Financial Conduct Authority

Market Study MS14/1

Annex B: Methodology and analysis of firm data

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As part of the market study we obtained relevant data and information from a variety of sources to enable us to test the effectiveness of competition in markets for the sampled products and, where relevant, the reasons why competition may be ineffective. The data and information requested from firms was designed to contribute towards this analysis.

This annex covers the following areas:

- Firm sample
- Data and information requested from firms
- Where does the premium go?
- Insurer profitability
- Distributor profitability
- Distribution costs
- Claims frequency
- Average claim payout
- Claims ratio
- Claims declinature rates
- Pricing and product quality
- Other non-sampled products
- List of firms who provided information

FIRM SAMPLE

Chapters 2 and 3 of the report describe the different ways that the sampled products are brought to market, sometimes by supply chains containing a number of different firms. Insurers and retail distributors were, in most cases, the key firms in the supply chain with the most relevant information for the market study. Insurers, for example, tended to have a good oversight of the supply chain, good quality data on pricing, claims, underwriting costs and market sizes. Retail distributors usually controlled the relationships with consumers, often set the prices and were in the strongest position to earn highest profits.

Information on the firms supplying each of the products was not readily available at the outset of the study and hence to identify potentially relevant firms we used market information from a variety of different sources including FSA insurance returns, Mintel and Datamonitor market reports, Defaqto market data and internal FSA knowledge. Where possible, we used a sample size large enough to compare add-on and stand-alone sales in each product area, as well as a balance of firms including some of the largest firms in each of the markets. As a result we requested data from over 80 firms (including both insurers and distributors). Despite the substantial number of firms sampled, we found that a number of firms did not have all the information that we requested from them. For example, some distributors did not collect profitability data on an individual product basis.

Add-on, deferred add-on and stand-alone definitions

As set out in Chapter 2 the distinction between an add-on and a stand-alone product is not always clear. In addition to add-on and stand-alone sales some products are sold as deferred add-ons, where the sale may be linked with a primary product but occur, for example through a follow up call at some point after the sale of the primary product.

We defined add-on, deferred add-on and stand-alone as:

- Add-on – A separate insurance contract sold at the initiation of the seller of the primary product (or their representative) either during the sales process for the primary product, or immediately after the completion of the sale of a primary product.

- Deferred add-on – A separate insurance contract sold at the initiation of the seller of the primary product (or their representative) on a later date than the completion of the sale of the primary product. For example, a utility supplier may ring up existing customers to offer home emergency insurance.

- Stand-alone – A separate insurance contract, independent of the primary purchase where the consumer will initiate contact with the seller.

DATA AND INFORMATION REQUESTED FROM FIRMS

Different questionnaires were sent out to insurers and distributors. Where insurers also distributed the products they completed both questionnaires. Firms were asked to provide information on the sampled products for both add-on and stand-alone sales.

Overall, the quality of data provided to the FCA by firms in response to the firm questionnaire was mixed, and the data we received for gadget insurance was limited.

Analysis of firm data

We examined the profits and losses firms generated from the underwriting and sale of the sampled products. In addition, we sought to establish what proportion of the retail price is retained by different firms in the supply chain. To do this we looked at commercial terms between insurers and distributors, pricing model information and also asked insurers to estimate what proportion of the retail price goes to which firms in the supply chain.

WHERE DOES THE PREMIUM GO?

There are two main ways that insurers and distributors interact on setting the retail price, and determining who earns what proportion of the premium. Under one method, insurers charge distributors a 'net rate' price to cover

the insurance of the policies to be sold, and then the distributors have responsibility for setting the retail price with the mark-up (from the net rate to the retail price) earned by the distributors. Using the alternative method, insurers will pay distributors a % commission based on the retail price. Additionally, there are often profit share arrangements between insurers and distributors whereby if insurers generate profits (above a specified level) a proportion of the additional profit is paid to distributors.

We would not expect the cost of distributing an insurance product to increase proportionally with the increase in insurance cost, and we would expect that as the insurance cost increases the proportion of distribution costs to insurance cost will decrease. Therefore other things equal, the proportion of the retail price that goes to distributors is likely to be larger when the insurance cost is lower. For example, a product with an insurance cost of around £2 per policy would have associated distribution costs which might appear substantial as a percentage of the insurance cost, especially for stand-alone products with higher associated distribution costs. Whereas those distribution costs may be a small proportion of an insurance product sold with an insurance cost of £150.

