Price Discrimination in the Insurance Market

A Complaint to the

Central Bank of Ireland

Submitted by Pearse Doherty TD

On behalf of Sinn Féin

Contents

Introduction

Price discrimination is not unique to the insurance market. Its practice is prevalent across many essential markets, including utilities and other financial products. However, its practice by the insurance industry has become increasingly apparent and particularly corrosive given broader problems that exist in the insurance market.

Confidence in the insurance market has never been lower among consumers. This is evidenced from the number of investigations that are currently underway against the industry, such as the European Commission's investigation into Insurance Ireland's data pooling system, and an ongoing investigation by the Competition and Consumer Protection Commission into anti-competitive practices in the motor insurance sector[1] [2].

While the practice of price discrimination, or dual pricing, is widespread in the insurance market, no formal study or investigation into the practice, or its impact on consumers, has been undertaken by regulators. For this reason, we have concluded that this practice and its impact on consumers warrants a complaint and requires an immediate investigation.

Insurance premiums have continued to rise for customers despite a decrease in the number and size of claims that have been processed through the Personal Injuries Assessment Board and the courts. These increases have led to businesses closing throughout the State, with dire consequences for communities, jobs and local economies.

In addition to this, it has become increasingly clear that insurance premiums no longer reflect the risk profiles of consumers, the cost of claims, or the broader operating costs experienced by the industry. Instead, it has become apparent that insurance companies are punishing loyalty by artificially setting premiums for customers who are deemed to be less 'price-sensitive', or more 'inert', than others. In short, this practice of dual pricing or price optimisation, targets consumers who are less likely to switch by charging higher premiums on renewal than would be offered to other consumers of an identical risk profile.

In October 2018, the Financial Conduct Authority began an investigation into the practice of price discrimination in the British insurance market. Its recent interim report, published in October 2019, found that the British insurance market is not working well for customers, with firms using complex and opaque pricing practices that punish loyal customers and allow them to raise prices for customers who renew year on year[3]. Their findings were stark, estimating that 6 million policy holders paid prices high above the average for their risk

[1] European Commission, 'Antitrust: Commission opens investigation into Insurance Ireland data pooling system', 14 May 2019, https://europa.eu/rapid/press-release_IP-19-2509_en.htm
[2] Competition and Consumer Protection Commission, 'CCPC issues summonses to motor insurance providers', 13 September 2016, https://www.ccpc.ie/business/ccpc-issues-summonses-motor-insurance-providers/
[3] Financial Conduct Authority, 'General insurance pricing practices', *Interim Report*, Market Study MS18/1.2, October 2019.

profile in 2018. It found that, had they paid the prices reflective of their risk profile, they would have saved a combined £1.2 billion.

As a consequence of their findings, several recommendations have been put forward, including:

- Restricting or banning dual pricing or price optimisation based on a consumer's likelihood of renewing;
- Automatic switching of consumers who pay high prices to lower priced products that provide the same cover;
- A ban or restriction on the use of auto-renewal of insurance policies, or making auto-renewal opt-in only;
- Requiring firms to publish information about price differences between their customers.

While these steps are being taken in the interests of consumers in Britain, nothing is being done by regulators to strengthen the rights or protection of consumers in the Irish insurance market. Sinn Féin's Consumer Insurance Contracts Bill would strengthen the hand of consumers as they engage with insurance companies, while increasing the transparency of the insurance industry. However, direct and immediate action is required by regulators to ensure that the widespread practice of price discrimination is examined and confronted.

As you are aware, many insurance companies operating in the British market operate in Ireland, with some known to practice dual pricing. Given this is the case, it is impossible to justify why British consumers should be offered protections that are denied Irish consumers, or why Irish regulators should be less active than their British counterparts.

To date, the Irish Government and domestic regulators have been inactive on the issue of dual pricing. Our complaint asks only that Irish regulators are reactive, recognising the practice of price discrimination in the Irish insurance market, investigating its prevalence and impact on consumers, and drawing up recommendations for further action to end this discriminatory practice.

We would expect that the investigation we are requesting would address the following questions:

- The differences between prices paid for insurance by consumers compared to the actual cost of providing insurance to them;
- The number of consumers who are affected by paying higher than average prices for their risk profile;
- Pricing strategies used by firms and whether these strategies lead to firms taking advantage of certain types of consumer;
- The impact of auto-renewal on consumers;
- The practice and prevalence of dual pricing by insurance companies;

- The impact of dual pricing on certain types of consumer, particularly low-income and vulnerable groups;
- Remedial actions that can be taken to end dual pricing and the negative impact it has on consumers and the insurance market.

Price discrimination is a central feature of the Irish insurance market, and a central plank of several insurance companies' pricing strategies. We know this is happening and we know it is harming consumers. Despite this, regulators and Government have done nothing to address this issue and enhance the protections of consumers who suffer as a result.

While regulatory inaction is unacceptable in any circumstance, it is only heightened given the fact that British regulators have been investigating this very issue since October 2018. In this complaint, Sinn Féin will argue that that the practice of price discrimination is widespread in the Irish insurance market, erodes consumer protections, harms vulnerable groups, and requires immediate investigation and remedial action.

It is our hope that the Competition and Consumer Protection Commission act on this request and deliver good outcomes for consumers in accordance with its objectives; to empower consumers, increase compliance with competition and consumer protection law, and take enforcement actions where appropriate.

The Loyalty Penalty: What is Dual Pricing?

Most people who buy insurance products believe that their premium is based on a number of factors. These include their own risk profile or how likely they are to make a claim, the operating costs for the firm or insurer of running the policy, and the margin the firm or insurer wants to earn.

To consumers, this makes sense. An insurer offers a policy on the basis that the customer might make a claim, and transfers some of that risk to the customer. The bigger the risk, the bigger the premium. In addition to this, the insurer needs to pay for the costs of employing staff and running the business. And finally, the insurer wants to make a profit. To the public, these three elements are what make up a premium.

Figure 1: Summary of how most firms are perceived to set prices[4]

Source: FCA analysis of information gathered from firms during the market study

The insurance industry has sought to strengthen this perception in recent times, by claiming that the cost of claims and personal injury awards are the primary reason for increases in insurance premiums for customers[5].

But this is no longer the case. In recent years, insurance companies have begun to use big data (data mining insurance databases and personal consumer information) and complex statistical modelling to select prices that differ from the 'real rate' and identify consumers who are less likely to switch or shop around if they are charged or offered these selected prices.

[4] Financial Conduct Authority, 'General insurance pricing practices', *Interim Report*, Market Study MS18/1.2, October 2019.

[5] Pogatchnik, S., 'Premiums won't fall until fraudsters are stopped, insurance chiefs claim', *The Irish Independent*, 4 October 2019, https://www.independent.ie/irish-news/premiums-wont-fall-until-fraudsters-are-stopped-insurance-chiefs-claim-38561769.html

This practice is called '*price optimisation'*, '*dual pricing'*, or more accurately, price discrimination.

But how does this work in practice?

Milliman are an independent actuarial and consultancy firm who work extensively with Insurance Ireland and have partnered with several insurance companies in the Irish market[6].

In a Briefing Note they published in September 2017, entitled *Price Optimisation for Personal Lines in Ireland*, they provide a straightforward example of how price optimisation works in practice[7] (see Appendix C).

Milliman give the example of a policy holder with a "technical" premium of €560. What they mean is that the policy holder's technical premium of €560 is the price determined by their risk profile and the policy's operating costs.

But they note that a company may be able to quote this policy holder a premium of €580, despite their 'risk profile' and the operating costs of their policy setting a premium price of €560. By determining how price-sensitive this customer is, or how unlikely they are to shop around, the insurer can charge them the artificially set price of €580. Milliman note that in practice, "the range of prices for two identical risk profiles could be wider".

This is how price optimisation works. But in reality the premiums offered to customers can be as much as 100% more expensive than the "technical" premium their risk profile warrants.

While one customer could be offered an insurance policy of €800, another customer with exactly the same risk profile could be offered the same insurance policy from the same insurance company at a cost of €500.

In other words, there is more to insurance premiums than the cost of claims or the risk posed by a customer. Using price optimisation, there is another factor that is built into the price that is offered to consumers; the likelihood that they will pay a higher price without asking any questions. In the words of Milliman, price optimisation "is intended to work as a ***dynamic layer on top of the risk-based price***".

[6] Milliman, http://ie.milliman.com/#

[7] Ó Baoighill, E. & Subramani, A., 'Price Optimisation for Personal Lines Insurance in Ireland', *Milliman: Briefing Note*, September 2017.

Figure 2: Optimisation seeks to differentiate between customers on considerations other than pure risk

Source: Milliman Briefing on Price Optimisation

What determines whether an insurance company adds this 'dynamic layer' to a customer's insurance premium is called *price elasticity of demand*. This measures the change in response of quantity demanded for a good given a change in price. In other words; how sensitive a consumer is to a change in price to their insurance premium, and whether they are likely to switch or shop around as a result.

Using data mining on large data sets that are collected not just from the databases of insurance companies but other public databases that hold the personal information and characteristics of consumers, insurance companies are able to estimate the likelihood that an existing or potential customer is likely to shop around, or how they will react to changes in price.

The aim of price optimisation is therefore quite clear; no to charge premiums that reflect the risks consumers pose and the operating costs of their policies, but to charge the highest prices that consumers can bear in the hope that they do not know and will not ask.

In the State of Ohio, where price optimization is banned, the Department of Insurance describes it as "varying premiums based upon factors that are unrelated to risk of loss in order **to charge each insured the highest price that the market will bear**"[8].

This practice is known to target loyal and vulnerable customers, who are more likely to renew and so less likely to shop around or ask questions about the prices they are offered. As Milliman recognise in their briefing note for the Irish insurance industry:

> "Optimisation algorithms can push prices up for loyal customers that have been renewing their policy with the same insurer for a few years, because the model perceives them to be less price-sensitive"[9].

[8] Ohio Department of Insurance, 'Price Optimization', Bulletin 2015-01, 29 January 2015
[9] Ó Baoighill, E. & Subramani, A., (n 7), p1

It is for this reason that industry players such as Milliman openly describe this practice as price discrimination, which is not confined solely to the insurance market but elsewhere.

> *"Price discrimination is an integral part of the competitive process in many markets"*
>
> Milliman, September 2017

The precise aim of price optimisation in the Irish insurance market is unknown, whether it is used to maximise profits or increase market share. Whatever its aims, what is clear is that it is used extensively in the Irish insurance market against the interests of consumers and without their knowledge, raising serious questions for the industry and for regulators.

Its Prevalence and Impact

Price discrimination is an integral feature of the pricing strategy adopted by several insurance companies in the Irish market. While its prevalence and impact is unknown given there has been no formal market investigation into its practice, that it is taking place is beyond dispute.

As has been previously noted, the actuarial and consultancy firm Milliman has worked extensively with companies in the Irish insurance market. They have made clear that price optimisation not only takes place in the domestic insurance market but is a widespread practice by a number of insurance companies.

> *"Several Irish insurers and brokers have embedded price optimisation algorithms within their pricing"*
>
> Milliman, September 2017

Not only is the practice widespread, but it takes place on a live basis, meaning that "as a quote request arrives, the optimisation algorithm runs in the background, producing a tailored optimisation load for the specific quote profile"[10].

