

General Insurance Pricing Practices

Terms of reference

Market Study

MS18/1.1

October 2018



How to respond

We are asking for comments on the questions in this document by 3 December 2018.

You can send them to:

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1 Executive summary

Introduction

- 1.1** In the FCA's 2018/2019 Business Plan we announced that we were looking at pricing practices in retail general insurance. Following diagnostic work, we have concluded that a market study on general insurance pricing practices is needed. The market study will examine whether pricing practices for home and motor insurance lead to consumer harm, who is affected, and, if required, what action is needed to improve the market. These terms of reference are published alongside the findings of our diagnostic work and a discussion paper on fair pricing in financial services markets. The market study will build on the findings of the diagnostic work and look at pricing practices in motor insurance. The discussion paper will open a debate on fairness in pricing across financial services and inform the market study.
- 1.2** General insurance pricing practices can lead to different consumers paying different prices for the same insurance product, even if the cost to supply the product may be the same. Our diagnostic work found that some consumers who stay with their home insurance provider for a long time pay prices that are much higher than those paid by new consumers. The market study will consider whether pricing practices are leading to competition working well in these markets for all consumers. In doing so we will consider the fairness of these pricing practices.
- 1.3** As set out in the accompanying discussion paper, assessing whether a pricing practice is fair involves considering a range of factors such as the number of consumers affected, their characteristics and by how much they are impacted as well as the nature of the practice. There are difficult trade-offs between those who may benefit and those who lose out from a particular form of pricing, especially when vulnerable consumers fall into both groups. We will examine these issues in the market study to ensure that any remedies properly tackle any identified harm and do not lead to wider unintended consequences for other consumers.
- 1.4** Our Mission and Approach to Consumers set out that we intend to prioritise the needs of the most vulnerable and least resilient groups of consumers. We are concerned that general insurance pricing practices have the potential to cause harm to consumers, particularly those who are vulnerable. Our Financial Lives Survey, for example, shows that 23 per cent of consumers who have held their home (contents and buildings) insurance with the same provider for 10 years or more show characteristics of potential vulnerability.
- 1.5** General insurance pricing practices have attracted wide interest and debate.¹ Most recently, Citizens Advice made a super-complaint to the Competition and Markets Authority (CMA) about excessive prices for disengaged consumers. This market study

¹ The Financial Ombudsman Service published a report in April 2018 that provided some examples of insurance pricing complaints and set out its approach to dealing with these issues fairly. Which also published the findings of an investigation into home insurance policy prices. The Government's Consumer Green Paper highlighted that there is a large gap between the best and worst deals received by consumers, with the vulnerable often suffering disproportionately. It also stated that consumers should not be exploited for their loyalty to suppliers.



will deepen our understanding of consumer outcomes from pricing practices, the scale and nature of any harm and inform how to, if necessary, improve the market. This is crucial for identifying whether any remedies are required and what form they may take. We are also working closely with the CMA in relation to the Citizens Advice super-complaint and this will also inform this market study. Our goal is to ensure that general insurance markets deliver competitive and fair pricing outcomes for consumers.

- 1.6** On 1 April 2017, we introduced rules to increase transparency and engagement at renewal in general insurance markets. This aimed to encourage some consumers to check their insurance cover and pricing and shop around for the best deal at each renewal – evidence from our field trials in the home and motor insurance markets showed that including last year’s premium in renewal notices for home (property and contents) insurance caused some consumers to switch or negotiate their policy. We have started an evaluation of the impact of these rules. However, we have also seen potential non-compliance by firms. This was identified in monitoring work, the findings of which were published in October 2017.
- 1.7** In May 2018, the Association of British Insurers and British Insurance Brokers’ Association published Guiding Principles and Action Points for General Insurance Pricing. The aim was to act on excessive differences between premiums charged to new customers and those renewing. It is not our policy to endorse such initiatives but we welcome actions taken by industry to address concerns about pricing practices for their customers. We expect industry to continue such work while we conduct this market study. The report on our diagnostic work reiterates our existing expectations of firms regarding general insurance pricing practices.
- 1.8** Concerns about fair pricing are not restricted to general insurance markets. We have seen examples in other markets we regulate such as cash savings and mortgages. We are publishing a discussion paper to launch a wider debate on fair pricing in financial services markets. The discussion paper sets out how we consider the fairness of pricing. We want to hear views from stakeholders on this to help inform the judgment of when pricing is unfair. The feedback will also inform our thinking on fairness in this market study.