Commercial terms and mark up from net rate to retail price

We examined the terms of a number of the commercial relationships between insurers and distributors, as well as comparing the net rate to the retail price where possible. In most cases the retail distributors were responsible for setting the retail price.

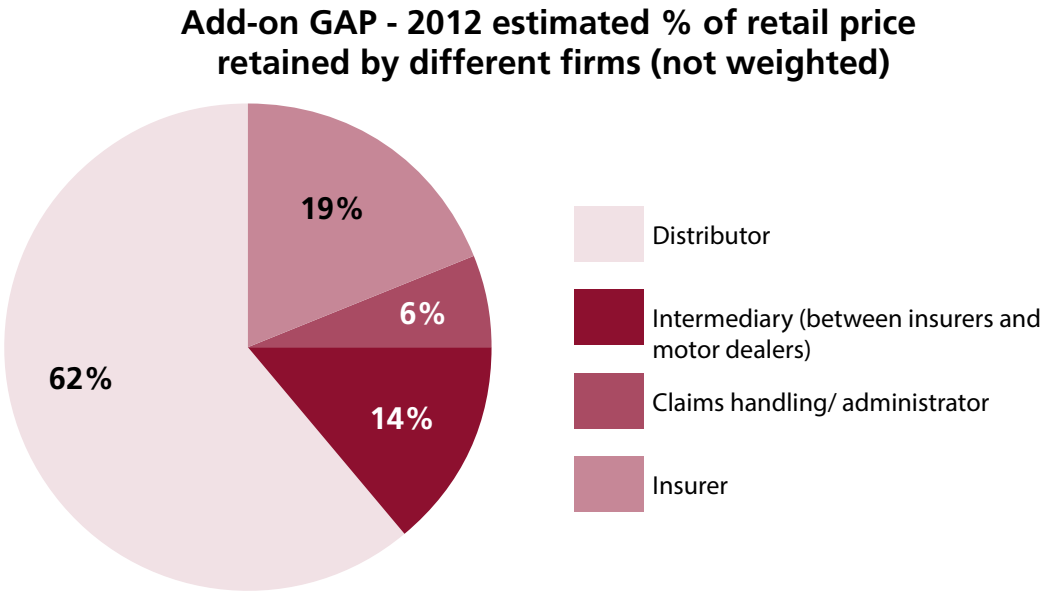
For home emergency insurance the commercial terms between insurers and distributors generally limited insurers' ability to generate high profits from the underwriting of this product. For example, one insurer, with a variety of different distribution arrangements, supplied us with details of its profit share and net rate target rate arrangements that limited the insurer's ability to generate high profits. For another insurer providing home emergency insurance, commission paid by the insurer to the distributor for add-on sales accounted for approximately two-thirds of the retail price paid by consumers. Several distributors confirmed that the percentage commission is significantly higher for their add-on home emergency product than for the primary home insurance product. We often found that profit sharing arrangements between insurers and distributors further restricted the ability of underwriters to generate high profits.

For home emergency insurance four firms provided information on the net rate and retail pricing for stand-alone products and 10 firms for add-on products. The net rates ranged from 11 per cent to 60 per cent of the retail price for the stand-alone providers and a similar range for add-on providers although for most of the add-on products the net rate percentages were below 30%.

This shows that for home emergency insurance a substantial proportion of the retail price is not retained by insurers, but goes to other firms in the supply chain (normally the retail distributor). We found that for many of the home emergency add-on products a high percentage of the retail price is retained by distributors rather than going to the insurers.

For GAP we only obtained information from underwriters of GAP insurance sold on an add-on basis. The stand-alone market for GAP is very small, as the vast majority of GAP policies are sold alongside the purchase of a vehicle. GAP insurers were asked to estimate the proportion of the retail price that is retained by each of the firms they identified in the supply chains for their sampled product sales. A summary of this information is displayed in Chart B.1.

Chart B.1: GAP Add-on supply chain



The chart shows that a substantial proportion of the retail price is retained by the retail distributors for GAP sold on an add-on basis. By contrast, the pricing information we have from two of the stand-alone providers indicates that the percentage of the premium that goes to the insurer is around 50% or 60%. Thus it appears that a significantly higher proportion of the premium goes to the insurer for stand-alone sales compared to add-on sales. Table 5.3 in the main report sets out examples of mark-ups from net rates to retail prices for both stand-alone and add-on GAP (as well as other products).

