

General Insurance Add-ons Market Study – Remedies: Value Measures

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Contents

	Abbreviations used in this document	3
1	Overview	5
2	Improving value in general insurance markets through greater transparency	9
3	Scope and granularity	15
4	Options for a value measure	19
5	Reporting and publication	27
6	Other measures we considered	31
7	Conclusion and next steps	34
Annex		
1	Calculation of the measures	36
2	List of questions	41

We are asking for comments on this Discussion Paper by 24 September 2015.

You can send them to us using the form on our website at:
www.fca.org.uk/your-fca/documents/discussion-papers/dp15-4-response-form.

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Abbreviations used in this paper

Acronym	Description
ABI	Association of British Insurers
ALAE	Allocated Loss Adjustment Expenses
CMA	Competition and Markets Authority
GAP	Guaranteed Asset Protection
GI	General insurance
GIAO	General Insurance Add-ons
ICOBS	Insurance Conduct of Business Sourcebook
IFRS	International Financial Reporting Standards
IPT	Insurance Premium Tax
FCA	Financial Conduct Authority
FSA	Financial Services Authority
HMRC	Her Majesty's Revenue and Customs
Market Study	The General Insurance Add-ons Market Study
ULAE	Unallocated Loss Adjustment Expenses

1. Overview

Introduction

- 1.1** In December 2012 the Financial Services Authority (FSA) launched a study into general insurance (GI) add-ons. This became our first market study in July 2013. The market study looked at the effect of the add-on mechanism in GI markets and found that competition for add-ons is not effective.
- 1.2** The market study focused on five products: guaranteed asset protection (GAP) insurance, home emergency insurance, travel insurance, gadget insurance, and personal accident insurance.
- 1.3** We analysed product literature, pricing and management information, profitability and claims data from firms as part of the study. We also conducted quantitative and qualitative consumer research, as well as a behavioral experiment. We published our final findings in July 2014¹.
- 1.4** We found that competition was not working well for consumers in add-on markets. The add-on mechanism has a material impact on consumer behaviour and decision-making. There is little pressure on firms because add-on buyers are less likely to shop around and are less price sensitive. Add-on buyers also have poor awareness of product ownership or of the price they have paid. We found that consumers' attention was often focused on the primary product during the sale, leading them to buy products they did not need or understand. Consumers were also given insufficient information to make an informed decision about their add-on purchase, with this information being presented too late in the buying process. We are already taking action to address these issues².
- 1.5** We identified poor value in both add-on and some stand-alone products as measured by claims ratios³. For example, for personal accident and GAP add-ons, only around 10% of the retail premiums were paid out in claims. Stand-alone personal accident insurance had an average claims ratio of 15%⁴. These low claims ratios, in some cases persisting for over five years, indicate that firms are not under pressure to improve value. We believe that the issue of poor value was exacerbated by the fact that there are no commonly available measures to assess the value for money of general insurance products.

1 *General Insurance add-ons: Final Report – Confirmed Findings of the Market Study*: <https://www.fca.org.uk/static/documents/market-studies/ms14-01-final-report.pdf>

2 *CP15/13: General Insurance Add-ons Market Study – Proposed Remedies: banning opt-out selling and supporting informed decision-making for add-on buyers* – <https://www.fca.org.uk/news/cp15-13-gi-add-ons-proposed-remedies>

3 A claims ratio is broadly the percentage of the retail premium paid by consumers that is paid out in claims by insurers e.g. if a consumer pays £100 for a product and the insurer, on average pays out £50 in claims, the product will have a claims ratio of 50%.

4 *General insurance add-ons: Provisional findings of market study and proposed remedies*: www.fca.org.uk/your-fca/documents/market-studies/ms14-01

- 1.6** We concluded that ineffective competition led to consumers paying too much for their add-on products, often receiving poor value for money. We estimated that this resulted in an overpayment of at least £108m a year⁵.
- 1.7** To address these issues we suggested four potential remedies. We have already consulted on three of the four remedies:
- imposing a deferred opt-in period in GAP sales and increased information to aid shopping around – consultation paper published in December 2014⁶ and policy statement published in June 2015⁷
 - banning opt-out selling – consultation paper published in March 2015⁸
 - improving information provision for general insurance add-ons – consultation paper published in March 2015⁹
- 1.8** Through the final remedy proposed – the publication of claims ratios – we sought to introduce a measure of value into general insurance markets to address concerns over poor value and introduce transparency over value.
- 1.9** The market study was not the first time we raised the question of how to increase transparency in general insurance markets. In FSA Discussion Paper 13/1¹⁰ we stated that “we will seek to use transparency where we believe it will help consumers make more informed choices or change consumer or firm behaviour in ways that help us achieve our objectives”. We also introduced the idea of publishing a measure of general insurance product value.
- 1.10** This paper explores a range of options for introducing a measure, or measures, of value in GI markets. These measures do not give a perfect representation of value – not least because all consumers have different needs and risk appetites – but they can be used as indicators of value.
- 1.11** We are committed to introducing such measures in order to shine a light on poor value in the market place. We want to increase competition on value, and incentivise firms to improve value.

About this paper

- 1.12** The options discussed in this paper have been informed by feedback to previous papers, meetings with relevant stakeholders and a number of industry working groups. We thank contributors for their input.

5 We estimated that consumers overpaid for the add-on products in the market study by around £108m to £200m a year. *General insurance add-ons: Provisional findings of market study and proposed remedies*: www.fca.org.uk/your-fca/documents/market-studies/ms14-01

6 *CP14/29: Guaranteed Asset Protection Insurance: a competition remedy* – www.fca.org.uk/news/cp14-29-guaranteed-asset-protection-insurance

7 *PS15/13: Guaranteed Asset Protection insurance: competition remedy Including Feedback on CP14/29 and final rules* – www.fca.org.uk/your-fca/documents/policy-statements/ps15-13

8 *CP15/13: General Insurance Add-ons Market Study – Proposed Remedies: banning opt-out selling and supporting informed decision-making for add-on buyers* – <https://www.fca.org.uk/news/cp15-13-gi-add-ons-proposed-remedies>

9 *CP15/13: General Insurance Add-ons Market Study – Proposed Remedies: banning opt-out selling and supporting informed decision-making for add-on buyers* – <https://www.fca.org.uk/news/cp15-13-gi-add-ons-proposed-remedies>

10 DP13/1, *Transparency*, March 2013 – <http://www.fca.org.uk/static/fca/documents/discussion-papers/fsa-dp13-01.pdf>

- 1.13** Chapter 2 explains why we are looking at value in GI markets, what we hope to achieve by using transparency as a regulatory tool and what aspects of GI value we are concerned with.
- 1.14** Chapter 3 sets out some common features and principles for the scope and granularity of such measures or indicators of value.
- 1.15** Chapter 4 discusses the potential measures we identified in more detail, namely:
- the claims ratio as a stand-alone value measure
 - a package of measures: claims frequencies, claims acceptance rates and average claims pay-outs, and
 - the claims ratio plus claims acceptance rates
- 1.16** However, these options are not intended to be exclusive or exhaustive. We welcome suggestions from stakeholders on other ways to highlight product value and create the right incentives for firms to improve the value they offer to consumers.
- 1.17** Chapter 5 describes our proposals for how the various measures could be reported, published and contextualised.
- 1.18** Chapter 6 outlines some alternative measures that we have considered.
- 1.19** This paper describes the options we are considering in some detail and also highlights key technical aspects of the various options. This reflects the significant engagement we have undertaken in relation to this remedy. We have adopted this approach because we want stakeholders to consider how the challenges of calculating, reporting and publishing the individual measures might be overcome. This will help us decide which measures to take forward.
- 1.20** Before making any proposals in relation to the introduction of value measures we will consult on our proposals and will conduct a cost benefit analysis of the chosen option(s). In completing this assessment we will consider the availability of the required data, the cost involved to firms, and the potential benefits to both firms and consumers.

Who does this document affect?

- 1.21** The matters discussed in this paper will be of interest to any firm involved in the underwriting, sale and/or distribution of general insurance products.
- 1.22** We would also be particularly interested in the views of consumer advocates to help us determine the most effective approach for our policy decisions.
- 1.23** The paper may also be of interest to the wider financial services industry. Any potential remedies will follow on from our first market study and will be an example of using transparency to bring about market change, which is in line with our wider approach to delivering better consumer outcomes.

Is this of interest to consumers?

- 1.24** This paper will be of interest to consumers who buy general insurance products. Consumers may want to consider what indicators of value they might find useful.

2. Improving value in general insurance markets through greater transparency

What do we mean by 'value' in general insurance markets?

