FAIR BY DESIGN
Ending the extra costs of being poor

FINANCIAL CONDUCT AUTHORITY (FCA) INVITATION TO COMMENT: "GENERAL INSURANCE PRICING PRACTICES" TERMS OF REFERENCE

NOVEMBER 2018

1. INTRODUCTION

1.1. Fair By Design welcomes the Financial Conduct Authority's invitation to comment on the "General Insurance Pricing Practices" Terms Of Reference.

1.2. Please note that we consent to public disclosure of this response.

1.3. For more invitation about this response please contact Lucie Russell, l.russell@barrowcadbury.org.uk Tel: 020 7632 9070.

2. ABOUT FAIR BY DESIGN

2.1. Fair by Design is a movement dedicated to reshaping essential services, like energy, finance and insurance, so they don't cost more if you're poor.

2.2. People in poverty pay more for a range of products including expensive energy tariffs for pre-payment meters, high cost loans, rent to own products such as kitchen appliances, and insurance in poorer postcodes. This is known as the Poverty Premium.

2.3. We collaborate with industry, government, and regulators to design out the Poverty Premium, and raise awareness amongst the public to bring about change.

2.4. Our venture fund provides capital to help grow new and scalable ventures to innovate the market.

2.5. Fair by Design was conceived by the Joseph Rowntree Foundation and Big Society Capital and is being led by the Barrow Cadbury Trust.

RESPONSE TO FCA INVITATION TO COMMENT: "GENERAL INSURANCE PRICING PRACTICES" TERMS OF REFERENCE

1. 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:

1.1. Previously insured, priced out households

1.1.1. Fair By Design is concerned about households that were previously insured, but whom now are uninsured due to being priced out. Previous research by the Joseph Rowntree Foundation[1] – which has not since been replicated, but for which there is a need – found that just under half of low income households without an insurance policy have had one in the past, but have let it lapse. JRF also found that in the round this was associated with financial difficulty, causing people to reassess their need for home contents insurance. Most commonly, participants in the JRF research said that they would have liked insurance but could not afford it. We would like to see this research replicated, and in particular this question of previously insured households letting policies lapse, but certainly we would note that there is potentially a market for a lower cost 'basic' insurance product for home and motor insurance, with a demand from currently uninsured low income households.

1.1.2. While recognising the risks in doing so, if we were to assume that around half of those uninsured low income households (61 per cent of people earning under £15,000[2]) have previously been insured and would wish to be if the cost of insurance was affordable, there is a market demand of at least 4.27m people[3].

1.1.3. For our submission we interviewed a group of people on low incomes about their attitudes and decisions on insurance. One person who was previously insured but is now priced out told us the following: "Just being able to afford stuff is the main concern for me at the moment, but I do want insurance. For me to get insurance, I'd just have to budget better. At the moment I'm looking at contents insurance through my bank. It's because it's easier to do it with them and it comes straight out my bank account." (Jade, renter, two dependents).

1.2. Pricing practice identified: 'Price walking'

1.2.1. Fair By Design is concerned about the practices of 'price walking', which leads to households paying the 'loyalty premium', particularly where this practice impacts upon those in poverty or very low incomes. We are concerned that the only forthcoming remedy for these premiums is consumer switching – primarily because this remedy rests on increasing consumer engagement alone and not market remedy per se. Where the particular remedy necessitates more

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[1] https://www.jrf.org.uk/file/38738/download?token=WI93RDNs&filetype=findings

[2] Based on the WPI Economics analysis of FCA Financial Lives Survey, unpublished, attached to our submission.

[3] This is based on there being 14m people in poverty (source: https://www.jrf.org.uk/report/uk-poverty-2017), and an equation of 61per cent of half of that figure. Analysis by Fair By Design.

consumer engagement alone, this penalises those consumers who are considered "disengaged" by virtue of their being either disconnected, or time-poor to the extent where having the ability to 'compare the market' is a luxury they cannot afford.