Three firms provided information on net rate and retail pricing for personal accident insurance. Net rates ranged from below 10 per cent to 30 per cent of the retail price for add-on sales. We only received information on net rates for one stand-alone product, with a net rate to retail price of below 20%.

For travel insurance three firms provided information on the net rate and retail pricing for stand-alone products. The net rates ranged from 40 per cent to over 80 per cent of the retail price. We did not obtain information on net rates for add-on travel insurance sales.

For gadget insurance four firms provided information on the net rate and retail pricing for stand-alone products. The net rates ranged from 35 per cent to 80 per cent of the retail price. We were not provided with any information on net rates for add-on gadget insurance sales.

The evidence shows that, for travel and gadget, for stand-alone sales at least, a higher proportion of the retail price paid by retail consumers goes to insurers, compared to home emergency, GAP and personal accident.

INSURER PROFITABILITY

Sampled insurers were asked to submit a profit and loss account for the sampled product for each year from 2008 to 2012. All profit and loss data was requested to be provided on an underwriting year basis and not on an accident

year basis to try and obtain comparable data. The pro forma insurers were asked to complete for each year included the following categories:

- Earned premium (net of reinsurance)
- Claims incurred in each year (net of reinsurance)
- Reinsurance commission earned in this year
- Claims management costs
- Other technical income or charges
- Net operating expenses
- Balance of underwriting
- Adjustment for prior years: balance
- Balance of all years underwriting

Insurers use the Combined Operating Ratio ('COR') to calculate their profits from underwriting products. For the purposes of this report we have calculated COR, using the firms data submissions, as:

(Claims incurred in each year (net of reinsurance) + claims management costs + other technical income and charges + net operating expenses + adjustment for prior years) / earned premium (net of reinsurance)

The COR excludes any investment income insurers earn from these products, but this accounted for less than 2% of the premium in most cases, so is not a material component in our profitability analysis.

There were two main ways that insurers populated the profitability data submissions for the study. Most insurers based their 'earned premium' data submission on the retail premium charged to consumers, whilst a minority of insurers based their 'earned premium' submission on the 'net rate' charged from insurers to distributors (before the distributor added any mark-up before retail sale). There were several firms who used a mix of the two approaches depending on the contractual terms of their arrangements with different distributors. The different approaches to the income recognition for the earned premium had an impact on the comparability of the COR results.

In addition, we considered whether the cost allocation methodologies applied by insurers for indirect costs might have a significant impact on the COR results. However, we found that with the claims costs and the distribution costs comprising a significant majority of the insurers' costs, differences in cost allocation methodology for more indirect costs such as operating costs would not materially impact on our conclusions about insurer profitability.

A significant majority of the CORs we observed were in excess of 80 per cent. In a number of cases the CORs exceeded 100 per cent. In a low number of cases the COR was below 80 per cent. There was no consistent pattern to indicate that COR was different between add-on and stand-alone products.

The insurer submissions were compared, where possible, to internal firm management information (such as management accounts) to assess the reasonableness of the submissions. Where there were material differences, we sought to identify the more reliable data and where necessary follow up with firms to determine the correct data to use.

The results show that insurers were generally not in a position to generate high profits from the underwriting of the sampled insurance products, with the exception of personal accident where underwriting performance varied between firms.

DISTRIBUTOR PROFITABILITY

We asked distributors to submit profitability data for the distribution of the sampled products. In addition distributors were asked to provide internal management accounts as well as other relevant internal papers and documents.

Distributors were asked to provide profit and loss accounts for each year from 2008 to 2012 for the sampled products. As part of this, distributors were also requested to provide a detailed methodology used to allocate costs for the products along with supporting calculations, explanations and justifications.

We found that a number of distributors were unable to allocate costs to the sampled products and or do not allocate the costs to these products for internal management information (because the costs would not outweigh the benefits of doing so). Reasons some firms were unable to provide cost allocations included:

- Product income very low relative to overall business revenue
- Internal recognition that the incremental cost of selling add-on products is very low, and hence there is little benefit investing in understanding the exact level of costs
- Product costs are captured in the primary product costs and firms do not have the management information systems to separate out the costs
- Costs are allocated on a different basis, such as by online sales and telephone sales rather than by product.

