FCA Whitepaper

How FCA Pricing Reform is *Reshaping* the General Insurance Market

Earnix assessment of market dynamics in the wake of the FCA's clampdown on 'price walking' on home and motor policies, which came into full effect on 1 January 2022.

Why Reform Was Needed

Years of soft market conditions, coupled with the commoditization of personal insurance, have forced many UK insurers to offer lower premiums for new business. Some insurers have resorted to what the FCA calls 'price walking'—systematically upping prices at multiple renewals—to recoup margins from these lower initial revenues. The FCA found that due to this practice, approximately six million policyholders in the UK were paying more than 50% higher premiums than a cohort with a similar risk profile.

>50%

What It Means for Insurers

To protect UK consumers from perceived unfair pricing, the FCA is instituting two remedies:

1

The Pricing Remedy (effective 1 January 2022) states that renewal business premiums for home and motor insurance must not be higher than the premium that would be given to an equivalent new business or new customer risk. Insurers must submit an executive signed attestation stating that they are adhering to these rules.

2

The Reporting Remedy (effective 30 September 2022) requires annual reports submitted to the FCA to show customer outcome metrics by tenure. These detailed reports must prove that insurers are not engaging in price walking and that renewal business is adhering to the guidelines outlined in The Pricing Remedy. In many cases, insurers may have to develop completely new reports to demonstrate compliance.

The reforms include numerous non-price-related elements such as the removal of barriers for consumers to cancel automatic renewals and the requirement that firms ensure the data they use in pricing does not discriminate against customers based on any protected characteristics highlighted under the Equality Act 2010.

Designed to ensure insurers deliver and can demonstrate fair value to customers, **the FCA projects these remedies will save UK consumers £4.2bn over the next 10 years.**

"We believe that our remedies will improve competition and ensure firms deliver fair value to their customers. This is fundamental to a healthy and well-functioning market."

FCA FINANCIAL CONDUCT AUTHORITY

"Without question, the new system of regulation is fairer for consumers."

POST OFFICE

Nick McCowan
Head of General Insurance

Initial Impact on Pricing and Business

Unsurprisingly, insurers have reported **a decline in demand for new insurance policies** in the wake of the reforms while their retention rates have risen significantly. The reforms have reportedly led to a slight drop in renewals prices and a rise in new business prices, closing the price differential.

According to market research firm Consumer Intelligence, motor premiums jumped by 5% in January as a direct response to the reforms before levelling off, meaning premiums rose 4.3% overall, year-on-year, in Q1.

Age	Average Premiums
Under 25	↑ 2.3%
25-49	↑ 4.1%
Over 50	↑ 6.2%

This suggests a softening of insurers' approach to age-based price optimisation.

As insurers are no longer hiking renewal rates to fund new business discounts, customers are no longer facing a typical 5-10% increase in premiums at renewal and are therefore are not shopping for better deals on price comparison sites as much. The market also appears to have generally pulled back from using incentives to win customers. **Cash or cash equivalent incentives for new customers now appear economically unfeasible** as they would have to be replicated in renewals.

Certain non-cash equivalent incentives like carbon offsets or toys, for example, can still be offered without being reflected in both new and renewals business, so incentives have not disappeared altogether. However, with less competitive tools at insurers' disposal, companies whose growth strategies have historically focused on targeting new customers through a combination of competitive pricing and incentives will need to re-evaluate their tactics.

"Over the longer-term, we anticipate general inflation in prices in 2022, with underlying pricing pressures remaining broadly upward."

consumer intelligence

31 March 2022

"Insurers have typically had one algorithm for new business and one for renewals. Mashing these together changes the dynamic of the market significantly."

RSA

Justin Clarke
CUO, Personal Lines

At a broad level, **the FCA's predictions appear to have played out**—albeit over a very short timeframe:

- Price walking on new business would cease
- Premiums would rise slightly on average
- Renewals would become more attractive for consumers

However, assessing the pure impact of the reforms on pricing dynamics is very difficult due to a convergence of socio-economic factors, which add complexity to the pricing and claims environment.

Inflation and supply chain disruption caused by the Ukraine conflict, the pandemic, and Brexit have triggered significant claims cost inflation, for example, while loss patterns also changed significantly during the pandemic due to variations in normal property and vehicle, adding further nuances to pricing.

These factors mean the FCA's predictions on **the impact on claims costs for home and motor policies are likely to be way off the mark.**

View from the ground: Justin Clarke, CUO, Personal Lines, RSA

- According to Clarke, the reforms have reset the motor and home markets and had a significant impact on market dynamics.
- The number of quotes and new business through price comparison websites (PCWs) has fallen.
- The market is shying away from incentives.
- There is more focus among large insurers on retaining renewal customers than competing for new business.
- Innovation will increasingly focus on customer-centricity and managing customer relationships.
- Overall, Clarke believes the market will move towards a pure pricing model.

