General insurance pricing practices
Final Report

Market Study
MS18/1.3

September 2020

How to respond

In this final report we set out our proposed remedy package and final findings of the general insurance pricing practices market study.

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1 Executive summary

Overview

1.1 This is the final report for our general insurance pricing practices market study. It sets out our final findings on how the home and motor insurance markets are working and the remedies we propose to address the harm identified. It builds on the work in our interim report published in October 2019.

1.2 General insurance markets are important for consumers, and provide protection when things go wrong. Almost 46 million home and motor insurance policies were written in 2019. These markets are also important for the UK economy –home and motor insurance generated almost £18 billion in gross premiums in 2019.

1.3 It is important that general insurance markets work well and deliver good outcomes for all consumers. Our work on general insurance pricing practices has shown this is not the case. We found extensive evidence of some firms gradually increasing the price to customers who renew with them year on year. This is called price walking. Firms use complex and opaque pricing techniques to identify consumers who are more likely to renew with them. Firms then increase prices to these customers at renewal each year resulting in some loyal customers paying very high prices. In addition, some firms use practices that can discourage consumers from shopping around. While lower prices are available for consumers if they regularly switch or negotiate with their existing provider, price walking distorts competition and increases costs for both consumers and firms, leading to higher overall prices for consumers. We identified these issues in our interim findings, and our final findings confirm them.

1.4 These findings suggest some consumers are not getting fair value for their general insurance products. We would not expect to see these problems if these markets were working well for all customers. As our 2020/21 Business Plan explained, delivering fair value in a digital age is a key priority for us. So we are putting forward a package of remedies to address the harm we have identified. Our aim is to make competition work better, to provide long term fair value for all consumers in the future and to improve trust in these markets. All consumers should be able to make informed choices about general insurance products that meet their needs at a suitable quality and price, and they should not be exploited or targeted with poor value products. We recognise that we are consulting on remedies at a challenging time for consumers and the general insurance industry given the ongoing coronavirus pandemic. We will continue to monitor the situation. However, we recognise the importance of ensuring customers are treated fairly and will also consider this before we decide to make any final rules and issue any policy statement.

Our work on general insurance pricing practices

1.5 In October 2018, we published the terms of reference for our market study into general insurance pricing practices. We launched the market study to understand whether current pricing practices in home and motor insurance support effective competition and lead to good consumer outcomes.

1.6 We published our interim report in October 2019, which set out our interim findings. We found that 6 million policy holders paid high prices in 2018 – if they paid the average for their risk they would have saved £1.2bn. Firms use complex and opaque pricing practices that allow them to raise prices for consumers that renew with them year on year. We also set out a range of industry-wide measures that we could implement to tackle this harm.

1.7 Stakeholders have also raised concerns about outcomes from general insurance pricing practices. In September 2018, Citizens Advice made a super-complaint about loyalty pricing to the Competition and Markets Authority (CMA). Home insurance was one of 5 markets included in the super-complaint. We continue to work closely with the CMA on the response to the super-complaint. However, the remedies we have decided to consult on are based solely on the findings of this market study.

1.8 This market study is part of a package of work to make general insurance markets work well for consumers. Since publishing the interim report, we have continued other work on:

- ensuring that firms improve the governance, control and oversight of pricing practices;
- assessing whether firms are consistently delivering the changes required following implementation of the Insurance Distribution Directive, and publishing additional guidance on our expectations in relation to this and product value;
- responding to the issues created by the coronavirus pandemic by producing a range of materials and guidance for firms and consumers;
- continuing to improve transparency and engagement at insurance renewal. We introduced rules to do this in 2017, and published our evaluation of the impact of these alongside the interim report; and
- developing our rules on the reporting and publication of general insurance value measures data and publishing the fourth set of data under our general insurance value measures pilot, as well as additional product governance requirements. These are set out in the value measures policy statement.

1.9 We have undertaken further analysis to increase our understanding of these markets and our options for addressing the harms we identified. We have evaluated our remedy options in light of our final findings and are now consulting on a package of remedies. Our proposed package of remedies includes:

- a pricing intervention aimed at tackling harmful pricing practices in home and motor insurance; and
- additional measures which aim to ensure firms offer fair value to all customers in the future, improve competition and strengthen our ability to supervise firms' behaviour in this area.

1.10 Alongside this final report we have published a consultation paper which sets out how the remedies we are consulting on would work in more detail.

Our objective

1.11 Our statutory objectives are to make the relevant markets work well by securing appropriate protection for consumers, promoting effective competition in consumers' interests and protecting and enhancing the integrity of the UK financial system.

1.12 We want to see a market where:

- Firms compete in effective and innovative ways to provide long term fair value (reflecting both price and quality) for all consumers throughout the duration of their relationship with the firm. This is ingrained in their behaviour and underpinned by strong governance. All consumers continue to receive fair value over the long term as technological developments advance.
- Firms do not engage in practices that limit customers' ability to make informed choices. They are transparent with consumers about the overall cost and quality of products from the start. They do not impose barriers to consumers switching to better deals. This helps consumers make more informed choices about which general insurance products meet their needs.
- Consumers can trust that firms are offering long term fair value. Consumers who remain with their insurance provider can be sure that they will not end up paying high prices simply because they have not switched provider. They no longer need to search, switch or negotiate at every renewal to avoid price walking.
- Differences in firms' products, including the type of service and quality they offer, in the evaluation of insurance risks, and in pricing structures, maintain the incentive for consumers to search and switch in the market. This drives competition and helps to ensure that all consumers receive fair value. Over the longer term, new technology helps make it easier and quicker to search and switch to better deals.

1.13 In this final report, we set out our analysis of how the market is working currently, how we would like to see it develop and the measures we propose to achieve this. This takes account of feedback on our interim report and our work since.

Our findings

1.14 Since publishing our interim report, we have conducted further analysis and reviewed stakeholder feedback. Our analysis confirms that the market is not delivering good outcomes for all consumers. Our key final findings are:

- Some firms gradually increase the price to customers who renew with them year on year. This is called price walking.
- When setting a price, most firms take account of the likelihood that a customer will switch supplier at their next renewal or in the future.
- Some firms also use practices that make it more difficult for consumers to make more informed decisions and raise barriers to switching. In particular, we saw practices that make it difficult for consumers to stop their policy from automatically renewing.
- The cost of attracting business is significant. Using financial data from firms we estimate that the cost of attracting business is £2 billion per year for insurers, £0.3 billion for intermediaries and £0.1 billion for price comparison websites. Ultimately, consumers will bear this cost by paying higher prices.

- The fact that firms use price walking practices is not clear to customers and so many are not aware that firms do this.
- Some consumers are unlikely to switch because they do not know that their renewal price may not be competitive. These consumers tend to be price walked each year. Some consumers may wrongly view price increases as due to industry-wide cost increases and so underestimate the benefit of switching provider. Over time, some of these consumers are charged prices that are substantially greater than those available if they were to switch.
- Many consumers who frequently switch provider or negotiate their premium can get lower prices. Shopping around and switching is generally good for competition and can benefit consumers, for example where consumers want to find better quality products or better service. However, shopping around and switching merely to avoid price walking takes time and effort and can impose unnecessary costs on consumers and firms.
- Our analysis of data combined from consumer research and from firms shows that people who pay high premiums are less likely to understand insurance products or the impact that renewing with their existing provider has on their premium.
- Our analysis of data from firms shows that for a typical risk, on average:
  - New customers pay £285 for motor insurance while customers who have been with their provider for more than 5 years pay £370.
  - New customers for buildings insurance pay £130 while customers who have been with their provider for more than 5 years pay £238.
  - New customers for combined buildings and contents insurance pay £165 while customers who have been with their provider for more than 5 years pay £287.
  - New customers for contents only insurance pay £56 while customers who have been with their provider for more than 5 years pay £138.
  - 10 million policies across home and motor insurance are held by people who have been with their provider for 5 years or more.
- We found that 6 million policy holders paid high prices in 2018 – if they paid the average for their risk they would have saved £1.2bn.