Despite the inability of some firms to provide credible cost information, there were still a number of firms who were able to provide product cost information. Firms used a variety of methods to allocate costs to products. We found the cost allocation methods using activity based costing to be more reliable, as well as some firm models which used a variety of different cost drivers for different cost types. Less reliable methods included allocations based on income, although these may have been more appropriate for internal business reporting purposes.

The pro forma insurers were asked to complete for each year for the sampled products included the following categories:

- Total income
- Direct costs
- Indirect costs
- Other material business costs
- Profit before tax/ net profit

For home emergency, a majority of distributors who submitted profitability data for their add-on sales generated a profit before tax percentage for 2012 of over 70%. One of these firms identified that the higher profits and low claims ratio for home emergency suggested "*… an opportunity to reduce customer price and/or broaden cover*", thus indicating that the firm considered the level of profits earned on the product were high. For two out of the three home emergency distributors who distributed home emergency products on a stand-alone or deferred add-on basis the net profit percentage for 2012 was substantially lower, although for one of these firms the net profit percentage appears to be understated.

For personal accident insurance, stand-alone providers identified that the acquisition costs for new customers are high, although personal accident customers tended to retain/ renew their policies for a longer period of time than customers of other sampled products. One firm, for example, indicated that its average stand-alone customer had remained with them for 10 years. Only one add-on provider was able to submit profitability data for its personal accident add-on product and for this firm the 2012 profit before tax percentage was between 60 and 70 per cent. Another firm indicated that the profit margin on its add-on personal accident product was about 80%. A further firm, who acted as an introducer rather than a retail distributor, calculated its profits to be around 90% of its income. Most sampled distributors who sold personal accident on a stand-alone or deferred add-on basis generated profit before tax percentages above 35%, with one earning net profit above 80% in 2012. Despite this the level of new stand-alone personal accident sales appears to have declined over the relevant period with providers citing difficult stand-alone personal accident market conditions and the high current customer acquisition costs. The net profit percentages for the stand-alone providers may reflect the profitability of the existing book of customers more than the profitability of a balanced mix of new and existing business.

Internal documents from one stand-alone personal accident distributor reported that its stand-alone personal accident book was "… *very profitable* …", and for its add-on personal accident product the firm was able to significantly increase the price with relatively little apparent impact on demand. For a subsequent proposed price increase the firm identified internally that there was a "*Danger of apparent 'profiteering' given estimated PA profitability … there is a risk that increasing prices for a product with a c80% profit margin would be damaging to […] in light of further investigations into add-on profitability and pricing*". Notwithstanding this risk the firm increased its prices further.

One add-on GAP provider submitted pricing model information which indicated that the net profit % earned on the distribution of its GAP product was above 60%. For the stand-alone GAP providers we found that a greater proportion of the retail price goes to insurers, and firms were not generally able to earn high profits, with 12% weighted average profit before tax percentage over a three year period from 2010 for the sampled providers.

The evidence indicated that stand-alone travel insurance distributors generally did not generate high profits from the distribution of travel insurance with weighted average profits before tax of 5% over the period 2008 to 2012. We were unable to obtain information on the profitability of add-on distributors of travel insurance.

From the limited information we saw, stand-alone providers did not appear to be in a position to generate high profits from the distribution of Gadget insurance. We did not obtain sufficient reliable information on the profitability of add-on distribution of gadget insurance.

Overall, we found that add-on providers were in a position to earn high profits from the distribution of home emergency and personal accident, both in overall terms and also when compared to profits earned by stand-alone providers. For GAP, there are indications that add-on GAP retail distributors can generate high profits from GAP insurance. The information for travel and gadget was limited.

DISTRIBUTION COSTS

A number of firms across the sampled products have indicated that distribution costs are significantly lower for add-on sales than for stand-alone sales. Reasons identified by firms for the difference include add-on product sales and operating systems efficiencies, minimal add-on advertising costs and add-on product advantages in building customer relationships. Where one product is sold as an add-on to another product the distribution costs is likely to be lower than where a firm is seeking to generate a sale on a stand-alone basis. One sampled add-on distributor noted that ancillary products use minimal specific resources. Often add-on distributors do not undertake any additional advertising (over and above the primary product advertising) and instead promote the add-on product on the customer's primary product sales journey. One firm distributing on an add-on basis reported, "*Marketing costs are negligible as we will rely on existing cross-sell/ up-sell leaflets and not spend any money advertising the product in its own right*".

