FAIR BY DESIGN
Ending the extra costs of being poor

GENERAL INSURANCE PRICING PRACTICES MARKET STUDY INTERIM REPORT

NOVEMBER 2019

1. INTRODUCTION

1.1. Fair By Design welcomes the FCA's invitation to comment on the General Insurance Pricing Practices Market Study Interim Report.

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

1.3. For more information about this response please contact Martin Coppack, m.coppack@barrowcadbury.org.uk Tel: 0207 632 9060.

2. ABOUT FAIR BY DESIGN

2.1. Fair by Design is a movement dedicated to reshaping essential services, like energy, credit 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 energy, through standard variable tariffs; credit, through pay day loans; and insurance, through post codes considered higher risk. This is known as the Poverty Premium.

2.3. We collaborate with industry, government, and regulators to design out the Poverty Premium.

2.4. Our Venture Fund provides capital to help grow new and scalable ventures to innovate in the market.

2.5. Fair by Design was conceived by the Joseph Rowntree Foundation and Big Society Capital. The Campaign is led by the Barrow Cadbury Trust, and the Venture Fund is managed by Ascension Ventures.

COMMENTS ON THE GENERAL INSURANCE PRICING PRACTICES MARKET STUDY INTERIM REPORT

1. Executive summary

1.1. We welcome FCA's investigation into the fairness of pricing in general insurance. Home and car insurance represent essential products for many consumers, and they are particularly important for those with no savings to fall back on.

1.2. We strongly agree that these insurance markets are not working well for vulnerable consumers, especially those with less financial resilience or capability, and we believe that intervention is necessary.

1.3. But we are concerned that the interim report is very focused on the loyalty premium. There are other pricing practices in these markets which may be giving rise to high prices for vulnerable consumers, especially those on low-income. These include risk-based underwriting methods; monthly payment charges; and issues related to individual item insurance. We would like to see further analysis in these areas before the publication of the final report.

1.4. When considering potential remedies, we would urge the FCA to approach this with a clear mindset about the ability of consumers to make the right choices. Our Roadmap for tackling the Poverty Premium[1] warns against design predicated on the myth of a 'super consumer'. These are consumers who never become ill, always have a steady income, are able to understand complex terms and conditions and always have the time and technology to easily find the best deal for them. Fair By Design is campaigning for inclusive design to be central to regulators' interventions and firms' design and delivery of products and services. We also urge the FCA to model carefully the firms' potential responses to remedies under consideration to ensure that there are no unintended consequences for vulnerable consumers.

1.1. We would also like the FCA to explore remedies that might address the high prices associated with monthly payments and individual item insurance which disproportionately affect lower income consumers.

1.2. Finally, we recognise that there may be solutions to the problems experienced by lower income consumers which may require increased engagement across regulators, government, industry and consumer organisations, especially if we are to increase access in these markets.

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[1] https://fairbydesign.com/wp-content/uploads/2018/09/FbD-Roadmap-Artwork-Web-with-revision.pdf

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

2.1. We welcome FCA's investigation into the fairness of pricing in general insurance. Home and car insurance represent essential products for many consumers, and they are particularly important for those with no savings to fall back on.

2.2. We agree with the FCA's interim conclusions that these insurance markets could work better and are not delivering good outcomes for all consumers. We note specifically that the work suggests that outcomes are not good for certain types of vulnerable customers, especially those with less financial resilience or capability. We agree that FCA intervention is likely to be necessary. Indeed, we believe the need for intervention is absolutely necessary.

2.3. While the study provides useful insights into how vulnerable customers are affected by the loyalty premium, we would like to see more analysis on other pricing practices which may have an unfair impact on vulnerable customers, especially those who may be incurring a poverty premium.

Focus on loyalty premium

2.4. No doubt the FCA's focus on the loyalty premium reflects the origin of the work, and in particular the FCA's thematic review which identified differentials in the margins earned between customers of equivalent risks as well as the Which? super-complaint to the CMA which highlighted specific issues around the loyalty premium.

2.5. Nevertheless, this focus runs the risk that high or unfair prices for vulnerable customers are ignored because they are not reflected in customer margins. This could be because the differential is due to underwriting or some other factors (see 2.10).