Our proposed remedies

1.15 Despite industry taking some steps to address concerns about pricing practices, we believe that FCA intervention is necessary to address the harm we have identified in this market and to deliver good outcomes for consumers.

1.16 We have looked carefully at which remedies can achieve our aims in the most effective and proportionate way. We have used analysis to model the expected impact of our remedies on the market, on different types of firms and on consumer outcomes.

1.17 The package of remedies we are consulting on would stop firms systematically increasing prices in home and motor insurance for loyal customers in the future, as well as helping to ensure firms in the general insurance market focus on providing fair value to all their customers.

1.18 We will need to monitor these remedies to identify any non-compliance and address it quickly. The complexity of insurance pricing makes this challenging and we have proposed specific remedies to help us do this.

1.19 We have sought to design remedies to allow firms sufficient freedom to develop new products and vary the level of prices in a competitive way across customers and distribution channels.

1.20 We do not want to stop good deals being available to customers who shop around and switch regularly, so we have taken steps to reduce this potential risk from the proposed remedies.

1.21 We expect our remedies to improve the nature and intensity of competition. This would mean firms competing in a more effective and innovative way, which should lead to lower overall costs for supplying insurance, more intense competition and ultimately lower average prices paid by customers.

1.22 We have carefully considered the potential impact of our remedies on a market that continues to be affected by the coronavirus pandemic. Although there have been some impacts on motor and home insurance, for example from reduced driving mileage under lockdown, these have not fundamentally changed the way in which firms set their prices or altered our concerns about pricing practices. Therefore, we believe action is still required to address the harms we have identified. We will continue to monitor the market during the consultation period and will consider the ongoing impacts of the pandemic before making any final rules and issuing any policy statement.

1.23 We will be monitoring these markets closely to see how firms respond to our proposed remedies. We have also planned an evaluation for any remedies we do decide to implement. To help this evaluation, we will ask firms to store key, relevant data before and after our rules come into force in order for us to collect and analyse at an appropriate date. We will then use this data to understand the impact our remedies had on the market.

1.24 We will look closely at how firms could change or adapt their business models in response to our proposed potential remedies, including during the consultation and implementation phase. Examples of this include reducing the quality of core insurance products, imposing additional charges or increasing the sale of add-ons to customers that do not provide additional value or provide poor value. We will take appropriate action where changes to business models result in breaches of our rules.

Pricing remedy

1.25 Our proposed pricing remedy would apply to retail home and motor insurance products. It would require firms to offer a renewal price that is no higher than the equivalent new business price for that customer through the same sales channel. This aims to prevent firms from price walking customers by tenure.

1.26 The remedy ties the renewal price to the equivalent new business price. So firms would not be able to increase prices for renewal customers without also increasing the prices they offer the new business customers. In a competitive market, where customers shop around and switch provider, a firm that raises its prices for new business customers would lose market share. As a result, we expect that our proposal will also tackle high prices for existing customers who have already been price walked.

1.27 The remedy will help to achieve our aims by:

- Preventing firms from increasing prices at renewal – and where they want to, this will need to be reflected in their new business prices which will make them less competitive.
- Reducing the costs to customers in having to search and switch to avoid paying higher renewal prices because of price walking.
- Reducing firms' marketing spend to attract highly profitable long term customers.
- Increasing competition, by making the new business price a better indication of the long-term cost of the policy.
- Helping to ensure firms compete to attract new customers by providing fair value at the outset and throughout a customer's relationship with them.
- Increasing price transparency and building consumer trust.

1.28 We recognise that firms may change the way they price as a result of this remedy and it will be important to ensure their changes deliver fair value to all consumers. The pricing remedy will be accompanied by enhanced product governance rules to help ensure that firms change their pricing practices to deliver good outcomes for all consumers. The proposed product governance rules would apply to all general insurance and pure protection products, not only to home and motor insurance. Our aim is to drive changes in firms' behaviour by requiring them to consider how they deliver fair value in their insurance products' pricing and design throughout their lifetime. This includes when the product is initially offered to the customer and over the longer term for renewals.

1.29 Our proposed pricing remedy and product governance rules will require firms to change their pricing practices to comply with the pricing remedy and ensure they are providing these customers with long term fair value for their insurance products. We intend to monitor this and will assess any changes during the consultation and implementation phase.

Additional measures to further improve competition and deliver fair value

1.30 The pricing remedy and enhanced product governance requirements will work alongside additional measures focused on increasing transparency and competition in these markets, as well as addressing barriers to switching.

1.31 We are consulting on measures to stop auto-renewal being used as a barrier to switching.

1.32 We will put in place a strong supervisory approach to ensure firms comply with any rules we implement. We will start to monitor the impact of these remedies immediately on implementation and undertake a longer-term evaluation to understand how our remedies are affecting the market. Our supervisory strategy will be centred on 3 elements:

- assessing whether there is appropriate pricing governance, ownership and accountability within firms;
- verifying firms' compliance with the specific rules and guidance arising from the market study; and
- ensuring that firms are actively considering the value they provide to their customers and consistently treating them fairly.

1.33 In this context, we are also consulting on reporting requirements to help us supervise the market and further assess whether firms are following the rules. We may also decide to regularly publish some of the data we gather on firms' pricing practices as a sunlight measure, if we consider there would be value in this.

1.34 Alongside this report, we are publishing final rules on the reporting and publication of value measures data and value measures product governance. This includes the reporting and publishing of data on claims frequencies, claims acceptance rates, average claims pay-outs and claims complaints as a proportion of claims across all general insurance products. In 2019, we consulted on this and we have now published our value measures policy statement.

1.35 Delivering fair value in a digital age is a priority for us. We want to ensure that consumers share the benefits from digital innovation and competition. Since our interim report, we have engaged with stakeholders and further considered how Open Finance could benefit consumers and competition. We believe Open Finance has the potential to revolutionise the way financial services markets work for consumers. In the general insurance market, this could deliver significant consumer benefits and spur better competition and more innovation through helping to make it easier for consumers to compare offerings and switch providers. We recognise it could take some time for the potential of Open Finance to be fully realised, and will depend on consumers engaging with it. We want general insurance markets to be part of these transformations to ensure they work well for the future. We published a Call for Input on our strategy towards Open Finance last year. The period for responding to the Call for Input has now closed. We will publish a feedback statement in due course based on the responses we have received.

Next steps

1.36 We thank those organisations and individuals who responded to our interim report. Our summary of their feedback and our responses is in Annex 1: Detailed feedback on our Interim Report and our response.

1.37 Alongside this final report we have published a consultation paper and cost benefit analysis which sets out the full details of our proposed remedies. We welcome feedback on our consultation paper by 25 January 2021. You can send them to us using the form on our website at: www.fca.org.uk/cp20-19-response-form.

Or in writing to:
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1.38 We have also published our policy statement on general insurance value measures

2 Scope and approach

Scope of the study

2.1 The market study covers retail home and motor insurance. Since publishing the interim report, we have also considered whether there is a case for applying any remedies more widely in general insurance markets. Our proposed pricing remedy would only apply to home and motor insurance. However, some of our other proposals will apply to non-investment insurance products more broadly. We set out the scope of our proposed remedies in chapter 5.