Data provided by a number of sampled distributors showed that very little advertising expenditure was spent on add-on products. One firm reported that all their home insurance marketing budget is assigned to the sale of the home insurance product and these costs would be the same regardless of whether home emergency insurance was offered or not. Marketing and advertising costs often account for a substantial proportion of the distribution costs for new stand-alone business, and one firm identified that for its home insurance business marketing costs amount to 58% of the total costs.

One firm reported that stand-alone products have a higher brand development cost and the operating model is more costly to implement compared to add-on sales, with a higher acquisition cost for stand-alone products. For this firm, which distributes on both a stand-alone and add-on basis for one of the sampled products, its latest pricing model indicated that expenses on the add-on product would be £7 against £24 for the comparable stand-alone product. This pattern is consistent with the firm's management accounts.

Another firm in its home emergency product design papers identified that the costs (excluding claims costs and claims handling expenses) would only equate to around 3% of premiums received and that the "… *the running costs of the product are modest*". The same firm estimated that the home emergency add-on sales would increase the average home insurance handling time by a nominal amount with an average cost of sales of around £1.

One personal accident provider set out in its product design papers that its add-on personal accident product "*Should produce incremental income at low acquisition costs … after set up costs*". By contrast, two personal accident stand-alone distributors set out that the cost required to build a personal accident book can be very high, and a second distributor provided data showing that in the first three years after the product launch, the total product marketing expenses were over double the Gross Written Premium over the three year period.

One large provider who distributes a range of general insurance products on both an add-on and stand-alone basis confirmed that on a general basis costs for add-on products are lower than the costs for an equivalent product sold as a stand-alone product.

These lower distribution costs for add-ons are reflected in higher penetration rates (the proportion of those customers offered the product who buy). For example when sold on an add-on basis we saw a penetration rate (from primary product sales to personal accident sales) of 17%. By comparison one distributor identified that a 2% to 3% take up rate for direct marketing campaigns would be considered relatively high.

In addition to the ease with which new add-on customers are acquired there are administrative savings too (compared to stand-alone sales) whereby sales staff and firm systems will have already captured a lot of the necessary information about the customer to conclude the sale.

Overall we found that distribution costs for add-on product sales are likely to be significantly lower than the distribution costs for comparable stand-alone product sales. There are significant differences in advertising, marketing and sales costs.

CLAIMS FREQUENCY

We have calculated claims frequency as being the number of claims settled as a percentage of the average number of policies in force (taken as the simple average of the number of policies in force at the start of a year plus the number of policies in force at the end of the year divided by two[1]). The claims frequency will be affected by the nature of the events covered. Some insured events have a very low likelihood of occurrence compared to others, for example a life changing event covered by personal accident insurance is less common than losing luggage covered by travel insurance.

1 With the exception of 2008, where we used the number of policies in force as at 31 December 2008.

However, the claims frequency (both based on notified claims and settled claims) affects consumer understanding of the financial value of the insurance product, since it is only when a consumer comes to claim that they may appreciate fully the extent or limitations of the cover.

However, products with low claims frequencies can still have considerable value to retail customers. For example, most life assurance products will have a very low claims frequency but where successful claims are made the claim payout would be substantial, and hence a low claims frequency does not preclude products from providing appropriate value for customers. Furthermore, for products such as life assurance and travel insurance emergency medical cover there may be considerable peace of mind benefit for some consumers regardless of the financial value of the product or the low likelihood of claiming.

We found that claims frequencies were very low for personal accident for both stand-alone (0.15% weighted average) and add-on products (0.05% although for a majority of the firms there appeared to be around one claim per 20,000 to 25,000 policies in force per year). One personal accident firm identified internally that its add-on personal accident product was deemed to be of limited value and the firm was investigating further, identifying potential issues of overlapping cover and raising the possibility of adding additional cover options. Given the remote likelihood of a claimable personal accident event occurring, it is difficult for consumers to understand the financial value that the product provides.

