

# General Insurance Pricing Practices



## Time for action

For many years the impact of pricing practices in retail General Insurance, and Home and Motor Insurance in particular, have regularly featured in the media as a source of enormous customer frustration.

Whether it relates to how data is used (“fleece by the insurance spies”<sup>1</sup>), the seemingly inexplicable movements in premiums as personal details are updated (“widower hit with higher insurance”<sup>2</sup>) or how premiums can increase over time (“elderly, loyal and charged 10 times more for insurance”<sup>3</sup>), pricing practices have long undermined consumer trust in the sector.

## Price disconnect

Over time the pricing of retail General Insurance products has become ever more sophisticated, leveraging the explosion in data availability and analytical capabilities. The underlying cost of insurance – the expected cost of claims and cost of service – has become disconnected from the ultimate price charged to customers. Many firms use “price optimisation” techniques and extensive data enrichment to incorporate behavioural characteristics of customers into prices, such as propensity to renew, rather than just reflecting variation in risk.

## Over time the pricing of retail General Insurance products has become ever more sophisticated, leveraging the explosion in data availability and analytical capabilities.

This is not necessarily unreasonable, and there are many markets where price discrimination is an accepted practice. The General Insurance market has certain features, such as the mandatory nature of some products, the difficulty some consumers have in comparing products and the relatively low level of engagement some consumers have with their insurer. These features do mean that particular care is required to ensure that the Financial Conduct Authority’s (FCA) expectations of a market that offers “high quality, good value products ... [that are] competitively priced” are met.

## Protecting vulnerable customers

It has been long argued that the UK General Insurance market is one of the most competitive markets in the world. Whilst this may well be the case, there is also evidence that there are segments of consumers, many of whom are vulnerable, who are not receiving value for money from their insurer. Citizens Advice have investigated the “loyalty penalty” in a number of markets, including Home Insurance where they have estimate the annual cost is £709m, or £57 per customer.

The Competition and Markets Authority (CMA), in response to the Citizens Advice super-complaint, agree there is clear evidence of harm and note that the loyalty penalty is often paid by those least able to afford it.

In response, regulatory, Government and media scrutiny continues to intensify, most recently evidenced in the publication, by the FCA, of

- A Thematic Review of Pricing Practices in Household Insurance and accompanying ‘Dear CEO’ letter
- A Discussion Paper on Fair Pricing in Financial Services
- The launch of a Market Study into General Insurance Pricing Practices.

We should also not forget the potential extension of the publication of Value Measures to cover most General Insurance products as well as the requirement, under the IDD, to adhere to the ‘customer’s best interest rule’.

## There is much more to do

There is much for insurers to do in response. And, indeed, many in the industry want to act – the ABI and BIBA Guiding Principle and Action Points are a welcome step forward in ensuring insurers and intermediaries consider the impact of pricing decisions on long-standing customers and strengthen senior management oversight of outcomes from pricing.

Action should not just be taken in response to regulatory expectations, but in order to build trust in the market and demonstrate that customers are at the heart of firms’ strategies.

<sup>1</sup>Mail on Sunday, 25th May 2018

<sup>2</sup>The Times, 1st February 2019

<sup>3</sup>The Times, 14th May 2017

## A seven point plan

Firms should have a clear action plan in place with Board and ExCo visibility. This plan should include:

-  **1) The development of a clear pricing strategy** which articulates how customers are offered value for money. This needs Board oversight and challenge and must consider the business model implications of alternative approaches. A definition of value is required, with an associated risk appetite framework to enable ongoing monitoring of the extent to which the value offered to customers is understood.
-  **2) An assessment of the impact of pricing on different customer segments** with particular focus on long-standing or vulnerable customers. The customer outcomes arising from pricing must be incorporated into decision making and there must be adequate Board visibility of these outcomes in conduct risk reporting.
-  **3) An evaluation of the resilience of business models** to different potential regulatory remedies, together with high level planning should particular remedies be adopted.
-  **4) Implementing appropriate governance, control and reporting** to ensure that the agreed pricing strategy is implemented in practice. This should include, consideration of the Senior Managers & Certification Regime, ensuring adequate challenge from the 2nd line decision making frameworks and Board/ExCo reporting.
-  **5) A review of operational considerations relating to pricing**, such as how pricing messages are explained to customers in marketing material or other customer engagement communications and how complaints are handled.
-  **6) Documentation of pricing processes with potential risks to customers identified and managed.** Where technical pricing and retail pricing is separated, and where price optimisation is used, constraints should be in place to ensure that value for money checks continue to be met.
-  **7) A review of the use of data within pricing.** Sources of internal and external data must be understood and appropriately governed with consideration given as to why the data used is reasonable and will not give risk to unfair outcomes. It is critical that “unintended consequences” of pricing approaches and use of data is considered to mitigate the risk of indirect discrimination, as highlighted by the FCA, or the reputational risk associated with variation in price that is not easily explained.

This is a hugely complex area with profound implications for business models – we recognise that it is not possible to address all these points overnight and many firms will have been busy responding to the FCA Market Study in recent months. However, finalising the submission is not the time to pause for breath, rather it is time to redouble efforts to tackle the issues that have been raised. This is a pivotal time for the industry – it is a time for action if consumer trust is to be regained.

## [kpmg.com/uk/futureinsurance](https://kpmg.com/uk/futureinsurance)

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

© 2019 KPMG International Cooperative (“KPMG International”), a Swiss entity. Member firms of the KPMG network of independent firms are affiliated with KPMG International. KPMG International provides no client services. No member firm has any authority to obligate or bind KPMG International or any other member firm vis-à-vis third parties, nor does KPMG International have any such authority to obligate or bind any member firm. All rights reserved.

CREATE. | CRT108039A | February 2019

## How KPMG can help you

With our combination of Actuarial, Pricing, Regulatory Risk and Competition Economics expertise KPMG is uniquely placed to support you in the months ahead.

We can work with you to:



**Review your market study response** and support the identification of potential risks arising; assessing the potential remedies and analysing business model implications; high level planning in response.



**Assess your plans in response** to regulatory engagement, ensuring issues raised through the ‘Dear CEO’ letter and thematic review are addressed.



**Provide support with any of these issues:**

- Pricing strategy development and evaluation, including value measures and risk appetite
- Testing pricing outcomes for current customers and identifying risks
- Reviewing pricing processes, governance (including SMCR), controls and reporting
- Reviewing how pricing practices are reflected in operational processes
- Assessing approaches to the use of data and any resulting risks.

## For further information, please get in touch:



Dave Lennon  
**Director, Regulatory Risk**

M: +44 (0)7585 401164  
E: [dave.lennon@kpmg.co.uk](mailto:dave.lennon@kpmg.co.uk)



James Hillon  
**Director, Actuarial**

M: +44 (0)7468 351269  
E: [james.hillon@kpmg.co.uk](mailto:james.hillon@kpmg.co.uk)