- 2.1** When considering the value of a product or a service we generally think about the quality or benefits offered by the product, relative to the price paid for it.
- 2.2** It is fairly easy to determine the price paid for an insurance product: this is the premium paid by the consumer. However, the quality or benefits of an insurance product are more complex and multi-faceted. Key elements of a good quality product might include the following:
- broad cover with few restrictive terms and conditions
 - a good sales process that leads to engaged and informed consumers making good decisions
 - good claims service, placing the interests of the consumer at the heart of the process, without the firm placing barriers in the way of claims, and
 - efficient distribution that does not erode value or drive up premiums
- 2.3** We believe that any assessment of value should incorporate the cost to consumers i.e. the retail premium, alongside a consideration of the product's benefits or qualities. To exclude one or the other only gives a partial representation of value.
- 2.4** The value derived from a general insurance product is of course related to an individual's risk appetite and personal circumstances. Therefore, any value metric we introduce should be seen as a general indicator of value rather than an absolute measure. A product that might be poor value for the majority of consumers could still provide good value to a small number of individuals for whom it is perfectly suited. Any measure introduced could therefore be supplemented by additional text or information to reflect this point and reduce the risk of misunderstanding.
- 2.5** For each of the measures discussed in this paper we will highlight which aspects of value we believe they do, and do not, capture. This is discussed in more detail in Chapter 4.

What about peace of mind?

Both consumers and firms identify “peace of mind” as a valuable part of insurance products – giving consumers comfort that they are covered if the worst happens. However, “peace of mind” is highly subjective and dependent on an individual’s risk tolerance and wider circumstances. It can also be misplaced or secured at very high cost.

“Peace of mind” is often cited without any real assessment or consideration of the cover provided. The consumer research we carried out for the market study shows that, while many consumers were happy with their products, a huge proportion had a very poor understanding of the cover provided. Consumers also frequently overestimated their cover or failed to understand excesses, restrictions or exclusions. As many as one in five consumers did not appreciate that they even owned the add-on in question. This highlights that “peace of mind” can often be misplaced. Even where the consumer has purchased suitable cover, and might be justified in having “peace of mind”, the insurance could still be overpriced.

“Peace of mind” can therefore be valued by consumers, but it does not necessarily equate to a good value product in the sense discussed above (where an assessment of cost and quality/benefits is conducted). As such, we have not considered “peace of mind” as part of the value measures discussion.

How did we measure value in the market study?

- 2.6** In the market study we looked to compare the value of add-on and stand-alone products using price and cover information. However, in general we were not able to use this information in a way that allowed us to draw definite conclusions about the price/ cover relationship. We also considered a number of indicators of the effectiveness of competition and value for money. These indicators included the scale of mark-ups from net rates, (which the point of sale advantage allows distributors to charge), the profitability of firms and the claims ratio; which we broadly measured as the claims paid out as a percentage of the premiums paid. In the market study we used the claims ratio as our core measure of product value.

Why introduce a value measure, or measures, in GI markets?

- 2.7** The market study confirmed that ineffective competition led to consumers paying too much for their add-on products, often receiving poor value. This was also the case for some stand-alone products. We found that for personal accident and GAP add-ons, only around 10% of the retail premiums paid were paid out in claims. Stand-alone personal accident insurance had an average claims ratio of 15% and home emergency add-on cover had an average claims ratio of 25%. The CMA’s Private Motor Insurance Market Investigation (2013) also found that average claims ratios in 2012 for motor add-ons were 7% for motor legal expenses insurance (MLEI), 5% for personal accident insurance, 25% for key loss cover and 29% for extended foreign use cover. We estimated that the poor value offered resulted in an overpayment of at least £108m a year for the five add-ons in the market study.

- 2.8** In a well-functioning market, we would expect consumer switching to exert pressure on firms to deliver good quality products at competitive prices. However, we know that in financial services this is often not the case – financial services products can be very complex, there are significant information asymmetries, and consumers are not as engaged as they are with less complicated, ‘everyday’ products.
- 2.9** A large percentage of the population hold general insurance cover and these products play a vital role in consumers’ lives. For example, ABI key facts 2014¹¹ set out that approximately 20 million households have motor insurance and 17 million have buildings insurance. Having the right insurance cover offers consumers protection from risk and uncertainty, as well as the potentially severe consequences an unforeseen event can have. In turn, knowing the right cover is in place can bring consumers peace of mind.
- 2.10** However, for consumers to assess the value of a general insurance product they are expected to weigh up a number of complex considerations, such as:
- the risk they are trying to protect against and its likely impact
 - the likelihood of the event occurring/the risk materialising
 - the cost of dealing with the event themselves against the cost of buying insurance
 - the cover they need for the risks they are seeking to protect against
 - the cover any policy offers and any excesses or exclusions, and
 - the cost of the insurance
- 2.11** This means that the vast majority of consumers will struggle to make an assessment of the value offered by an insurance product. Their task is made harder by the fact that commonly used terms or jargon can mean different things for different products, or can be used differently by different firms.
- 2.12** In fact, these issues are not restricted to consumers; many market participants will experience similar difficulties. For anyone wanting to compare the cover offered by different products they will therefore have to:
- compare products from a range of different sources
 - assess trade-offs between price, cover, excesses and any exclusions
 - navigate different terminology used by different providers, and
 - work through lengthy product documentation if they need to consider the fine print
- 2.13** The above is compounded by the lack of any meaningful value metric or indicator to help inform comparisons and decisions¹², which can result in reduced pressure on firms to improve value and quality. Therefore, we believe there is real merit in introducing indicators to aid understanding and comparisons in this area. We see this helping to promote more effective competition and, in turn, securing better outcomes for consumers.

¹¹ UK Insurance Key Facts 2014 – <https://www.abi.org.uk/Insurance-and-savings/Industry-data/Key-Facts-2014>

¹² Defaqto, an independent researcher, publish start ratings giving an indicator of cover for GI products. However, the criteria does not explicitly link cover to price.

- 2.14** Our objective is not to enhance competition solely on the basis of price – in fact in many of the core markets the focus is already very much on price, and this can be at the expense of cover and quality. Instead, we are concerned here with introducing indicators of value and focusing competition on value.
- 2.15** We see value measures being introduced on a market wide basis, and being used to publicly shine a light on poor value. At this stage we do not intend to require firms to provide consumers with value measures during their purchasing journey – any such point of sale disclosure would need to be subject to consumer testing and would be part of a later phase of the project.
- 2.16** Moreover, any measure or indicator we introduce should not serve as a shortcut for consumers to use when buying general insurance. If consumers do decide to look at the value data they will still have to consider very carefully what their needs are and whether a product is right for them. Having these indicators available may offer useful context to some consumers, but it should not replace other assessments that need to be made as part of the customer journey.
- 2.17** Our objectives for this work are therefore to:
- collect and publish a measure, or measures, of value to increase transparency in GI markets
 - incentivise firms to improve product value, and
 - explore the case for a future extension of any measure(s) to be disclosed to consumers in due course

How would such a measure work and what benefits would it bring? Using transparency as a regulatory tool

- 2.18** In August 2013 the FCA published a paper setting out our commitment to promoting and using transparency to advance our objectives¹³. One strand of our drive towards greater transparency is to identify information we could release, or require firms to release, about their products. This is to help market participants make informed choices and to provide an incentive for firms to change their behaviour in beneficial ways.
- 2.19** Our commitment to introducing a measure of value in GI markets is part of this wider move towards greater transparency. We believe that publication of value metrics will publicise poor value, incentivise firms to change their behaviour and secure better outcomes for consumers.
- 2.20** We believe that introducing any measure(s) of value would work in the following way:
- We would require firms to report the value data to us. We would then publish the data in an easily accessible and comparable format, for example on our website. This data would be accompanied by appropriate contextualisation to aid understanding.
 - Users of the data could look up results for an individual firm across a range of products, or could compare data for a product across a number of firms.
 - This data could be used by consumer groups and the financial press to highlight poor value products or firms; for example through consumer campaigns or warnings.

¹³ FCA Transparency Framework – <https://www.fca.org.uk/static/fca/documents/feedback-statements/fca-transparency-framework.pdf>

- We could use the data as an additional source of intelligence in prioritising areas for further investigation or supervisory intervention.
- Individual consumers might consider the data in making their own buying decisions.
- Price comparison websites might incorporate the indicators into their own sales journeys.

2.21 We envisage that firms might compare their own performance against their peers, and be encouraged to improve their product offerings. We expect that the combined pressure generated by publicity, changes in consumer behaviour, regulatory intervention and peer review will incentivise firms to focus more on the value that their products offer and take action to improve this. Some of the areas firms might review include:

- product design
- product pricing
- target markets
- quality of sales processes
- distribution models, and
- approach to claims handling

2.22 We expect that the introduction of any measure(s) of value will be most effective in highlighting potentially low value products, or firms offering potentially poorer value than their competitors in any given product class. Where products already represent good value for consumers the introduction of these metrics will be less effective in generating change. However, they could serve to encourage firms to maintain a good performance and can also be used by firms to highlight their performance to consumers. As noted earlier, value measures will give indications rather than absolute assessments of value. We will use contextualisation to frame data, and firms may also wish to give reasons for their particular performance.