One add-on distributor conducted a review of its personal accident product sold as an add-on to motor insurance. The review covered a 30 month period and identified that 14 claims had been made in that period, with 8 declined, 4 outstanding and only two paid, despite selling over 90,000 new policies in the period. The firm's review acknowledged that the product was too restrictive. In addition, during the review period the firm increased the price significantly (despite only approving a maximum of 1 claim at the point of the price rise).

For add-on GAP insurance the claims frequencies were also low, with annualised claims frequencies averaging around 0.33% (although the frequencies for some firms were above 0.5%), which for a typical three year GAP policy will equate to a policy claim frequency of around 1%. The average GAP claim payouts for most firms were above £2,500.

The average claims frequencies for add-on home emergency sales were 5% (although frequencies fluctuated between firms) with average claim values typically between £85 and over £130 depending on the firm. For stand-alone providers the claims frequencies were significantly higher, but for home emergency the higher claims frequency is often driven, to an extent, by the inclusion of annual boiler service in a greater proportion of home emergency stand-alone products than add-on products. Claims frequencies for stand-alone providers tended to vary significantly depending on which home emergency product was being sold, but on average are under £100. The average claim values of both add-on and stand-alone home emergency sales indicated that in most cases and for most products consumers are not protected against high financial impact risks.

One firm in this market identified "*Our experience is that the claims frequency rates increase the more active the customers are in selecting the product for purchase. This means that the frequencies are lowest for Opt-Out policies, slightly higher for Opt-In and significantly higher for Stand Alone*". Hence, a firm in this market (and other general insurance markets) identified that even for similar quality products stand-alone customers are more likely to claim. Several providers in the home emergency market provided information that indicated there were higher claims frequencies or higher product value extraction for more aware customers and/or stand-alone customers. For two of these providers the net rate for add-on home emergency products were significantly lower than the net rate for the equivalent stand-alone product.

For travel insurance we found that the proportion of claims settled as a percentage of policies in force was 3% on average for add-on products (between 2008 and 2012), and around 4% for stand-alone, although there was significant variation between individual firms.

Overall, we have seen that claims frequencies for stand-alone products tend to be higher than for add-on products. Whilst, part of this difference is driven by product cover differences between add-on and stand-alone there are indicators that add-on customers are less likely to claim, even for similar quality products. This could be linked to lower retail customer product awareness found in add-on sales. One major distributor explained that "*Stand-alone policies in general insurance are traditionally more expensive than Add-on policies because the claims frequencies are higher*".

AVERAGE CLAIM PAYOUT

A summary of the claims payout distribution results for the sampled products are set out in table B.1 below:

Table B.1: Average payout for settled claims (2008 to 2012)

Average payout for settled claims (2008 to 2012)		
	Add-on	Stand-alone/ deferred add-on
Personal accident	£1,067	£3,498
Gap	£3,080	–
Travel	£732	£713
Home emergency	Range between £85 and £165 depending on the firm	Typically around £75 to £100 per job on average

The results show that, where claims are settled the settlement amounts are relatively large for personal accident and GAP. We found that for travel there were examples of claims settled over £300,000 (which for travel appeared to relate to emergency medical expenses), although these were typically in significantly less than 1% of claims settled for those products. For home emergency we found a very low proportion of claims settled over £500[2], although for home emergency firms there were examples of individual claims settled over £1,000.

CLAIMS DECLINATURE RATES[3]

We found that the claims declinature rates ranged significantly between products, with GAP declinature rates being the lowest and home emergency the highest, with a number of firms having claims declinature rates over 25% in at least one year (between 2008 and 2012) covering both add-on and stand-alone sales. One distributor recognised that the high declinature rate on its home emergency product highlighted that the firm needed to enhance customer understanding of the home emergency product.

For GAP, add-on claims declinature rates tended to be below 5% for most firms in most years. The claims declinature rates for travel varied significantly between different firms, and typically ranged from around 5% to over 15% depending on the firm. For some firms the add-on sales have higher declinature rates than stand-alone sales and for other firms the pattern is reversed.

For personal accident the claims declinature rates varied significantly by firm, with simple average rejection rates ranging from 7% to 16% for all but one of the firms who provided detailed claims data. A further firm identified that, over a 30 month period, the claims rejection rate for its add-on product was 57%.