1.2.2. 'The insurance loyalty penalty' report produced by Citizens Advice found that across the UK, 12.9m households – 63 per cent of the home insurance market - are paying a 'loyalty penalty'. Someone with the average cheapest combined policy would pay an extra £13 after 1 year and £110 after 5 years. [4]

1.2.3. The Association of British Insurers Chairman Andy Briggs said: "The renewal market simply doesn't work where loyal customers get charged much more than new customers. Given many consumers expect to get cheaper insurance when they shop around, there is no easy solution."[5]

1.3. The characteristics of consumers likely to be paying higher prices as a result of firms adopting a 'price walking' strategy:

1.3.1. The FCA's Financial Lives survey, published in October 2017, suggests that half of UK adults have characteristics of potential vulnerability in relation to their financial resilience and capability. [6]

1.3.2. Potential vulnerability covers those who may suffer disproportionately if things go wrong; the reasons for this can vary from suffering a recent life event (such as redundancy, bereavement or divorce) to low financial capability i.e. managing money or knowledge about financial matters. The reason may also be a health-related problem.

1.3.3. **Those on low incomes or who are disabled** (though the two are not mutually exclusive) are less likely to actively engage in the market when an insurance policy is up for renewal.[7]

1.3.4. The reasons for inertia are two-fold. On the one hand, **low income consumers** are worried about their financial situation and have less capacity (literal and cognitive) to devote time to managing their utility suppliers.[8] This is known as a 'scarcity mindset'.

1.3.5. A study in Northern Ireland Executive Tenants found that, of the 70 per cent without contents insurance, almost half cited the reason as they "hadn't got round to it."[9]

1.3.6. However, lack of engagement can also be because of practical barriers. OFCOM found that low income consumers have less access to the internet. The

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[4] https://www.citizensadvice.org.uk/Global/CitizensAdvice/Consumerper cent20publications/Reportper cent20-per cent20Insuranceper cent20loyaltyper cent20penalty.pdf

5 https://www.abi.org.uk/news/news-articles/2018/05/insurance-industry-takes-action-on-excessive-differences-between-new-customer-premiums-and-renewals/

[6] https://www.fca.org.uk/publication/research/financial-lives-consumers-across-uk.pdf

[7] https://www.citizensadvice.org.uk/Global/CitizensAdvice/Consumerper cent20publications/Reportper cent20-per cent20Insuranceper cent20loyaltyper cent20penalty.pdf

[8] Citizens Advice, The Cost of Loyalty 2018

[9]https://web.archive.org/web/20180901161529/http://www.financialinclusioncommission.org.uk/pdfs/improving_access_to_household_insurance.pdf

proportion of adults in 'DE6' households who do not go online is almost double the UK average – 22 per cent vs. 12 per cent.[10]

1.3.7. In addition, more than a quarter (27 per cent) of **disabled consumers** have never used the internet [11][12] reducing their likelihood of obtaining a competitive premium as more business moves to digital.

1.3.8. Indeed, as many as 2.5 million disabled consumers feel that they are overcharged for insurance products.[13]

1.3.9. In the 12 months preceding August 2017, 35 per cent of disabled consumers worried about paying their insurance premium.[14]

1.3.10. This is likely because of the extra £570 a month already paid by disabled consumers, in relation to their condition.[15]

1.3.11. **Elderly consumers:** Nearly of quarter 65-74 year olds have not been online recently, defined as within the last three months.[16]

1.3.12. Given that price comparisons are most easily completed online, it is therefore unsurprising that a third (32 per cent) of those paying the loyalty penalty are over 65, compared with 23 per cent of the wider population.[17]

1.3.13. In 2016/17, 16 per cent of pensioners in the UK (1.9 million) were on low incomes (defined as less than 60 per cent median household income after housing costs).[18]

1.3.14. Mental Health Policy Institute's survey found that 82 per cent of **people with mental health problems** said the thought alone of switching and shopping around was exhausting. Nonetheless, more than two thirds (69 per cent) recognized that switching suppliers is the key to getting the best deal on essential services.[19]