During a meeting of the *Committee for Finance, Public Expenditure and Reform, and Taoiseach* on 3 October 2019, in response to questioning from Pearse Doherty TD, Aviva Ireland admitted to using price discrimination in their pricing models[11]. This was the first time a company in the Irish insurance market admitted to employing price optimisation. During the same committee meeting, it was put to Aviva that they had employed staff who had been required to have knowledge and experience of consumer behaviour modelling and price optimisation, confirming what had already been made clear by Milliman when they said: "It is not uncommon around the market to have at least two highly skilled team members working full-time on price optimisation for a single line of business".

While it is now clear that dual pricing has been embedded within the pricing strategies of insurers in the domestic market, it is also clear that it is not universally employed. In the same committee session, the General Manager of AIG Ireland confirmed that AIG did not practise price optimisation, while recognising that dual pricing was understood by the industry to be about punishing loyal customers with higher premiums.

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[10] Ó Baoighill, E. & Subramani, A., (n 7), p3

[11] Joint Committee on Finance, Public Expenditure and Reform, and Taoiseach, 3 October 2019, https://data.oireachtas.ie/ie/oireachtas/debateRecord/joint_committee_on_finance_public_expenditure_and_reform_and_taoiseach/2019-10-03/debate/mul@/main.pdf

Deputy Pearse Doherty: *"I want to go back to dual pricing… It is about identifying behavioural change and punishing loyalty. It is about looking at algorithms to identify people who are more likely to renew automatically and punishing them with higher premiums. Would that not be a fair summary of what dual pricing is?"*

General Manager, AIG: *"That is what it would be considered to be in the industry."*

Finance Committee, 3 October 2019

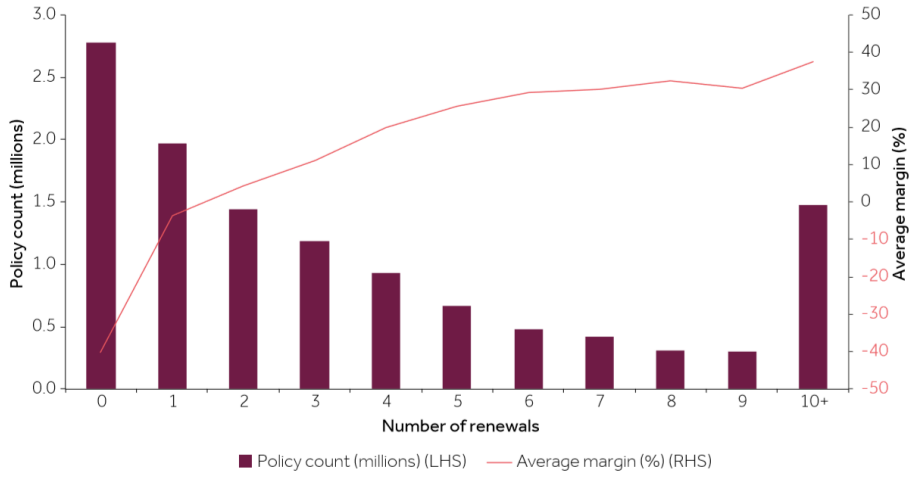
No official market investigation has been carried out into the prevalence of price discrimination in the Irish market. But its impact and causes are significant, with consumers being charged as much as 100% than other consumers despite having exactly the same risk profile[12].

In October 2018, the Financial Conduct Authority began an investigation into the general insurance pricing practices in the British insurance market. Their interim report found that the practice of dual pricing was systemic, with a significant and detrimental impact on consumers across motor and home insurance. In 2018 alone, the FCA found that as many as 6 million policyholders paid abnormally high prices as a result of price optimisation and estimated that had they paid the 'technical' or average price for their risk profiles, consumers would have saved as much as £1.2 billion[13].

In their early diagnostic work in October 2018, using a sample of around 40% of the home insurance market, the FCA found that 31% of consumers renewed with their insurer on 5 or more occasions, with prices increasing significantly as the numbers of renewals increased. In fact, early diagnostic work found that consumers were paying as much as 30% above the average price for equivalent risk on their fourth renewal.

[12] See Appendix B
[13] Financial Conduct Authority, (n 4), p3

Figure 3: Policy count and average margins by number of renewals[14]



Source: FCA market study terms of reference on general insurance pricing practices

Price discrimination is a systemic feature of the Irish insurance market, with consumers paying artificially high prices that do not reflect their risk profiles. Given several companies operating in the Irish market also operate in the British market, it would not be credible to assume that the impact of dual pricing in the Irish market is markedly different from its impact on British consumers.

While British regulators have begun to tackle this issue through investigations and recommendations for intervention, "Irish regulators haven't yet expressed an opinion specifically on price optimisation"[15], much to the satisfaction of the insurance industry and detriment of Irish consumers.

[14] Financial Conduct Authority, 'General insurance pricing practices', *Terms of reference*, Market Study MS18/1.1, October 2018.
[15] Ó Baoighill, E. & Subramani, A., (n 7), p3

Impact on Low-income and Vulnerable Customers

Price optimisation is a systematic strategy to penalise customers who display characteristics of 'consumer inertia', or who lack characteristics of 'price-sensitivity'. These customers are identified through extensive data mining, with algorithms and complex modelling used to discern the additional pricing that can be charged without these customers asking questions or seeking alternative options.

As is easy to conclude, this practice predominantly affects renewing customers, and is often seeing as a penalty on loyalty. However, evidence has found that those disproportionately affected by price discrimination display characteristics of vulnerability[16].

> *"Particular vulnerable groups, such as those on low incomes, older people, people with health problems and those with lower levels of formal education, are particularly likely to struggle with shopping around and switching… These people are likely to experience the financial impact of the loyalty penalty disproportionately."*
>
> Citizens Advice, September 2017

These characteristics of vulnerability vary, and the impact of the loyalty penalty is seen to affect different demographic groups including:

- Older people;
- People with mental health problems;
- People on low incomes;
- Less financially resilient households.

The insurance market is complicated. As has been discussed above, how premiums are priced is little understood by consumers. While it is often thought that premiums are primarily determined by risk factors, we now know that prices are increasingly determined using price optimisation to charge the highest price that the market will bear.

Complex markets inevitably impact consumers who find it difficult to understand their complexity. This is particularly dangerous when those markets and the products they sell are required by law. Third party cover is a legal requirement for anyone who wants to drive

[16] Citizens Advice, 'Excessive prices for disengaged customers: A super-complaint to the Competition and Markets Authority', September 2018, https://www.citizensadvice.org.uk/about-us/how-citizens-advice-works/media/press-releases/citizens-advice-issues-super-complaint-as-loyal-customers-continue-to-be-penalised-by-over-4-billion-a-year/

or open a business. As a result, the insurance market not only produces economic outcomes but crucial social outcomes, with citizens requiring motor insurance to commute to work, visit family, or transport their children to or from school.

Given this is the case, it is crucial that insurance markets do not produce unfair outcomes to citizens who rely on the products they sell.

Despite this, the recent interim report published by the Financial Conduct Authority "found strong evidence that consumers who pay the highest margins are, on average, the least aware of how pricing practices in the home and motor insurance market works"[17]. This is a worrying finding. Access to insurance is a not simply a consumer preference but a social necessity. Given the complexity and lack of transparency about dual pricing, it is probable that vulnerable consumers who find it difficult to understand how their premiums are set are most at risk of receiving high margin products.

As has been discussed, dual pricing affects customers who are more likely to renew their premiums. In its interim report, the FCA found that "potentially vulnerable customers, such as less financially resilient respondents and those who were not confident managing their money, were more likely to auto-renew without doing any research"[18].

Given this is the case, the practice of price discrimination in the Irish market and the similarity between the Irish and British industries, it is essential that the impact of price discrimination on vulnerable consumers is investigated.

[17] Financial Conduct Authority, (n 4), p30
[18] Financial Conduct Authority, (n 4), p41

Consumer Protection and Competition

Price discrimination acts against the interests of consumers, is practiced without their knowledge, restricts their access to insurance and hinders new entrants to the market.

> *"We found that these markets are not working well for consumers. Firms are using complex pricing that allows them to raise prices for consumers"*
>
> Financial Conduct Authority, October 2019

Research in Britain has shown that consumers have no awareness of dual pricing despite its widespread use in the insurance market, and that most firms, when setting a price, include their expectations of whether a customer is likely to switch or pay an increased price without making it clear to the customer. In fact, the interim report of the Financial Conduct Authority found that "55% of consumers in home and 57% in motor can be classified as someone who may not be aware of the competitiveness of the product they own, given current pricing practices"[19].

This is clearly the case in the Irish insurance market, with consumers, legislators and even Government wholly unaware that price optimisation is a systemic feature of pricing models by the Irish insurance industry. Despite this practice taking place and disadvantaging loyal customers on renewal, insurers make no effort to encourage customers to switch or shop elsewhere to find better deals.

Insurance regulation in the United States is set at State rather than federal level. The National Association of Insurance Commissioners is the American standard setting and regulatory support organisation that was created and is governed by insurance regulators from 50 states. Through the NAIC, state insurance regulators set standards and best practice, coordinating regulatory oversight of the insurance industry.

In their regulatory guidelines on insurance pricing they make clear that "unfair discrimination exists if, after allowing for practical limitations, **price differentials fail to reflect equitably the differences in expected losses and expenses**…"[20]. This is precisely

[19] Financial Conduct Authority, (n 4), p30

[20] National Association of Insurance Commissioners, NAIC Guideline 1776: Property and Casualty Model Rate and Policy Form Law Guideline, Model Regulation Service, October 2010, https://www.naic.org/store/free/GDL-1776.pdf

what dual pricing does, and this is why as many as 17 states in the United States have banned the practice of price optimisation in the insurance market.

Insurance premiums are understood by consumers to be based on risk and operating costs. In the Irish insurance market, this is not how prices are set. Nor are differences in price based on differences in risk posed by different consumers. In fact, dual pricing allows companies to offer grossly different prices to consumers of the same risk profile, manifestly failing "to reflect equitably differences in expected losses and expenses".

Price discrimination is also detrimental to competition in the insurance market, not only by restricting the choice of consumers but by limiting market access for new entrants.

Given the practice of price optimisation requires complex modelling based on extensive data mining, the practice requires the insurer to possess extensive data on the consumers to whom they are applying the model. Given the practice allows insurers to retain existing customers and increase their market share, it significantly disadvantages prospective new entrants to the market. As the FCA have acknowledged; "if only the current firm can identify which customers are the most profitable, rival firms will not be able to offer these customers with lower prices and so competition will be less effective"[21].

It is clear that the practice of price optimisation, or price discrimination, is carried out without the knowledge of consumers, restricting their choice, and damaging their access to insurance products. Furthermore, it is apparent that the practice not only harms the welfare of consumers but deters new entrants to the market.

Given the Central Bank of Ireland is mandated, in its mission statement, to "protect consumers through effective supervision that supports the sustainability of the insurance sector", it is incumbent on the Commission to investigate the practice of price discrimination in the Irish insurance market[22].

[21] Financial Conduct Authority, (n 4), p28

[22] Central Bank of Ireland, *Insurance Supervision Mission Statement*, https://www.centralbank.ie/regulation/industry-market-sectors/insurance-reinsurance

Conclusion

Price discrimination is a systemic feature of the Irish insurance market that systematically punishes loyal customers and disproportionately affects vulnerable and low-income groups.

