General Insurance Pricing Practices
Market Study Team
Competition Division
Financial Conduct Authority
12 Endeavour Square London
E20 1JN

15 November 2019

AFM Response to FCA on its Market Study on General Insurance Pricing Practices

1. I am writing in response to this consultation paper, on behalf of the Association of Financial Mutuals. The objectives we seek from our response are to:

- Comment on the issues raised in the Market Study; and
- Highlight the risks of implying the findings identified apply equally in different GI products and/or business models.

2. The Association of Financial Mutuals (AFM) represents insurance and healthcare providers that are owned by their customers, or which are established to serve a defined community (on a not for profit basis). Between them, mutual insurers manage the savings, pensions, protection and healthcare needs of over 30 million people in the UK and Ireland, collect annual premium income of £19.6 billion, and employ nearly 30,000 staff[1].

3. The nature of their ownership and the consequently lower prices, higher returns or better service that typically results, make mutuals accessible and attractive to consumers, and have been recognised by Parliament as worthy of continued support and promotion. In particular, FCA and PRA are required to analyse whether new rules impose any significantly

[1] ICMIF, https://www.icmif.org/publications/market-insights/market-insights-uk-2016

different consequences for mutual businesses[2] and to take account of corporate diversity[3].

4. This Market Study represents an important and significant piece of work for the FCA. General insurance products offer important protections to all consumers and businesses, and whilst the report focused on the more ubiquitous forms of motor and home insurance, the lessons are relevant across the broader range of general insurance solutions available.

5. The vast majority of premium income amongst AFM members is collected in non-life/ general insurance products, albeit much of this is in B2B general insurance, medical indemnity and healthcare, rather than motor and home cover for retail consumers. Included within our members are organisations who fall outside the main data gathering undertaken by FCA for their interim report, including:

    a. Smaller mutual insurers, who generally operate in particularly niches where the suppliers of cover are limited due to the lower profits available;
    b. As mutual and not-for-profits providers, the primary focus of the business is on securing the best interests of the customer rather than maximising returns to shareholders, and therefore pricing priorities are generally different, and profit levels lower;
    c. Where the profile of insurer revenues in general insurance is the polar opposite of the profile provided in figure 2 of Annex 2 (which indicated 89% of revenue from home and contents cover across the market, and where the comparison for AFM members is around 7%); and
    d. A number of relatively new GI providers, many of whom have faced significant barriers to building scale- through the actions of existing market forces.

6. Our response will therefore seek to relate the experiences of the market study to our experiences in aggregate and we have not therefore sought to respond fully on all aspects of the findings in home and motor insurance. Similarly, we made an extensive response earlier this year to FCA's consultation of general insurance value measures, which of course seeks to address similar concerns about the competitiveness of the market[4]. We note FCA is in the process of aligning further these projects, and the work on vulnerable customers is an obvious fit too.

[2] Financial Services Act 2012, section 138 K: http://www.legislation.gov.uk/ukpga/2012/21/section/24/enacted
[3] http://www.legislation.gov.uk/ukpga/2016/14/section/20/enacted
[4] https://financialmutuals.org/files/files/AFM%20response%20to%20FCA%20CP%20on%20GI%20value%20measures%20reporting.pdf

However, the brief treatment in the paper of the work on value measures, in paragraph 7.43, indicates FCA intends to press ahead with proposals which we consider are not well-formed and which may be detrimental to some consumers.

7. We have responded to the specific questions raised in the consultation below, and would welcome the opportunity to discuss further the issues raised by our response.

Yours sincerely,

Martin Shaw
Chief Executive
Association of Financial Mutuals

Responses to the questions raised in the consultation

Q1: Do you have views on the interim findings set out in this report?

Many of the interim findings are familiar and recognisable. Indeed, we have long advocated the need for this kind of work to identify circumstances in which the market currently works well, but also the risk that some consumers may get a bad deal.

In our view, practices such as ‘price walking’ help to undermine the public’s trust in the insurance industry which has a negative impact overall: for example, a lack of trust can lead to a greater propensity to commit claims fraud.

However, we are concerned that the interim findings represent a fairly narrow view of the market, focused on a small number of large providers in two product areas. Hence, the findings are not likely to be representative of the market as a whole, and we seek assurance that the FCA will exercise extreme caution in applying any general lessons from this review.

We are equally concerned that the analysis might be interpreted by claims management companies as an opportunity for creating new business lines post-PPI. Whilst some consumers have received a bad deal, the case presented by FCA does not clearly demonstrate systematic mis-selling at this stage, and we suggest FCA makes clear that the evidence does not amount to the conditions for opening up the possibility of mass claims.