2.23 We want to use transparency as a regulatory tool. Simply asking firms to report the data to the FCA for review would not be sufficient to generate the appropriate market pressures. This would rely on the regulator analysing all data and tackling issues on a product by product, or firm by firm, basis. As such, the process would necessarily be very reactive.

2.24 We will of course use the data as part of our day to day work to identify outlier firms or problem products or markets. The data will help inform and prioritise our firm-specific supervisory work, policy initiatives and thematic or market studies. Publishing this data is however crucial to enable firms to compare themselves with their peers and address issues of poor value. Publication is also in line with our wider strategic direction of using market dynamics to achieve better outcomes.

Using transparency as a regulatory tool – complaints data

A useful example of where the FCA has used transparency to create incentives for firms to deliver better consumer outcomes is the publication of complaints data. Since 2010, the FSA/FCA has required the reporting of complaints for firms that record 500 or more complaints in a six-month period. This data is published on our website. The post-implementation review of this work found that increasing transparency led firms to focus on complaints handling and improvements in the quality of underlying products and management of complaints. These improvements led to consumer benefits, with complaints being handled more effectively and efficiently, and the provision of better quality products. Since publication we have found that 76% of firms are aware of the complaints data published by their peers, with 59% stating that they used this data to help assess their own complaints performance. One firm also commented that 'data publication has allowed increased opportunity for discussion and comparisons...'. In a similar way, we think that increasing transparency over product value will lead to increased competition and better outcomes for consumers.

In 2014 the FCA published a Consultation Paper aimed at further improving complaints handling¹⁴. Amongst other things, this paper proposed that the FCA would increase the number of product categories for recording complaints, and proposed that firms provide new metrics in order to contextualise the data. These proposals are aimed at improving detail and increasing understanding around complaints. We can learn valuable lessons from this ongoing work, such as how best to present and contextualise the value measure(s) we decide to introduce.

- Q1: Do you have any comments on the aspects of value discussed?**
- Q2: Do you have any comments on our rationale for introducing a value measure and how we see such a measure working?**

¹⁴ *Improving Complaints Handling*: <http://www.fca.org.uk/static/documents/consultation-papers/cp14-30.pdf>

3. Scope and granularity

- 3.1** As part of any value measure design we need to address a number of common questions which will apply regardless of which measure(s) we might take forward. This chapter sets out the common features of scope and granularity.

Remedy scope

- 3.2** We would expect any measure to apply to general insurance products underwritten, distributed and sold to consumers in the UK by firms regulated by the FCA, as Home State Regulator. We also intend for any measure to apply to incoming EEA firms passporting on an establishment or services basis. The inclusion of incoming EEA firms would provide maximum coverage for any resulting rules, meaning that they cover general insurance products sold to consumers habitually resident in the UK. We are aware of the need to ensure that any application to EEA firms is not contrary to relevant EU legislation.

Product scope

- 3.3** We consider that a wide scope across GI products (both add-on and stand-alone) is most appropriate for a broad transparency measure because:
- when making comparisons, better value products can act as a benchmark for poorer value products
 - there could be a reduced risk that poor value will become more prominent in products outside of the scope of any remedy
 - poor value products, or firms offering poor value, in well performing markets can still be identified, and
 - it may deter the emergence of new poorer value products
- 3.4** We do not believe that a narrower scope, such as focusing only on what are currently considered poorer value products, would meet our objectives.

3.5 We set out a list of possible products/covers in Table 1:

Table 1: List of possible products/covers

	Product
1	Motor
2	Motorcycle
3	Home – buildings
4	Home – contents
5	Home – buildings and contents
6	Travel – EU
7	Travel – worldwide
8	Pet
9	GAP
10	Home emergency
11	Identity theft
12	Extended warranty – electrical goods
13	Extended warranty – motor
14	Breakdown insurance
15	Private medical
16	Healthcare cash plan
17	Dental cover
18	Personal accident (including personal accident and sickness, and Accident Sickness and Unemployment)
19	Gadget (including mobile phones)
20	Payment protection (including credit card, store cards and personal loans)
21	Mortgage payment protection (including both first and second charge mortgages)
22	Motor legal expenses
23	Home legal expenses
24	Motor add-ons not separately listed in this table
25	Home add-ons not separately listed in this table
26	Other products – other general insurance contracts not specifically listed or excluded

Products potentially excluded from scope

3.6 While the benefits of a wide scope across GI products are set out above, there are a few products (or types of product) where the benefits of inclusion are lower and/or reported data could potentially be misleading. We are therefore considering whether some products might be excluded from scope. That is not to say that these products will always deliver good value to consumers, rather we feel that the metrics discussed in this paper may not be the best way to encourage firms to improve value for these products. Excluded products might cover:

- general insurance sold as part of a packaged bank account. Insurance can be sold as part of a packaged bank account (particularly mobile phone and travel insurance), and as such we are keen to find a way of shining a light on poor value in this market. However, separating out the data in these circumstances could be complex, given that consumers pay for a package of products. Applying the measures discussed in this paper could therefore produce less reliable data
- policies for high net worth consumers – where cover is for multiple policies for different types of insurance at a single, bespoke, price e.g. one policy covering the consumer's home, holiday home, art work and pets
- no claims bonus protection – there are no claims pay-outs made on this type of policy and therefore we do not believe the identified measures accurately reflect the value provided by the product, and
- commercial products – commercial business is more likely to have differentiated products with more bespoke features and data may be less comparable

Data granularity

Product and sub-product

3.7 There is a trade-off between data granularity and reliability on the one hand, and the cost of any measure on the other. For any measure, the data will be more expensive to calculate and potentially less reliable if we were to require reporting at sub-product level e.g. a separate data set for personal accident bronze, silver and gold cover, rather than a single report for personal accident insurance. On the other hand, broader reporting categories could mean that sub-products offering poor value may be less easy to spot.

3.8 On balance, we believe that reporting and publishing at product level is more likely to produce a measure that delivers against our stated objectives, whilst also being proportionate in its cost and complexity. A possible product/covers list is set out in Table 1 above. For product categories which could include multiple products such as 'motor add-ons not separately listed' we expect that firms would list the individual products falling within that category, but that only one measure would be reported for the category as a whole. This would enable the FCA to keep track of any new or emerging products that may not be separately listed. Where new products become commonplace within a market these could be taken out of the "other" category, and separately listed and reported on.

Add-on and stand-alone sales

3.9 For any measure, we believe that firms should report product data split between add-on and stand-alone sales. Often add-on products offer significantly different cover compared to their stand-alone counterparts. In the market study we found that the value offered by GI products (when measured by the claims ratio) could differ quite significantly depending on whether

the product was sold on an add-on or a stand-alone basis. We also concluded that add-on consumers typically had lower product understanding and awareness, which could affect the measures discussed in this paper. For example, decreased levels of understanding for add-on products could result in lower claims acceptance rates and/or lower claims frequencies.

- 3.10** Overall we believe that splitting out data between add-on and stand-alone sales, and publishing the data split at this level of granularity, will incentivise firms to consider what value their add-on products offer to consumers.

Sales by distribution channel

- 3.11** In addition to the potential split by product and add-on and stand-alone sales, there could be some merit in firms reporting data by distribution channels; such as by direct, broker, affinity and other channels.
- 3.12** Requiring data to be reported and published by distribution channel could highlight whether different distribution channels have an impact on the value offered by products. For measures that link benefits to premiums, such as claims ratios, this split in data could show where distributors influence the final retail price (by charging a mark-up on the price set by the insurer). For value indicators such as claims frequencies and acceptance rates, the split in data could highlight the value in different sales approaches. For example, some sales channels could give consumers a better understanding and awareness of their products.
- 3.13** Splitting the information out in this way could therefore provide additional information for users of the data and, in turn, highlight differences in value and quality driven by distribution channel. To provide further information firms could also provide the names of the brands included in the different distribution channels by product. This could help users of the data more easily identify certain firms.
- 3.14** As explained in earlier chapters, we intend to have firms report data to us which we can then publish on our website. How we might do this, and what potential context might accompany any publication, is discussed in Chapter 5.

Q3: Do you have any comments on the proposed scope for a value measure?

Q4: Do you agree with the proposed product granularity and split by add-on and stand-alone sales? Do you think we should further split data by distribution channel?