Scope of our market study

- 1.9** Our market study will build on our diagnostic work and focus on pricing practices in home and motor insurance. These are two of the largest general insurance markets and these products are widely held across the UK population. They both use personalised pricing based on specific personal characteristics and consumers’ histories, and consumers usually pay a different price at renewal.
- 1.10** Other general insurance products such as health, pet and travel insurance are not included in the scope of this market study. However, where possible, we will identify lessons from this market study that are relevant to other markets that we regulate.
- 1.11** Different parties are involved in supplying general insurance. This includes those who provide or sell insurance directly to consumers, and third parties such as brokers and digital comparison tools, including price comparison websites. Not all of them set the price consumers pay for insurance, but they do influence the dynamics of competition

and pricing outcomes for consumers. All of the parties described in this paragraph are included in the scope of our market study.

- 1.12** The CMA published findings from its investigation into the private motor insurance market in 2014. The issues investigated by the CMA were not primarily related to pricing practices. We will not re-examine the issues looked at by the CMA in our market study, with the exception of add-ons, which we will look at in the context of business models that have developed in home and motor insurance.

Issues we will look at

- 1.13** The market study will look at the 3 key areas set out below.

Harm from pricing practices and what drives this

- 1.14** Our diagnostic work shows that some consumers pay prices for home insurance that are higher than those paid by other consumers. We need to understand the scale of any harm created by pricing practices, including the proportion of consumers that may pay very high prices and who they are. We also need to understand what drives firms to price differently and some consumers to engage and pay less than others. This is essential to inform consideration of whether remedies are needed and if so what they should be.

- 1.15** We will look at:

- The differences between prices paid for insurance by different consumers compared to the cost of providing them with insurance.
- How many consumers are affected by paying higher prices.
- The characteristics of consumers paying higher prices, especially the extent to which these consumers may be vulnerable.
- Why some consumers end up paying higher prices.

The fairness of pricing practices

- 1.16** We will look at 2 areas in specifically assessing the fairness of pricing practices.

- 1.17** Firstly, we will assess whether the way firms treat consumers is fair. We will look at:

- Pricing models and strategies adopted by firms and whether these lead them to take advantage of certain consumers.
- Whether firms provide consumers with clear and accurate information when they renew insurance.
- The impact of contractual terms, such as auto-renewal.
- How firms address their responsibilities to treat customers, including vulnerable consumers, fairly.

- 1.18** We will also examine consumers' perspectives and attitudes to the fairness of pricing outcomes in general insurance markets, and their understanding of how general insurance pricing works.



The impact of pricing practices on competition

1.19 We also need to understand whether pricing practices are conducive to effective competition. We will examine whether:

- Pricing practices increase or restrict consumers' access to good quality insurance products.
- Firms are making high profits from certain groups of consumers, especially from those who are vulnerable.
- The current nature of competition leads to higher or lower costs for consumers in purchasing and firms in supplying insurance products.
- Firms entering the market have proved successful or faced barriers. We will look at new and different business models that have developed and whether these deliver good outcomes for consumers or raise concerns. This will include looking at business models that involve the sale of add-on products.

Potential remedies

1.20 Our goal is to ensure that general insurance pricing practices deliver competitive and fair pricing outcomes for consumers. Where we identify harm, we will look at the full range of remedies available to address it and make the market work well for consumers.

1.21 In considering potential remedies, we will examine different approaches to pricing of general insurance in other countries, and what impact these have on consumer and competition outcomes.

Next steps

1.22 We are conducting this market study under the powers given to us by FSMA. We are not formally consulting on these terms of reference. However, we welcome any views on the scope of the market study and the specific questions in Section 4. Please send these to GIPricingPractices@fca.org.uk by 3 December 2018. We will also engage directly with stakeholders to gather their views and gather specific data from firms and third parties. We will begin discussions on this shortly.

1.23 We encourage stakeholders to send comments and any accompanying evidence on the questions in our discussion paper on fair pricing in financial services by 31 January 2019. Details of how to respond are in the discussion paper. Although the discussion paper has a wider scope than this market study, feedback received will inform the findings of this market study.