How we have analysed general insurance pricing practices

2.2 We have focused on understanding how competition works in the retail home and motor insurance markets by looking at:

- The structure of the retail home and motor sector. This includes the providers and distributors of home and motor insurance, their roles in supplying these products and associated add-on products and premium financing, and the different business models.
- How firms set prices and treat their customers in this process.
- Whether pricing practices support effective competition in delivering good consumer outcomes.
- Outcomes from pricing practices, including the scale of any price differentials between customers and who is paying higher and lower prices, including whether these customers may be vulnerable.

2.3 We have used our analysis of these areas to inform whether pricing practices raise concerns and whether we should take any action.

The evidence we used to inform our analysis

2.4 Since publishing the interim report, we have gathered further evidence to refine our understanding of these general insurance markets and to inform the design of our remedies. This evidence supplements the analysis set out in our interim report.

2.5 Our final findings are drawn from our interim findings and further analysis including:

- Analysis of data gathered from insurers, intermediaries and price comparison websites (PCWs). This includes information on firms' business structures, pricing models and strategies, policy level data over a 5-year period (from 2014 to 2018), financial information and management accounts and responses from firms to a range of important questions about their treatment of customers and competitive strategies.

- Consumer research in 2019 that combined (across 18 insurance companies):
  - online surveys of over 3,500 home and 6,800 motor insurance customers
  - Computer Assisted Telephone Interviewing of over 600 customers each for both home and motor insurance
  - 10 in-depth phone and face-to-face interviews to explore in more detail consumers' experiences, behaviours and perceptions
- Combined analysis covering a matched sample of consumers from the customer transaction data and those who responded to our consumer research. This analysis looked in more depth at the characteristics of these consumers and the outcomes they get from pricing practices.
- Research looking at pricing practices for general insurance in other countries. We analysed the similarities and differences between how these markets operated compared to the UK, and the resulting consumer outcomes. This was primarily to inform our consideration of potential remedies.
- A survey of 21 insurance providers undertaken in October-December 2019. The survey asked firms to estimate the implementation costs for a number of remedies designed to address the harms identified in the interim report. Our cost benefit analysis gives the results of these responses.
- Feedback from a wide range of stakeholders on our interim findings and the remedy options we set out. Stakeholders included insurance providers, PCWs, trade associations, consumer groups and individual consumers.
- Findings from the FCA's 2020 Financial Lives Survey (a survey of over 16,000 UK adults providing information on the financial products consumers have, their experiences engaging with financial services firms and their attitudes around dealing with money and the financial services market).
- Data from public sources, in particular: English indices of deprivation 2015 and ONS Pen Portraits data.

Structure of this report

2.6 This final report sets out:

- Our final findings. This includes the harm we are concerned about.
- The feedback we received on the potential remedies and the findings from our interim report.
- The remedies we are consulting on and the outcomes we want to achieve for the general insurance market. We explain why we are putting forward these remedy proposals and how our package of remedies will work.

2.7 We are also publishing a consultation paper alongside our final report. The consultation paper sets out our proposals to improve competition and consumer outcomes in the retail home and motor insurance markets.

3 Our final findings

Our final findings

3.1 Stakeholder feedback was broadly supportive of the key findings outlined in our interim report. Taking this into account, our conclusions about how the retail home and motor insurance markets are working have not changed materially since we published our interim report.

3.2 Home and motor insurance are important products for consumers and play a valuable role in protecting them from risk.

Firms' pricing practices

3.3 We found consumers paying a wide range of prices for their insurance.

3.4 We looked at how firms set prices and found that they optimise their margins (the amount of the price charged above or below the cost of underwriting the risk and serving the policy). Margin optimisation is a process where firms adapt the margins they aim to earn on individual customers. Firms' pricing strategies can change over time and the aim of the optimisation process will depend on the strategy they are seeking to achieve at any time. Examples include maximising profit, retention, conversion or customer numbers. Both insurers and intermediaries, with delegated underwriting authority to undertake risk pricing, typically use different pricing models in risk pricing and margin optimisation. In our sample, most firms used lifetime value and propensity models (conversion, retention, and ancillary product models) as part of their pricing.

3.5 The main propensity models we saw from firms in our sample were:

- Conversion models: These assess the expected number of sales of both the core policy and ancillary products compared to the number of quotes at new business. Firms model the impact of changes in the price on conversion rates for different customers or groups of customers.
- Retention models: These assess the expected number of sales of both the core policy and ancillary products compared to the number of quotes at renewal. Firms use these to model the expected impact of price changes on customer retention rates as a core input to assessing the price they wish to charge (including as part of lifetime value modelling).
- Ancillary product models: Firms offer ancillary products (add-ons) or premium finance alongside a core insurance policy. Firms may incorporate predictions of ancillary income into their pricing decisions.

3.6 Most firms adopt pricing practices that set different prices at new business and renewal. Firms typically aim to predict the likely behaviour of consumers when setting the price, taking account of their competitors' pricing. When firms offer a new business price, they may take into account the expected long-term profitability of the customer. This will depend on the potential income from selling ancillary products such as add-ons and premium finance and the likelihood that a customer will renew in the future at a higher price and continue to buy the add-on products. Firms also set different prices through different distribution channels, brands and product specifications.

3.7 New customers typically benefit from low prices for core home and motor insurance policies, which are sometimes below cost. Firms seek to recover any initial losses by increasing the customer margin, and thus the price, at renewal. After they make back the initial discount, many firms continue to increase customer margins on renewal. This is referred to as 'price walking'. Most firms in our sample operate a price walking strategy and we see very similar pricing practices in home and motor insurance.

3.8 As firms set prices in this way, prices for renewal customers can become considerably higher than those charged for new customers. Customers who do not respond to price increases at renewal by switching or negotiating with their provider usually pay more, even if it costs the same to supply them with insurance.

3.9 Our analysis of data from firms shows that for a typical risk, a motor insurance customer that has been with their provider for more than 5 years will expect to pay a premium that is on average £85 higher than a new business customer with the same risk. The typical new business motor policy costs £285. For home insurance, the difference is an increase of £108 over a new business price of £130 for buildings insurance. For combined buildings and contents insurance the increase is £122 on top of a new business price of £165, and the increase is £82 on top of a new business price of £56 for contents only insurance. These increases affect 10 million policies across home and motor insurance for people who have been with their provider for 5 years or more.

Impact of pricing practices on competition

3.10 We looked at the impact of pricing practices on competition as well as the nature and intensity of competition. We found some evidence of price discrimination based on the willingness of customers to switch brands to secure a better price deal. This strengthens competition as firms can target lower prices to customers who may otherwise prefer rival brands.

3.11 However, we find that firms also price discriminate based on consumers' awareness of how the market works and how good their deal is. Firms earn higher margins from consumers who are less aware. We expect this type of price discrimination to have a negative effect on competition because unaware consumers will not shop around for a better deal and so firms cannot compete for these customers.

3.12 Firms compete intensely to attract new customers. Firms typically make a loss on some of their new customers in the first year of their cover and recover those losses from higher renewal prices in future years. Firms focus on attracting consumers who are unaware of pricing practices and to whom they can charge higher prices on renewal. Firms compete to identify and attract profitable customers who do not switch or negotiate better deals each year.