4. Options for a value measure

Introduction

- 4.1** This chapter sets out three options for introducing value measures in general insurance markets. The options we explore are:
- the claims ratio as a stand-alone value measure
 - a package of claims frequencies, claims acceptance rates and average claims pay-outs, and
 - the claims ratio plus claims acceptance rates
- 4.2** We selected these options as we believe they would best meet our objectives. They have the potential to encourage firms to make value improvements, which we believe would result in better outcomes for consumers. However, these options are not intended to be exhaustive. We would welcome suggestions from stakeholders on alternative or additional measures of product value capable of meeting our objectives. As a reminder, the objectives for this work are to:
- collect and publish a measure, or measures, of value to increase transparency in GI markets
 - incentivise firms to improve product value, and
 - explore the case for a future extension of any measure(s) to be disclosed to consumers in due course
- 4.3** All of the potential measures will be challenging to define due to different industry approaches to capturing or measuring the relevant pieces of information. We will aim to deliver reasonable consistency, and in annex 1 we explore possible calculations in more detail. However, we also want to balance the potential cost implications of high degrees of prescription with the effectiveness of the resulting measure. We note that the measures are intended to be indicators of value rather than precise measures.
- 4.4** In Chapter 6 we set out some of the alternative measures that have arisen in the course of our discussions with industry and other stakeholders. We consider that these alternative are less likely to deliver against our objectives for this work, but we would welcome feedback on them.

The claims ratio

- 4.5** The claims ratio, which was the measure proposed in the market study, broadly shows the monetary value of claims paid out as a percentage of the premiums paid. For example, a claims

ratio of 50% on an insurance product would indicate that for every £100 a consumer paid in premiums, the insurer paid out an average of £50 in claims. This does not mean that consumers should expect to receive such a pay-out from each and every insurance product they buy, nor that consumers should view general insurance products as investments.

Elements of value

4.6 We believe that the claims ratio is a useful indicator of value, giving an indication of potential quality across a range of factors relative to the price paid by the consumer. A high (or low) claims ratio could suggest that, relative to the price paid, the product performs well (or poorly) in terms of the following factors:

- the level of cover
- the probability of needing to make a claim
- the claims pay-out (which will be a reflection of the level of pay-outs and the frequency of claims made)
- the sales process (i.e. the policy is likely to be bought by consumers who need and understand the cover)
- the firms' approach to handling claims, and
- the level of consumer engagement (i.e. consumers know they own the product and what it covers)

4.7 These factors will impact on the claims ratio. For example, products with a higher claims frequency and claims pay-out will typically have higher claims ratios than similarly priced products with lower frequencies and pay-outs. Furthermore, where consumers are less engaged in products that they own, this could potentially result in lower claims frequencies and lower claims ratios.

4.8 However, there are elements of value that a claims ratio may not fully capture. For example, the claims ratio will not capture differences in customer service, which can contribute to consumers' experience of purchasing and owning insurance products. There may also be differences in the measure that may not be reflections of better or poorer value. For example, firms may take different approaches to fraud prevention, which could result in those with stronger controls having lower ratios.

4.9 We acknowledged in Chapter 2 that a product representing 'good value' for most consumers will not always mean better value for everyone. Depending on the cover provided, products with lower claims ratios may be more suitable for consumers that have particular cover requirements, or may be targeted at niche markets. However, this is not limited to claims ratios and would equally apply to the other measures discussed in this chapter. It is worth noting however that there is still potential for these products to be designed or priced in a way that improves their resulting claims ratio.

Why the claims ratio?

4.10 As an aggregate measure, the claims ratio does not tell you which of the factors listed above is driving the resulting percentage. However, policies with higher claims ratios are likely to perform better on average in terms of these factors, relative to the price paid. We also believe that it is likely that any change in a firm's approach to pricing, claims handling, cover and exclusions, or policy excesses will have an impact on the measure. As such, the claims ratio incorporates in one measure a number of aspects of quality and price which can act as an indicator of value.

4.11 As the claims ratio can reflect product benefits and costs to consumers it could also enable comparisons to be made between both products and firms operating within a product market. For example, the market study highlighted that add-on GAP insurance has an average claims ratio of 10% against a claims ratio of 52% for add-on travel insurance. These comparisons can give users of the data a broad overview of value for certain products. Although it may not always be appropriate to compare one product with another, claims ratios can indicate where certain products may be performing poorly across the market and where certain products are performing well.

Scope

4.12 The general scope for any measure is discussed in Chapter 3. The claims ratio could have a broad product scope covering the products set out in Table 1 in Chapter 3, further split by add-on/stand alone and distribution channel. There may be some products where a claims ratio may be considered inappropriate. For example, the benefits of home and motor legal expenses insurance typically take the form of legal helplines and providing advice – with successful claims being paid out by a third party. Therefore, the claims ratio may not sufficiently capture the value offered by these products.

4.13 We would be interested in receiving feedback on whether the claims ratio could provide an indication of value for home and motor legal expenses insurance.

Calculation

4.14 The detail for a possible claims ratio calculation is discussed in more detail in Annex 1. For the purposes of this chapter we have worked on the basis of the following calculation:

Total of paid claims and incurred but still outstanding claims / the gross earned premiums.

4.15 Therefore, the claims ratio will capture the premium paid and the claims cost. We consider the premium paid to be the price paid by consumers for the insurance product (the retail premium), excluding any additional fees charged by distributors over and above the premium.

4.16 By claims cost we broadly mean the cost of settling claims made by consumers. This could include regular services such as a boiler service or dental check-up. Relevant costs could potentially include:

- claims pay-outs
- replacement goods costs
- costs associated with the processing of specific claims
- costs associated with the general processing of claims
- direct labour costs, and
- service costs

4.17 The claims ratio calculation may not necessarily include all of the costs listed above. In addition, we would not envisage that the claims cost captures other costs incurred in bringing products to market, such as distribution costs. Including distribution costs or commission in the 'claims cost' part of the calculation could mean that inefficient firms, or costly distribution channels, have higher claims ratios. This could create perverse incentives and reduce the number of

meaningful conclusions that can be drawn from the data. However, distribution costs will be reflected in the premium paid by the consumer.

- 4.18** In Chapter 6 we discuss whether we might consider commission disclosure or other ways of highlighting distribution as part of this work.

Claims frequencies, claims acceptance rates and average claims pay-outs

- 4.19** The claims ratio links indicators of consumer benefits with retail premiums to give a single, aggregated measure of value. In contrast, we might introduce a set of metrics such as claims frequencies, claims acceptance rates and average claims pay-outs. This package of measures generates more granular information focused on particular product qualities.
- 4.20** We consider that this alternative is less likely to deliver against our objectives for this work, but we would welcome feedback on it.
- 4.21** There is of course a balance to be struck between having too much information available, and providing more granular information to give users a fuller picture. As mentioned in earlier chapters, we expect the data to be used primarily by firms, the FCA, consumer groups, financial and trade press and, to a lesser extent, consumers themselves. These users may benefit from having a broken down data set, capable of providing a more detailed view of a product. Alternatively, users may find that having multiple indicators makes it more difficult to draw conclusions. We welcome feedback on how useful stakeholders think this more granular approach would be.

Elements of value

- 4.22** In terms of the product qualities this package of measures could highlight, claims frequencies could show how often consumers are likely to make a claim. Claims acceptance rates show what proportion of claims are accepted, relative to the total number of claims made. In addition, the claims acceptance rate could provide an indication of the breadth of cover, the level of restrictions in the terms and conditions and the firm's approach to claims handling. Claims frequencies and claims acceptance rates could also potentially give an indication of the level of consumer understanding of a product; with consumers being more likely to claim successfully on products that they understand better. Average claims pay-outs show the average amount paid out for a successful claim, and could indicate the scale of exposure consumers are typically protected against when they need to claim, although individual claim pay-outs could fluctuate significantly from the average.
- 4.23** Therefore, this package of measures could provide users with a significant amount of information about the quality of insurance products. However, as discussed in Chapter 2, we see the cost to consumers as an essential component of product value. This combination of measures does not incorporate the retail premium and therefore, whilst it might provide an indication of the benefits or quality of a product, the package does not give a full picture of value. As such, there will be a greater onus on users to link this information back to the premium to get an indication of product value.
- Why this package of measures?**
- 4.24** As mentioned above, this package could enable users to assess a number of different qualities of a product, which could allow multiple conclusions to be drawn. Unlike a single measure, this data set could potentially highlight which aspects of a product are performing better than others – which in turn could enable firms to focus their efforts on areas where their products are not delivering value.

4.25 All three of the measures are broadly comparable between firms and could provide users of the data with a broad sense of product benefits and quality. However, without a basis for including the premium paid it is of course possible that lower claims frequencies, acceptance rates and pay-outs still offer better value if they are matched by a correspondingly lower premium.