Not only is it damaging to consumers, but deeply corrosive of public trust in the insurance industry. Public perception of premium pricing is based on notions of risk and the cost of claims. This perception has been fed in recent times by insurance companies who have increased premiums annually despite the cost and number of claims reducing between 2014 and 2018.

This perception is not based on reality.

The price of insurance premiums is not simply based on the risk carried by the insurer.

Insurance companies are using price optimisation to charge, the words of the Ohio Department of Insurance, the highest price that the market and the consumer can bear. This has a number of consequences, one of which is that price optimisation can have an "alienating effect on consumers, who feel exploited by their relative ignorance of how premiums are calculated"[23]. Not only are consumers ignorant of this practice, they are being exploited by it.

> *"Two insurance customers having the same risk profile should be charged the same premium for the same coverage"*
>
> National Insurance Association of Insurance Commissioners, November 2015

It is for this reason that in October 2014, the insurance regulator for the state of Maryland announced that price optimisation was discriminatory, and as such was against state law. Since then as many as seventeen states have banned dual pricing, including California, Pennsylvania and Florida. These actions have come after the National Association of Insurance Commissioners established a task force to investigate dual pricing and publish recommendations for the benefit of consumers and State regulators. In its White Paper, the

[23] Minty, D., 'Price Optimisation for Insurance Optimising Price: Destroying Value?', The Chartered Insurance Institute, Number 122, March 2016

task force recommended that "two insurance customers having the same risk profile should be charged the same premium for the same coverage"[24].

Irish consumers deserve the same level of protections. Price discrimination should be banned with insurance premiums reflecting the risk of the consumer. Instead, insurers are exploiting consumers in an effort to maximise their profits at the consumers' expense. This must come to an end.

In its interim report, the Financial Conduct Authority asked a number of questions that formed the basis of their decision to begin a formal investigation into the pricing practices of the insurance industry:

- Who is harmed?
- How much are these individuals harmed?
- How are firms discriminating?
- Is the product essential?
- Would society view the practice as egregious and socially unfair?

Irish regulators are asking none of these questions. It is time to investigate price discrimination, ban it, and protect the welfare of consumers in the insurance market.

[24] National Insurance Association of Insurance Commissioners, 'Price Optimisation White Paper', November 2015, https://www.naic.org/documents/committees_c_catf_related_price_optimization_white_paper.pdf

Appendix A: Case Studies

The case studies below are a small sample of consumers who received insurance prices that were artificially higher than prices that were available to consumers of an identical risk profile.

In the case studies below, consumers received renewal quotes for their insurance policies which differed significantly from insurance quotes they were offered online after entering the exact same details.

All case studies below were compiled from email responses to Pearse Doherty TD, detailing the experiences as told by individual consumers.

In the case studies below, the price differential is given in nominal terms and as a percentage of the online quoted price.

Case Study:

Ray renewed his motor insurance with Liberty Insurance. He received a renewal premium of €1,420. After entering the same details online, he was offered a business premium of €680.

Price Differential: €740 or 109%

Quote: *"I have been with Liberty for four years. I have always taken out new policies as the renewal prices were extortionate".*

Case Study:

Kat lives in Mayo and renewed her motor insurance with Allianz Insurance. She received a renewal premium of €530. After entering the same details online, she was offered a business premium of €422.

Price Differential: €108 or 26%

"I am utterly appalled by the way the motor insurance industry is blatantly treating its loyal customers. I cannot understand how they can provide two different prices for the exact same product. I find their treatment of their customers egregious and I for one would wholeheartedly like to see this price discrimination stopped and customers treated fairly and transparently."

Case Study:

Alexandra is 27, lives in Waterford and works part-time. She renewed her motor insurance with AA. She received a renewal premium of €871. After entering the same details online, she was offered a business premium of €400.

Price Differential: €471 or 118%

*Quote: "*I have been insured with AXA through AA since October 2015. I received my insurance renewal from AA and was quoted €871.46 to remain with AXA. I have no claims and no penalty points. I've held a full licence for 4 years. In my innocence I thought I was being rewarded for my loyalty with a 40 quid decrease and was tempted to allow the renewal to run through; until I watched your video.

"When I ran a search online, I was quoted €400 using all the same details provided to AA."

Case Study:

Siobhan renewed her motor insurance with Liberty Insurance. She received a renewal premium of €1,911. After entering the same details online, she was offered a business premium of €1,485.

Price Differential: €426 or 29%

Case Study:

Eddie renewed his motor insurance with An Post. He received a renewal premium of €1,046. After entering the same details online, he was offered a business premium of €709.

Price Differential: €337 or 48%

Sinn Féin
BUILDING AN IRELAND OF EQUALS

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Central Bank of Ireland
PO Box 559
Dublin 1

Pearse Doherty T.D.

Dear Governor,

I am contacting you to request that the Central Bank undertakes a thorough and in-depth market investigation into the practice and prevalence of dual pricing in the insurance market.

Dual pricing is a strategy, largely unknown to consumers, whereby insurance companies charge existing customers extortionate penalties for their loyalty. This practice of price discrimination is carried out without transparency and represents an unjustifiable penalty that relies on the inertia and loyalty of existing consumers.

The requested investigation should consider not only the extent of dual pricing in the insurance market, but should also propose recommendations and actions, including regulations and fines that could be implemented by itself, the Central Bank and the Government.

I would request that this investigation considers:

- The practice and prevalence of dual pricing by insurance companies;
- The cost of dual pricing to consumers;
- What direct interventions could be taken to protect customers from price discrimination and exploitation;
- The capacity of sector regulators and Government to remedy this discrimination through regulations of and fines against companies who continue the practice of dual pricing.

It is clear the issue of price discrimination in the insurance market is widespread, systematic, unjustifiable and in breach of the Consumer Protection Act. However, no formal study or investigation into this issue has taken place.

In my view, an investigation by the Central Bank into this issue is justified on the grounds that, as things stand; the interests and welfare of consumers are harmed, the penalty is paid primarily by vulnerable and low-income customers, the practice is carried out without any transparency, and given the Central Bank is responsible for the regulation of the insurance sector.

Pearse Doherty TD
Constituency Office
Machaire Chlochair
Na Doirí Beaga
Leitir Ceannain
Dún na nGall
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I trust that the reasons given above justify an immediate investigation into this issue, which fundamentally break the principles that all customers should be treated fairly, and I look forward to your reply.

Is mise,

Pearse Doherty TD

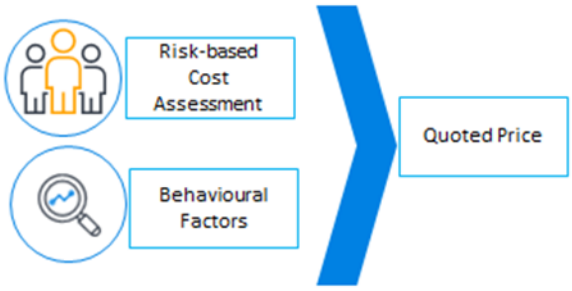
Price Optimisation for Personal Lines Insurance in Ireland

Eoin Ó Baoighill, FSAI
Anita Subramani

Price Optimisation is a powerful and often controversial technique that blends together traditional risk cost modelling and an understanding of behavioural considerations such as price sensitivity, to predict the "optimal" combination of premiums charged and expected profit.

Large Personal Lines insurers have long been using traditional pricing techniques such as Generalised Linear Modelling to analyse their historical claims frequency and average cost. Typically, these are then blended and a loading is applied for expenses, profit and other components of cost to calculate a Technical Premium. This means that two customers with exactly the same risk profiles would be quoted exactly the same premiums. But is this the best possible outcome for consumers and insurers?

Optimisation seeks to differentiate between customers on considerations other than pure risk.



The Value Proposition

Price Optimisation is based on the concept that the ideal price of a policy is not a single number; a prospective customer may well be willing to pay a premium that falls in a range that they perceive as good value.

Simplistically speaking, if the "technical" premium for a prospective policyholder of a particular profile is €560, a company might be able to quote a premium of €580 to one customer, and €540 to the other, such that it wins both customers and maximises overall value to the company. In practice, the range of prices for two identical risk profiles could be wider.

Optimisation Approach

The value proposition above allows insurers to build algorithms that dynamically adjust the quoted premiums to achieve a more commercially desirable outcome. Some possible outcomes are

- Maximise profit for a given premium income
- Maximise premium for a given level of profit
- Ensure the proportion of customers "converting" or buying a quote achieves a target figure while maintaining a target profit

With the right tools, pricing actuaries can set up the optimisation model to provide a model solution to any of the above goals.

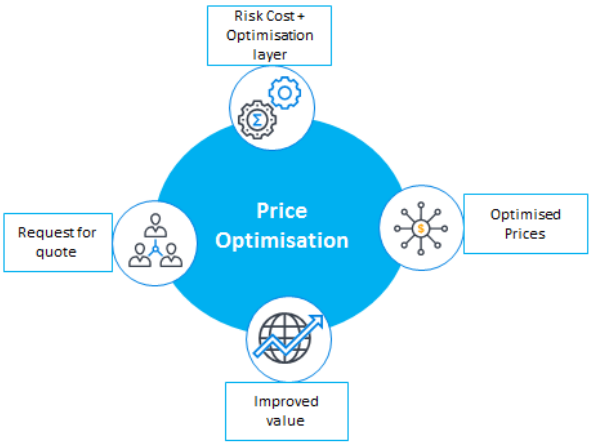
Optimisation algorithms can push prices up for loyal customers that have been renewing their policy with the same insurer for a few years, because the model perceives them to be less price-sensitive. On the other hand, the model might try to price the more competitive new business quotes at very low margins. It is possible that profitable, renewing customers contribute more towards expenses while new customers contribute less towards expenses leading to cross-subsidies in the overall portfolio.

If the price of renewals continues to increase year on year, it can prompt a customer to shop around for a new quote. The customer might then find a large differential between their quoted renewal premium and the new business premium for the same risk. This could manifest itself in the form of bad press, prompting more customers to shop around and potentially spiralling into a bigger problem for the firm.

Users of optimisation techniques for pricing should consider setting up management information dashboards to monitor the outputs of the optimisation model by rating factor and tenure of the customer, particularly for groups of customers that have been renewing their policy for several years.

How Price Optimisation works

Optimisation is not intended to replace risk-based pricing. It is intended to work as a dynamic layer on top of the risk-based price that can be thought of as a multiplicative factor with value less than 1 or more than 1 depending on whether the optimisation model is seeking to offer a discount or apply a load to the individual quote.

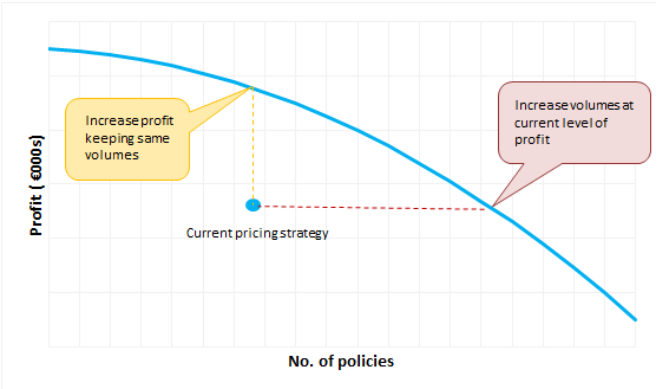


The Efficient Frontier

The optimisation algorithm produces an efficient frontier which can be thought of as a set of all combinations of risk and return such that risk is minimized for a given level of return, or return is maximized for a given level of risk.