3.13 As this pricing practice also increases customer switching, firms incur additional marketing and customer acquisition costs. Our analysis of financial data from firms in our sample shows that customer acquisition costs, including marketing expenditure, are the second largest cost to firms after claims costs. We found that home insurers spend significantly more on acquisition cost (29% of premiums) relative to motor insurers (7% of premiums). While all firms provided figures for commission, only 9 out of 14 motor insurers and 12 out of 16 home insurers provided us with data on advertising and marketing.

3.14 Firms do not make it clear that customers who renew each year are price walked over time. This leads some consumers to believe their renewal price is more competitive than it is.

3.15 In 2017, we implemented rules to increase transparency and engagement at renewal. These rules mean that when firms send customers a renewal quote, it should set out the price they paid last year alongside the new quote. They should also be reminded to check that the cover still meets their needs.

3.16 Despite these changes, firms still use some practices that could make it more difficult for consumers to make informed decisions about whether to switch or negotiate a better deal at renewal. We have seen practices that make it difficult for consumers to cancel automatically renewing contracts. This can deter them from switching to better deals with other suppliers.

Impact of pricing practices on profitability

3.17 We found that, overall, firms providing home and motor insurance are profitable, although there is no evidence that these profits are excessive. Firms earn profits primarily from activities other than underwriting, such as add-ons, premium finance, fees and charges or investment income.

3.18 We have conducted further analysis to examine whether our conclusions are affected by including the price of add-ons or premium finance in the total price. We note that add-on prices do not vary with tenure and we haven't seen evidence of progressive increases in the margin earned on add-ons for renewing customers. We also looked at premium finance. 25% of customers in home and 51% in motor used premium finance to buy their insurance. We have not seen evidence of a progressive increase in interest rates or fees at renewal.

Impact of pricing practices on consumers

3.19 We looked at the impact on consumers. We have analysed the characteristics of the groups of customers who are affected differently by the pricing practices in the markets. We found that:

- There is a higher proportion of older consumers amongst high margin consumers, with younger consumers being more likely to switch providers.
- There is some evidence that consumers who display characteristics of vulnerability pay higher prices relative to their risk for home insurance. However, we did not find evidence of this for motor insurance. We also did not find that any of the 4 drivers of vulnerability described in our Financial Lives Survey, such as having low financial resilience or capability, were consistently more common among high margin customers.
- High margin customers exhibited a lack of awareness of current pricing practices, or engagement with their insurance provider.
- For consumers who bought combined contents and building insurance, lower income consumers (with an annual income below £30,000) pay higher margins than those with higher incomes.

3.20 We also looked at the characteristics of consumers who are of longer tenure and so, on average, pay higher margins as a result of price walking. The main factor correlated with tenure is age. For motor insurance, the average tenure of consumers younger than 45 years of age is less than two years. For consumers 65 and above it is more than four years. A similar relationship between age and tenure is observed for home insurance.

3.21 We also found that some consumers incur unnecessary costs from the time and effort spent shopping around or negotiating. The practice of discounting new business premiums followed by increasing rates in subsequent years means that consumers must search each year to ensure they don't pay more than necessary. This means consumers pay a search cost in terms of time and effort. Shopping around and switching is generally good for competition and can benefit consumers, for example where consumers want to find better quality products or better service. However, shopping around and switching merely to avoid price walking takes time and effort and can impose unnecessary costs on consumers and firms. This can lead to higher prices overall.

3.22 Although the pricing practices in home and motor insurance are very similar, we found some differences in consumer outcomes. There is more switching in motor insurance and a smaller proportion of motor insurance customers are affected by price walking practices. We also found that there is a greater variability of underlying risk costs in motor insurance, which suggests that even without price walking many consumers would find it worthwhile shopping around and switching each year.

Conclusion

3.23 We found extensive evidence of price walking in the home and motor insurance markets. Many firms adopt 'lifetime value pricing' aimed at winning customers through introductory discounts and recovering initial losses over time by increasing margins. This is not transparent to consumers.

3.24 While the current market dynamics may have some benefits for consumers who frequently search, switch or negotiate, we have found that competition is not working well for all consumers in these markets. On the basis of the evidence we found, we believe that current pricing practices lead to:

- Distorted competition – firms do not focus on providing long term value to all consumers: Competition can be intense to attract new customers by focusing on offering low headline prices. These prices do not reflect the true long-term cost of home and motor insurance policies. Firms then increase margins for customers who stay with them over time.
- Higher prices for customers who do not switch or negotiate, many of whom are less aware of current pricing practices: Firms' pricing practices are complex and opaque and do not make clear the true lifetime cost of home and motor insurance policies. This leads some consumers to believe their renewal price is more competitive than it is. Firms also use practices that can discourage consumers from looking for better deals at renewal. These practices do not enable consumers to make effective and informed choices in these markets.
- Higher overall searching and switching costs for consumers: To avoid paying higher prices than they need to, consumers must spend significant time shopping around and switching or negotiating with their existing provider. Shopping around and switching is generally good for competition and can benefit consumers, for example where consumers want to find better quality products or better service.

However, shopping around and switching merely to avoid price walking takes time and effort and can impose unnecessary costs on consumers and firms. This can lead to higher prices overall.

- High acquisition costs being passed onto customers: We think it is likely that firms know that some customers will be very profitable over the long-term. This may mean they are willing to spend significant amounts to acquire them. These costs may then be passed on to customers through higher prices.

3.25 In the following chapters, we set out how we propose to address the harm to consumers from these market outcomes.

4 Feedback received

Stakeholder feedback on potential remedies

4.1 In our interim report, we set out some of the potential remedies that we were considering to address the harm identified and asked for stakeholder feedback. We have taken this feedback into account in developing our proposed remedy package.

4.2 This chapter summarises the feedback that we received.

Views on potential pricing remedies

4.3 In our interim report, we asked for views on the different ways we could limit or ban certain pricing practices. We have taken this feedback into account in developing our pricing remedy proposal.

4.4 Many respondents agreed the market is not working well for some customers. As a result, there was broad support for some of our potential pricing remedies to tackle harmful pricing practices.

4.5 Many respondents highlighted that a pricing intervention may have unintended consequences. In particular, respondents told us that lower prices for longstanding customers could be either partially or fully compensated for by price increases for new business and other lower tenure consumers. Some respondents suggested that a pricing intervention would remove the incentive for consumers to shop around at renewal, reducing the intensity of competition and leading to an increase in average prices in the longer term. We took this feedback into account and have undertaken analysis to understand the likely impact of our package of remedies on consumer outcomes and competition in the market as set out in Chapter 5.

4.6 Many respondents identified that the insurance market is heavily intermediated and different types of firms in the distribution chain determine prices in different ways. So there could be intentional and unintentional inconsistencies in how we apply the remedy, which may reduce its effectiveness. In response to this, we have tailored our proposed pricing remedy to apply for all firms throughout the distribution chain, including firms who set the net price.

4.7 Some firms also raised concerns about difficulties in applying a pricing remedy. There may be difficulties or inconsistencies in defining the new business price and the impact on revenue may lead to firms using alternatives, such as increasing the price of ancillary products or reducing product features. To deal with these concerns, we outline our proposed anti-avoidance measures. These rules will apply both to core products, as well as add-ons and premium finance. We are also committed to ensuring that we supervise any rules we implement effectively.

Views on product governance remedies

4.8 The majority of respondents supported our proposal to extend the application of product governance rules to products launched before 1 October 2018 and to all general insurance and pure protection products. They noted that this would lead to a more consistent approach across products and remove the risk of excluding longstanding customers with older products. However, a few respondents felt this could have significant cost implications and that applying the rules to products launched before 1 October 2018 could amount to retrospective regulation. The consultation paper contains a full cost benefit analysis and considers the cost implications of the proposed changes. The proposed obligations require firms to review and assess all of their non-investment insurance products under our rules going forward. They do not require a firm to apply those rules to conduct that happened before our rules came into force.