2 For all providers over 95% of the claims settled were below £500.

3 Claims declinature rates are defined as the proportion of claims submitted by customers which are rejected

CLAIMS RATIO

As set out in Chapters 5 and 6 of the report the claims ratio is a key measure of product value.

We define the claims ratio as:

$$\text{Claims ratio} = \frac{\text{Claims incurred (net of reinsurance and excluding claims management costs)}}{\text{(Net earned premium (plus IPT) (net of reinsurance but including distributor commission))}}$$

Net earned premiums (plus IPT) means the value of actual premiums earned in a year inclusive of any taxes or duties levied with no deductions for expenses relating to acquisition or administration of the policy (including distributor commission).

The proportion of the total premium (and Insurance Premium Tax (IPT)) paid by retail customers that insurers pay out in claims (claims ratio) is a key measure of product value. We have included IPT as this will be included in the retail price paid by the consumer, which is most relevant for the consumer's consideration of the value of the product.

Sampled insurers were not all able to provide claims ratio on a consistent basis, and difficulties we encountered included firms providing net earned premium data excluding distributor commission. Where possible we used firms' internal papers and internal management information to help provide insight on claims ratio and other value measures, as well as support the data submitted the study questionnaire.

Based on the data submitted by firms and pricing model or firm internal papers, the results show that for add-on home emergency insurance the claims ratios (based on 2012 data and information) for nine out of ten providers were below 30%. The claims ratios for the stand-alone products were more variable, and the claims ratios also fluctuated for different products within individual firms' home emergency product ranges. The claims ratios for stand-alone providers are also not directly comparable because a higher proportion of home emergency stand-alone products include an annual boiler service as part of the cover.

One add-on home emergency insurance distributor identified internally that its claims ratio was low and "*in aggregate the return (claim pay-out to the customer) is relatively low compared to the premiums collected*" and action would need to be taken to address this. One of the stand-alone home emergency providers considered that for one of its home emergency products, a loss ratio of 26% was a cause for concern, and for another of its products with a loss ratio of 15%, the firm was considering a price reduction as an option to deal with this low value.

The claims ratios for personal accident add-on products were less than 9%. The claims ratios for personal accident stand-alone sales tended to range between 10% and 30%, and were typically higher than the claims ratios on add-on sales. Both add-on and stand-alone personal accident products represented poor value, in terms of the claims ratio. One provider recognised that their add-on personal accident product offered low utility to their customers and the firm introduced changes to improve customer awareness of ownership of the product. Another add-on provider identified that its personal accident product needed 'action' because it was deemed to be of limited value.

The claims ratio results for add-on GAP insurance ranged from 4% to 15% for 2012, and were 10% on average over the period 2008 to 2012.

The weighted average claims ratio results for the sampled travel products were 52% for add-on sales and 42% for stand-alone sales in the period 2008 to 2012.

Unlike other general insurance products with an IPT rate of 6% the IPT rate on travel insurance of 20% has a larger impact on the claims ratio, and the claims ratios excluding IPT were 61% for add-on sales and 50% for stand-alone

sales in the period 2008 to 2012. The travel insurance products appear to be significantly better value than the other sampled products, both for stand-alone and add-on sales.

PRICING AND PRODUCT QUALITY

Due to data limitations we were unable to generate a meaningful comparison between price and quality for four of the five sampled products, the exception being GAP insurance. For travel, home emergency, personal accident and gadget we generally found that prices and product cover were lower for add-on products.

For GAP we found that stand-alone prices were significantly lower than add-on prices, and this held true even for comparisons between similar quality products. We examined the product pricing for approximately 2 million add-on GAP policies sold and found that the average price was around £310 (net of IPT). For four stand-alone providers we found that their average prices in 2012 were between £105 and £177. Some of this difference in prices between stand-alone and add-on GAP insurance could be accounted for by differences in the composition of car values. Accordingly we tried to compare like for like car sales.

One insurer provided GAP data on the prices for different priced vehicles, and for vehicles priced up to around £20,000 the average GAP prices were around £300, and the average claim payout for that insurer was around £3,000. Similar cover from one of the stand-alone providers ranged between £90 and £140 (depending on the type of GAP cover). For another insurer, whose finance GAP product had an average price of around £250, a comparable stand-alone price from two stand-alone providers appeared to be between £90 and £110. Whilst there were differences in the GAP stand-alone and add-on policies compared, we do not consider that these differences explain the significantly higher prices for the policies sold on an add-on basis. One insurer in this market reported internally that "*online GAP product quality generally appears to be of the same standard as that offered through dealers …*" and "*Initial analysis has identified that online GAP products are priced considerably lower than the retail price typically charged by a dealer*".