4.26 Whilst more granular data can focus attention, the complexities involved in understanding a number of individual measures and the relationships between them could cause confusion for users of the information. We would need to balance the potential benefits of greater detail with the potential for unintended consequences. For example, claims frequencies and average claims pay-outs when looked at separately may not adequately enable users to gain a clear understanding of the different risks covered by a product. An example of this can be seen with travel insurance – the market study showed average claims pay-outs at around £700, and average claims frequency at less than 5%. Stakeholders may not understand that there could be claims pay-outs (such as for medical expenses) which have a very low claims frequency but can, on occasion, amount to £0.5 million or more. We would need to ensure appropriate contextualisation is provided to prevent misunderstandings, such as the view that products offering low frequency/high-impact protection always represent poor value.

Calculation

4.27 The detail for the possible calculations for these measures, and a discussion of the terms set out below, are included in Annex 1. For the purposes of this section we have worked on the basis of the following calculations:

Claims frequencies: Number of claims notified / exposure or average policies in force

Claims acceptance rates: Number of claims accepted / number of claims notified (less the number of claims still being considered)

Average claims pay-outs: Total claim pay-out / total number of claims

4.28 These measures are already widely used by firms, but the data currently collected might not distinguish between stand-alone and add-on products, nor by the different distribution channels discussed in Chapter 3.

4.29 It is also likely that firms measure some of these metrics in different ways. For example:

- firms may record claims frequencies in different ways, with some firms recording a consumer call as an enquiry and others recording similar calls as a claim;
- claims that are only partially accepted may be recorded in different ways by firms – some firms may record both a claims acceptance and a claims rejection for this type of settlement and others may simply record an acceptance;
- a successful claim may not result in a monetary payment but could instead result in the provision of a replacement good or labour to attend and resolve a claim. Some firms may outsource these services and some may deal with them in-house. This could impact the ease with which firms can obtain relevant data.

4.30 As for other measures there will be some costs associated with collecting the data at the required level of granularity and in line with our calculation.

Claims ratios and claims acceptance rates

4.31 The claims ratio measure is a potential indicator of product performance over a range of factors relative to price. While using claims ratio as a single measure has the benefit of presenting users with one single metric, it is less able to point to different factors which might be driving product value. We therefore considered whether the claims ratio could be complemented by another measure(s) to provide a broader picture of product value and quality.

4.32 One measure put forward by firms at industry working groups was the claims acceptance rate. Claims acceptance rates represent the percentage of claims submitted by consumers which are accepted by insurers.

Elements of value

4.33 The potential value indicated by the claims ratio is discussed above. Claims acceptance rates could be an indicator of whether a product performs well in terms of the following factors:

- consumers' understanding of the level of cover provided by a product (which could give an indication of the quality of the sales process)
- the breadth of cover
- consumers' expectations at the time of needing to make a claim, and
- a firm's claims handling approach

4.34 A low claims acceptance rate could therefore highlight issues with the sale of a product; resulting in consumers believing they are covered for an event, when in fact they are not.

4.35 Data published in 2014 by the ABI highlights market average acceptance rates for protection products¹⁵. Therefore this measure is already recognised as a useful metric by market participants.

4.36 There will be some products which have lower claims acceptance rates than others. For example, some firms have indicated that home products tend to have lower claims acceptances than motor products. Reasons given for this include there being a larger scope for query over whether a consumer is covered for a home claim, and cover generally being in place for a motor incident. Therefore, a high or low claims acceptance rate will not always be an indicator of quality – especially when looking across different product categories.

4.37 Furthermore, claims acceptance rates do not link to the retail premium and as such cannot give an indication of value, in the sense discussed in the Chapter 2. Combining this measure with the claims ratio can however offer that link.

Why claims ratios and claims acceptance rates?

4.38 For the reasons discussed above, we see the potential for claims acceptance rates to provide an indication of certain aspects of product quality.

4.39 However, we do not believe that a claims acceptance rate alone would provide a sufficient picture of the value of a product. It does not:

- incorporate the retail price, which limits its ability to act as an indicator of value
- reflect the likelihood of claims arising, or

¹⁵ <https://www.abi.org.uk/News/News-releases/2014/05/Protection-Claims-2013-QA>

- reflect the likely pay-out

4.40 In addition, in the market study we found examples of products with a high claims acceptance rate but low claims ratio. For example, GAP insurance had the highest claims acceptance rates of any of the market study products, despite having low claims ratios. Clearly, claims acceptance rates alone would not have highlighted the poor value offered by GAP – which was driven by the low claims frequencies and claims pay-outs relative to the high premiums paid.

4.41 As such, we believe claims acceptance rates need to be combined with other measures to give a broader picture of value. The addition of claims acceptance rates to claims ratios has the potential to reflect a fuller picture of product value. This combination potentially gives an overall indicator of value, coupled with a more detailed indicator of consumer product understanding and breadth of cover.

Calculation

4.42 The calculation for claims ratios and claims acceptance rates would follow the models discussed above and in Annex 1.

Comparing the measures

4.43 Table 2 below compares each of the options included in this chapter against a number of criteria, which we believe represent relevant aspects of value. Our assessment is based on the discussion above, as well as some of the calculation aspects discussed in Annex 1.

4.44 Where the potential measures fully or substantially capture the elements of value this is represented by a fully shaded circle. Where measures partially cover the elements of value this is represented by a semi-shaded circle. Where the measure(s) do not capture the elements of value this is represented by a lightly shaded circle

Table 2: Comparison of the measures

Elements of value	Measure options		
	The claims ratios	Claims frequencies, claims acceptance rates and average pay-outs	The claims ratios and claims acceptance rates
Service e.g. boiler service			
Level/quality of cover			
Customer service and claims handling			
Claims pay-outs (likelihood and averaged amounts)			
Price paid by consumers			

Our assessment of the options

- 4.45** We believe that any of the measures described in this chapter could potentially meet our objectives for this work. Our current assessment is that the claims ratio, either on its own or with another measure, is preferable to a package of options, such as the claims frequency, claims acceptance rate and average claim pay-out package. The claims ratio covers most elements of value in a single figure and potentially allows a greater degree of comparison.
- 4.46** However, we recognise that there are limitations with the claims ratio and other measures have other potential merits, such as providing more granular information focused on particular product qualities. We are keen to receive stakeholders' views on which of the measures would give the best indication of value to a range of market participants, bearing in mind the discussion in Chapter 2 on value and our stated objectives. We would also be interested in hearing from stakeholders about any other measures they believe are capable of delivering these objectives. Some further considerations on alternatives are set out in Chapter 6.
- Q5: Do you believe the measures discussed can meet our objectives, and why? Do you have a preferred option?**
- Q6: Do you have any comments on the possible calculations? What challenges do the calculations raise, and how might these be overcome?**

5. Reporting and publication

- 5.1** For any value measure or indicator we expect firms to report the data to the FCA, and we expect that this data will be published. This chapter sets out some more of the detail for these topics.

Data reporting

Who should be responsible for the calculation?

- 5.2** For any of the measures discussed in this paper it is likely that a standard calculation will be necessary to ensure consistency and increase comparability. Possible calculations for the measures are discussed in more detail in Chapter 4 and in Annex 1. However, for all of the measures, we believe that insurers are in the best position to calculate and report the information. We therefore propose to apply any reporting requirements to these firms.
- 5.3** Insurers should have access to most, if not all, of the data required. Insurers will handle or outsource the claims handling functions, and should have strong oversight of claims and product data. Furthermore, insurers are required to account for Insurance Premium Tax (IPT) on the gross earned premium (including distributor commission) to HMRC. Therefore, insurers should have retail premium data, in addition to claims and product information.
- 5.4** Where products are white labelled we believe the firm best placed to perform the calculation for any measure will be the firm that performs the underwriting function for that product.
- 5.5** For the Lloyd's market we consider that Managing General Agents are in the best position to calculate the potential measures outlined in this paper, although we would be interested in receiving feedback on this point.
- 5.6** We recognise that for some measures there may be gaps in the information that certain insurers hold. However, where this is the case, we would expect firms to look to obtain any relevant data in order to complete the calculation. The absence of such claims and pricing data potentially raises questions about firms' product governance processes, and how they currently assess how their products deliver value and good outcomes to consumers.

Reporting period

- 5.7** In considering the most appropriate period over which firms should calculate and report this type of data, we have considered annual reporting and longer reporting periods e.g. three year rolling averages.
- 5.8** There are benefits and limitations to both longer and shorter reporting periods. A shorter reporting period, such as one year, would provide data on the most recent performance and would reflect any product improvements introduced by firms a lot sooner.