In an elastic world, as the price of a product decreases, its demand should increase. Therefore, the "economics" answer to attracting more business will be to reduce prices. However we know that unless the increase in profits from higher conversion rates more than offsets the reduction in price levels, overall profits will reduce. So business volume and profit can be thought of as competing forces in an optimisation problem. In this problem, the efficient frontier represents all outcomes where profit is maximized for a given level of business volume.

The following chart describes the decision a company might be faced with when deploying price optimisation for the first time. The blue line shows all combinations of business volume and profit that are "optimal" or efficient.



If the current pricing strategy does not lie on this line, it is said to be "sub-optimal" and means that there is a more efficient outcome for customers and the company. The current pricing strategy of the company is represented by the blue dot.

There are three ways to move the pricing strategy towards the efficient frontier. The company could choose one of the following options:

- maximise its profits for the current level of business volume.
- maximise the business volume for the current level of profit.
- improve both profits and business volumes at the same time by a lower amount.

Range of Deployment Options

Price optimisation can take a number of shapes and forms depending on the tools available, time and cost constraints, maturity of market and ease of deployment. For instance, offering customers a fixed percentage discount if they buy a policy online is a broad-brush form of price optimisation.

A more complex form of optimisation is when the seller of the insurance (insurer, broker, agent etc.) varies that discount depending upon on the customer's propensity to buy the insurance. For instance, a broker may have a panel of insurers that sell insurance through its platform. For each policy that the broker sells, the respective insurance company will pay it a commission, say 10% of the written premium. The broker might choose to approach this in a number of ways, two extremes of which are described below-

- Use the 10% commission to provide a 5% discount to each customer, and keep the remaining 5% to meet its own expenses. This will make its prices 5% cheaper across the board in the market and improve its market share. However, this will be a blunt tool.
- Keep 5% of the commission to meet its expenses. With the remaining 5%, vary the amount of discount being given to each customer depending on the customer's behaviour such that for the overall portfolio a 5% discount is achieved. This will improve the broker's overall conversion rate because a larger proportion of the quotes will return prices that are tailored to the customer's behaviour. A higher conversion rate will imply that the broker is successful in selling more policies, and therefore achieves a higher commission income.

Optimisation and Market Efficiency

The Financial Conduct Authority (FCA) in the UK published a paper[1] in which it noted that price discrimination can occur in markets where firms compete for consumers. Competitive pricing may encourage competing firms to charge lower prices

[1] "Price discrimination and cross subsidy in Financial Markets", September 2016 https://www.fca.org.uk/publications/occasional-papers/occasional-paper-no-22-price-discrimination-and-cross-subsidy

to win customers and may make all customers better off than uniform pricing.

Innovation in pricing practices to attract new customers often involves offering one or more group of customers more attractive prices than another group of customers. Price discrimination is an integral part of the competitive process in many markets.

From the viewpoint of customer fairness, it is important that price optimisation algorithms are designed to be mindful of vulnerable customers. For instance, in low-lying areas, property insurance may naturally be more expensive because of increased flood risk. This might also be influenced by the availability of insurance, as the number of providers in such areas might be significantly lesser than those in the core market. If the optimisation algorithms of all or most of the players puts up the price further for these customers, it represents an imbalance in the system because a cohort of customers is systematically being priced out of the market.

Regulatory focus on Price Optimisation

The FCA maintains that although price optimisation on its own is not an unfair practice, the results of price optimisation or price discrimination should be monitored closely by firms and the regulator to ensure fair outcomes for the end customer. In its assessment of price comparison websites in the UK, it did not find any evidence of groups of customers being priced out of the market. Since price segmentation of this nature is based on the firm's own view of the customer's behaviour, price optimisation algorithms of different firms can have favourable outcomes for different groups of customers.

The UK regulator is encouraging firms to be transparent and improve engagement with its customers at renewal.

On 1 April 2017, new rules of engagement came into force in the UK where firms were required to:

- Disclose last year's premium at each renewal, so that it can be easily compared to the new premium offered.
- Encourage consumers to check their cover and shop around for the best deal at each renewal.
- Identify consumers who have renewed four or more consecutive times, and give these consumers an additional prescribed message encouraging them to shop around.

In the United States, the regulatory attitudes vary by state. The Irish regulators haven't yet expressed an opinion specifically on price optimisation.

Price Optimisation in Ireland

Several Irish insurers and brokers have embedded price optimisation algorithms within their pricing. The actual variables that are optimised can vary depending on who is running the optimisation. For instance, an insurer may want to find an optimal combination of profit and premium income, whereas a broker or an agent may want to optimise the combination of business volumes and fee/commission income.

New Business optimisation for some of the larger players in the market happens on a live basis. This means that as a quote request arrives, the optimisation algorithm runs in the background, producing a tailored optimisation discount/load for the specific quote profile. New business optimisation can be programmed to maximise profit, premium or conversion rate, tailored to the objectives of the business.

Renewal business on the other hand is usually optimised in "blocks", usually each month before the renewal invitation letters are sent out to the customers. Like new business, renewal business can also be optimised to achieve different business objectives e.g. to maximise retention rate for a given profit level, achieve the planned year-on-year rate increase for a given premium income, etc.

Practical Considerations

Pricing actuaries face some practical difficulties when deploying price optimisation algorithms. Some factors need to be treated with caution in optimisation routines, such as:

- Gender, as it is banned under EU regulations
- Discounts that are communicated to policyholders, such as the No Claims Bonus
- Marketing promises, like 10% off second policy

Clients also must see consistency between prices. To do this, insurers use algorithms to identify the same client getting multiple quotes.

Modernised, dynamic optimisation algorithms as described above can be demanding in terms of human resource requirements. It is not uncommon around the market to have at least two highly skilled team members working full-time on price optimisation for a single line of business.

Current Market Outlook

The Irish motor insurance market is slowly returning to profit after five years without an underwriting profit. As with every underwriting cycle, the market will start to soften again in the future. Premium levels will begin to reduce and the consumer demand for insurance will increase. The greatest benefit of price optimisation is seen on products with a sizeable amount of customer data, such as Private Motor, Household and

Health insurance. Price optimisation can help firms manage their competitive footprint effectively, reduce cross subsidies in their pricing structure, and avoid leaving money on the table.

How Milliman Can Help

Our consultants have held a range of senior pricing roles in the industry and have been advising our clients on price optimisation for a number of years. We have also provided training to industry audiences on pricing concepts and methodologies.

We are ideally suited to assist you in the following aspects:

CONSULTING

- Optimisation feasibility study – cost vs benefits
- Advice relating to industry best practice

MODELLING

- Building customer demand models for conversion and retention
- Deploying live price optimisation
- Customer lifetime value models

MONITORING AND FEEDBACK MECHANISM

- Building monitoring dashboards
- Monthly new business and renewal optimisation

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Insurance Sector: Discussion (Resumed)

Chairman: We are dealing with No. 5, the difficulties being experienced with insurance. The committee recently heard direct evidence about the difficulties faced by businesses with the escalating costs of insurance. To assist us in our consideration of this matter, I am pleased to welcome: Mr. Declan O'Rourke and Mr. Owen Kelly from AIG Insurance; Mr. John Quinlan, Mr. Brian Mahon and Mr. John Farrell from Aviva Insurance; and Mr. Anthony Brennan and Ms Siobhán Corbett from Zurich Insurance.

I draw the attention of witnesses to the fact that by virtue of section 17(2)(*l*) of the Defamation Act 2009, witnesses are protected by absolute privilege in respect of their evidence to the committee. However, if they are directed by the committee to cease giving evidence on a particular matter and they continue to so do, they are entitled thereafter only to a qualified privilege in respect of their evidence. They are directed that only evidence connected with the subject matter of these proceedings is to be given and they are asked to respect the parliamentary practice to the effect that, where possible, they should not criticise or make charges against any person, persons or entity by name or in such a way as to make him, her or it identifiable.

Members are reminded of the long-standing parliamentary practice to the effect that they should not comment on, criticise or make charges against a person outside the House or an official either by name or in such a way as to make him or her identifiable. We have a number of opening statements. I invite AIG to give its opening statement first.

Mr. Declan O'Rourke: We thank the committee for the invitation to give evidence today on behalf of AIG. We understand the valuable work of the committee and the importance of these hearings and welcome the opportunity to contribute to the discussion. My opening statement will provide some background on AIG in Ireland and then address the costs and availability of insurance in Ireland.

AIG is 100 years old this year and has operated in Ireland for 43 years. AIG companies have a team of 900 people in Ireland. The team is involved in insurance and shared services, both domestically and internationally. Domestically, AIG is the seventh largest general insurer and the second largest health insurance provider in Ireland. In addition, the AIG team in Ireland provides IT support to AIG operations in Europe, the Middle East and Africa. The AIG team also provides treasury and investment services to AIG globally from Ireland. Our general insurance business is roughly €300 million in premiums, 50% in insuring individuals and 50% in insuring companies. Our principal lines are financial, for example, directors and officers insurance, professional indemnity and cyber insurance, motor insurance, travel insurance, liability insurance and property insurance. For 40 years, AIG has been the insurance partner for large and small companies, not-for-profit organisations and consumers in Ireland. Operating in over 80 countries, our global footprint combined with our local presence and knowledge has enabled us to support the insurance needs of Irish based companies expanding in the EU and around the world, as well as the insurance needs of US and other multinational businesses in Ireland. We are proud of the part we play in safeguarding people and property.

The high cost of insurance has been an ongoing challenge in Ireland for many years. Representing the Government back in 1992, the former Minister, the late Des O'Malley, stated in the Dáil that insurance costs in other countries are only a fraction of what they are here. However, the claims and awards in other countries are also only a fraction of what they are here. Inevitably, the former is a reflection of the latter and that will continue. As has been discussed, Ireland

has experienced significantly higher personal injuries awards from its courts than comparable European jurisdictions, with awards for minor injuries, on average, 4.4 times higher than in the UK, according to the Personal Injuries Commission. Claims awards and legal costs make up the majority of insurance premiums, and this is a key factor in the cost of insurance in Ireland. The higher awards arise from a combination of factors, including the relatively high award levels for personal injury claims set out in the book of quantum, the inconsistency of awards made by the courts, and a time-consuming and costly appeal process. There is real commitment from Government, the Oireachtas and key stakeholders, including the insurance industry, to implement change. We welcome the Judicial Council Act 2019 as it provides an opportunity to address some of the root causes of higher insurance costs by creating a fairer and more consistent framework for the allocation of personal injury awards. We look forward to the establishment of the personal injuries guidelines commission, under a judicial council, to oversee the delivery of new personal injuries guidelines. We also support the Civil Liability (Capping of General Damages) Bill 2019.

It is critical for the market that insurers are well capitalised with a strong governance and risk management framework. For insurers to continue to provide services to consumers and businesses, they also need to be profitable. Although the Irish motor insurance market made a profit for the first time in many years in 2017, liability remains loss-making. In the last six years of published data, the liability market has made a net underwriting loss of over €500 million and the motor market has made a net underwriting loss of over €800 million. This has led to some companies exiting the market or exiting poorly performing segments, which has impacted the cost and availability of cover in these areas. We want to work together with the Government and Oireachtas to create a sustainable, fair and consistent cost framework for insurance claims, allowing AIG to play its role supporting businesses and consumers in Ireland.