1.24 We aim to publish an interim market study report in Summer 2019. This will set out our preliminary conclusions including, where appropriate, a discussion of potential remedies. We aim to publish our final market study report and, where relevant, a consultation on proposed remedies by the end of 2019.

2 Background

- 2.1** This chapter describes the general insurance sector and home and motor insurance markets, and summarises how general insurance pricing practices work.

The general insurance sector

- 2.2** General insurance plays an important role in providing consumers with protection from uncertainty. The sector is a key part of the UK economy generating over £78 billion in premiums for UK insurers ([Sector Views](#)). Our [Financial Lives Survey](#) shows that most UK adults (82%) have one or more general insurance products, with the 3 most commonly held products being motor insurance (61% of all UK adults), combined home building and contents insurance (49%) and motor breakdown (36%).

Home insurance

- 2.3** There are 2 types of home insurance:
- Buildings insurance, which covers damage to the structure of homes such as walls, floors and the roof. Having buildings insurance is usually a condition of a mortgage.
 - Contents insurance, which provides cover for items kept in the home such as furniture, televisions and personal belongings.

- 2.4** Buildings and contents insurance are frequently bundled together as combined cover.

Motor insurance

- 2.5** All drivers of vehicles on UK roads must have motor insurance (required under section 143 of the Road Traffic Act 1988). Third party insurance is the legal minimum. This means consumers must be covered if they have an accident causing damage or injury to another person, vehicle, animal or property. Comprehensive cover provides third party insurance, coverage for fire or theft, and repairs to the consumer's own vehicle in the event of an accident. It may also cover additional costs such as for belongings stolen from a vehicle or for hiring a replacement vehicle.

Pricing practices in general insurance markets

- 2.6** General insurance pricing practices can result in different prices for consumers even if it costs the same to supply them with insurance. Some consumers do not respond to price increases by shopping around or switching. Where consumers do not shop around or switch provider regularly, this is known as inertia.
- 2.7** Where consumers are inert, firms can operate a 'price walking' strategy. This is where firms gradually increase prices and after a few years prices reach a level considerably above the price for new customers and the cost of supplying insurance. As a result, inert consumers can be very profitable. Our diagnostic work shows that some consumers who have renewed home insurance with the same provider for a long time

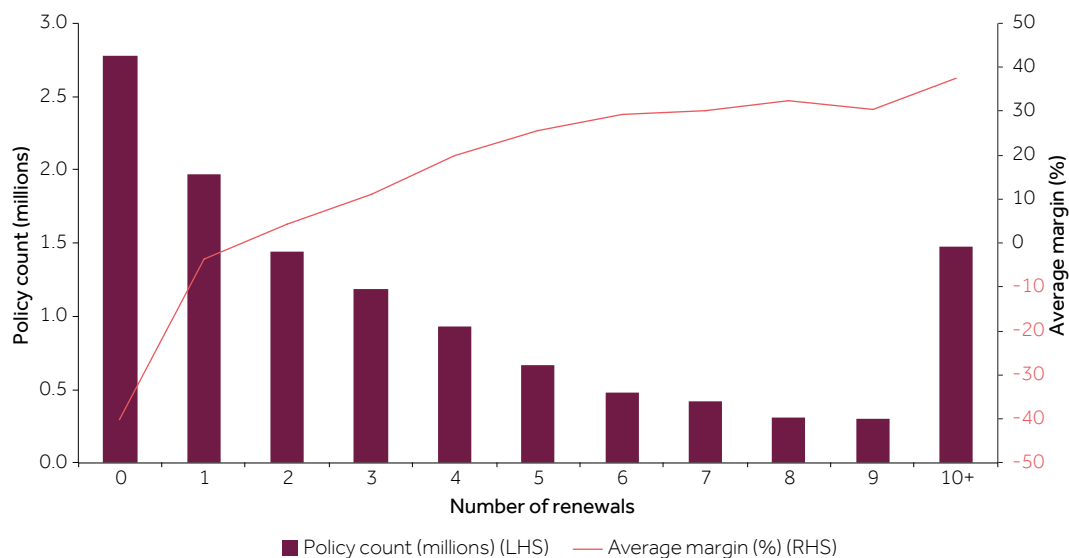


pay prices that are much higher than those paid by newer consumers. This is even though the cost of providing them with insurance may be the same. By contrast, our diagnostic work suggests that price competition to attract new customers can be intense with some firms willing to make losses until the second year of renewal. Firms may expect that a proportion of initially loss-making consumers will not switch in future and become profitable longer term. While not all price increases are problematic, they may be harmful if they exploit consumers' inertia over time.