- 5.9** A longer reporting period, such as a three year period, would allow more reliable data to be generated; especially for measures that involve a more material degree of estimation (such as claims ratios and average claims pay-outs). Three-year data would also help smooth the impact of fluctuations in claims, which can be volatile for some products from year to year and would affect measures such as claims ratios and claims frequencies. The types of product affected by this would include those with a catastrophe element, such as home insurance or potentially travel insurance.
- 5.10** One approach could be to adopt a three year reporting period for products with volatile claims frequencies, to reduce any misunderstanding resulting from claims fluctuations. Another approach could be for multi-year averages to be published alongside the annual data, again to reduce the risk of any misunderstanding.
- 5.11** On balance we consider a one year reporting period may provide the most helpful data, with the possibility for the data to also be supplemented by multi-year averages. The averages could smooth out the figures for any products with a significant fluctuation in claims figures.

Threshold limits

- 5.12** The requirement to report against these value measures could be limited to situations where the earned premiums for a product, or reporting category in the most recent accident year, are above a certain level. One approach might be to set a threshold of £1 million for gross earned premiums by product.
- 5.13** Having a threshold would help reduce the burden on firms that have lower levels of sales, or are new to a market. It would also focus any measure on cases where potential harm to consumers is higher and data is more reliable.

New product lines

- 5.14** When firms enter a new product market they will be required to start reporting on that product line once they meet any threshold requirements.

Publication

- 5.15** Publication of the measure(s) is a key driver to increase transparency and to create the incentives for firms to improve product value. Our starting point is that the measure(s) could be published annually, in a comparison table format, on our website. As discussed above, this includes the potential to publish multi-year averages for products with higher claims volatility.

- 5.16** Publishing in this way could enable users to make comparisons across both products and firms.

Publication of specific figures vs publication in bands

- 5.17** Under any of the measures discussed in this chapter we could publish the specific figures reported to us, or we could publish the information in bands.
- 5.18** Insurance claims cost data could include an estimation element (e.g. expected claim settlement values and “Incurred but Not Reported” claim reserves), so publishing data in bands could reduce the need for us to be overly-prescriptive in a calculation. Publication in bands could also help overcome confidentiality issues, where exact figures could provide insight into a firms’ business model, or the way in which it sets prices. However, publishing specific figures would provide users of the data with more detailed information.

5.19 It may of course be the case that the most appropriate form of publication will differ depending on which measure is being considered. For measures incorporating information that could potentially be viewed as sensitive, or where there is an element of estimation, bands may be more appropriate – for example bands of 5% (0%-5%, 5%-10% and so on). Broader or narrower bands could also be applied where percentages are above or below certain levels, for example bands of 10%. For other measures specific figures may be more appropriate.

Market averages

5.20 In addition to firm or product specific data there could be some benefit in publishing market averages, to provide users with additional contextualisation.

5.21 This information would enable users to compare the data for individual firms against the market averages for products they are interested in. This could highlight where certain products have a lower value measure across the board.

Contextualisation

5.22 Data for any of the measures discussed in this paper could be used by a variety of different users, who will have varying levels of understanding of what the data shows. Therefore, it is important that additional context is provided to help users understand the information and to reduce the risk of it being misunderstood or misinterpreted. This will also guard against the data being used by consumers in isolation from wider considerations, such as whether a particular product meets their needs.

5.23 Appropriate contextualisation could include:

- an explanation of what the measure is/measures are, and what is included in the calculation
- an explanation of the purpose of the measure(s)
- a warning that data should not be used by consumers in isolation of product suitability and cover assessment, and
- specific product context, such as for products that are exposed to significant claims fluctuations from year to year, or niche products to aid understanding

5.24 Firms have told us that, in addition to any FCA publication, they are also likely to publish their own data and provide supplementary information on it. This additional information could help firms explain differences in their data compared to other providers. For example, if firms provide cover for a niche section of the market they can explain why their data does not correlate with market averages. They can also emphasise benefits that are not captured by the measures, for example customer helplines. We would expect that any information provided by firms in relation to these benefits, or any explanations given, would be clear, fair and not misleading.

Use of information at the point of sale

5.25 As mentioned earlier, at this stage of our work we are focusing on how we might best take forward a market-wide transparency measure by publishing the data ourselves.

- 5.26** In the future we might explore whether there are any benefits in making this information available to consumers at the point of sale. This would need to be carefully tested to ensure that it is effective in informing consumers and does not overload or confuse. In line with our wider commitment to smarter, more effective, consumer communications we would subject any such disclosure to consumer testing before deciding whether or not to proceed.

Impact of design on industry costs

- 5.27** We expect firms to already be considering different types of value measures as part of their own internal management information and product governance reporting practices. However, given the variety of different ways firms record and capture claims and premium data any measure, or measures, that introduce a standard calculation could generate implementation costs for firms.

- 5.28** The specification of each potential measure could have a material effect on the costs, especially one-off system change costs for firms. We expect ongoing costs to be lower, although we are keen to receive feedback on this from stakeholders. We set out here the main drivers of the costs of a transparency measure.

- Number of metrics: Options with more than one metric could impose a higher cost on firms, although costs may not be proportionate to the number of metrics involved.
- Scope: The benefits and costs of a transparency measure could vary between products. However, given that a high proportion of costs are likely to be system change costs, a narrower scope may not result in significantly lower costs.
- Granularity: We expect that a remedy requiring publication of transparency data at a very granular level is likely to impose higher costs. This is because, where firms already collect data at a granular level, they should be able to aggregate data with relative ease. However, where firms currently collect data at a less granular level, substantial changes to data collection may be needed.
- Calculation prescription: There will be a link between the level of calculation prescription and the potential costs to firms.

Q7: Do you have any comments on our proposals for reporting?

Q8: Do you have any comments on our proposals for publishing and contextualising data?

Q9: Are there any measures you think we should consider for point of sale disclosure to consumers in the future?

Q10: What costs – both type and scale – would be incurred in delivering the different value measures discussed? Are there any ways to reduce these?

6. Other measures we considered

- 6.1** This paper has discussed a number of options which we believe could measure product value in general insurance markets. We have also set out how we envisage these measures working in practice. However, as noted earlier, the remedies we have outlined are not intended to be exclusive and we remain open to alternative suggestions.
- 6.2** We want to hear from stakeholders how other measures might meet our objectives of increasing transparency and creating incentives for firms to improve product value. We believe any measure of value is likely to be more useful if it reflects a wide range of quality factors, relative to the price paid by the consumer.
- 6.3** In suggesting alternatives stakeholders may find it useful to see what other options we have looked at.

Capturing the cost of distribution, including commission and other incentives

- 6.4** Long and complex distribution chains can increase the cost of distribution (e.g. through higher operational costs, commission payments etc.) and erode value to consumers by contributing to higher premiums. Commission and other incentives can also encourage intermediaries to sell products that are not right for consumers, in turn contributing to poor consumer outcomes and low value.
- 6.5** In launching this work, our objectives have been to highlight poor value and create incentives for firms to improve it. In earlier chapters we have described how we envisage that some of our potential measures could highlight, indirectly, where there is potentially inefficient and value-eroding distribution. We noted in Chapter 2 that we want to encourage firms to consider the impact of their distribution on ultimate product performance and value.
- 6.6** We would also be interested to hear from firms whether we should consider other ways of capturing and highlighting distribution costs, including total commission or other distributor income.
- 6.7** Any such measure could be published alongside other measures we have considered in this paper, or we could require firms to disclose this data to consumers at point of sale. Feedback from firms on making the cost of distribution more transparent and the merits of commission disclosure will also help us consider the implications of the Supreme Court Judgment in *Plevin v Paragon Personal Finance Limited* for our Handbook.¹⁶

¹⁶ *Plevin v Paragon Personal Finance Limited* [2014] UKSC 61

Customer satisfaction rates

- 6.8** We considered whether publishing satisfaction rates could highlight poor value and create incentives on firms to improve value. We already publish complaints data, which gives an insight into customer satisfaction.
- 6.9** A customer satisfaction rate could provide insight into a firm's interactions with its consumers e.g. its claims handling approach. However, this kind of measure does not directly reflect the breadth of cover, the likelihood of having to claim, nor likely pay-outs. Moreover it does not reflect the price paid by the consumer. As such, key aspects of both the price and quality – which provide a fuller picture of value – would not be captured. There is also a risk that this measure could be highly subjective.
- 6.10** Our general assessment is that this measure, on its own, may not capture sufficient aspects of value. However, it could be combined with some of the other measures discussed in Chapter 4 to deliver a more rounded view. Firms may wish to collect and publish satisfaction rates, and in fact many already do. However, we do not believe that customer satisfaction rates as a stand-alone measure – is likely to meet our objective of encouraging firms to improve value.