That is not to say that in a competitive market firms should not be able to take an active approach to pricing products against a wide range of factors, including those that go beyond underwriting and claims experience. However, we are concerned that, for the reputation of the sector and the good of consumers, FCA acts effectively where it sees clear evidence of exploitative pricing- such that consumers pay more because the insurer does not believe they either can or would seek to transfer to another provider.

Looking beyond retail consumer home and motor insurance, we have witnessed and supported in recent times the creation of new mutual competitors in specific markets. Often this is the result of potentially exploitative pricing by incumbent insurers and brokers in markets where there is limited competition. New mutuals have therefore been created in recent times in education (2018), local government and self-employed IT contractors (2019) and independent schools (going live in 2020). In each of these cases, members of an industry have pooled resources and experience.

This is typically in response to a lack of competition for cover that has resulted in higher prices and cosy relationships between brokers and commercial insurers, as well as poor claims experiences. In these cases, pricing is one of the factors that have created barriers to entry for new mutuals to compete with incumbent insurers. We have also seen defensive action, by insurers and brokers, to misinform consumers, which has created the possibly most significant barrier to new entrants. This may include pricing, by heavily discounting prices in the short-term to see off competitors and in the knowledge that prices can be increased again after the potential competition has been seen off[5].

To illustrate the risk posed in some cases, a recent government consultation cited that the costs of insurance (including buildings cover) in academy trusts via commercial insurers amounted to an average of £50 per pupil, until a self-insured solution was created that halved that cost[6]. We would welcome the opportunity to explore these issues further with FCA and the CMA.

Q2: Do you have views on the potential remedies we propose to focus on? What are the potential benefits, challenges and unintended consequences that may arise from these?

Experience from other markets demonstrates that consumers do not always act rationally. Behavioural economics identifies that decisions are not always driven by a logical, ordered or conscious mind. Mutuals work by offering a route to market that puts the policyholder at the centre of decisions.

Elsewhere, Ofgem reported in 2019 that over half of energy customers remain on costly default tariffs, whilst the regulators has frequently had to intervene when customers transfer to fledgling providers who subsequently fail. We would be concerned therefore that within insurance, consumers might risk loss of cover if FCA concludes they should not be permitted to renew cover with an existing provider, and there are few if any relevant alternatives, or the customer does not act on the prompt to renew.

We would like to see FCA undertake further research with consumers focussed on why some people stay with a particular provider over long periods of time. In our experience, many consumers do not change provider because they *can't*, as well as those that stay with the same supplier because they don't *want* to change. Smaller mutual providers for example often work in targeted niches; there are many mutuals for example that offer protection products to people with pre-existing health problems or who work in a particular profession, or for

[5] For an interesting overview of actions taken to kill off the development of local authority mutuals in England and Scotland in the first decade of this century, read: https://link.springer.com/article/10.1057/gpp.2009.3. The paper highlights aggressive action to exclude new competition in markets where price had risen by 92% in two years.
[6] See: Extending the Academies Risk Protection Arrangement (RPA) to Local Authority Maintained Schools (LAMS), September 2019

people who are unable to find affordable cover via mainstream providers such as those covered in the FCA review work to date.

We are concerned that FCA is therefore applying lessons from a limited sample of firms to a wider group of organisations, and whilst the FCA sample has width in terms of market share, the limited range of organisations means it does not address different providers, in different markets, pursuing different business objectives. We saw this concern also in the FCA work on GI value measures, and were critical there as well on the apparent lack of desire to investigate more widely, or to assess the different consequences of their proposals on a wider marketplace.

FCA interventions on prices and how they are set by insurers are in our view necessary, due to the exploitative issues FCA identifies in its paper. However, such interventions could have structural consequences for the market, the exact nature of which are hard to predict, and which therefore warrant a wider research base. For example, some consumers could suffer higher prices for cover, and the withdrawal of cover at renewal. In other cases, with the signal from FCA that price is paramount, some providers will seek to remove valuable features and consumers risk being unable to make claims for elements that were previously covered. Some consumers may be forced to move from their preferred provider to an inappropriate alternative.

For small providers, responding to FCA requirements is likely not to be proportionate, so the cost per policy of complying with new rules will be higher for specialist mutuals. As stated in paragraph 3 of our introductory letter, we expect that any proposals for new rules will include a thorough assessment of the likely impact on corporate diversity as well as on the consequences for small mutuals offering specialist products in niche markets.