OTHER NON-SAMPLED PRODUCTS

There were a number of firms who provided data and information covering products not included in our sample of five products. This additional data highlights that there are value issues for a wider range of products than the market study captures. The following table provides a number of examples of other product data provided to us:

	Proportion of premium retained by insurer	Claims ratio
Add-on to home insurance		
Legal expenses	10%	Estimated < 10%
Key	14% – 20%	Estimated < 14% – 20%
Garden	31%	Estimated < 31%
Legal expenses	21%	Potentially around 14%
Accidental damage		<39%
Extended contents		<21%
Cycle		<14%
Add-on to motor insurance		
Legal expenses	5.7%	Estimated < 5.7%
Key	14% – 20%	Estimated < 14% – 20%
Excess	33% – 50%	Estimated < 33% – 50%
Replacement vehicle	22%	Estimated < 22%
Breakdown	38.5%	Estimated < 38.5%
Breakdown	Range 19.7% to 56%	
Legal expenses	0.5%	
Breakdown	43% to 57%	25% to 29%
Car hire	20% to 40%	18% to 20%

The table shows that there are a variety of add-on products that are sold alongside motor and home insurance and in a lot of cases the insurance provided does not represent good value for retail customers. For certain products, such as some legal protection policies, part of the value that retail customers get may be from a legal helpline which would not be captured in the claims ratio. Where the claims ratio information is not available we have assumed that the claims ratio will be lower than the proportion of retail price which is retained by the insurers.

LIST OF FIRMS WHO PROVIDED INFORMATION

Firm Name
ACE European Group Limited
Acromas Insurance Company Limited
Admiral Insurance Company Limited
Adrian Flux Insurance Services Group
Age UK Enterprises Limited
Ageas Insurance Limited
AIG Europe Limited
Aioi Nissay Dowa Insurance Company of Europe Limited
Allianz Insurance Plc
American Express Insurance Services Europe Limited
Amtrust Europe Limited
Assurant General Insurance Limited
Automobile Association Insurance Services Limited
Avantia Insurance Ltd
Aviva Insurance Limited
AXA Insurance UK Plc
Barclays Insurance Services Company Limited
British Gas Insurance Limited
BUPA Insurance Limited
Car Care Plan Ltd
Castle Cover Ltd

Firm Name
Click2Protect
Click4gap.co.uk
Columbus Direct
DAS Legal Expenses Insurance Company Limited
Direct Gap
Domestic & General Insurance Plc
Allianz Insurance Plc
Endsleigh Insurance Services Ltd
Esure Services Limited
Supercover insurance
Global Insurance Management
Autoprotect
Great Lakes (Reinsurance) UK plc
Halifax General Insurance Services Limited
Hastings Insurance Services Limited
Homeserve Membership Limited
HSBC Bank Plc
Insure & Go Insurance Services Ltd
Inter Partner Assistance SA
i-Partners Insurance Management
Jubilee Managing Agency Limited
Kwik fit Insurance Services Ltd
LAMP Insurance Company Limited
Liverpool Victoria Insurance Company Limited
Lloyds TSB Bank Plc
Lloyds TSB Insurance Services Limited
London General Insurance Company Limited

Firm Name
Mapfre Asistencia, Compania Internacional De Seguros y Reaseguros, S.A.
Marks & Spencer Financial Services Plc
Pinnacle Insurance Plc
Post Office
Principality Building Society
R.J. Kiln & Co. Limited
RAC Insurance Limited
Royal & Sun Alliance Insurance Plc
Saga Services Limited
Sainsbury's Bank Plc
Santander Insurance Services UK Ltd
Simplyhealth Access
Sterling Insurance Company Limited
Swinton Group Ltd
Tesco Personal Finance PLC
The Green Insurance Company Limited
The Post Office
Toyota Financial Services (UK) Plc
U K Insurance Limited
Warranty Direct Ltd
www.insurance4gadgets.com

Financial Conduct Authority

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