4.9 The majority of respondents supported our proposal to require firms to consider the fair value of the product to the target market over time. However, some raised concerns about the definition of value. They suggested that this should not be too price-focused and should be measured at an overall firm level, rather than at an individual customer level. This could avoid costly systems changes and the need for customers to provide additional data to support personalised measurements of value.

4.10 Most respondents supported requiring a Senior Manager to take responsibility for the fair value of products. A few respondents suggested that there should be more flexibility over where the responsibility should lie, as some firm structures could make it difficult to allow this responsibility to sit with any one Senior Manager.

Views on monitoring pricing practices

4.11 There was general support for monitoring pricing practices, but many respondents noted that firms collect and use data in different ways. This could cause problems for some firms to provide the data we request in a comparable way. There were also some opposing views on the scope of the data. This included suggestions that it should cover large consumer groups, focus on specific consumers or be more focused on specific firms or products. As such, many respondents highlighted that the requirements would need to be standardised and prescriptive to ensure consistency across firms' data and allow meaningful comparison. We have taken this into account and will be asking firms to report on a standardised list of metrics.

4.12 Many respondents were concerned about the costs of this remedy option. To address this, some suggested that we would need to engage with the industry to assess what is the most proportionate way to design reporting requirements. We want firms to engage with us on the costs and practicalities of our remedy proposals through our consultation paper.

Views on remedies to tackle practices that discourage switching

4.13 Nearly all respondents were strongly against a ban or other form of restriction on auto-renewal. Respondents across the industry, as well as consumer groups, highlighted the potential for serious and life-changing consequences, particularly for vulnerable consumers, were they to forget to renew their policy at the end of the contract term.

4.14 Some respondents suggested that offering auto-renewal on an opt-in basis may result in increased consumer engagement. This could lead to consumers having a better understanding of the renewal process, and so make more informed decisions about whether to auto-renew. However, many respondents did not support making auto-renewal opt-in, largely because they believed it could also lead to some customers unintentionally becoming uninsured.

4.15 Most respondents agreed with making it easy for consumers to decline auto-renewing policies at the time of purchase and at renewal. Some firms also highlighted that they already had, or were in the process of, introducing new ways for customers to stop their policy from auto-renewing – for example, by enabling customers to do this online. We support the changes that some firms are making to improve existing processes, but we are concerned that there are still many firms that do not give customers a range of easy and accessible methods to stop auto-renewal.

4.16 Many respondents also agreed that policies should be easy for customers to exit or cancel. Some firms highlighted that they are already taking steps to make the exit process easier for consumers – for example, through introducing online processes to do this. We support these changes and encourage firms to continue to review their existing processes to ensure that they do not impose unnecessary barriers on customers wanting to cancel their policy.

Views on potential remedies we proposed not to focus on

4.17 Respondents agreed with our proposal not to focus on requiring firms to offer multi-year contracts. This was largely due to the difficulties of calculating risk over a longer period of time. Respondents also agreed with our proposal not to focus on requiring a single switching and renewal period for all consumers as it is unlikely to address the harm that we have identified.

Views on additional potential remedies not mentioned in the interim report

4.18 Some respondents noted the prevalence of PCWs in the market. They highlighted the negative impact of acquisition costs and 'most favoured nation' (MFN) clauses on insurance providers, suggesting a review or outright ban on MFN clauses. MFN clauses are clauses that limit the price at which the insurance provider can offer a product through other sales channels. Wide MFNs restrict insurance providers from offering the same product at a cheaper price via any other channel. Narrow MFNs restrict the insurance provider from offering the product for a cheaper price via channels where the provider controls the pricing.

4.19 We note that the CMA is currently investigating under the Competition Act 1998 the use of wide MFNs by a price comparison website in respect of certain contracts with home insurance providers. The CMA's final decision on case outcome is currently estimated for Winter 2020. We will consider whether we need to do further work on MFN clauses after the CMA's decision and when we have assessed the impact of any remedies we introduce.

Views on potential changes and innovations that may address the harm identified in our interim report

4.20 Many respondents referred to Open Finance and recognised that this could lead to easier access for consumers to obtain insurance. Some respondents said that broader collection of data could support innovation in the market by helping to increase the accuracy of calculating the risk price. However, some respondents also said that Open Finance could increase costs through higher operational costs and additional parties in the distribution chain and that this could ultimately lead to higher prices.

Views on remedies to improve transparency

4.21 Many respondents supported our proposal to improve the way firms communicate with customers. Several respondents suggested that communications making clear to consumers that their renewal price has increased because they have not switched for a long time may help improve consumer decision-making. However, many respondents did not think telling customers why premiums have increased would be effective. They noted that the reasons behind price changes are complex and it may not be helpful to add to the information consumers already get in renewal documentation.

4.22 Most respondents did not support our proposal to require firms to publish more information on their pricing practices.

4.23 Some of these respondents believed that publishing this information could be difficult for firms that are not involved in setting the final price charged to customers. They recommended that responsibility for reporting and publishing data should be placed on product manufacturers only. Others suggested that such data would not be of value to consumers if they cannot understand or use it.

4.24 Many respondents also noted that publishing commercially-sensitive information would be a problem. They were concerned about the impact publication would have on their business models and underwriting decisions.

Views on Open Finance

4.25 Many respondents to the interim report commented on Open Finance, its applicability to general insurance markets, and the potential for technological developments to help address the harms we have identified.

4.26 Some respondents noted that Open Finance could support data collection and lead to increased accuracy in calculating the risk price. It could also help to make it easier for consumers to compare offerings and switch providers.

4.27 On the other hand, some respondents set out a number of risks, noting that some consumers may be reluctant to share their data and so it may be difficult to engage, particularly with those who are vulnerable. They also suggested that there may be an increased focus on price where insurance providers control access to products.

4.28 Several respondents highlighted that the general insurance market differs significantly from others given the wide range of products, data and systems. Many noted that this will make introducing Open Finance costly and so it should be viewed as a longer-term project, rather than a short-term remedy to the harms we have identified.

5 Proposed remedy package

Introduction

5.1 This chapter sets out a package of remedies to address the harm we have identified. It explains the outcomes we are seeking, our proposed remedies package and our assessment of the likely impact of the remedies. We are consulting on the remedies package in the accompanying consultation paper.

5.2 Our proposed package of remedies includes:

- a pricing remedy to stop firms from price walking retail home and motor insurance customers in future; and
- additional measures which aim to ensure firms offer fair value to all customers in the future, improve competition and strengthen our ability to supervise firms' behaviour in this area.

The outcomes we are seeking

5.3 Given our conclusion that competition is not working well for all consumers, we want to change the way these markets work. Our package of remedies seeks both to improve outcomes for consumers and to change the nature of competition. Where we successfully do this and address the concerns highlighted above, we would want to see a market where:

- Firms compete in effective and innovative ways to provide long term fair value (reflecting both price and quality) for all customers throughout the duration of their relationship with the firm. This is ingrained in their behaviour and underpinned by strong governance. All customers continue to receive fair value over the long term as technological developments advance.
- Firms do not engage in practices that limit customers' ability to make informed choices. They are transparent with customers about the overall cost and quality of products from the start. They do not impose barriers to customers switching to better deals. This helps customers make more informed choices about which general insurance products meet their needs.
- Customers can trust that firms are offering long term fair value. Customers who remain with their insurance provider can be sure that they will not end up paying high prices simply because they have not switched provider. They no longer need to search, switch or negotiate at every renewal to avoid price walking.
- Differences in firms' products, including the type of service and quality they offer, in the evaluation of insurance risks, and in pricing structures, maintain the incentive for customers to search and switch in the market. This drives competition and helps to ensure that all customers receive fair value. Over the longer term, new technology helps make it easier and quicker to search and switch to better deals.

