutes the price and how this will be viewed from the consumer's perspective. For example, to what extent under the FCA's proposed remedies can a firm provide incentives provided that the price does not increase at renewal?
    - Can a firm provide cashback, whether absolute or proportionate to the price, to customers?
    - Can a firm provide 'free months' cover to customers?
    - Can a firm provide promotional 'gifts' to customers, such as soft toys, retail vouchers, carriage clocks?
    - Can a firm provide 'free' products to customers alongside the core home or motor insurance product, such as roadside rescue, legal expenses, or home emergency cover?

  The FCA has indicated to market participants in feedback sessions that it is supportive of cash and non-cash incentives at new business. We are concerned that this defeats the purpose of the remedy by providing greater value to customers who switch provider every year at the expense of those who stay with their existing insurer.

- Competitive Environment: Whilst it is clear the FCA is seeking to eliminate unnecessary 'churn' and expect a reduction in the volume of consumers 'shopping around' and the frequency with which 'shopping around' occurs, the Panel feels it is important that the FCA is also clear in its articulation of the competitive market environment which it envisages following the implementation of the proposed package of remedies. Specifically, the Panel expects that the FCA continues to recognise the importance of a competitive market in terms of differentiated products, brands and service offerings for customers – itself an important stimulant for innovation, rather than a market which is characterised by increasingly homogenised products and price commoditisation which would likely lead to a hollowing out of products, brand, and service offerings in the long term.

The Panel believes that without further clarification, the intended outcomes of the core pricing remedies proposed by the FCA may be diluted in the short to medium term, and that further regulatory interventions would be required in order to ensure the long-term objectives are achieved.

- The FCA should work with the industry on these points to develop a clear understanding of the market it is envisaging, to ensure a 'level playing field' and to minimise unintended consequences.
- As a general, but linked, observation, the FCA should more clearly state its recognition that industry margins are not excessive and that a sustainable, profitable insurance industry is vital for prudential regulation and to allow the industry to invest in other critical and regulatory initiatives.

Q4: Do you have any comments on our proposal to ban price walking?

Delivering choice and fair value for customers: The intent of the intervention is to eliminate a subsidy. Overall the intervention will, as result of removing the cross subsidy between new and renewing customers, mean some customers will pay more and prices may become more volatile.

The FCA's General Insurance pricing practices Interim Report (October 2019, para 5.39) stated that "For insurers, we observed that the underwriting of the core insurance product is marginally profitable for home insurance and generally loss-making for motor insurance."

Since the remedy equalises new business and renewing prices, in the transition year the "£1.2 billion" saving for some customers will necessarily, in a competitive market making minimal underwriting profits, be equally balanced by higher prices for the remaining customers.

The FCA suggests that average premiums will fall significantly leading to a £4-11bn reduction in aggregate premiums to consumers over a 10 year period. It does not seem credible, at a macro level, that the bottom-up approach taken by the FCA could lead to premium reductions of this size, especially as they anticipate a market where customers switch insurer less frequently.

Depending on the distribution of underwriting profit by tenure, the result of this remedy in the short to medium term may in fact be to increase prices paid by most consumers without changing the overall gross written premium in the market.

For practical reasons, beyond the scope of the proposed remedies, consumers will also continue to see different prices at new business as they do at renewal. To take the simplest example, changes to pricing will occur between the renewal invitation being issued, typically one month in advance of the renewal data, and a new business quote being requested. It would be helpful to see further details of the modelling used that evidences that the proposed remedies represent a viable long-term solution. The FCA may also wish to consider the challenges of a lack of symmetry for providers between the data retained for risks for long-standing customers and those at new business.

- The FCA should consider more broadly the likely impacts of the proposed remedies on those consumers who are active and engaged in the general insurance market.
- The FCA may want to assure itself that the negative effects are also not unduly skewed towards customers in vulnerable circumstances, include those that can least afford premium increases, or who are least resilient to premium volatility, in a period of economic stress. It would be helpful if the FCA shared further details of the modelling used to determine the proposed approach and remedies.
- The FCA should acknowledge more specifically that the proposals will have short to medium-term negative premium outcomes for those consumers who currently 'shop around' for their insurance, notwithstanding that the new market model should give better long-term outcomes for all.
- The FCA should consider how it should communicate these likely negative impacts to consumers through the transition period, in order to avoid insurers being censured when the active and engaged consumer body expresses a perception of having suffered 'harm' as a result of implementation of the proposed remedies.
- The FCA should be careful not to suggest that consumers will see the same price at new business as they do at renewal. The remedies will address systemic actions that cause differential pricing, but rightly do not seek to no eliminate all practical reasons for variations in premium. The FCA should also be careful not to suggest that the pricing remedy will result in constancy of margins by tenure, which may well increase or decrease due to changes in the assessment of the underlying risk over time even after the implementation of the remedy.

<u>Q22: Do you agree with our proposed scope for the reporting requirements?</u>
<u>Q23: Do you agree with our proposed reporting granularity?</u>

Q27: Do you agree with our proposals on reporting periods and frequency?

Frictional Costs: The Panel is concerned to note the increased costs of compliance, particularly centred on the proposed reporting requirements, and the impact that this will have on competition and innovation in the long term.

We are concerned that the data being requested will not help the FCA monitor the impact of the remedies. In particular, we would note that monitoring of margins will not provide evidence of compliance with the remedy due to the volatility of likely claims outcomes by segment. In addition, the FCA should be aware that:

- Not all this data may be available, for example where business has migrated to a new product, original tenure may no longer be available. Further, risk models may not exist where portfolios are very small or where the risk details held are very sparse.
- Portfolios can have a wide range of risks. The proposal to draw out large premium differences in a portfolio is unlikely to be a useful measure in isolation and it's unclear whether it adds any insight not available through the other metrics
- Figures that include reserve estimates or releases should ideally fit with existing reporting schedules to avoid insurers having to set up additional bespoke processes to comply with the reporting metrics requested, even if that means they are provided separately.
- It may not be possible to provide all this data within three months of the implementation date of the remedies where it sits across legacy systems, in different formats, or simply not accessible in data marts at all.

The high regulatory burden of providing the pricing data on firms, and the high cost of managing that data from the regulators' perspective, will add frictional costs to the market, while also reducing the attractiveness of the personal lines market to new entrants and new innovators. While this may be seen in the short term as a benefit for incumbent insurers of scale in the current market, the overall effect is likely to diminish competition and innovation in the longer term.

We note also that these additional costs of compliance for market participants will ultimately be passed onto consumers in the form of higher prices.

- The FCA should consider the potential for the proposals in relation to reporting to not be 'fit for purpose' and to bring about frictional costs for the market which, in the context of the FCA's statutory objectives, are disproportionate to the outcomes being sought from this aspect of the proposed pricing practices remedies.