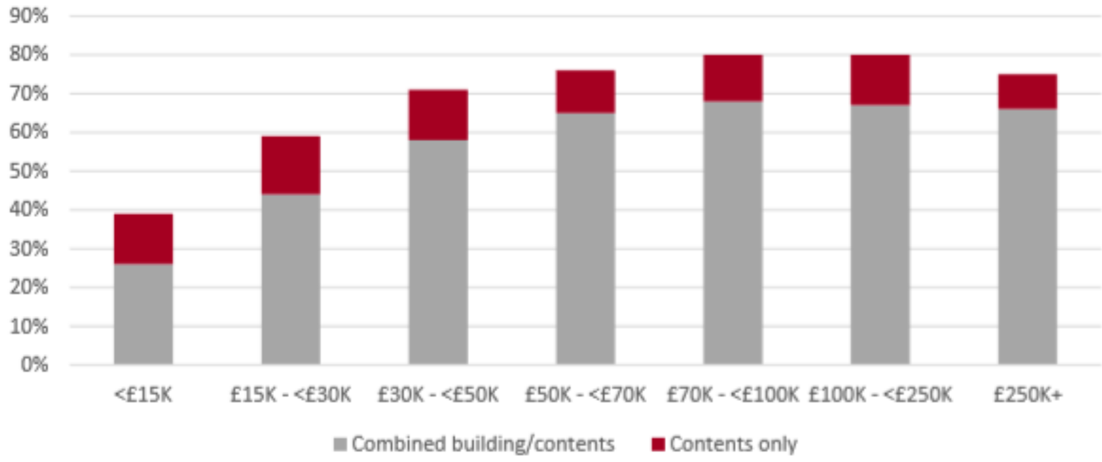
1.3.15. The penalty for inertia therefore forms part of the poverty premium, the extra costs of being poor. The practice of price walking is likely to amplify the Poverty Premium paid by low income consumers, calculated as an average of £27 per year for insurance.

1.4. Income deciles and insurance cover

1.4.1. An analysis of the FCA's Financial Lives survey by WPI Economics (attached to this submission) looked at take-up of home contents and motor insurance by income decile. They found that lower-income households have much lower

[10] https://www.ofcom.org.uk/__data/assets/pdf_file/0011/113222/Adults-Media-Use-and-Attitudes-Report-2018.pdf
[11] ONS: Internet Users, 2015, May 2015
[12] http://www.bristol.ac.uk/media-library/sites/geography/pfrc/pfrc1614-poverty-premium-key-findings.pdf
[13] Ipsos MORI: Disabled people and Financial Wellbeing, August 2013
[14] https://www.scope.org.uk/getattachment/Get-Involved/Campaigns/Campaigns-content/2016-WYSIWYG/Working-for-all-text/Improving-access-to-insurance-for-disabled-people-(August-2017).pdf.aspx
[15] https://www.scope.org.uk/Scope/media/Documents/Publicationper cent20Directory/The-disability-price-tag-Policy-report.pdf?ext=.pdf
[16] Age UK, Everything is online nowadays, 2018
[17] Age UK, Everything is online nowadays, 2018
[18] Age UK, Poverty in later life, 2018
[19] Money and Mental Health Policy Institute, Levelling the playing field. 2017

rates of contents insurance ownership.



Source: WPI Economics analysis of the FCA Financial Lives Survey[3]

1.4.2. As WPI Economics' analysis describes, this may in part be because lower-income households have a lower insurable need if they have fewer or lower-value assets in their home to insure – for example some items may be bought under rent-to-own agreements rather than owned outright, or owned by their landlord. In order to explore this more we would ideally be able to compare renters and homeowners with similar incomes, which is likely to explain at least some of the variation between contents insurance and income; just 28% of renters have standalone or combined contents insurance, compared to 83% for mortgagors and owner-occupiers.

1.4.3. While lower-insurable need is one explanation for lower rates of contents insurance, another is access and affordability. WPI Economics has supplied some evidence from a survey from the housing charity Shelter, in which the most common reason for not having insurance, cited by 42 per cent of respondents without home insurance, was that they couldn't afford coverage[20]. Also, research from the Joseph Rowntree Foundation found that low-income households were less likely to have contents insurance, and that many of these had previously had a policy but had let it lapse due to financial constraints[21].

1.4.4. WPI Economics identify what they call a 'latent poverty premium' for those individuals without coverage, which from the information above we identify as an occurrence that disproportionately affects those on low incomes.