Our proposed remedy package

Pricing remedy

5.4 We propose to require that when a firm offers a home or motor insurance renewal price to a consumer, that renewal price should be no higher than the equivalent new business price the firm offers. This will stop firms from price walking customers.

5.5 Where products are not currently sold, our proposed rules set out requirements on identifying close matching products to determine the equivalent new business price. We think it will be rare that a firm is unable to identify a close matching product. However, our proposed rules also set out that firms must not systematically discriminate against their customers by tenure.

5.6 Firms will still be able to offer different prices to different consumers. They will also still be able to offer a range of brands and types of products to consumers at different prices and via different channels. This will help to ensure that consumers still have a range of choices in the market. It also means firms can still offer competitive deals to consumers who shop around and switch regularly.

5.7 We are proposing to introduce an anti-avoidance provision to make it clear that operating in a way which defeats the intended outcomes of the pricing remedy would be a breach of the product governance rules. In addition, we are also proposing to introduce an attestation provision requiring regular confirmation from a Senior Manager that the firm's pricing practices comply with the pricing rules.

Enhanced product governance rules

5.8 We propose to enhance and expand the scope of our existing product governance rules by:

- Applying the proposed new product governance rules to all general insurance and pure protection products, not only to home and motor insurance. While we did not include this as an option in the interim report, the current product governance rules apply to all general insurance and pure protection products manufactured or significantly adapted after 1 October 2018, not only to home and motor insurance. We consider our proposed requirements are equally relevant to all products, not only to home and motor insurance. We also propose to apply the product governance requirements to all non-investment insurance products, rather than just newly manufactured or significantly adapted products.
- Requiring firms to consider fair value in their product governance processes. Fair value is where there is a reasonable relationship between the overall cost to the end customer and the quality of the products and services. We note some respondents' concerns about the definition of fair value and have taken this into account in developing our proposals. The proposed fair value requirements would apply to core products, as well as add-ons and premium finance where these are sold alongside insurance products.
- Reminding firms that their governing body has ultimate responsibility to ensure the firm is complying with all product level requirements under our product governance rules.

Monitoring firms' actions to tackle concerns about pricing practices

5.9 We propose to introduce a reporting requirement for firms to report data on their pricing to us. This will be on several elements of pricing practices, including price differentials for new and renewing customers.

5.10 We do not propose to publish any data we collect through reporting requirements at this time. However, we may choose to do so in future if we consider there would be value in doing so, for example, to increase scrutiny of firms' pricing practices.

Remedies to tackle practices that discourage switching

5.11 For all types of general insurance, including home and motor insurance, we are proposing requirements to ensure that firms:

- explain to customers whether their policy is set to automatically renew and what this means for them;
- make it easy for customers to stop a contract from auto-renewing; and
- make it easier for consumers to decline auto-renewal of policies at the time of purchase and at renewal.

Our assessment of the impact of the remedy package

5.12 We have conducted analysis and modelling to assess the potential impact of our proposed remedies. Our assessment is that there are significant potential benefits from the remedies we are consulting on.

5.13 The remedy package would stop firms systematically increasing prices in home and motor insurance for loyal customers, as well as ensuring firms in the general insurance market focus on providing fair value to all their customers.

5.14 In assessing the effectiveness and impact of our remedy package, we looked at how our proposed package will impact:

- the outcomes for consumers, and
- the nature and intensity of competition for new customers.

Potential impacts of the remedy package on outcomes for consumers

5.15 We assessed the potential impacts of our remedies package on the outcomes for different groups of consumers.

5.16 Our remedy package will reduce prices for consumers who currently pay higher prices because they do not switch or negotiate. Consumers who have been with their provider for more than 5 years will expect to pay a premium that is on average £85 higher than a new business customer with the same risk. The typical new business motor policy costs £285. For home insurance, the difference is an increase of £108 over a new business price of £130 for buildings insurance. For combined buildings and contents insurance the increase is £122 on top of a new business price of £165, and the increase is £82 on top of a new business price of £56 for contents only insurance.

5.17 We expect that our remedy package will probably lead to some consumers paying higher prices if they currently benefit from significant new business discounts as inducements to switch. We think these discounts reflect prices that are unsustainably low. They are low to attract customers, some of whom will pay more in future or who are cross-subsidised by existing customers paying higher prices. The extent of any increase of new business prices will be significantly restrained by the intensity of competition for new customers, which we expect to continue to be strong. We assess the impact of the remedies on the nature and intensity of competition in the next section.

5.18 We developed a simulation model to estimate the effect of the pricing remedy on the prices that new customers and regular switchers, and those who do not search or negotiate, would pay. We have used the simulation model to inform the quantification of the benefits of our pricing remedy for our cost benefit analysis (see Annex 2: Simulation of remedy impact). An important limitation of the simulation is that by its nature it does not predict strategic decisions made by firms that will shape the nature of competition and the ultimate change in prices.

5.19 The simulation model provides an estimate of the initial price effects of the pricing remedy. It does so in a mechanical way based on assumptions and constraints we have used as a proxy for the behaviour of consumers and firms. Our model showed that home insurance customers who have renewed 5 or more times will see average reductions in premium of at least £55 for building and contents insurance, £29 for contents, £55 for building insurance per year. The model predicts a fall of at least £62 for motor insurance. We estimate there will also be increases in new business prices for each product but on average, across all consumers, the model predicts prices to fall for both motor and home insurance. The discounted total savings for consumers over 10 years are estimated to be £3.7bn under a scenario with no change in the intensity of competition. Under a scenario where the intensity of competition is increased, the estimated savings would be £11bn.

5.20 To understand the full effect of our remedies we have assessed the impact of the whole package together and assessed potential consumer and firm behavioural responses. This assessment requires judgement, informed by our understanding of how the market works, consumer behaviour and firms' business models and strategies from all the evidence we have gathered throughout the market study.

5.21 General insurance customers differ from one another in important ways. They differ in their tastes and preferences for brands, their sensitivity to price or other product attributes and features and in the cost of searching and switching products.

5.22 Firms respond to these differences in their pricing strategies. Pricing strategies can change over time and the aim of the optimisation process will depend on the strategy they are seeking to achieve at any time. Margin optimisation is a process where firms adapt the margins they aim to earn on individual customers. We found that firms used margin optimisation for both new business and renewal pricing. Firms set prices to maximise growth or profitability, taking account of a customer's willingness to pay and their likelihood of buying or renewing the main insurance product or buying add-ons.

5.23 So the price that a firm offers a customer will therefore depend on different factors. A firm may offer a customer a low new business price because it:

- has identified that the customer is price sensitive and the firm expects to need to offer a low renewal price to keep them. Firms will continue to have an incentive to offer low new business prices to price sensitive customers.
- has identified that the customer is unlikely to search or negotiate at renewal, so the firm expects to be able to increase prices for this customer and earn high profits in the future. In this case, the low new business price may be illusory – a form of 'bait and switch' pricing – if it is followed by higher prices. Our proposed remedies may lead to these customers being offered higher new prices at the start, but overall, we expect they would lead to lower expected average life time prices.
- cannot identify in advance how long a customer will stay, but learn that over time. So they may charge low prices to all new customers. Regular switchers gain and can potentially sustain low (even below cost) average prices, while customers who do not search or negotiate pay higher prices on average and so cross-subsidise the switchers. Our proposed remedy would eliminate this cross subsidy and so may lead to higher prices for regular switchers.