Mr. John Quinlan: The issues being discussed today are of great importance to economic well-being and we welcome the opportunity to contribute to the discussion. Aviva has been operating in the Irish market for nearly 240 years. This year, we reinforced our commitment to this market by completing the establishment of separate legal entities in Ireland for our general insurance and life assurance businesses. This allows us to continue to protect our customers and serve their best interests in Ireland post-Brexit. We employ circa 1,600 people in Dublin, Galway and Cork. We are a socially responsible insurer that seeks to deliver value for all stakeholders, including our customers, over the long term. We contribute significantly to national sports and community organisations through our sponsorship of the Aviva Stadium and our support of charitable and community causes. We are one of the largest providers of insurance in the Irish market, with a general insurance market share of approximately 15%. To give a sense of that figure, we insure one in every five small and medium enterprises, SMEs, one in every five motorists and one in every six homes. We are well placed to know and understand this market and we exist to pay our customers claims. We hear from our customers on a daily basis about the difficulties they are facing as a result of the problems in the insurance market.

What is driving the cost and availability of the insurance sectors under discussion today? We point to three areas that have caused challenges for profitability in the market. Those challenges are the increasing cost of claims, a reduction in investment income and a reduction in premiums. The problems faced by the insurance market became a consumer issue from 2015 onwards, manifesting first in significant increases in customer premiums and thereafter in significant reduced availability of cover for certain market segments. Most domestic insurers reduced capacity for volatile and unprofitable segments of the market, including leisure, and these were replaced primarily by UK-based insurers. The additional problem, as highlighted

in the media recently, is that these UK insurers are now exiting the market. Business customers in these sectors can find it difficult to get a quote and if they do, it can be at prohibitively expensive prices.

The cost of insurance working group was established in 2016 to address the issue of increasing insurance costs. The group correctly identified the need to establish the Personal Injuries Commission, PIC. One of the most significant aspects of the PIC was that for one of the first times ever, it included representatives of all stakeholders, including the Law Society, insurers, the Bar Council, the medical profession, consumer and competition representatives and relevant Government Departments. The excellent work of retired Mr. Justice Nicholas Kearns, who chaired the PIC, confirmed that personal injury award levels in Ireland are 4.4 times those in England and Wales, with the commission unanimously recommending the establishment of a judicial council to recalibrate awards back to reasonable levels. When whiplash awards are aligned to levels in England and Wales, this will result in substantial premium reductions. What are the key changes that need to be made to improve the landscape for the cost and availability of insurance? The insurance landscape continues to create significant issues for Irish customers in terms of premium volatility and the withdrawal of insurance underwriters from what is an open market here. The issue of excessive award levels was validated by the cost of insurance working group and the Personal Injuries Commission and Aviva fully supports the recommendations they outlined. However, our customers remain frustrated that in spite of all the activity in implementing changes, there has been no real reduction in claims costs and, as a consequence, we cannot deliver more substantial premium reductions and sustainable premiums.

Business customers face an additional challenge. The excessive award levels have created a "compo" culture that is significantly impacting the liability market in Ireland. In our experience, the courts are taking a much broader view of the duty and standard of care. We are asking the Government to review the law of negligence as it applies to personal injury actions against small and medium enterprises, SMEs, and community and voluntary organisations in Ireland.

What has Aviva done to promote, encourage and deliver these required changes? In 2015, we launched our "road to reform" agenda and wrote to our customers highlighting the reasons for the rising cost of premiums and the changes required to reduce the cost. We have since proactively engaged with key stakeholders including Ministers, Opposition spokespersons and senior officials in the Departments of An Taoiseach, Finance and Transport, Tourism and Sport on the drivers of premium increases and the urgent reforms required. We recognise the need to substantially increase our capacity to prevent and detect fraud. We have invested heavily in our fraud team, which now has more than 30 dedicated fraud investigators working alongside a network of more than 50 additional claims investigators nationwide. Over the past three years we have worked very closely with the Garda Síochána and have increased the reporting of criminal disclosures to it under section 19 of the Criminal Justice Act 2011. In addition, we have proactively engaged with the Garda, industry stakeholders and the media to raise awareness of the issues of claims fraud, ghost broking, which involves the sale of counterfeit policies, and fraud tourism, involving claimants who travel to Ireland from countries with lower award levels solely to commit insurance fraud.

What is Aviva's commitment to Irish consumers if the required changes are delivered? Aviva will continue to operate prudently from an underwriting and pricing perspective, as it always has, to ensure that we are here to protect our customers when they need us most, namely, at point of claim. The target return we hope to achieve is a small percentage of the overall cost of insurance. Most of a premium goes towards paying our customers' claims. For example,

65% of motor insurance premiums goes toward paying claims, with a further 11% going towards paying levies and claims from uninsured drivers. The cost of claims remains the largest influencing factor on the cost of insurance in Ireland. We would be delighted to pass on lower premiums to our customers who are bearing the brunt of these excessive awards. Changes in the awards handed down are essential if we are to deliver lower and more sustainable premiums to our customers and we encourage the Government to prioritise the completion of this reform process. We are committed to ensuring our customers will benefit directly from any such reductions when claims costs come down.

What is Aviva's request of the Government and the committee? The biggest factor determining the cost and availability of insurance is the cost of claims. The mechanism to address this is a recalibration of award levels as provided for in the Judicial Council Act. Aviva calls for the establishment of the judicial council without further delay and for it to then establish the personal injuries guideline committee to recalibrate injury award levels as a matter of urgency rather than in accordance with the maximum timeframe permitted under the legislation. Aviva also asks the Government to review the law of negligence as it applies to personal injuries actions against SMEs and community and voluntary organisations.

I thank the Chair and members.

Mr. Anthony Brennan: I thank the committee for the opportunity to discuss the cost and availability of insurance in Ireland. Zurich welcomes the opportunity to be part of this discussion, contribute to the work of the committee and discuss the next steps in the reforms required to address the challenges on the agenda today. As this is our first time to appear before the committee, I will briefly introduce Zurich Ireland. It was originally founded in Cork in 1952 and has been part of the global Zurich Group since 1998. Our AA- financial strength rating means Zurich customers can rely on us to consistently deliver on our promises when it matters. We are a proudly Irish business with a 100% local management team focused solely on the Irish market, with 380 employees across our Dublin and Wexford offices. We write over €300 million in premiums in Ireland, giving us a market share of approximately 9%. Our business profile is similar to that in the market overall, with 45% of premiums in motor insurance, 30% in property and the remaining 25% spread across a number of more specialised business lines including farm, financial lines and liability business.

Like most companies in the market, Zurich experienced the ups and downs of the Irish insurance cycle in recent years, with underwriting losses after several years of falling premiums and rising claims costs across the industry. In 2015 we enacted a turnaround programme to restore our business profitability. By 2018 we had completed the programme and delivered a 6% underwriting profit on our written premiums. Even during the turnaround period, we continued to experience consistently rising claims costs. The continued rise in claims costs and volatility has been the key driver of increased insurance premiums and reduced availability of cover in certain lines across the Irish market. We have worked to help drive change and reform and have been consistent and active supporters of the actions outlined in the reports of the cost of insurance working group which lay out a clear framework that can deliver real change for Irish customers in terms of internationally benchmarked claim awards, faster resolution of those claims and improved predictability of total claims costs which will deliver reduced cost and increased availability of insurance for Irish customers.

We accept that providing more consistent and transparent industry data to independent bodies such as the Central Bank will help all stakeholders to understand relevant trends and drivers of performance. We have seen the useful impact of making such data available through the

work of the Personal Injuries Commission which used independently verified industry data to drive an informed debate on the level of personal injury awards in Ireland and provide that Irish soft tissue injury awards are more than four times the level of such awards in the UK. It determined the cost of inaction on the issue, with awards for such injuries increasing by more than €900 each year benchmarked from 2011 to 2016. We welcome, therefore, the recent passage of the Judicial Council Act through the Oireachtas. It promises to be a significant step in reforming and modernising the way our courts work. However, real measures need to be implemented as a matter of urgency to align the level of compensation awarded in Ireland with that in other jurisdictions. We also welcome recent Court of Appeal rulings which recognise that minor injuries should attract appropriately modest general damages. We acknowledge and welcome other key steps taken in 2019 such as the progress of the Civil Liability (Capping of General Damages) Bill and the commencement of the Personal Injuries Assessment Board (Amendment) Act which should enable more timely and accurate settlements to injured parties.

The introduction of the Personal Injuries Assessment Board in the early 2000s was a landmark event and initially led to material reductions in the duration and cost of claims as well as delivering reduced insurance premiums across the market. These benefits have been eroded over time as more and more claimants have chosen to reject the recommended awards and instead pursue a longer, more adversarial and more costly settlement path. The steps I have outlined are key enablers of reform and it is important to acknowledge progress that will benefit customers, insurers and society. However we must also acknowledge and act on public frustration with the pace of change and the need for a continued sense of urgency. All stakeholders need to remain engaged and vigilant to ensure the benefits are delivered and maintained from these actions and not allowed to erode over time as happened with the Personal Injuries Assessment Board.

We recognise the committee's major concern regarding the cost and availability of insurance in the Irish market. There are a number of factors, so how do we fix the problem? The way forward is to continue to deliver the recommendations laid out in the reports of the cost of insurance working group, which lay out a comprehensive suite of reforms agreed through co-operation and commitment across multiple stakeholders. We cannot get away from the fact that the single biggest input into our calculation of insurance premiums is the cost of claims. Insurers transfer the risk and cost of claims and we share it across our portfolio. This means the cost of claims directly impacts on every insurance premium we calculate and collect from our customers. Our premiums must reflect the prevailing level of awards to ensure our business is sustainable. If the level of injury awards and incurred legal costs reduce, this will drive meaningful reform in the claims environment which will deliver a stable and sustainable cost of insurance for businesses and consumers. We want to be part of the solution and we welcome any help from the committee to maintain the necessary sense of urgency on reducing uncertainty and delivering these core reforms. I wish to take this opportunity to confirm that we will pass on the benefits of reduced claim costs to our customers. I thank the Chair and look forward to answering questions from members.

Senator Kieran O'Donnell: I welcome all of the witnesses to this committee hearing, which follows on from our previous one with AXA, FBD and Allianz. Today, I would like to follow up with a few quick questions. All three insurers present share a common theme. Mr. O'Rourke from AIG stated: "Claims awards and legal costs make up the majority of insurance premiums and this is a key factor in the cost of insurance in Ireland." Mr. Quinlan from Aviva Ireland stated: "The cost of claims remains the largest influencing factor on the cost of insurance in Ireland." Mr. Brennan, representing Zurich, stated: "We cannot get away from the fact

that the single biggest input into our calculation of insurance premiums is the cost of claims." I ask the witnesses to break down the premia into the cost of claims, awards, legal fees, administration and the profit margin that they seek to cover. My request is simply to elicit the information and I ask Mr. Quinlan to respond first.

Mr. John Quinlan: I am happy to start, Senator. Let us consider a typical premium. Our premia is made up as follows: Claims would represent 65% out of €100 and of that 65% the legal fees would be 19% or 30%; levies, including for uninsured drivers, would be 11%; commissions to intermediaries would be 9%; our expenses would be 12%; and our profit would be 3% but that is a target. From 2012 to 2018, one can see from the facts that we achieved nothing like that.

Senator Kieran O'Donnell: I will be consistent in terms of my questions to the previous three insurers of AXA, FBD and Allianz. Am I correct to say that the target of profitability in Aviva is 3%?