1.4.5. Their analysis posits the following:

20 http://media.shelter.org.uk/home/press_releases/over_five_million_households_in_the_uk_have_no_home_insurance

21 http://www.jrf.org.uk/sites/default/files/jrf/migrated/files/spr348.pdf

1.4.6. If something goes wrong but the household does not have insurance, there are a number of options. Broadly these are to go without, to use savings, or to use credit. An uninsured household, therefore, faces a latent poverty premium even if no incident ever arises, because the prospect of an event that leads to them needing to take out high-cost credit, or to use up savings (which may simply push the latent premium a little down the line), is always looming in the background.

1.4.7. Low-income households are less likely to have built up savings to cover an emergency, and may lack access to (affordable) credit, meaning they may simply have to go without the relevant item, lowering their quality of life (and potentially leading to additional costs and inconveniences, e.g. going to a launderette rather than using a washing machine). As with needing to take out potentially high-cost credit, in this way, parts of the poverty premium interact.[22]

1.5. Interviews with low income consumers, conducted by Fair By Design found that:

1.5.1. "[I have] full nine years no claims [but] my insurance from last year to this year went up £100. [I am] penalised because someone had an accident. I pay it monthly - £24 per month. [I] don't know how much it is [yearly] without looking at the policy." (Jane, renter, no dependents, benefit recipient).

1.5.2. "When you're living on a budget: £160 a month pension, £60 on insurances is quite a lot of money." (Lucy, renter, retired)

1.6. Pricing practice identified: Geographic-based price discrimination

1.6.1. Data from the Association of British Insurers (ABI) shows how low-income households are often exposed to greater risks. For example: social-rented households are almost twice as likely to be burgled as owner-occupied houses; arson rates are 30 times higher in lower income communities than affluent ones; and low-income households are eight times more likely to be living in tidal floodplains than people in more affluent households. As a result, they are likely to be charged higher premium rates to reflect this risk. Whilst they may have less to insure than households with higher incomes, the total cost of insurance may be similar or even greater than that for a higher income household.[23]

1.6.2. The Consumer Council found that low income households in Northern Ireland pay £345 more for insurance (car, contents and buildings) than they would if they lived in similar areas in Great Britain.[24]

[22] P.12 of WPI Economics' analysis of insurance and the poverty premium, attached alongside this submission.
[23] https://web.archive.org/web/20180901161529/http://www.financialinclusioncommission.org.uk/pdfs/improving_access_to_household_insurance.pdf
[24] http://www.consumercouncil.org.uk/sites/default/files/original/Insurance_Report_FINAL_Web_version.pdf

1.6.3. Interviews with low income consumers, conducted by Fair By Design found that:

1.6.4. **"**Before I got divorced, I lived in a leafy suburb, now [it's] police and helicopters. I do think where you live has a big impact on what you have to pay." (Lucy, renter, retired)

1.6.5. **"**I've noticed a difference definitely. Used to live in [post code] BD9, now BD21, [car insurance] was higher in BD9 because it was the "rough side" – very deprived. Lots of differences between the haves and have nots." (Shirley, social housing, benefit recipient).

2. 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.

2.1.1. Just 53 per cent of insurance customers are confident they could identify unfair charges - so many are unlikely to act. Of those who identified an unexplained increase in their premium, only 7 per cent renewed without shopping around.[25]

2.1.2. The Chartered Insurance Institute found that nearly 1 in 5 adults (19 per cent) find the information provided by insurers to be hard to understand.[26]

2.1.3. 16 per cent of low-income households were apparently over-insured, holding both home contents and some other form of individual-item insurance. The Personal Finance Research Centre suggest it is likely that this reflects a risk aversion among these households, although it might also indicate that they have been 'sold' insurances which they do not need.[27]

2.1.4. Analysis by WPI Economics (attached with this submission) has assessed some of the reasons for why there is a lower uptake of insurance policies taken by low income households. One of the reasons put forward is that since insurance is important but not essential, an individual household may not be able to justify the costs of insurance if other essential and unavoidable costs take priority.

2.1.5. Some evidence of the above is provided by a survey from the housing charity Shelter, in which the most common reason for not having insurance, cited by 42 per cent of respondents without home insurance, was that they couldn't afford coverage[28]. Research from the Joseph Rowntree Foundation also found that low-income households were less likely to have contents insurance, and that

[25] https://www.citizensadvice.org.uk/Global/CitizensAdvice/Consumerper cent20publications/Reportper cent20-per cent20Insuranceper cent20loyaltyper cent20penalty.pdf

[26] https://web.archive.org/web/20180901161529/http://www.financialinclusioncommission.org.uk/pdfs/improving_access_to_household_insurance.pdf

[27] http://www.bristol.ac.uk/media-library/sites/geography/pfrc/pfrc1615-poverty-premium-report.pdf

[28] http://media.shelter.org.uk/home/press_releases/over_five_million_households_in_the_uk_have_no_home_insurance

many of these had previously had a policy but had let it lapse due to financial constraints[29].