"Some providers either over- or under-shot their expectations of market-level inflation and have made adjustments subsequent to their initial pricing changes."

consumer intelligence — 31 March 2022

"Customers are staying with their existing providers at renewal in greater numbers than many anticipated—even with insurers who were at the sharp end of price walking. That presents a big challenge for lots of businesses like us who want new business growth."

POST OFFICE — Nick McCowan
Head of General Insurance

View from the ground: Nick McCowan, Head of General Insurance, Post Office

- McCowan reports a notable drop-off in demand for new insurance policies.
- Retention rates have risen significantly.
- The price difference between new and renewal business has closed.
- Customers appear to be shopping around to swap deals less but are still seeking affordable deals via PCWs.
- Price remains an important factor in consumer-buying decisions.
- New business prices haven't risen by the quantum many were forecasting.
- Consumer savings have not been as large as once expected due to limited margin in motor and home insurance available to be redistributed.

Commercial Insurers Are Watching Closely

The FCA reforms currently only apply to consumers, not commercial insurers. However, their principles may already be bleeding into commercial insurers' approaches—particularly concerning policies for on-demand and part-time workers who use their own vehicles, such as couriers and Uber drivers. Van insurance is an especially contentious area as vans are often insured for business use with social use permitted.

It is understood where there is clear consumer use of a vehicle, even under a commercial contract, the reforms should be applied. **Van pricing has reportedly risen significantly—by 13.6%** for new business customers in the first half of 2022 due to a combination of inflation and the FCA price reforms, according to Consumer Intelligence — suggesting insurers are erring on the side of caution and treating van drivers like consumers.

"It's surprising the price reforms don't include commercial customers when the definition of a commercial customer can be a grey area. We firmly believe everyone should be treated fairly, regardless of whether they are a commercial customer or a consumer. We think every insurer should be applying these rules, but they are not."

INSHUR

Edward Hill
SVP, European Markets

However, significant uncertainty and room for interpretation remains around how commercial insurers should treat the rapidly growing subsection of on-demand and part-time insurance buyers. Smaller players focused on winning new business may be more likely to continue treating consumers as commercial insureds as it will enable them to bypass the reforms and continue to offer discounts and incentives.

Still, many firms may see it as a compliance risk to define these people as commercial risks.

Going forward, **a growing number of commercial insurers may proactively choose to apply the FCA's pricing rules** to commercial business in anticipation of similar legislation eventually being rolled out into the commercial market.

INSHUR: A Blueprint for Commercial Insurers to Follow?

INSHUR is a commercial insurer that already prices new and renewal business the same, ensuring its customers are treated like consumers under FCA rules, but maintains a strong focus on controlling loss ratios:

- INSHUR has a single pricing model approach, treating new business and renewals the same and reassessing renewal risks as if they were new business each year.
- It competes by excelling in pricing accuracy, validation, and strict risk selection.
- INSHUR augments its risk models with alternative data sets, including those from partners like Uber and Amazon, for improved pricing agility, responsiveness, and accuracy.
- The company has a strong focus on claims management by having a full in-house claims team providing exceptional customer service with an emphasis on loss-ratio control.
- It leverages these efficiencies to pass cost savings on to customers across their lifetime with INSHUR, raising customer loyalty and retention.

"We have a strict focus on sticking to our technical rates and deviate away from discounting premiums. We've always been against that approach, because we don't think that the benefits are worthwhile over the long term for our customers and the market in general."

"Our focus is on sustainable, long-term growth as opposed to some of our competitors. This approach has resulted in excellent loss-ratio performance, allowing us to provide competitive rates to our customers,making it a win-win situation for all parties involved in the insurance value chain."

INSHUR

Edward Hill
SVP, European Markets

How Reform May Influence Buying Behaviours

The FCA reforms already appear to be reducing customers' need to shop around at renewal. However, **price remains a very important factor** in consumer buying decisions —particularly in times of economic hardship. Inflation and the associated cost of living crisis are likely to make insurance buyers more price sensitive in the short-term, driving demand for affordable coverages via PCWs.

Insurers should prepare to compete over a larger pool of new business shoppers as the cost-of-living crisis intensifies. Customer complaints and attempts to negotiate on price may also rise as people look to make savings where they can. Insurance buyers may also increasingly look to strip back the 'extras' typically found on motor and property coverages, like legal or windscreen cover for example, and focus on essential coverage.

Fraudulent claims typically rise in periods of economic hardship, meaning robust fraud detection and validation processes are key. The number of uninsured drivers is also expected to rise significantly, so insurers should keep a close eye on policy cancellations and missed payments as indicators of customers struggling with costs.