2.6. This is a concern because underwriting assumptions are one of the main components of the total price that consumers will pay, even though underwriting profit can make up a small share of insurers' profits.

2.7. Underwriting is based on an assessment of expected claims and increasingly features sophisticated risk-based pricing which may not be transparent. These use rating factors where certain data are used as proxy for the likelihood and amount of potential claims.

2.8. Vulnerable or lower-income consumers could be disproportionately affected by underwriting methods. This could be due to the way insurers price risk based on the area where people live (with more deprived areas incurring higher premiums); or because insurance underwriting models penalise certain characteristics such as those with special needs, e.g. higher costs due to adapted cars or high-value items to make homes accessible.

2.9. What is not clear from the study is whether underwriting methods are putting certain customers, especially vulnerable consumers, at a disadvantage. We note that the study acknowledges that these effects may exist (paragraph 4.21 of the FCA's interim report suggests that some firms have changed or discontinued the use of factors that unintentionally correlate with potential vulnerability).

2.10. NatCen Social Research produced a report in early 2019 which suggested ways to measure the poverty premium in various sectors, including retail insurance[2]. In retail insurance, they identified four main mechanisms by which premiums may emerge:

- Cost-reflective pricing: insurance premiums can be higher for individuals living in low-income areas, as these areas are considered riskier and are subject to a higher premium from the insurer;
- Loyalty penalties;
- Bulk purchasing: payment schedules; and
- Bulk purchasing: general contents insurance versus single item insurance.

2.11. We would like to see more analysis on issues other than the loyalty premium ahead of the publication of the final report.

Monthly payments

2.12. We note the finding that premium financing is a significant factor in many insurers' overall profits. Those paying monthly are most likely those who do not have significant disposable income, which implies that the poorest are providing an element of cross-subsidy to those who can afford to pay upfront.

2.13. The FCA's actions around monthly payment options have been focused to date on reminding firms of their obligations to consumers, and on disclosure, but we believe this is insufficient. We would like to see the FCA explore other remedies in this area, including capping or eliminating profits derived from premium financing. (see 5.3)

Access

2.14. The report acknowledges that FCA had little data about those who do not buy insurance and the extent to which pricing practices act as a barrier to access.

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2 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/782513/natcen_report.pdf

2.15. The study suggests that pricing practices do not increase access to those with lower incomes, and indeed there is some evidence that those with lower incomes pay higher margins in combined home insurance (see paragraph 5.58 of the FCA's interim report). Given the pooling nature of insurance, we might expect insurers to price in a way that widens the insured consumer pool; but risk-based pricing may make this less attractive.

2.16. There is clearly an access issue for some consumers who would like insurance but cannot afford it. This is acknowledged in the interim report. While we appreciate how difficult it is to get data on those who are 'excluded' from the market, we would urge the FCA to investigate what more can be done to understand the role of pricing practices in restricting access, building on existing work on access and exclusion (see also paragraphs 5.5-5.7 This would be in line with ensuring the FCA meets its own vision of a well-functioning market that works for consumers, where 'Fair treatment and fair risk pricing mean consumers are not unduly excluded. All consumers can access basic financial services. The needs of all consumers, including vulnerable consumers, are taken into account'[3].

Individual item insurance

2.17. Another area of concern is the extent to which some consumers, often low-income consumers, who buy individual item insurance (white goods, other household items and mobile phone insurance) are paying high prices for individual item insurance or are over-insured[4].

2.18. Where the FCA has reviewed individual item insurance (e.g. mobile phone insurance), it has repeatedly found poor outcomes and practices. We would like to see more analysis of pricing in this area and regulatory intervention to reduce the risk that consumers may end up paying too much for individual item insurance because they are poorly informed.

2.19. The Bristol research indicated that 16% of low income households could be over-insured[4]. This could reflect risk aversion or those households having been sold insurance they do not need.

Remedies

2.20. We comment on specific remedies in our comments to Q3. However, we also have comments more generally about the approach to the remedies. We would urge the FCA to approach remedies with a clear mindset about the ability of consumers, in particular vulnerable consumers, to make the 'right' choices. In our

[3] https://www.fca.org.uk/publication/corporate/approach-to-consumers.pdf
[4] https://www.bristol.ac.uk/media-library/sites/geography/pfrc/pfrc1615-poverty-premium-report.pdf

roadmap for tackling the Poverty Premium[5] we refer to this as the 'myth of the super consumer'. These are consumers who never become ill, always have a steady income, are able to understand complex terms and conditions and always have the time and technology to easily find the best deal for them.