Mr. John Quinlan: We would look for 5%. When one looks at the interest rate environment and what is happening in Lloyds, one of the reasons that capital is withdrawing is because interest rates are so low that people have to make money at the underwriting level.

Senator Kieran O'Donnell: What was Aviva's premium income in 2018, which is the most recent year?

Mr. John Quinlan: Our premium income in 2018 was €508 million.

Senator Kieran O'Donnell: What was Aviva's profit?

Mr. John Quinlan: Our profit was €58 million in our general insurance business.

Senator Kieran O'Donnell: Is that a profit margin of 10%?

Mr. John Quinlan: One is looking at lots of different moving parts within that. One is looking at benign weather, which is a factor. We have a hurricane, potentially, on the way, which can cost a multiple of millions of euro in damage. When one considers the return that we make the figure I would always consider is our combined operating ratio.

Senator Kieran O'Donnell: Yes.

Mr. John Quinlan: Our combined operating ratio is the critical figure of our premiums, less claims costs and less expenses. If that is less than €100 million then we are making money without having to rely on investment income, which we cannot do. Our group, to attract capital in Ireland and remain safe, will require a combined operating ratio of 95% out of 100%. It is important that we continue to attract capital here. We are struggling to do so, certainly from the Lloyds market following its remediation of its book.

Senator Kieran O'Donnell: What does AIG seek in terms of the breakdown of the premium?

Mr. Declan O'Rourke: Typically, we are quite happy with the industry norm of 5%. AIG has a similar breakdown of between 65% and 70% for claims.

Senator Kieran O'Donnell: What was the turnover for AIG in 2018?

Mr. Declan O'Rourke: It was €280 million.

Senator Kieran O'Donnell: What was the profit?

Mr. Declan O'Rourke: We lost money in 2018.

Senator Kieran O'Donnell: What was the loss?

Mr. Declan O'Rourke: It was €30 million.

Senator Kieran O'Donnell: Is the target margin 5%?

Mr. Declan O'Rourke: Correct.

Senator Kieran O'Donnell: What was 2017 like for AIG?

Mr. Declan O'Rourke: We consider things over the long term. Over a six-year period, for every €100 we collected, we paid out about €97.

Senator Kieran O'Donnell: What were the AIG figures for 2017?

Mr. Declan O'Rourke: In 2017, it was €314 million in premium so it was a year in which we broke even.

Senator Kieran O'Donnell: What was the turnover for Zurich in 2018?

Mr. Anthony Brennan: In 2018, it was €312 million. Our total breakdown for 2018 in terms of our actual profit margin was 6% and our cost of claims was roughly 63%.

Senator Kieran O'Donnell: What was the target profit margin?

Mr. Anthony Brennan: We would aim for about 5%.

Senator Kieran O'Donnell: So all three insurers aim for a 5%.

Mr. Anthony Brennan: In or around that, yes.

Senator Kieran O'Donnell: What was Zurich's profit?

Mr. Anthony Brennan: In 2018, we had an underwriting profit of 6% on the €312 million so that is roughly €18 million, plus €10 million of investment income, which means we had a total profit of €28 million.

Senator Kieran O'Donnell: Did Zurich have €10 million in investment income?

Mr. Anthony Brennan: Yes.

Senator Kieran O'Donnell: Was the actual profitability overall €28 million?

Mr. Anthony Brennan: Yes.

Senator Kieran O'Donnell: I am sure Mr. Brennan will appreciate that, to the ordinary person viewing this meeting, it would be higher than 5%.

Mr. Anthony Brennan: It would but that is the total, as I said, across €312 million in premiums.

Senator Kieran O'Donnell: If there was a reduction in claims and awards how much of it

would be passed on to customers in reduced premiums?

Mr. John Quinlan: We have figures that I cannot provide, unfortunately, under competition law. Given the components of our premiums we will pass back anything above our 5% margin. We are absolutely committed, pound for pound, to return that by way of reduced premiums. I cannot give an exact figure but I can tell the Senator that we have done calculations.

Senator Kieran O'Donnell: Is it fair to say that Aviva will always seek to retain the 5%?

Mr. John Quinlan: Absolutely, Senator. We need to make sure that we are here to pay the claims. The cost of the Quinn liquidation to this State is €2 billion.

Senator Kieran O'Donnell: If claims are reduced will the profit margin for Aviva be reduced to 5%?

Mr. John Quinlan: One will see more competition come into the market, which is really important. A 5% margin, for any provider of capital in a risk-based industry, is a minimum acceptable return. The percentage will stay at that level but one will see substantial premium reductions. I cannot give figures under competition law, as the Senator will appreciate.

Senator Kieran O'Donnell: Will Zurich pass on a reduction in its entirety?

Mr. Anthony Brennan: Yes, and we have considered competition law. I cannot talk about our actual premiums but I can go a little bit further and talk about the theoretical premium calculation model. To be very clear, for competition reasons, I am not saying this is exactly Zurich's premium. Right now, if we consider motor insurance, roughly 30% of our claims are personal injury-type or soft tissue damage and we are four times the UK average. If we reduced the figure to twice the UK average, which is reasonable, and thus a reduction of 50%, I think I could bring that 30% in a theoretical model down to 15%. It would be quite reasonable that if that were to happen and insurers had reduced their prices, with all things being equal and somewhere in the region of 10% to 15%, the committee should ask us a lot of questions. I cannot really go much further than that.

For liability, where the vast majority of claims are injury related, it would be a higher percentage and probably close to 20%. Again, this is a theoretical pricing model and not a commitment on Zurich's premiums, which I cannot give for competition reasons.

Senator Kieran O'Donnell: Will AIG pass on a reduction?

Mr. Declan O'Rourke: We will take a reduction into consideration. It is the biggest part of our inputs and pricing so we will take it into consideration. If one looks back, because we cannot look forward with pricing legislation, one can see that when the injuries board was established premiums dropped dramatically fairly quickly. As the market has returned to profitability over the last couple of years one can already see decreases across the market, particularly on the motor side.

Senator Kieran O'Donnell: To date, the committee has met six insurance companies and AIG is the only one to make a loss. Why? AIG broke even in 2017 yet it showed a loss of €30 million on a turnover of €280 million in premiums in 2018. Have there been major write-offs? Was the loss of €30 million made after exceptional provisions were made? A loss by AIG is out of kilter with what happened in the rest of the insurance industry. Why is that?

Mr. Declan O'Rourke: Our mix is different from that of a lot of the other insurers. We tend

to write a lot of major multinational accounts and financial lines. We had a reasonably large adjustment in our financial lines piece that is separate from the motor and liability business.

Senator Kieran O'Donnell: I am reading from the Insurance Ireland fact file of 2017, which shows that the company was consistently among the highest. It had the second highest market share in the motor sector, the sixth highest in property, and the highest market share in terms of liability insurance.

Mr. Declan O'Rourke: Liability insurance for the fact file includes employer liability, public liability and financial lines. Financial lines is a different kind of business. It is director's and officer's insurance, cyber insurance-----

Senator Kieran O'Donnell: In that loss of €30 million, how did the company do in the areas of motor, property and liability insurance, respectively?

Mr. Declan O'Rourke: We made money in motor, we lost money in liability, and we also had a loss, mainly coming from prior years, in financial lines.

Senator Kieran O'Donnell: Is the latter the property line?

Mr. Declan O'Rourke: No. Financial lines is a much bigger part for us. We are not a major household insurer in Ireland. In the property side, we are more involved in insuring large commercial property.

Senator Kieran O'Donnell: Mr. O'Rourke referred to losses coming forward from previous years. Did the company make money in 2018 in financial lines?

Mr. Declan O'Rourke: In 2019?

Senator Kieran O'Donnell: No, in 2018.

Mr. Declan O'Rourke: In 2018, we did make money, yes.

Senator Kieran O'Donnell: The company made a profit in motor insurance. Mr. O'Rourke has said that in the financial lines, the issue was a provision coming forward from previous years. In liability, the company made a loss. Did AIG make a profit in 2018?

Mr. Declan O'Rourke: No, we made a loss.

Senator Kieran O'Donnell: How much of that loss was from previous years? Mr. O'Rourke referred to payments in respect of previous years.

Mr. Declan O'Rourke: Correct. We had what are known as prior year developments. If one excludes the prior year developments, we would still have made a small loss.

Senator Kieran O'Donnell: How small? Was it more or less a break-even scenario?

Mr. Declan O'Rourke: It was approximately €5 million.

Senator Kieran O'Donnell: An overall loss of €5 million. Would it be fair to say that the company almost broke even? How are things looking for 2019?

Mr. Declan O'Rourke: Again, it is going to be a difficult year. We have a number of very large losses in Ireland and one from abroad, and it will depend on how they work out.

Senator Kieran O'Donnell: Do the figures provided by Mr. O'Rourke relate solely to AIG's operations in the Irish market?

Mr. Declan O'Rourke: That is our total premium.

Senator Kieran O'Donnell: That is the total for 2018 for the Irish market. Is some of it for operations overseas?

Mr. Declan O'Rourke: Yes, some of that is overseas.

Senator Kieran O'Donnell: If we just drill down into the Irish market, how did AIG do?

Mr. Declan O'Rourke: I would say about €30 million of that is overseas. Most of our difficult lines are written here in the Irish market.

Senator Kieran O'Donnell: The company made a loss in the Irish market.

Mr. Declan O'Rourke: Correct.

Senator Kieran O'Donnell: During previous engagements with insurers, FBD representatives spoke about high levels of fraudulent claims. Will the witnesses outline briefly the percentage of claims they believe are fraudulent?

Mr. John Quinlan: I will pass that question to our claims director, Mr. John Farrell.

Mr. John Farrell: The main source of fraud is in the personal injuries area. In terms of the personal injury claims that we receive, approximately one in five would be fraudulent.

Senator Kieran O'Donnell: One in five personal injury claims, which is 20%, are fraudulent.

Mr. John Farrell: Yes, one in five or 20%. Over a three-year period, that is approximately 800. If one looks at the three-year period and the reports made to An Garda Síochána under section 19, we would have reported fewer than one in five of those.

Senator Kieran O'Donnell: The company reported one in five of that 20% to An Garda Síochána.

Mr. John Farrell: Yes.

Senator Kieran O'Donnell: I direct the same question to Mr. O'Rourke and Mr. Brennan.

Mr. John Quinlan: There were 100 cases this year and 500 over recent years.

Mr. Declan O'Rourke: Looking at our personal injury cases, we had 5,700 in total, which is a mix of employer's liability, public liability and motor. If we drill down into the figures for motor, where this issue is most prevalent, we have 2,500 personal injury cases, with red flags and cases being passed on to the fraud team at around 18%. We see ten being reported to An Garda Síochána and one conviction.

Senator Kieran O'Donnell: What percentage of claims does Mr. O'Rourke believe are fraudulent?

Mr. Declan O'Rourke: About 18%, according to our figures.

Mr. Anthony Brennan: We had about 2,700 injury claims last year. We have a three-line defence system but I will not go into that now. We identified 200 claims to be directed to our special investigations unit and we did not pay out on roughly half of those. In 2018, we reported four cases to An Garda Síochána.

Senator Kieran O'Donnell: What percentage of the claims does the company believe were fraudulent?

Mr. Anthony Brennan: Our fraud savings from those cases were roughly €15 million, which is approximately 6% to 7% of our total premium income. Obviously, we do not know about what we have not found, but I would be fairly confident that we found the majority of fraudulent claims against the organisation.