Cost-saving efforts may also drive more demand for short-term insurances, particularly among part-time and on-demand workers. With growing numbers joining the gig economy, insurers may consider developing flexible policies for this key buyer group.

"Customers are still shopping through price comparison websites (PCWs) for products they can afford, and PCWs are doing a better job of displaying product value and features to help them make an informed choice."

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Nick McCowan
Head of General Insurance

Pricing Methodologies Under the Spotlight

Going forward, the ability to accurately price and select risk in the face of heightened market volatility will be an increasingly important competitive differentiator for insurers. For example, there will be an increased focus by insurers on intelligently segmenting customers who are better risks and improving loss ratios through risk mitigation. Agile reserving will also be important in a volatile economic, pricing, and claims environment.

Data and technology will play a huge role in enabling this, but the use of algorithms must be tempered with an increasing focus on fairness and transparency. Heightened scrutiny on pricing methodologies and consumer duty may limit insurers' ability to segment customers and personalise pricing as complex or opaque 'black box' methodologies will make it difficult to demonstrate fair treatment under the Reporting Remedy. Historically, insurers have tended to focus their optimisation algorithms on lowering prices for high-paying customers (to attract more revenues). The reforms may encourage insurers to place more focus on delivering lower prices for lower-paying customers to deliver fairness and value across the board.

Insurers also need to be extremely cautious of using non-risk-related data (such as protected characteristics like disability or ethnicity, for example) in their pricing methodologies and processes. The FCA is exploring potential correlations between profit margins and the racial composition of local geographic areas that could result from pricing algorithms, which could inspire further reform. Data science teams must be vigilant to factors that could inadvertently be considered within their algorithms, and discrimination risk should be embedded into models so it can be flagged early.

"The reforms reinforce the need for better predictive models, market modelling, and monitoring to allow you to trade competitively in this market."

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The Role of Data and Technology

Accessing more comprehensive, reliable, and timely customer data and harnessing AI-driven technologies and dynamic analytics tools to intelligently analyse it will **enable superior risk selection, pricing, and risk mitigation**. Insurers will increasingly seek to augment data gathered from customers with data from external data sources, such as:

- Aggregators/PCWs
- Consumer credit ratings
- Police records
- DVLA and other public records
- Modelling information«

Insurers using manual underwriting methods will find it **increasingly difficult to compete** against companies whose underwriting systems are underpinned by agile technology stacks that enable them to:

- Ingest data from a variety of sources to augment decision-making
- Manage complex pricing more efficiently
- Feed granular real-time insights into risk models
- Automatically identify and flag potential fraud as early as possible

Data feeds from Internet of Things (IoT) technology will also play a bigger role in both risk mitigation and pricing going forward, enabling insurers to act quickly on market trends or individual risk information in close to real-time. In fact, according to Consumer Intelligence, over a quarter of the five cheapest insurance quotes now come from telematics firms—the highest figure it has recorded.

"Leveraging alternative forms of data brings advantages to both the customer and insurer—lower premiums and better-quality risk being transferred and priced appropriately. Our technology enables us to make quick and agile changes in a commercial motor market that has yet to catch up."

INSHUR

Edward Hill
SVP, European Markets

Sustainable Business Models for the Future

In the post-reform environment, **larger incumbent insurers appear keen to protect their profitable renewal back books** and may place less focus on competing for new business. Some insurers may also attempt to de-risk through product diversification.

At the other end of the spectrum, new entrants or insurers with new products lines—who don't have to worry about mirroring pricing in renewal back books—may be tempted to leverage this advantage to set their own very competitive pricing levels (and rise to the top of the price comparison websites). Companies with a focus on new business could in theory release new products each year at these price levels, flooding the marketplace (and PCWs) with cheap new products. However, PCWs would probably attempt to restrict this behaviour as it would be detrimental to customer experience.

As the reforms do not prohibit offering lower prices for renewals, **insurers may consider offering more loyalty discounts** to retain customers. The prevailing trend will be to reinforce loyalty by offering value over the insured lifecycle and by passing on cost savings to customers gained through improved loss ratios and claim spend.

Over the long term, experts expect the price reforms to encourage insurers to favour sustainable, long-term profitability over short-term growth and profits. This should ultimately benefit end customers as well as those insurers who successfully adapt their strategies and processes and employ intelligent pricing and rating technologies to comply and compete.

"Over time, the market will move to a pure pricing model. Insurers will offer one price and customers will take it or leave it. Innovation will be focused on managing the customer relationship better, being more centric to customer needs, offering better renewal pricing and improving risk management."

RSA

Justin Clarke
CUO, Personal Lines

"Entrenching better behaviours across the market and creating a level playing field on pricing is a really good thing. Customers will, I think, get even better products and services as a result."

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Head of General Insurance

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