2.21. Fair By Design has begun a new inclusive design project. Inclusive design involves:

- understanding the needs of all consumers through evidence, research and market analysis, and setting priorities/developing interventions accordingly (in the case of regulators); and
- designing and delivering products and services that consider all consumers, including those on a low income (in the case of businesses).

2.22. We would like to see clear expectations on firms to consider the characteristics and needs of vulnerable consumers, including low-income consumers, at the design stage, as well as on an ongoing basis. This is relevant to the remedies proposed in the interim report.

2.23. Finally, we would recommend that the FCA carries out careful modelling of firms' potential response to the proposed remedies, with a specific focus on the potential for firms' response to negatively impact vulnerable consumers, including low-income consumers.

3. 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?

3.1. As set out in our response to Q1, we would urge the FCA to avoid putting the onus on consumers to make the 'right' purchasing decisions, and to focus more on firms' actions, such as inclusive design and delivery where firms must design products and services that consider all consumers. We would also like to see careful modelling of firms' potential responses to the proposed remedies. Our concerns are that firms' responses could lead to reduced coverage, or the most vulnerable being priced out.

Restrictions on pricing practices

3.2. We generally agree that pricing practices that exploit customers' biases or low financial capability should be restricted. This appears to be the main focus of the FCA's proposed restrictions.

3.3. However, as we explained in our response to Q1, it is possible that there are also significant pricing effects due to other pricing practices (e.g. underwriting based on postcode groupings) and restrictions of such practices may have a larger impact. It is not easy to gage the scale of such effects in the absence of further

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[5] https://fairbydesign.com/wp-content/uploads/2018/09/FbD-Roadmap-Artwork-Web-with-revision.pdf

analysis and their effect on different groups of consumers, especially the most vulnerable.

3.4. The main benefits of the FCA's proposed restrictions on pricing practices would be that customers are not being charged an unfair loyalty (/ low financial capability) premium. The main challenge is that, as is evident from both FCA and other consumer research, society does not have a consistent view of what is fair – for example whether consumers should be rewarded for searching or cross subsidies between different groups of consumers.

3.5. Our view is that it is not reasonable to expect all consumers to have the time or knowledge to assess whether they are getting the right product. Therefore, we generally welcome pricing restrictions that would curb firms' exploitation of behavioural / capability traits.

3.6. We favour restricting the use of such factors in firms' setting of prices/margins (the FCA's second bullet in paragraph 7.15 of the interim report). The other two proposals are more narrowly focused on price walking and may fail to capture and future-proof against similar practices emerging.

Helping customers find and switch to better deals

3.7. Generally, we support attempts to switch people onto better deals for them. However, we are not persuaded that remedies that rely on consumers taking proactive and informed action will be effective, especially for the least financially capable consumers or those who are time poor or have other access issues. Most fairness benefits are likely to be realised when switching does not involve consumer action or costs (phone charges, digital access, search time), which are likely to affect vulnerable consumers the most.

3.8. We agree that the FCA should explore auto-switching further, although we would like this to involve those paying high prices generally, not just those affecting renewing consumers, and the FCA would need to be particularly alert to the issue of comparable coverage.

Strengthening product governance rules

3.9. We welcome the aim of making clear to firms what is expected of them in terms of product governance. Firms should be best placed to identify any detrimental effect from their pricing practices on customers (both for legacy and new products, in real time).

3.10. In our response to the FCA's proposed Guidance on the fair treatment of vulnerable customers, we said that we would like to see more detailed guidance on what is expected from firms in terms of product design (in particular we are launching a call for action around inclusive design, see 2.20); a clear definition of what fair means for different products; a better articulation of the links between SMCR and vulnerability (to boost responsibility and accountability and the chances of culture and process change); and monitoring by FCA. We would also like to see rules and guidance capturing the specific needs of vulnerable customers and firms' staff trained in what this means.

3.11. We agree that any product governance requirements should be applied to all products, not just those manufactured or significantly adapted after 1 October 2018, as doing so risks leaving out customers who have long tenures with the same provider.