Customer retention rates

- 6.11** Looking at the reasons consumers decide to stay with a particular firm could provide information on the value derived from being a customer of that firm. If this measure were also contextualised by looking at the retention rates for those consumers that have had reason to claim, further information could be generated.
- 6.12** However, we believe that this type of data could potentially be misleading – given that high retention rates could be a consequence of high consumer inertia (especially where the product auto-renews) or a lack of awareness of product ownership. A high customer retention rate could also reflect the fact that consumers find it difficult to switch providers.
- 6.13** There is a possibility that collecting this type of data will generate helpful information about firms, but may not provide as much information on the products sold by the firm – due to retention rates being more likely to relate to customer service and claims handling, rather than products. As such, this measure may not sufficiently highlight price and/or the quality of the product. We do not therefore believe this measure is likely to deliver the objectives discussed in Chapter 2.

Time to settle

- 6.14** The time between a consumer first notifying a firm of their claim and receiving any resulting settlement can be a useful measure of the quality of the insurance product or service. Many consumers complain about delays in settlement and it can be the cause of much dissatisfaction with the industry and consumer detriment – as is evident from complaints data. A timely and prompt settlement could therefore be important to consumers.
- 6.15** However, there may be legitimate reasons for a delay in settlement – such as the consumer not providing vital information in a timely manner. There is also a potential issue with comparability, as different products and different claim types will have very different settlement times. For

example, you would not expect a mobile phone claim to settle in the same time as a personal injury claim under a motor policy. Finally, this measure does not incorporate any aspect of the cost to consumers.

- 6.16** On balance, this measure could help improve the service provided by a firm and firms may wish to consider this metric further. However, if published alone, it is unlikely that settlement times would deliver our objectives of encouraging firms to improve overall value to consumers.

Percentage of claims settled ‘in full’

- 6.17** Consumers can feel that they have not received a full settlement for their claim (whether this be ‘full’ according to the terms of their policy or ‘full’ when measured up to their expectations). This can be because they have received what they feel is an inferior replacement item or because they have only received a partial payment. This measure could therefore reflect the level of cover provided by certain products, or give an indication of consumers’ understanding of cover or a firm’s claims handling philosophy.
- 6.18** This measure is therefore capable of reflecting a number of different aspects of product quality, but again does not reflect the cost to consumers. Some difficulties may also exist when trying to define what represents a ‘full’ settlement and there is also likely to be natural differences between products, for example for products where there are multiple parts of a claim. It is also unlikely that firms already collect this type of data, which could increase costs.
- 6.19** Therefore, we see this measure as being both subjective and complex, as well as only offering a partial picture of value. We also believe there is an overlap between this measure and claims acceptance rates discussed in Chapter 4. As such, potentially, a lot of the benefits encapsulated by this measure could be incorporated in some of the other measures discussed in this paper.

Q11: Do you have any comments on the alternative measures discussed? Or do you have any suggestions for how another measure might meet our objectives for this work?

Q12: Should we consider commission disclosure – either as a transparency measure or as a point of sale disclosure remedy? How should any such measure be calculated and by whom? What are the benefits and costs of a measure highlighting distribution costs?

7. Conclusion and next steps

- 7.1** In this paper we have set out why we are committed to introducing a measure of value in GI markets. Consumers and other market participants can find it difficult to assess the value of the products that are on offer. As the value of general insurance products is multi-faceted, designing a reliable indicator of value is not easy. However, we believe that these challenges make it all the more important that we work with industry and other stakeholders to introduce such an indicator of value in GI markets.
- 7.2** We want to take this work forward in line with our wider strategy of using transparency to achieve better outcomes for consumers. We believe that publication of value metrics for GI will incentivise firms to focus more on value, and will lead to more effective competition in the interests of consumers.
- 7.3** Our current assessment is that the claims ratio, either on its own or in combination with another metric, is the option that is most likely to meet our objectives of introducing transparency and creating incentives for firms to improve value. It can capture key aspects of the quality of a product and relates these to price in a single measure. However, we are keen to hear your views on the different value measure options we discuss in this paper, as well as any suggestions for alternative measures.
- 7.4** Choosing the right measure or measures, and designing them in a way that is effective yet proportionate will be a challenge. We are keen to meet this challenge. We look forward to receiving your feedback and working with stakeholders over the coming months on what is a critical piece of work for the FCA- in respect of our work in general insurance, our competition mandate, and our wider transparency strategy.

Next steps

What do you need to do next?

- 7.5** We want to know what you think about the policy options set out in this paper, for example whether you believe they will help us meet our objectives. We would also welcome any alternative suggestions for how we might deliver a measure, or measures, of value. We are particularly interested in measures that take account of the price paid by consumers and the quality and benefits offered by a product.
- 7.6** We are also keen to hear your views on how we might overcome any of the challenges associated with the individual options. We would like to know how you think the individual options, or indeed any alternatives, would benefit consumers or impact on a firm's business.
- 7.7** Please send us your comments by 24 September 2015 via the online response form, or by writing to us at the address on page 2.

What will we do?

- 7.8** We will consider your feedback and will consult on our preferred measure(s) later this year. At that time we will also comment on the responses received to this Discussion Paper.

Annex 1

Calculation of the measures

1. In Chapter 4 we set out possible calculations for each of the measures discussed at a high level. Below we provide more detail on each of the calculations and discuss what we mean by certain terms used.
2. We are interested in receiving comments and feedback on these possible approaches as well as any suggestions for alternative calculations.

Claims ratio calculation basis

3. At a high level the claims ratio is the claim cost as a percentage of the retail premiums. This section sets out one possible approach to calculating the claims ratio.

Possible approach

4. We are considering the following calculation: For the reported period, the total of paid claims and incurred but still outstanding claims as a percentage of the gross earned premiums to which those claims relate. Under this approach we have excluded IPT, as it does not represent income of any firms in the supply chain and is the tax collected and remitted to HMRC.

What do we mean by gross earned premiums?

5. The gross earned premium is the value of gross premiums earned in the previous accident year (excluding IPT). The calculation above captures the premium paid by retail customers and apportions it over the period in which it is earned. For example, if an annual insurance policy was sold covering a period between 1 July 2014 and 30 June 2015, and the product had a simple time-apportionment earning pattern, half the premium would be earned in 2014 and half earned in 2015. The earnings pattern should reflect the incidence of risk, to ensure that claims and earnings are appropriately matched.
6. The gross earned premium figure will include acquisition costs such as distributor commission, as they are part of the insurance premium paid by consumers. If we were to adopt the calculation above, in all circumstances we would be aiming to capture the price paid by the consumer for the product and incentivise firms to ensure consumers are getting a good price. However, the gross earned premiums would exclude additional fees charged by distributors over and above the insurance premium.

What do we mean by paid and outstanding claims?

7. The paid and outstanding claims element of the calculation could include the value of total claims incurred during the previous accident year, developed to cover the expected ultimate cost of claim events occurring in that accident year. For example, where applicable, this should include an allowance for claims incurred that have yet to be reported. If a claimable event occurred in November 2014 but the claim had not been settled by March 2015, the relevant insurer would estimate the expected final settlement cost and include this in the relevant claims ratio calculation for the 2014 accident year.
8. We recognise that the uncertainty involved in calculating the future claims settlement aspect of the claims incurred cost will vary from product to product. For this reason, and to improve

the comparability of information between firms, one option is to calculate on an International Financial Reporting Standard ('IFRS') best estimate basis (excluding margin, unallocated loss adjustment expenses (ULAE) and other expenses). This could be most useful for the following products/covers:

- motor
- motorcycle
- worldwide travel
- personal accident
- extended warranty
- home (buildings)
- home (contents)
- home (building and contents)
- GAP

9. A number of firms have indicated that they compile their insurance data together on an IFRS basis. They have said that calculating and reporting more granular claims and premium data on this basis is less problematic than if the data is calculated on a Solvency II basis.
10. For the other products/covers we have listed in Table 1 in Chapter 3, firms could still calculate the outstanding claims on a best estimate basis (excluding any margin, ULAE and other expenses), but not necessarily on an IFRS best estimate basis. Firms could instead use their existing outstanding claims best estimate approach. This recognises that for these other products the uncertain future element of the claims cost is less significant and so there is likely to be less variability.

How might other claims costs within paid and outstanding claims be treated?

11. We believe firms could include Allocated Loss Adjustment Expenses (ALAE) within paid and outstanding claims. ALAE are claims expenses linked to the processing of specific claims, and may include outsourced loss adjustment services. Where activity or expenses (including third party invoices) can be explicitly tracked back to a claim, firms could include the relevant cost within claims incurred. Where insurers have outsourced claims arrangements, one option would be to include ALAE claims costs on a 'look through' basis using the underlying cost information and excluding any element of profit margin.
12. For ULAE, where the claims expenses are linked to the processing of general claims rather than specific claims, costs could be excluded from the claims ratio calculation. Likewise, other general claims costs - such as claims handling and management costs - could also be excluded. While these general claims management costs will be reasonable costs to incur, it is questionable whether they can be included in the claims ratio calculation in a reliable way across the different reporting categories.
13. A number of general insurance products include a service element which represents a genuine benefit for consumers. However, the service element would not typically be captured by the paid claims, and incurred but still outstanding claims, element of the calculation. Examples include

customer helplines which may provide advice to customers in certain situations, or an annual boiler service or regular dental check-up.