Senator Kieran O'Donnell: That is the number for the claims the company paid out-----

Mr. Anthony Brennan: No, it is for the claims that we did not pay. It is the savings compared with what-----

Senator Kieran O'Donnell: Mr. Brennan is estimating that fraudulent claims amount to roughly 6% or 7%.

Mr. Anthony Brennan: Yes, roughly 6% or 7% of our total premium income was saved.

Chairman: Deputy Pearse Doherty is next.

Deputy Pearse Doherty: I want to pick up on some of those numbers again, starting with Mr. Brennan. He said that the company suspected fraud in approximately 200 cases. Is that correct?

Mr. Anthony Brennan: We identified 200 cases with fraud flags, and with around 100 of those cases, we went further.

Deputy Pearse Doherty: In what period?

Mr. Anthony Brennan: In 2018.

Deputy Pearse Doherty: In terms of the other 100 cases, did the company believe, on further inspection, that there was no fraud involved?

Mr. Anthony Brennan: There was no evidence of fraud. There was nothing more to work on. We have a number of flags for identifying fraud. When flags are raised, the cases are passed on to a specialist team who work through them to see if there is more evidence to indicate that they merit further investigation.

Deputy Pearse Doherty: The company paid out on the other 100 cases. Is that correct?

Mr. Anthony Brennan: Yes.

Deputy Pearse Doherty: There were around 100 claims that the company believed were fraudulent.

Mr. Anthony Brennan: Certainly there was an element of suspicion of fraud.

Deputy Pearse Doherty: What percentage do those 100 cases represent of the overall number of personal injury cases?

Mr. Anthony Brennan: The 100 is out of 2,700 which represents about 3% to 4%. That is the percentage by number rather than amount. Such claims tend to be for higher amounts, which is why I referred to a 7% saving against the premiums.

Deputy Pearse Doherty: It is 3% in terms of-----

Mr. Anthony Brennan: It is 3% in terms of the number of claims, but that works out at about 7% in terms of the value of claims.

Deputy Pearse Doherty: Yes. I am only looking at the number of claims as such but I understand the point Mr. Brennan is making about the value. Zurich believes that in 3% of its personal injury claims it found sufficient evidence of fraud. In those 100 cases, the company did not pay the claims. Is that correct?

Mr. Anthony Brennan: Correct.

Deputy Pearse Doherty: They were not paid because the company believed it had strong evidence that they were fraudulent. Is that correct?

Mr. Anthony Brennan: We would have challenged the people making the claims, and in some cases they withdrew their claims. Some cases moved forward towards the court process and we simply said that we were not paying. Some cases would have been dismissed.

Deputy Pearse Doherty: Only four of those were reported. The company believed there were around 100 fraudulent cases but it only reported four of them, or 4%, in 2018.

Mr. Anthony Brennan: There were 100 cases in which there was a suspicion of fraud, and in some instances that suspicion was real and we went further. We reported four of those cases where we felt we could be of material assistance to An Garda Síochána We work very closely with gardaí and co-operate with them through the fraud round table and so on. We pass cases on to gardaí that we feel would be of material assistance to them.

Deputy Pearse Doherty: I do not understand this. Here we have an insurance company that did not pay out on claims that were made because it believed those claims were fraudulent. They were not paid out so those involved did not get any money. They obviously did not challenge that but only four of those cases were reported to gardaí. How does that sit with section 19 of the Criminal Justice Act 2011, which imposes an obligation on insurers to report suspicions of fraud to An Garda Síochána? Under that Act, failure to do so can result in up to three years in prison.

Mr. Anthony Brennan: We work very closely with An Garda Síochána. There is a protocol in place for reporting claims to An Garda Síochána. The section to which the Deputy refers includes a piece on providing "material assistance" to the gardaí. I do not believe that sending those 100 claims forward would be of material assistance. We would not have had court level proof of fraud in all 100 cases. That is quite important, even from a civil liability point of view, and then we must move on to a level of evidence that allows for prosecution for fraud. It is quite a difficult offence to prosecute successfully. We work very closely with gardaí and will continue to do so. I welcome the fact that An Garda Síochána announced recently that it has increased resources in this area, and we look forward to working with it. We would be very happy to take gardaí through the other 96 cases if there is a change or improvement in the guidelines around what would provide material assistance to them.

Deputy Pearse Doherty: It is not about whether Mr. Brennan is happy to work with the Garda or provide further information. There is a legal obligation on insurance companies to report suspicions of fraud. Mr. Brennan's company, Zurich Insurance, determined that there were 100 fraudulent claims made in 2018 and in 96% of those cases the information has not been passed on to the Garda. Zurich is therefore in breach of section 19 of the Criminal Justice Act 2011. It is up to the Garda to decide whether it has enough information to warrant a prosecution, once it is given that information. The requirement in that section is that one has to provide the information where there is a suspicion of fraud.

Mr. Anthony Brennan: I am not sure what I else I can say to answer the Deputy's question. We have worked very closely with the Garda and will continue to do so.

Deputy Pearse Doherty: We heard from Zurich that 3% of its 2018 claims were fraudulent. What percentage of claims did AIG believe to be fraudulent, following investigation?

Mr. Declan O'Rourke: The 2% to 3% that we reported to the Garda.

Deputy Pearse Doherty: Is Mr. O'Rourke saying that AIG reported every claim it believed to be fraudulent to the Garda?

Mr. Declan O'Rourke: Yes. We reported all cases where we had proof that they were fraudulent.

Deputy Pearse Doherty: How many fraudulent claims were made to AIG in 2018?

Mr. Declan O'Rourke: Ten.

Deputy Pearse Doherty: What percentage of the total number of claims is that?

Mr. Declan O'Rourke: It is about 2% or 3% of the motor bodily injury cases.

Deputy Pearse Doherty: Okay. That is a very low level of claims.

Mr. Declan O'Rourke: Unfortunately, the level of convictions is even lower. Of those ten cases, only one resulted in a conviction. It can be difficult to get convictions in these cases because much of the evidence is gone and CCTV is often needed to prove one's case. We only won a conviction in that case because we could prove that the person who claimed they were in the car was not as they were visible elsewhere on CCTV. We spent a lot of money on that case. It went to court and the person was given community service for the offence.

Deputy Pearse Doherty: I will rewind a bit. Mr. O'Rourke says that AIG reported all fraudulent claims to the Garda. There were ten cases in 2018, which is 3% of AIG's overall personal injury claims. Is he saying that only 300 personal injury claims were made?

Mr. Declan O'Rourke: That is 3% of the suspicious cases.

Deputy Pearse Doherty: Mr. O'Rourke said that AIG reported all fraudulent claims. What is the overall figure?

Mr. Declan O'Rourke: Some 2,500 motor claims for bodily injuries were made, of which 450 were suspicious. Ten were reported after investigation and there was one conviction.

Deputy Pearse Doherty: Of the other 440 cases that were deemed suspicious, did AIG concur that they were not fraudulent, having looked into them further,?

Mr. Declan O'Rourke: We typically let such cases run to the courts and let the judge decide. We tend to make the plaintiffs prove their cases in the courts.

Deputy Pearse Doherty: Did AIG challenge every one of the 440 cases?

Mr. Declan O'Rourke: In such cases many people will withdraw and we might win a small percentage. We tend to put the onus on the plaintiff to prove the case through the courts at that stage.

Deputy Pearse Doherty: How many court cases did AIG challenge in 2018? Is Mr. O'Rourke telling me that AIG has 440 cases before the courts?

Mr. Declan O'Rourke: No, because by the time the cases work their way through, between withdrawals and other types of cases-----

Deputy Pearse Doherty: How many cases does AIG have before the courts, or how many did it challenge?

Mr. Declan O'Rourke: I do not have that number right now. If there is any suspicion, we let a case run through the courts, so most of them would go that way.

Deputy Pearse Doherty: Are there fewer than 20 before the courts?

Mr. Declan O'Rourke: I would say there are more than that.

Deputy Pearse Doherty: Would there be many more than that?

Mr. Declan O'Rourke: I do not have the exact numbers right now.

Deputy Pearse Doherty: Mr. O'Rourke said that all suspicions of fraud were reported to the Garda. Does AIG therefore believe that other 440 cases that are not in the courts system were not fraudulent?

Mr. Declan O'Rourke: That is up to the courts to decide. The bar for proving fraud is very high, and in many cases we did not have the evidence as it was gone.

Deputy Pearse Doherty: I do not want to go around the house on this. The witnesses need to read section 19 of the Criminal Justice Act 2011. It is not for insurance companies to decide whether the evidence reaches the threshold for prosecution. That is a matter for the Garda and the Director of Public Prosecutions, DPP. The witnesses and their companies have a clear responsibility to report any suspicions of fraud to the Garda and allow its members to do the work for which they are trained.

Mr. Declan O'Rourke: Absolutely.

Deputy Pearse Doherty: I ask the representatives of Aviva the same question.

Mr. John Quinlan: I will give an overall direction of travel before I pass over to my claims director for the refined figures. According to our internal legal advice, we are compliant with the relevant Act in our reporting of fraud. We have 80 people working on fraudulent claims and the division is headed by a former Garda superintendent. We have taken a proactive and aggressive stance on fraud detection and prevention, of which the Deputy will be aware. I will pass over to our claims director, Mr. Farrell, for the facts and figures on fraud cases, the percentages, numbers brought to court, and so on.

Mr. John Farrell: This is a real problem area. Over the past three years, we have reported more than 500 claims to the Garda under section 19 and have reported an additional 100 this year alone. The issue is not with the cases that are not reported, the vast majority of which will not provide material assistance to the Garda. The real problem is with the ones that are reported. Of the hundreds that have been reported, there have been virtually no convictions. Gardaí are incredibly hard-working, professional and dedicated people, but there is simply not sufficient capacity in the Garda with enough dedicated resources to follow up on fraud. We are fighting fraud in AIG, with 30 employees backed up by 50 full-time investigators.

I refer to what happens when a case goes to court. Take for example the case of a businessman who burns down his premises, against whom we plead fraud in open court to defend that case on behalf of innocent policyholders, as is our obligation. We are forced to spend 21 days in the High Court, at a cost of more than €1 million. That man then simply walks away from his claim, and that €1 million has to be paid by SME customers around the country. That is why their premiums have gone up despite not having made any claims. As long as claims in this country are a free-risk endeavour, people will continue to make fraudulent claims. We need assistance in this area. There needs to be far more effective follow-up on fraudulent crimes, because they are crimes and they have a real impact.

In another case, one of our customers rear-ended a third party. The cost of the damage was €80 and no personal injuries were reported at the time of the accident. Some time after the accident we were presented with two personal injury claims, which is not unusual. The first claim that went through the court was awarded €105,000. The legal fees were €98,000, though that was subsequently adjusted to €65,000. That was only for one of the injuries. There is a very real problem with the compo culture in this country and it has to be addressed.

Deputy Pearse Doherty: Okay.

Chairman: Did Mr. Farrell say €80?

Mr. John Farrell: There was €80 damage to a bumper.

Deputy Pearse Doherty: Serious questions must be asked about how our Judiciary operates if those are the types of awards being given out for €80 worth of damage to a bumper with no other personal injury damages.