3.12. The FCA proposes a new requirement for firms to consider the value of the contract to the target market over time. We favour an explicit requirement for firms to embed consideration of all consumers (including low-income consumers) in their design and delivery of products and services – including the fairness of their pricing practices.

3.13. We agree that including a responsibility for a senior manager to take responsibility for any new requirement in this area would help to embed changes in firms. This should also include the existing ICOBS requirement, derived from the Insurance Distribution Directive[6], for a firm to act honestly, fairly and professionally in accordance with the best interests of its customer.

Monitoring firms' actions to tackle concerns about pricing practices

3.14. We support FCA's aim to monitor price differentials across different firms and groups of consumers. However, a sole focus on new versus renewing customers may not be useful, especially if there are other interventions, such as restrictions on pricing based on customers' propensity to renew, which eliminate such differentials.

3.15. We would favour monitoring pricing differentials across different groups of customers – with a special focus on vulnerable customers. This may help the FCA identify both outliers and market trends that impact different groups and drive future regulatory policy. This is also in line with the FCA's own framework questions to help assess concerns about fairness in price discrimination which states that 'consumers with characteristics which might be deemed vulnerable (eg low income, old age, etc)' are of greater concern.[7]

3.16. Such monitoring is not without challenges in terms of identifying clear definitions of vulnerable customers or comparable groups. As a starting point, monitoring

[6] ICOBS 4.5.2 in the FCA's Handbook (article 17(1) of the IDD).
[7] https://www.fca.org.uk/publication/feedback/fs19-04.pdf

could involve broad comparisons between different groups, e.g. comparing the prices paid by similar households in different areas of the country.

Remedies to tackle practices that discourage switching

3.17. We agree that it should be made easier for consumers to exit contracts or decline auto-renewals if they want to (the last two bullets in paragraph 7.26 of the interim report). In determining what measures might be needed in this area, FCA should consider the issues that might affect certain vulnerable consumers, for example the costs of phone calls or digital access. The main benefit of these measures would be that consumers would not be 'trapped' in poor value propositions.

3.18. Other restrictions on auto-renewal (such as a ban or making auto-renewal opt-in only) would prevent firms from taking advantage of consumers' inertia but there is a risk which the FCA has identified that some consumers will accidentally become uninsured, which could have a detrimental effect. The risk is that those with low financial capability or who are time poor may be disproportionally affected by this.

3.19. We have not been able to identify information about the impact of Italy's ban on auto-renewal of third-party motor insurance on different groups of consumers, but this may be something for the FCA to discuss with Italian counterparts. The effect could also be different for motor insurance (which is a legal requirement) and home insurance (which is more optional, especially for those in the rental sector).

Improving the way firms communicate with customers

3.20. In theory we agree that better information should help consumers make better informed choices, by highlighting pricing considerations which they can actively change. In practice, we know that consumers find information about financial products complex and are often too confused or time poor to act on it. This is especially the case for more vulnerable consumers, including those on low incomes.

3.21. Therefore, we do not believe that the burden should be placed on consumers with little time or financial capability to understand and make better choices or that disclosure should absolve firms of the responsibility to ensure that their pricing practices are fair for all consumers.

3.22. The more likely positive effect of transparency might be to shed a light on pricing practices, both for firms internally, and for the wider public – likely through intermediaries such as journalists or consumer organisations. This scrutiny might lead firms to review their practices to ensure that they are defensible in the court of public opinion.

3.23. Any disclosure/transparency measure should be accompanied by actions for firms to ensure that consumers are getting the right product at a fair price. On balance we believe that the latter is more important.

3.24. We would however like to see improvements in the way insurers communicate with consumers who buy individual item insurance to help them identify whether they are over-insured or paying too much.

3.25. As set out in 2.18, we would like to see more analysis and regulatory intervention to reduce the risk that consumers may end up paying too much for individual item insurance because they are poorly informed.

Increasing public scrutiny of firms pricing practices

3.26. The main benefit of greater public transparency of firms' pricing practices is likely to be the result of scrutiny by trusted intermediaries (such as consumer organisations or the media). This would increase firms' focus on their pricing practices, and any perceived unfairness arising from them. Some consumers might also act on the information (although any such effect is likely to be small). Transparency might also help inform public debate around what is fair.