5.24 We analysed the evidence for the prevalence of these different components of pricing (see Annex 3: Analysis informing the proposed pricing remedy). Our analysis indicates that under the remedy consumers that firms identify at new business as price sensitive will continue to be offered low new business prices.

5.25 Our analysis of the types of customers who do not switch and negotiate and so pay higher prices from price walking is in chapter 3.

The impact of the remedy package on the nature and intensity of competition for new customers

5.26 The effect of our remedy package depends on its impact on the nature and intensity of competition for new customers. Our pricing remedy will restrain the way that firms set prices by tying the renewal price to the equivalent new business price. This will mean that it will only be possible for firms to increase prices for customers that do not switch or negotiate by also increasing prices for new customers.

5.27 We set out our analysis of the impact of the remedy package on the nature and intensity of competition for new customers in Annex 3: Analysis informing the proposed pricing remedy. It shows that competition for new customers is intense and we expect that to continue. We expect the nature of competition to improve, with consumers being better informed about the overall cost and quality of products when they choose an insurance provider and firms becoming more focused on delivering fair value to consumers.

5.28 In our interim report, we noted that firms told us that they compete intensively to attract customers who they expect to be more profitable over time (based on lifetime value). We expect this to continue.

5.29 Different firms have different business models and different competitive and pricing strategies. Firms that currently use price walking more extensively will need to adapt their front book prices more. However, there are other firms that do not use price walking as much. We expect these firms to continue offering good deals to customers which would restrain the pricing behaviour of the firms most affected by our remedy.

5.30 Lifetime value pricing and price walking are not the only approaches firms use in their pricing practices. There are very wide differences in new policy prices that are not solely accounted for by differences in customers' expected tenure. Our analysis shows that much of the significant variation in new business margins is driven by factors other than price walking, such as competition on brands and customer characteristics. We expect firms to continue to offer low prices to customers who are price sensitive and to attract those customers who would prefer their rival's brand (see Annex 3: Analysis informing the proposed pricing remedy).

5.31 Our pricing remedy will mean that customers will be able to make more informed decisions when they switch. The quote that a firm gives a customer will be a better indication of the price that they will pay in future years if they do not search or negotiate. This will intensify and improve the nature of competition.

5.32 In our interim report, we explored the impact of price discrimination on competition in home and motor insurance. We found some evidence of price discrimination based on how willing customers were to switch brands to get a better price. This strengthens competition as firms can target lower prices to customers who may otherwise prefer rival brands. Our remedy package preserves the scope for firms to set their prices in this way.

5.33 Other parts of our remedy package will make it easier for customers to switch and this will also intensify competition. Our proposed package of remedies addresses the potential for firms to misuse auto-renewal to discourage customers from switching. This will be reduced by remedies that make it easier for customers to decline auto-renewal and to cancel the auto-renewing feature during the lifetime of the contract.

5.34 Our remedies package will reduce some of the switching costs that customers incur to avoid being price walked. Regular switchers spend time searching, switching and/or negotiating with their firm each year, even if they are happy with their current provider and their risk has not changed.

5.35 We want to promote good governance and reduce potential harm to consumers by making senior individuals more accountable for firms' conduct. Senior Manager oversight of fair value for customers should help to embed cultural improvements within the firm. We expect these proposed rules to ensure firms focus on offering fair value to all customers in their target market over the longer term. That is what we would expect to see in a market where competition is working well.

5.36 This will be supported by our proposed reporting requirements, which will give us an overview of firms' pricing practices. The data we will collect from firms will help us identify where we need to take follow up actions with specific firms.

5.37 Overall, we expect intense competition for new customers to continue and that this package of remedies will improve the nature of competition. Our remedy package will lead to lower prices for customers who are paying higher prices because they do not switch or negotiate. It will also change the incentive for firms to price walk these customers in future. Our remedy package may lead to some customers paying higher prices if they currently benefit from significant discounts as inducements to switch. However, we think this reflects prices that are unsustainably low and the extent of any increase in prices will be significantly restrained by the intensity of competition for new customers.

Proportionality of our remedy package

5.38 We have assessed whether the package of remedies could effectively address harm and is proportionate.

5.39 In designing our remedies package, we aimed to balance the need to tackle pricing practices that penalise loyal customers who lack awareness of pricing practices and distort competition, with the risk that doing so may lead to higher prices for some customers.

5.40 We also aimed to ensure that our interventions are sufficient to address the harm we have found, but also maintain the incentive for firms to compete and to offer consumers access to a range of products that meet their needs and that they can afford.

5.41 Based on our assessment, we think that our proposed package of remedies is the most effective and proportionate way to address the harms we have identified. We have focused our proposed remedy package at the harm while allowing firms flexibility to offer different products to different customers and different prices. This should drive improved competition, leading to better overall outcomes for consumers. But we recognise the impact may include price increases for some customers. The proposed pricing remedy will also be supported by reporting measures so that we can monitor firms' reactions and the ongoing effect on the market.

5.42 If implemented, our remedy package will require careful monitoring to ensure firms' compliance. The complexity of insurance pricing makes this challenging, so we are consulting on requirements for firms to report data on several elements of their pricing practices, including price differentials for new and renewing customers.

5.43 We will look closely at how firms could change their business models in response to potential remedies, for example reducing the quality of core insurance products or increasing the sale of add-ons to customers that do not provide additional value. Where changes to business models result in breaches of our rules we will take appropriate action.

5.44 We will evaluate our remedy package. To do this, we will ask firms to report information to us on a regular basis. We will then use this data to understand the impact of our remedies on the market. We intend to review the effects of the remedies approximately a year after implementation and to conduct a full post-implementation evaluation 2 years after implementation or earlier if deemed appropriate.

5.45 We have carefully assessed the impact of the coronavirus pandemic on the general insurance market and tested whether it affects the rationale and timing of our proposed remedy package. We have identified three main effects:

- During the early part of the crisis and during the peak of lockdown, there was a significant reduction in the number of journeys by car and therefore a significant reduction in the risk that motor insurers had to cover for their customers (see Transport use during the coronavirus (COVID-19) pandemic).
- The pandemic has led to a significant impact on the economy and financial position of customers, both in the short-term but also in the coming years. There will likely be an increase in the number of households experiencing significant financial distress. This could reduce demand for insurance. For example, customers might

stop driving (and therefore no longer need motor insurance) or reduce the level of insurance coverage for their property. There might also be greater numbers of uninsured drivers or uninsured property owners (even when required by mortgage contracts). More uninsured drivers may increase costs for insured drivers and their insurance in the event of crashes (as the costs of uninsured drivers falls on insured drivers through funding for the Motor Insurers' Bureau).
- There was a significant reduction in the level of switching and use of price comparison websites during the initial stages of the pandemic. We would expect this impact to be short-term and switching levels to have recovered by the time our remedies are implemented.

5.46 Overall, our analysis of the available evidence suggests that the pandemic has not had a particularly significant impact on the home and motor insurance markets. Therefore, we believe action is still required to address the harms we have identified. We will continue to monitor the market during the consultation period and will consider the ongoing impacts of the pandemic before making any final rules and issuing any policy statement.