14. It is challenging to include all possible service elements of general insurance products in a claims ratio calculation in a reliable way. This is in part because of the differences in the ways firms allocate costs internally and across products. However, firms could potentially include, in the paid claims and incurred but still outstanding claims figure, the cost for regular service elements e.g. an annual boiler service, an annual medical check-up or a regular dental check-up. However, services such as a helpline, which consumers may or may not use, do not constitute a regular service and it is questionable whether they can be included in the calculation in a reliable way. This is a potential limitation of this approach, as any non-regular service elements can result in costs for firms and benefits for consumers but they would not be included as part of the claims ratio. We expect that where firms do sell products with a significant service element the benefits could still be highlighted by firms during the sales process.

Claims acceptance rates calculation basis

15. There are a number of ways in which firms could define and record claims acceptances. A standard definition is likely to be necessary to bring consistency and avoid manipulation of the measure. Below we set out one possible approach to calculating claims acceptance rates.

Possible approach

16. At a high level the claims acceptance rate captures the number of claims accepted as a proportion of the total number of claims notified by consumers. However, firms will measure claims acceptance and declinature rates in a variety of different ways. For example, some firms may log claim enquiries from customers about whether they are covered for an incident as a claim notification and others may not. In addition, firms may accept one element of a claim, but reject another element, and log the events differently on their systems. For certain products (such as motor) there are additional measurement complications, such as how to treat claims that are classified as fault or non-fault claims.
17. The claims acceptance calculation could be as follows:

Claims acceptance rate = number of claims accepted / (number of claims notified less number of claims still being assessed)

18. Therefore the key elements of the claims acceptance rate are the claims notified, the treatment of claims that are still being assessed and measuring claims accepted or rejected. These are discussed below.

Claims notified

19. Claims notified could be defined as any report or communication from a customer enquiring whether they are covered for an event that they have suffered, or contacting the insurer to raise a claim. This would help capture cases where consumers do not understand the cover they have purchased, which is a key purpose of the metric. An alternative approach would be to exclude any incomplete or not progressed claims where the customer has decided not to pursue the claim, or separately record this type of claim/enquiry.
20. Where there are multiple claims or components of a claim relating to one insurance policy and one notifiable incident, this could be treated as one claim, both for claims notified and in the assessment of claims accepted.

21. As for the claims ratio, we expect that linking claims notified to accident year could generate the most reliable data. If a firm received a claim in January 2014 for an accident in November 2013, this would be a claim notification allocated to 2013, rather than 2014. Firms will typically capture both the accident and the claims notification dates. However, for claims notified there is a risk that there will be claims notified after the reporting deadline relating to the prior accident year. We consider that volume of affected claims will not be significant for most products, and in any case, these claims would not have been either accepted or rejected at the reporting date.

Claims accepted

22. At the time when firms compile the claims data there will be claims which have been accepted (including accepted and paid), rejected, or still being assessed. Claims rejected could include customer enquiries – where consumers have enquired about an event or accident that they have suffered, but where they have been informed by the insurer that they are not covered.
23. For claims where different elements of the claim have been rejected or accepted, a simple approach could be to require that a claim is reported as rejected if any element of it is rejected. While this would not reflect the precise reality of a partial acceptance, it would improve data consistency. Alternative approaches could be to treat claims as a decline where the insurer will not satisfy a material element of that claim or, for certain products, to split out partial acceptances from full acceptances.

Treatment of claims still being assessed

24. Claims still being assessed could either be excluded from the claims numbers (both for notified and accepted numbers), or included in the claims notified numbers- with an assessment being made about the expected proportion of the outstanding claims likely to be accepted. It may be that claims being assessed are more likely to be rejected, and that firms may be incentivised to settle smaller claims quickly to improve acceptance rates.
25. One option is for claims still being assessed to be excluded from the data, and once the claims have been closed the underlying data could be included in re-stated prior year figures.

Alternative approach to calculating claims acceptance rates

26. One alternative way to calculate claims acceptance rates would be to base the data on the claims decision date within the reporting period. This could be beneficial as firms should already capture claim decision dates in their claims systems and it would provide an indicator of recent acceptance rates.

Claims frequencies calculation basis

27. As for the previous metrics, firms will define and calculate claims frequencies in different ways. It is important that any calculation and reporting requirements enable data reported by firms to be compared in a meaningful way. Below we set out a possible approach to calculating claims frequencies.

Possible approach

28. Our preferred claims frequency calculation is:

Claims frequency = number of claims notified / exposure or average policies in force

29. For the claims frequency calculation, there are two main options. Claims frequencies could be based on claims notified, or could be based on the number of successful claims as a proportion

of the number of policies in force or exposure. We believe that the inclusion of claims acceptance rates in this potential remedy package means that claims frequencies based on claims notified could generate more helpful data. This is because the claims frequency could highlight the likelihood of making a claim and the claims acceptance rate will show the likelihood of a claim being successful.

30. Exposure measures the amount of risk on a policy that a firm is exposed to during the year. For example, for an annual insurance policy taken out on 1 January 2104 (with a relatively even risk exposure) the exposure in 2014 would be 1. For another similar policy taken out on 1 July 2014, the exposure in 2014 would be 0.5, and the exposure in 2015 would be 0.5 (using a simple time apportionment). However, some products will have a different risk, and hence claims, profile.
31. An alternative approach to using policy exposure would be to use the average policies in force in the accident year. This could perhaps be based on an average of the policies in force at the end of each month. The approach taken may depend on the product type, and there are additional complications where products are not annual policies.

Average claims pay-out calculation basis

Possible approach

32. Average claims pay-outs could be based on the actual monetary payments received by claimants. However, for many products a successful claim may not result in a monetary payment, but could be the provision of a replacement good or labour to attend and resolve a claim. We therefore believe that an average claim pay-out could broadly include the same costs captured in the claims ratio calculation set out above, and include both the direct claim costs and claims expenses linked to the processing of specific claims.
33. The only exception is the regular service cost, which if included alongside claims frequencies, could distort the average claim pay-out figure. Regardless of the approach adopted it will be important to contextualise the data to make it clear that the average claim pay-out will not always equate to the average amounts consumers receive directly.
34. The average claims pay-out calculation could be the total claim pay-out divided by the total number of claims. The total claim pay-out could be based on the total of paid claims, and incurred but still outstanding claims relating to the previous accident year (excluding the regular service cost). This could include incurred but not reported claims reserves, which relate to claims that have not been notified. If the total number of claims is based on the calculation of number of claims notified (less rejected claims and claims with a £0 value) this could overstate the average claims pay-out. This is because the total claim pay-out could include claims reserves relating to unreported claims that have not been notified, whereas the total number of claims would exclude these claims. However, for most products we do not expect this understatement to be material. Where products are expected to have a high proportion of claims notified a long time after the end of the accident year, firms could be required to include an estimate.
35. An alternative approach would be to base average claims pay-outs only on settled claims, based either on accident year or by settlement period. This would remove the need to include estimates of unsettled claims. However, for some products the higher value claims may be more complicated and take longer to settle. For the accident year basis this alternative approach could understate the expected average claims pay-out.

Annex 2

List of questions

- Q1:** Do you have any comments on the aspects of value discussed?
- Q2:** Do you have any comments on our rationale for introducing a value measure and how we see such a measure working?
- Q3:** Do you have any comments on the proposed scope for a value measure?
- Q4:** Do you agree with the proposed product granularity and split by add-on and stand-alone sales? Do you think we should further split data by distribution channel?
- Q5:** Do you believe the measures discussed can meet our objectives, and why? Do you have a preferred option?
- Q6:** Do you have any comments on the proposed calculations? What challenges do the calculations raise, and how might these be overcome?
- Q7:** Do you have any comments on our proposals for reporting?
- Q8:** Do you have any comments on our proposals for publishing and contextualising data?
- Q9:** Are there any measures you think we should consider for point of sale disclosure to consumers in the future?
- Q10:** What costs – both type and scale – would be incurred in delivering the different value measures discussed? Are there any ways to reduce these?
- Q11:** Do you have any comments on the alternative measures discussed? Or do you have any suggestions for how another measure might meet our objectives for this work?
- Q12:** Should we consider commission disclosure – either as a transparency measure or as a point of sale disclosure remedy? How should any such measure be calculated and by whom? What are the benefits and costs of a measure highlighting distribution costs?

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