2.1.6. Interviews with low income consumers, conducted by Fair By Design found that:

2.1.6.1. "I would consider getting insurance if it was a really low premium. Mainly to cover electricals. The excess charge needs to be affordable. Depending on the time of the month, maybe I would pay all up front. And I would have to consider how much the interest for paying monthly would be". (Rachel, social housing, four dependents).

3. 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.

3.1. Pricing practices such as 'price walking', particularly for disengaged customers is not conducive to effective competition. Instead, firms are making high profits from certain groups of consumers, especially those who are vulnerable. There is too great an emphasis placed on consumer switching to better deals, and reliance on individual agency.

3.2. In cases where premiums had risen year on year, eventually reaching levels that customers – or their relatives considered unfair – the Financial Ombudsman found that people had been counting on businesses to do the right thing.[30]

3.3. 1 in 3 customers purchased their policy over 5 years ago. These people could be paying up to 70 per cent more for a policy than a new customer.[31]

3.4. The Financial Ombudsman noted that "from the complaints we see, it's clear insurance is an area where people may feel they've been penalized for staying put. In particular, people who've stuck with their insurer for a number of years are telling us they've discovered they're paying far more than new customers – or more than they'd pay for similar cover elsewhere."[32]

3.5. To ensure households, particularly those on low incomes impacted by the poverty premium (e.g. the inability to pay upfront, instead in relatively more expensive monthly instalments), are not priced out of the insurance market altogether, one potential remedy, that we think the Financial Conduct Authority ought to consider, could be to regulate to eliminate the monthly payment premium. We feel that depending on the savings that this would potentially create for those low income households currently priced out of the market but have an insurable need, the demand might satisfy the potential losses to firms not able to recoup in full the current amount in monthly payments. A full economic analysis of this would be needed. Furthermore, a condition would be necessary to ensure firms don't seek to recoup lost costs through increasing premiums of low income households.

[29] http://www.jrf.org.uk/sites/default/files/jrf/migrated/files/spr348.pdf
[30] Financial Ombudsman Annual Review 2018
[31] https://www.citizensadvice.org.uk/Global/CitizensAdvice/Consumerper cent20publications/Reportper cent20-per cent20Insuranceper cent20loyaltyper cent20penalty.pdf
[32] https://www.financial-ombudsman.org.uk/publications/ombudsman-news/144/144-insurance-pricing.html

4. 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?

4.1. Potential remedies to the cost of insurance for low income households

4.1.1. An analysis of insurance access and the poverty premium, carried out by WPI Economics, commissioned by Barrow Cadbury Trust, considers the demand-side options for reduce the costs of insurance for those households impacted by the poverty premium. They consider the following:

4.1.2. **The scope for a 'basic insurance product'**: 'Basic' or 'simple' financial products have been raised as a potential solution to a lack of access to financial services regarding a range of products. Anyone with basic ID in the UK can open a basic bank account, which has no fees or charges and is available regardless of credit rating. More widely, the Simple Financial Products agenda following the Sergeant Review proposed such products should be available in relation to savings and fixed-term life insurance[33].

4.1.3. This was ultimately dropped in 2017 on the grounds that other work on the priority products was ongoing. However, a basic financial insurance product could have merit in reducing the costs of insurance. There would of course be questions of design to resolve, including:

4.1.4. - Eligibility: Which households would be eligible is a key question for any such product. The effects of this on competition in the wider market would need to be considered.

4.1.5. - Awareness: Eligible consumers would also need to be aware that the basic insurance product was available. This has been a challenge with basic bank accounts.

4.1.6. - Cost of premiums and how they might vary: If a basic insurance product is intended, the cost of premium will be a key factor, as will the extent to which that can vary if someone who is a higher risk applies for the scheme.