2.8 This form of competition can lead to positive and negative outcomes. For example, consumers who shop around may get good deals but may have to spend a lot of time shopping around. Consumers who do not shop around, and who may be unaware of how pricing practices work, can pay much higher prices compared to new consumers.

2.9 Figure 1 presents information on pricing tenure and average margins from our diagnostic work. Insurers included in the diagnostic work account for around 40% of the UK home insurance market. The overall picture is that while many consumers have been with their provider for a relatively short period there may be a sizeable group of customers who have stayed with their insurer for several years. 31% of consumers have renewed with their insurer on 5 or more occasions. In addition, on average margins appear to increase with tenure, at least in the first few years.

Figure 1: Policy count and average margins by number of renewals



2.10 Analysis of the evidence obtained through our diagnostic work suggests that some categories of consumers differ in average tenure and the average margin they pay:²

- The sub groups reported in the diagnostic work that on average have been with their provider for less time include private renters with children, those with low credit scores, unemployed renters and those with contents only insurance. Firms also tend to earn lower margins on groups of consumers who have been with the insurer for fewer years.

² Not all firms in the sample for the diagnostic work were able to provide data on each sub group, so some of the subgroup information is based on a small sample of firms. In the market study we will explore the impact of different consumer characteristics at a more granular level.

- The sub groups reported in the diagnostic work that on average have been with their provider longer includes those who are over 65 years old, those who pay monthly, those who auto-renew, those who have made previous claims³ and those who have buildings only insurance. Firms also tend to earn higher margins on groups of consumers who have been with the insurer for longer.

2.11 The findings described in paragraphs 2.9 and 2.10 provide us with the average picture across consumers. The market study will give us a deeper understanding of the drivers of different outcomes for individual consumers over time, and for specific groups of consumers, in particular those who may be vulnerable.

2.12 Other forms of pricing can also lead to different consumers paying different prices for similar products. These include the pricing of add-on products⁴, different charges for paying monthly or annually, or by varying the quality or level of insurance coverage. Each of these could impact on the overall price that a consumer will pay for their cover.

3 After taking into account the risk premium impact of the claim.

4 Our general insurance add-ons market study showed that consumers pay less attention to add-ons, instead focusing on the primary insurance product, and therefore buy add-ons that they do not need or understand.



3 Scope of this market study

Markets in scope

- 3.1** We will focus on pricing practices for home and motor insurance. These are two of the largest general insurance markets and these products are widely held across the UK population. They also have common features. They use personalised pricing based on the specific personal characteristics and histories of consumers, and consumers usually pay a different price at renewal.

Parties in scope

- 3.2** There are different parties involved in supplying home and motor insurance. This ranges from those who provide or sell insurance directly to consumers, to third parties such as brokers and digital comparison tools. Not all of them set the price consumers pay for insurance, but they do influence how competition works and therefore the prices paid by consumers. All of the parties described in this paragraph are included in the scope of this market study.

What is not in scope

- 3.3** There are other general insurance products such as health, pet and travel insurance that are not included in the scope of this market study. However, where possible, we will identify lessons from this study that are relevant to other markets that we regulate. Insurance for small and medium sized enterprises is also not in scope.
- 3.4** The CMA published findings from its private motor insurance market investigation in 2014. The issues investigated by the CMA were not primarily related to pricing practices. For example, the CMA identified problems with the claims process and agreements between price comparison websites and insurers that could restrict competition. The CMA also identified problems with price information relating to private motor insurance add-ons. The CMA made recommendations to the FCA to consider in relation to improving the availability of information about add-ons and enabling consumers to compare prices. We have taken steps to address these issues, in particular banning opt-out selling and improving information provided to consumers buying add-ons ([PS15/22](#)). We will not re-examine the issues looked at by the CMA in our market study, except for add-ons. We will look at add-ons in the context of assessing whether different business models that have developed in the home and motor insurance markets deliver good outcomes for consumers.

4 Issues this market study will look at

4.1 The market study will look at 3 key areas:

- Harm from pricing practices and what drives this.
- The fairness of pricing practices.
- The impact of pricing practices on competition.