3.27. A key challenge would be to come up with useful data to compare. For example, a focus on equivalent risk might prevent an important debate around the impact of risk-based pricing for different groups of customers.

Harnessing the benefits of innovation

3.28. Technology has the potential to help firms get the right product to consumers; it could also help firms to identify vulnerable consumers.

3.29. However, there are questions about privacy and the extent to which firms' pricing model could become less transparent or exacerbate the potential for the most vulnerable to incur higher prices.

3.30. There is also a risk that technological innovations will not benefit the most vulnerable or poorest customers. For example, open insurance solutions may not be easily accessible to those with less technological access. Telematics may rely on an upfront investment which the poorest consumers may not be able to afford, leading to further exclusion[8].

3.31. On-demand insurance is another innovation which may benefit some consumers especially those who have limited funds available. However, consumers could end up paying higher prices than if they arranged for a more traditional annual policy.

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[8] We note that in Italy, insurers must bear the costs of such investments, but it is not clear what impact this could have on pricing and/or access.

Combined with what we know about low levels of financial capability this may exacerbate adverse differential prices for more vulnerable customers.

3.32. On-demand insurance use may also be driven by insurers' need to substitute income streams for those who would traditionally have paid monthly, as there has been a recent regulatory focus on high premium financing costs. This could disproportionately affect the most vulnerable consumers.

3.33. We recommend that the FCA should put in place a monitoring mechanism to identify potential negative and positive effects of these innovations on vulnerable consumers. This should involve industry and consumer representatives.

4. **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?**

4.1. We agree that the discarded remedies should not be a focus. In addition to the issues the report identifies, we believe that they risk having a disproportionate impact on vulnerable customers.

4.2. Multi-year contracts could result in higher financing costs, which would disproportionately affect lower-income customers who could not pay upfront.

4.3. A single switching and renewal period might disproportionately affect vulnerable consumers because of the correlation between these and those who are more time poor or less likely to switch.

5. **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?**

5.1. We believe that there are further remedies which the FCA should consider:

- requirements around the costs associated with monthly payments; and
- requirements around individual item insurance.

5.2. The interim report suggests that insurance firms make substantial profits from those who pay monthly. These are most likely to be people on low-income who don't have the money upfront to pay for an annual premium. As we set out in 2.13, we believe that it is unfair for firms to profit in this area, given the essential nature of insurance.

5.3. We would like to see consideration of price-capping remedies beyond simple disclosure, such as banning excessive or any profits from premium finance or banning differential pricing between those who pay monthly and annually.

5.4. As set out in paragraph 3.24, we would also like to see more information provided to consumers who buy individual item insurance to ensure that they do not end up duplicating existing cover or paying more than they should.

5.5. We would also like to see consideration given to remedies to help such consumers switch, with a focus on remedies requiring minimal or no action on the part of the consumer. Long-term, open insurance could help identify consumers who may be making poor purchasing decisions.

5.6. In addition, we believe that further work should be done with a view to address access issues. Such work might lead to a wide range of remedies, such as a basic insurance product, a government scheme to help those who are uninsured, incentives for employers to offer insurance as a staff benefit or some form of auto-enrolment (which could be linked to universal credit or rental agreements).

5.7. We were also interested in the 'One Big Switch' campaign conducted by a consumer network in Australia[9] . It would be interesting to see if there might be value in a similar approach to help excluded consumers or vulnerable consumers paying high prices, although risk-based pricing might make this unviable.

5.8. As documented in the FCA's Occasional Paper Number 17[10], we would like to see increased engagement between government, industry, regulators and consumer organisations to come up with comprehensive solutions to prevent the uninsured being left in vulnerable situations following an adverse event. Many of the issues consumers face in the insurance market require both social and regulatory policy action and, as such, strategic collaboration between the FCA and HM Treasury is essential. The UK Financial Inclusion Policy Forum is another *additional* route to address such issues collaboratively

6. **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?**

6.1. We are not aware of changes or innovations that have not already been mentioned in the interim report or earlier in this response.

[9] As mentioned in Annex 3 of the interim report - International Comparisons, paragraph 96.
[10] https://www.fca.org.uk/publication/occasional-papers/occasional-paper-17.pdf