Pricing may only be part of the challenge though: developing products with appropriate and relevant features, and providing the basis by which the customer can claims with confidence are equally as important, as our experiences of new mutuals setting up indicates.

Hence whilst FCA promotes price comparison websites as part of the 'long-term reform' of the market, there is a risk that as currently constructed, PCWs give an unhealthy priority to price. For this reason, and because of the high commissions and complex broker-provider relationship, many mutuals prefer to help consumers find a better deal directly rather than feature on PCWs. We consider there is scope for FCA to ensure PWCs make more balanced comparisons, and make clearer differences in product features and claims experiences between providers.

With regard to the proposals FCA is exploring, to address high prices for consumers who do not switch or negotiate, we consider there is scope for FCA to act on potential price discrimination via, for example, the practice of 'margin optimisation'. To an extent, insurers that adopt this approach might argue that this is part of the general trend towards personalisation of GI pricing. We do not accept that this approach is necessarily in the best interests of customers: "*It's built upon inherent partiality, and will progressively feel exclusionary, rather than complete and inclusionary. Therein lies its fatal flow.*[7]*"* To be able to effectively ban this practice though, FCA would need to be able to satisfy itself that the margin on each product sold by a company was the same: this would be an extensive exercise and the results may not enable customers to make a fully informed decision due to the assumptions and detailed required.

We agree that a requirement for firms to provide data to enable the FCA to monitor price differentials with a view to follow up actions with specific firms sounds sensible, although it does depend on the data that is required and the proportionality of the exercise. We also agree that a requirement for firms to publish information as to their pricing practices could lead to greater public scrutiny and therefore improved insurer behaviour. Again, it would depend on the information requirement.

In the energy industry, providers now need to explicitly state the availability of lower priced products, though the level of differentiation in insurance products would make this exercise less meaningful, and risks consumers focusing on price solely, to the exclusion of considering properly the product features and standard of service that they require.

Whilst we do not advocate the removal of auto-renewal of policies, due to the greater consumer harm that might result, we see a strong argument for making auto-renewal opt-in at initial purchase, and that this is renewed every three years. We consider firms should also give consumers the chance each year to cancel auto-renewal via a straightforward method.

Q3: Do you have views on the potential remedies that we propose not to focus on? What are the potential benefits, challenges and unintended consequences that may arise from these?

The price of a product may not always be entirely set by the insurer, as stated in the FCA paper. Indeed, profit margins for insurers are significantly lower than those for intermediaries and PWCs.

Where a broker or PWC has discretion over the price set to the consumer, they should state this clearly and provide the consumer with information about the manufacturer's (provider's) cost, the commission they receive, and any additional charges that make up the original price. Similar transparency should

[7] Arguments against personalised pricing are covered comprehensively in this article: https://ethicsandinsurance.info/2018/03/08/personalisation/.

be provided for administrate charges and any add-on finance or product elements.

We agree that FCA should not mandate a requirement for multi-year contracts, or a single switching/ renewal period. We do not consider either of these options will address the issues FCA is seeking to address.

Q4: Do you think there are other remedies that we should be considering? If so, what remedies and how do you think they would address the harm we have identified?

We consider that as part of the FCA work to improve transparency of general insurance pricing, it might be viable to consider whether broader disclosure of commission received by PCWs and brokers would be of benefit. This might expose further some of the excessive commissions paid and some of the anomalies in certain markets, as highlighted in the interim report, as well as offering another opportunity for pricing to revise downwards and/ or enable greater competition on the basis of what is in the best interests of the customer, rather than price.

We would suggest that a pilot process is established in the first instance, with hard disclosure of commission in £ terms, to understand better whether this is likely to have an impact on the market more generally.

We see transparency of commission rather than banning it as a better outcome at this stage.

Q5: Are you aware of potential changes or innovations in the home and motor insurance markets that may address the harm we have identified? If so, what are these and how will they address the harm and are there any potential unintended consequences?

We recognise the developments highlighted in paragraph 3.26 and consider that currently these are the most significant market developments.

Contrary to the theory that customers who stay with a provider for an extended period get a poor deal compared to a new consumer, we have seen some mutual providers, such as NFU Mutual, provide a loyalty discount to existing customers[8]. AFM's work on The Loyal Company provides a basis by which our members can demonstrate how they deliver loyal to customers and other stakeholders[9].

[8] https://www.nfumutual.co.uk/about-us/mutual-bonus/
[9] https://www.financialmutuals.org/governance/the-loyal-company/