4.1.7. - Features of the policy: Insurance contracts include a combination of an excess (that must be paid before the insurance pays out), clauses (that restrict the insurer's liability in certain cases), and maximum payouts.

4.1.8. - Who would offer it: Whether all, or a specific set of, insurers would be required to offer it, or whether it would be a standalone scheme.

4.1.9. - How would it be paid for: The primary rationale for a basic financial product is that it is not economically viable for companies to offer them to certain groups of consumers. This suggests that there would need to be some form of subsidy for the products and related marketing – which could be from a levy on insurance providers, in a similar way as Flood Re.

4.1.10. There could also be an issue of adverse selection, whereby only higher-risk customers entered the scheme. This could increase the costs of the scheme to unanticipated levels, which could make it unsustainable over the longer term.

33 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/191721/se rgeant_review_simple_products_final_report.pdf

4.1.11. However, if these could be resolved, a basic insurance product could bring wider benefits than just its lower price. It could be seen as more trustworthy, and could also be, or be seen as, simple to apply for.

4.1.12. **Reducing the distinction between low-income and high-income households**: To the extent that insurance costs are higher for low-income households because of their greater perceived risk, one option could be to reduce the distinction between low- and high-income households. This could be done by restricting the criteria insurers can use in setting premiums, such as postcode (or income itself) in a similar way as has been done in motor insurance, where insurers are not able to use sex as a factor.

4.1.13. This effectively mandates greater pooling of risk, and spreads costs more evenly. However, there are a number of potential drawbacks. Most significantly, it may only prevent one route to a price distinction between low- and high-income households, rather than ending the distinction itself. Since the ban on varying premiums by sex was introduced, the difference between premiums paid by men and women has grown, which has been put down to other factors that correlate with sex (including professions)[34].

4.1.14. We have also not assessed whether the industry would adapt in other ways, for example by excluding whole postcodes from coverage, rather than varying premiums. While this has not happened in motor insurance, this is likely to be because sex-based discrimination is covered in the Equality Act, whereas income-based discrimination is not.

4.1.15. Another more promising option could be to prevent the current additional cost low-income households face from being unable to pay a year's premiums in one go. While this would slightly increase the costs of single premium payments, in a competitive market it should also reduce the costs of monthly payments. This might also lead to more consumers who currently pay annually to pay monthly (as they would receive no financial benefit from doing so), so more work would be needed to understand the impact this would have on the insurance market more widely, and any unintended consequences.

4.1.16. A further contributor to the higher costs faced by low-income households is likely to be engagement in the market and rates of switching. We have not assessed how this aspect of higher costs could be reduced, given the work we expect the CMA will be undertaking in this area across markets following Citizens Advice's super-complaint, but reducing this penalty would be likely to disproportionately benefit low-income households.

4.2. A basic insurance product

4.2.1. While more research is needed to assess the size of the market (see above, p.2), there is very likely a market for a basic insurance product that reduces the price for potential consumers who were once previously insured but allowed their policy to lapse based on the financial difficulties in maintaining payments, or who are priced out of the (contents and/or motor) insurance market by

[34] https://www.theguardian.com/money/blog/2017/jan/14/eu-gender-ruling-car-insurance-inequality-worse

virtue of costs. In which case companies need to develop lower-premium insurance products specifically for low income and vulnerable consumers, to mitigate against the loyalty penalty.

4.2.2. If low income consumers present higher risk for insurers (living in areas susceptible to crime, flooding etc.), while higher premiums to reflect the level risk are themselves not a market failure, a system akin to Flood Re could be developed. When the cost of the risk (burglary, arson etc.) climbs above a certain level, the insurer could place that part of the policy into a pooled fund where, in the event of a customer making a claim, the insurer will then be able to recover those costs associated with a payout.

4.2.3. These products need to be created using the principles of service user-centred design.

4.2.4. Addressing affordability issues and a subsequent higher take up rate could enable economies of scale, and address concerns around commercial viability.

4.2.5. Features could include a lower excess, and the removal of the premium for paying monthly.

4.2.6. We would recommend that the FCA’s Project Innovate consider supporting businesses and entrepreneurs seeking to innovate around lowering costs of insurance for low income households, and redoubling efforts to interest and target businesses and entrepreneurs involved in this work.

5. 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.

5.1. N/a