4.2 More detail of our intended analysis in each of these areas is below.

Harm from pricing practices and what drives this

4.3 Our diagnostic work shows that on average longstanding consumers pay prices for home insurance that are higher than those paid on average by newer consumers. We need to understand the scale of any harm created by pricing practices, including the proportion of consumers that may pay very high prices, who they are and their characteristics. For example, within the group of longstanding customers, some may have recently negotiated with their insurer a price similar to the new business price, while others may simply pay their proposed renewal price.

4.4 We also need to understand what drives firms to price differently and some consumers to engage and pay less than others. This is essential to inform consideration of whether remedies are needed and if so what they should be.

4.5 We will look at:

- The differences between prices paid for insurance by different consumers compared to the cost of providing them with insurance.
- How many consumers are affected by paying higher prices.
- The characteristics of consumers paying higher prices, especially the extent to which these consumers may be vulnerable.
- Why some consumers end up paying higher prices.

The fairness of pricing practices

4.6 Given the disparity of prices that consumers may pay for insurance, we will consider the fairness of the contrasting outcomes from pricing practices. In conducting this analysis, we will use our framework for dealing with questions about fairness of prices in financial services, which is set out below and was published in our research note: [Price discrimination in financial services. How should we deal with questions of fairness?](#)

Figure 2: 6 evidential questions to help assess concerns about fairness in price discrimination

	- Lesser concern	Greater concern +
Who is harmed by price discrimination?	Wealthier consumers – eg time poor, cash rich	Consumers with characteristics which might be deemed vulnerable (eg low income, old age, etc)
How much are these individuals harmed?	Profitability difference between consumer segments is minimal and is immaterial to the harmed segment	Significant profitability differences and the harm has a significant adverse effect on the segment affected
How significant is the pool of people harmed?	Very small minority	Significant group of consumers
How are firms price discriminating?	Transparent and based on behaviour which consumers can easily change (eg switching)	Hidden and based on intrinsic characteristics which consumers cannot easily change (eg personal characteristics)
Is the product/service essential?	Product/service is considered non-essential but desired by some consumers	Essential product/service (eg current account or motor insurance)
Would society view the price discrimination as egregious/socially unfair?	Little concern expressed about practices and firm behaviour widely accepted	Persistent and broad-based concern expressed and firm behaviour seen as poor conduct

- 4.7** We will examine how firms treat different groups of consumers and what impact this has on pricing outcomes. We will assess:
- Firms' pricing models and strategies and whether this leads firms to take advantage of particular consumers.
 - The information that firms provide to consumers when they renew insurance.
 - The impact of contractual terms, such as auto-renewal.
 - How firms address their responsibilities to treat customers, including vulnerable consumers, fairly.
- 4.8** We will also look at the consumer perspective in considering the fairness of outcomes. We will use consumer research to understand consumers':
- Understanding of how general insurance pricing works.
 - Attitudes to their provider and insurance products, including why they decide to switch or not.
 - Perspectives on the fairness of outcomes from pricing practices.

The impact of pricing practices on competition

- 4.9** We will analyse whether pricing practices are conducive to effective competition. The key areas we will investigate are below.
- What impact do pricing practices have on coverage and access to insurance?**
- 4.10** We will assess what impact pricing practices have on the access and level of insurance coverage consumers have. Charging some consumers lower prices may mean they can afford insurance that they would not have been able to previously. On the other hand, consumers may not know how to get better deals or be able to afford higher renewal prices and choose to become uninsured.
- Are firms making high profits overall in these markets?**
- 4.11** We will explore what impact pricing practices have on profitability of firms and how this varies between different business models and parts of the supply chain.
- Does the current nature of competition lead to excessive costs?**
- 4.12** Consumers who do not regularly switch or negotiate with their general insurance provider may pay higher prices. This can encourage more active consumers to shop around and switch for better deals. However, there are 2 potential consequences from this. The first is that firms may be able to take advantage of inert consumers. The second is that the need for consumers to regularly search and switch can create costs for both consumers and firms. Consumers may spend lots of time searching for other deals. Firms may need to spend large sums on trying to attract new customers, which could also increase the cost of supplying insurance. We will analyse the extent and prevalence of these in the home and motor insurance markets and their impact on consumer outcomes.