Alternative pricing remedies we considered

5.47 We considered other potential pricing restrictions. We included some of these in our interim report. We set out our key reasons for not proceeding with these alternative options below.

5.48 We considered a cap on the level of margin that firms could earn from each individual customer. We decided not to take this forward for 2 reasons. Firstly, a cap on the level of margin would not stop price walking. Firms would still be able to increase the renewal price to customers up to the level of the cap. Secondly, it could lead to some consumers being left without insurance.

5.49 We considered a ban or restriction to stop firms assessing consumer characteristics to assess the likelihood a consumer will renew or negotiate at renewal. This gives firms an indication of the maximum customers might pay for insurance and the likelihood they will switch provider in the future. Firms then factor this into the price offered to customers.

5.50 While price optimisation is not transparent to consumers, our analysis indicates there can be competitive advantages to using it. Most significantly, it can allow firms to compete by offering different prices and products to different consumers. This can benefit consumers if it allows firms to offer a range of choice and better deals. Our judgement is that stopping firms from price optimising completely could lead to less effective competition and worse consumer outcomes overall. However, we know there can be concerns about the fairness of certain types of price optimisation techniques. Firms are prevented or restricted by law from using certain protected characteristics as a factor in calculating the price. We will continue to consider optimisation techniques used by firms and will take appropriate action, such as issuing guidance, should we identify any issues.

5.51 A reset of the price after a set number of renewals was another remedy option that we considered. However, it was not clear that this would tackle price walking effectively. For example, firms could still price walk customers in the years before their price is reset. We also considered variants of a restriction on the level of the renewal price relative to the new business price. We did not consider these options to be appropriate as they would also still allow firms to price walk, only limiting the extent to which they could do so.

5.52 Overall, we did not think that any of these alternative options would be as effective as our proposed pricing remedy in addressing price walking, while still allowing firms flexibility to tailor prices and maintaining a range of choice for consumers.

Remedies to improve transparency around firms' pricing practices

5.53 Our interim report highlighted that many consumers did not know that premiums increased significantly the longer they stayed with the same insurer. Moreover, the complexity and lack of transparency around how firms set prices is unlikely to help consumers make informed decisions. We set out potential options to improve the ways firms communicate with customers, and to increase public scrutiny of pricing practices.

5.54 We do not propose to take forward requirements considered in the interim report for firms to be transparent about their pricing strategies and the reasons for price increases or to publish information about price differentials between their customers. We are also not proposing to require firms to provide information about the reasons for premium increases in renewal notices. Having considered this further, we do not believe that this would have sufficient impact to be proportionate. Customers who do not engage with renewal notices will be protected by other remedies we are consulting on, in particular the pricing intervention and stronger product governance requirements.

Open Finance

5.55 In our interim report, we said that we would look at ways general insurance markets could benefit from technological developments. We noted that Open Finance has the potential to deliver significant consumer benefits, improve competition and spur greater innovation.

5.56 We highlighted that Open Finance could make the process of finding better deals and switching provider easier and quicker. Currently, PCWs help consumers shop around and compare prices. However, consumers must actively provide their data to benefit fully from these services. This process could be automated in the longer term.

5.57 We acknowledged that it could take some time to fully realise the potential of Open Finance. But we want general insurance markets to be part of these transformations to help to ensure they work well for consumers in the future.

5.58 We confirmed that we would take this work forward and develop our future strategy on Open Finance.

Analysis of Open Finance

5.59 We have engaged on Open Finance with stakeholders from across the insurance sector, including firms, industry bodies and academics. These were wide-ranging discussions on the benefits and risks that Open Finance could present to general insurance markets. We have also held initial discussions with a selection of firms to begin to explore how greater sharing of data across the insurance industry could make the search and switching process easier for consumers. This work was targeted to consider whether Open Finance could help to remedy the harm we identified in the Interim report.

5.60 We published our Open Finance Call for Input on 17 December 2019, inviting views on the potential of Open Finance and the role we should play in its development. We subsequently delayed the closure date until 1 October 2020, to give stakeholders more time to respond to the Call for Input in light of disruption caused by the coronavirus pandemic.

Potential benefits

5.61 We think Open Finance could make it easier for consumers to get a good deal on their insurance. Consumers often need to shop around to get the cover they need at a competitive price. They are usually required to input large amounts of data to do this and it can be difficult to compare product offerings, other than on headline price. The time, effort and cost involved in this process acts as a barrier to switching to better deals for some consumers.

5.62 Open Finance could overcome the need for significant consumer involvement in the search and switching process. The consumer's existing provider holds the data they need to provide to find and compare products. This could be shared with the market in much the same way that it is shared when the customer searches for cover through a PCW. This would allow other providers the opportunity to offer comparable cover at a competitive price and switch customers to them. Over time, it may be possible to automate this process, as seen in the energy sector.

5.63 This kind of solution could prompt disengaged consumers to access better deals. It could drive more effective competition, particularly for longstanding customers, and reduce the high prices some consumers pay. This process could give firms direct access to consumers, lowering their advertising and acquisition costs. This could in turn lead to lower insurance premiums for consumers.

Potential risks

5.64 Many of the stakeholders flagged potential risks connected to Open Finance and its application in the insurance sector. We will explore this as outlined in our Call for Input process.

Next steps

5.65 We think Open Finance could make it easier for consumers to get a good deal on their insurance. However, we recognise that it presents risks and challenges, and is likely to take some time to implement effectively. Therefore, we do not consider it to be a remedy to the harm we have identified in the short term.

5.66 The package of remedies we are consulting on, including the pricing remedy and improvements to product governance, should reduce the need for consumers to switch to get a good deal. If we proceed with these remedies following consultation, we will monitor their effectiveness and consider whether Open Finance could offer incremental benefits to consumers.

5.67 Our work on Open Finance will continue through the Call for Input process. This has the potential to lay the foundations for switching services to develop in the future. We also know that some firms are already taking steps to harness open data to develop new insurance propositions for consumers.

6 Next steps

6.1 We are publishing the final report with a consultation paper to further explain our proposed remedies. This includes our proposal to restrict price walking and our other remedies. We have also published a technical annex (Annex 3: Analysis informing the proposed pricing remedy) outlining additional information on the analysis for our pricing remedy.

6.2 We are seeking views on our proposals as set out in our consultation paper. Please send us your comments by 25 January 2021. We will consider all the feedback and intend to publish a policy statement in Q2 2021 with our response to the feedback.

6.3 We expect firms to engage with the consultation process and then to work to implement any remedies which we introduce in line with the relevant implementation periods. We have already been actively engaged with firms on insurance pricing practices and our interim report set out the range of potential interventions we were considering.

6.4 We have considered the impact of coronavirus and current economic conditions. While these have clearly had an effect on the general insurance market, they have not materially impacted the structure or functioning of the home and motor insurance markets, so we believe our chosen remedies remain appropriate. We also note the importance of addressing the issues identified in this market as promptly as possible, given the harms that they continue to cause, hence the proposed implementation periods set out in our consultation.

6.5 If we proceed with our proposed remedy package, we intend to put in place a strong supervisory approach to ensure that firms work to implement the remedies on a timely basis. As noted at 1.32, we plan to make use of a suite of reporting and management information which we are also consulting on. We will focus our supervisory work on assessing the effectiveness of firms' pricing governance, verifying firms' compliance with the specific rules and guidance arising from the market study and ensuring that firms actively consider the value their products provide and consistently treat customers fairly.

6.6 Where we see firms failing to meet our expectations and comply with the relevant rules we will look to intervene as appropriate using the full range of our regulatory tools.

Pub ref: 007299

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