Does the current nature of competition lead to barriers to entry or expansion in the market?

- 4.13** Some firms have a large number of longstanding consumers paying higher prices. We will assess the extent to which this is a barrier to entry and expansion and the impact it has on competition. We will also look at what new and different business models have developed to enable firms without a large number of longstanding consumers to compete, and whether these business models result in good outcomes for consumers or raise concerns.

Potential remedies

- 4.14** Our goal is to ensure that general insurance pricing practices deliver competitive and fair outcomes for consumers. If harm is identified, we will take appropriate and proportionate action to tackle it, and to achieve fair outcomes and improve competition in the interests of consumers.
- 4.15** Any potential remedies arising from this market study will be proportionate to the degree of harm identified. Although we have not pre-judged the outcome of this market study, potential remedies that we might examine further could include:
- Changes to the way that firms price insurance.
 - Contractual changes, such as limiting auto-renewal.
 - Limits on differences in prices between different groups of consumers.
- 4.16** When considering remedies, we will explore whether technology-based and innovative solutions could help deliver better pricing outcomes for consumers. If so, we will look at how we may be able to encourage and facilitate this. We will also learn from models of general insurance pricing in other countries, and the impact these have on consumer outcomes.

Q1: Do you have any views about whether pricing practices for home and/or motor insurance may cause harm? If so, please explain how and which consumers this affects.

Q2: Do you have any views about the fairness of outcomes from pricing practices for home and/or motor insurance? Please provide evidence to support your views.

Q3: Do you have any views on the impact on competition of pricing practices for home and/or motor insurance? Please provide evidence to support your views.

Q4: Do you have any views on the appropriate way to remedy any harm or any concerns about fairness or competition that you identify under Q1, Q2 and/or Q3?

Q5: Do you have any examples of international models of general insurance pricing that work well for consumers and competition? Please provide details of any examples.

5 Next steps

- 5.1** We are conducting this market study under the powers given to us by FSMA. We are not formally consulting on these terms of reference. However, we welcome any views on the scope of the market study and the specific questions in Section 4. Please send these to GIPricingPractices@fca.org.uk by 3 December 2018. We will also engage directly with stakeholders to gather their views and gather specific data from firms and third parties. We will begin discussions on this shortly.
- 5.2** We also encourage stakeholders to send comments and any accompanying evidence on the questions in our discussion paper on fair pricing in financial services by 31 January 2019. Details of how to respond are in the discussion paper. Although the discussion paper has a wider scope than this market study, feedback received will inform the findings of this market study.
- 5.3** We aim to publish an interim market study report in Summer 2019 setting out our preliminary conclusions including, where appropriate, a discussion of potential remedies. We aim to publish our final market study report and, where relevant, a consultation on proposed remedies by the end of 2019.
- 5.4** If we find that competition is not working well in these markets, we may intervene to promote more effective competition. We can do this in several ways, including:
- Making rules.
 - Publishing general guidance.
 - Proposing enhanced industry self-regulation.
 - Introducing firm-specific remedies or taking enforcement action under FSMA or the Competition Act 1998.
 - Proposing removal of existing rules that create disproportionate barriers to entry, expansion or innovation.
 - Referring one or more features of the market to the CMA for further investigation – this is known as a market investigation reference.
- 5.5** We may decide to take no further action. This could be because we do not identify any concerns that can be proportionately addressed by regulatory intervention, or we consider that concerns are likely to be addressed by upcoming legislative measures or action by the relevant firms. We may monitor the market in case our concerns are not addressed. Where we find issues that fall outside our remit, we will continue to work collaboratively with a wide range of stakeholders to ensure that we influence and inform debate and policy to ensure best outcomes for consumers.
- 5.6** For more information on our market study powers and procedures please see our [market studies and market investigation references guidance](#).



Annex 1

Abbreviations used in this paper

CMA	Competition and Markets Authority
FCA	Financial Conduct Authority
FSMA	Financial Services and Markets Act 2000

We have developed this work in the context of the existing UK and EU regulatory framework. The Government has made clear that it will continue to implement and apply EU law until the UK has left the EU. We will keep the proposals under review to assess whether any amendments may be required in the event of changes in the UK regulatory framework in the future.

Despite this, we may be asked to disclose a confidential response under the Freedom of Information Act 2000. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the Information Commissioner and the Information Rights Tribunal.

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