Mr. John Farrell: Unfortunately, it is a common occurrence in court, as is widely reported. People submit fraudulent claims that did not happen in the manner they are presented. In some cases they are staged. Even when these people are thrown out of court, there is no effective follow-up or prosecutions. There needs to be a deterrent. Our awards are worth 4.4 times the value of similar claims in the UK, which is a huge magnet. Some people come into this country with no other purpose than to perpetrate crime by committing fraud. We are currently defending ourselves from a fraudulent claim by a gentleman from England. When he came to Ireland to attend a medical examination for the claim, he caused another single car accident that same day. This is a very real problem that we have to address. It will ultimately be addressed by bringing down the high cost of awards. If we reduce the figure from 4.4 to one, many of these problems will go away. Our customers cannot understand why the Minister has not signed the Judicial Council Act into effect. Why are we waiting one more day? We call on him to sign it today.

Deputy Pearse Doherty: I appreciate that. Our guests will hear from many members of

the committee that we want additional action in respect of an insurance fraud unit and to ensure there is not a revolving door in the courts, with those who make fraudulent claims just walking out with no losses. Deputy Michael McGrath has prepared legislation in that regard. Nevertheless, this meeting is about the industry and I wish to address the figures, not anecdotes or stories. Mr. Farrell stated Aviva reported 100 fraudulent claims to the Garda. What proportion is that of the overall number of suspected fraudulent claims?

Mr. John Farrell: The figure of 100 relates to this year to date. For the three-year period before that, it was 500, or approximately 20%. A total of 20% of all the claims we suspect to be fraud are reported.

Deputy Pearse Doherty: There are two issues with that. Every claim that is believed to be fraudulent needs to be reported. What percentage of claims made to the company does Mr. Farrell believe are fraudulent? What proportion of the total number of claims made to Aviva are the 100 cases that were reported to the Garda?

Mr. John Farrell: In a typical year, we identify approximately 800 fraudulent claims-----

Deputy Pearse Doherty: Aviva reported 100 claims in 2018. For what proportion of the overall number of claims made to the company does the figure of 100 account?

Mr. John Farrell: I apologise but I cannot answer that in respect of the 100 claims. I know the overall numbers-----

Deputy Pearse Doherty: Does Mr. Farrell know how many claims were made against the company in 2018?

Mr. John Farrell: It was approximately one third of 800.

Deputy Pearse Doherty: How many personal injury claims were made against Aviva in 2018?

Mr. John Farrell: In any one year, there are approximately 4,000 injury claims.

Deputy Pearse Doherty: I have worked the figure out. It is 2.5%. Is that correct?

Mr. John Farrell: No, of the 800-----

Deputy Pearse Doherty: I do not mean the 800. I am asking for the ratio of fraudulent claims to personal injury claims made to the company. There are 4,000 personal injury claims each year and Aviva reported 100 of them to the Garda, which is 2.5%. Is that correct?

Mr. John Farrell: No, I apologise but I will try to be clearer. Of the 4,000 injury claims we receive, we estimate that approximately 20%, or 800, are fraudulent. Of those 800, we report 20%, or 160, under section 19.

Deputy Pearse Doherty: What does Aviva do with the other 700?

Mr. John Farrell: The Deputy stated we have an obligation to report all of them but we do not. Under section 19, the obligation is to report them where they would provide material assistance. We have regular engagement with the Garda. For example, there could be an instance where the Garda is already aware, through other channels, that fraud is present and, therefore, a section 19 report would provide no assistance, material or otherwise.

Deputy Pearse Doherty: Let us say somebody makes a fraudulent claim, which is a crime. Aviva believes that passing on the name and address of the criminal and the details of the crime is not of material assistance to the Garda, whose job is to prevent and detect crime.

Mr. John Farrell: We examine all our fraudulent claims and report those under section 19 that we believe are reportable. We are increasing the number of section 19 reports we make and amending our systems to make more section 19 reports-----

Deputy Pearse Doherty: I return to the question of what happens to the 700 that Aviva does not report to the Garda.

Mr. John Quinlan: The 80 people we have employed to fight exaggerated claims or fraud do so and we will bring the claimants to court. Despite the level of the fees we pay, even when someone walks away scot-free for something that was obviously wrong, that is what we do. The cases we report to the Garda are those that offer material assistance, as adjudicated by our legal counsel and head of fraud, who is a former superintendent with the Garda. We could tick a box, dump over all our claims and say we report every single one. We saw what the Criminal Assets Bureau did to the criminal fraternity and we need the same in the form of a dedicated fraud unit in the Garda. It will not change anything if we just tick a box and send over everything.

Deputy Pearse Doherty: Are our guests suggesting that Aviva fights every one of the 700 claims?

Mr. John Farrell: Yes, we do not pay claims we regard as fraudulent. The purpose of the meeting is to consider the cost and availability of insurance. I can categorically state that if we increase the number of section 19 reports we make, it will make absolutely no difference to the cost or availability of insurance. The issue is with those that are reported. All stakeholders need to come together to ensure there is a far more effective deterrent against fraudulent activity.

Deputy Pearse Doherty: We have heard that but we need to move on to other questions and perhaps Mr. Quinlan might be able to answer them. What is Aviva's claims ratio? I refer to the number of claims, or the amount that is paid out in claims, for motor insurance versus the premium earned.

Mr. John Quinlan: That is not a problem but I will pass to Mr. Mahon, our chief underwriting director, who covers underwriting and pricing.

Mr. Brian Mahon: Our claims ratio is 65%.

Deputy Pearse Doherty: I would like to hear the figure from each of the companies.

Mr. Anthony Brennan: Our figure is 63%.

Mr. Declan O'Rourke: Our figure is 66%.

Deputy Pearse Doherty: The claims ratio, that is, the amount that is paid out in claims as a proportion of the premium earned, is below the European average. European insurance companies have a higher claims ratio. They pay out more on claims compared with the earned premium they bring in. Do our guests accept that the European average is 76%, which means that each of our guests' companies has a claims ratio of approximately 10% below the European average? It is well below Britain, which has a ratio of 92%, and Germany, Poland, Portugal, Turkey, the Netherlands, Spain, France and Italy. Do our guests accept that?

Mr. Anthony Brennan: I am not familiar with the numbers but I have no reason to disbelieve the Deputy.

Deputy Pearse Doherty: Is Mr. Brennan familiar with Insurance Europe and its work?

Mr. Anthony Brennan: Yes, but we tend to focus on the Irish marketplace because that is where our business is.

Deputy Pearse Doherty: All our guests have told us that the cost of claims is the major issue. When one considers the cost of claims compared with the premiums the companies bring in, however, the three companies appearing before the committee paid less in claims compared with the premium as a ratio. Do our guests accept that?

Mr. John Quinlan: I am not familiar with those figures. The ratio of 92% for the UK, which the Deputy mentioned, would create an ultimate combined operation ratio well in excess of 100%.

Deputy Pearse Doherty: The UK's combined operation ratio is 110%. As Mr. Quinlan will be aware, insurance companies offset that loss by investment returns.

Mr. John Quinlan: There are few or no investment returns-----

Deputy Pearse Doherty: At present. I can outline the figures-----

Mr. John Quinlan: I do not believe that the point being made could lead one to believe that the cost of claims is not the root cause of the cost and availability of insurance. It is not appropriate.

Deputy Pearse Doherty: Let us examine it. Has the number of claims made in respect of motor insurance in the past four years for which we have statistics, from 2014 to 2017, dropped or increased?

Mr. John Farrell: The average cost of claims has increased-----

Deputy Pearse Doherty: I refer to the number of claims that have been made in respect of motor insurance.

Mr. John Farrell: It is not about just the number of claims but also the cost of claims, which is a significant driver-----

Deputy Pearse Doherty: Would any of our guests be surprised to learn that there was a 25% reduction in the number of motor insurance claims across the industry between 2014 and 2017? It is a reduction of 55,000 claims.

Mr. John Farrell: I would not be surprised because car safety technology has improved the accident rate. Equally, however, the cost of claims has increased, which is a fact we must acknowledge.

Deputy Pearse Doherty: Let us deal with the following facts. In the four years in question, there was a reduction in the number of claims by 25%. Mr. Farrell stated the cost of claims has risen but it has not. The industry, as a totality in Ireland, saw the amount provided for claims reduce from 2014, from €978 million to €954 million, or a reduction of €24 million. Does Mr. Farrell accept those figures? They are from Insurance Ireland and I can provide the fact file if necessary.

Mr. John Farrell: Figures are figures but the Personal Injuries Commission, which was established-----

Deputy Pearse Doherty: Mr. Farrell stated it is not about the fact there is a 25% reduction in the number of claims but rather that the cost of claims has risen. I have given him the facts. Does he accept that the cost of claims to the insurance industry has reduced by €24 million in recent years?

Mr. John Farrell: I do not comment on the industry but specifically on Aviva. The cost of our claims has increased. I draw attention to the independent Personal Injuries Commission, which was attended by the Law Society, the Bar Council, consumer groups and medical professionals. Its overriding recommendation related to the fact was that our claim level was 4.4 times higher than the level in the UK.

Deputy Pearse Doherty: In the past four years, the number of claims has fallen by 25%, or 50,000 claims, and the amount being paid out in awards by the industry has reduced by €24 million. What has happened to premiums in that time? Would Mr. Farrell be surprised to hear that his company, along with 14 other companies, increased motor insurance premiums by €669 million during that period?

Mr. John Farrell: I have no comment to make on premiums.

Deputy Pearse Doherty: I will finish on this question, but I will come in again. I direct this question to Mr. Quinlan. Regarding price optimisation and dual pricing, he may have read in the media that I have asked the Central Bank and the Competition and Consumer Protection Commission, CCPC, to investigate the issue. I will be providing evidence next week to the CCPC. Dual pricing is controversial. It punishes loyalty and targets vulnerable policyholders. The Financial Conduct Authority, FCA, across the water is investigating this practice and its initial investigations show that not all companies operate price optimisation. Will Mr. Quinlan clarify whether his company, Aviva, operates price optimisation and dual pricing?

Mr. John Quinlan: We have done much detailed work on this issue in preparation for this session. I will hand over to our underwriting director to give precise details.

Mr. Brian Mahon: We do operate differential pricing in the Irish market. We have also contributed to the FCA review. We were a branch of our company in the UK, Aviva Insurance Limited, until February 2019 and we are working very closely with our counterparts there on differential pricing.

Deputy Pearse Doherty: Aviva is operating dual pricing, which looks at the behavioural attitudes of customers and how to get the best price from them.

Mr. Brian Mahon: It is no different to any other industry. Aviva offers a lower new business price point and we look at renewals. Some 33% of our renewal customers are offered prices lower than our new business price. Other customers are offered prices higher than our new business price. On average, however, we come in at about 3% across the piece.

Deputy Pearse Doherty: Price optimisation punishes loyal customers. Does Mr. Mahon accept, given the findings so far, that the more loyal customers are, the more likely it is that they will have a price premium? Aviva's experts in price optimisation need to understand behavioural attitudes so that people willing to renew repeatedly will be penalised with higher premiums. Is that what this really means?

Mr. Brian Mahon: From 2015 to 2018, the vast majority, if not all, of our renewal customers received a lower price than the new business price. While the FCA has a number of issues with the practice, and its interim report is being released tomorrow morning, it stated in its initial review that differential pricing is not inherently unfair, harmful or always results in poor customer outcomes. Differential pricing encourages new business competition within the market. We are here to talk about cost and availability of insurance. Adjusting differential pricing will have no impact on the cost of insurance. It will, instead, harmonise it. Costs will be increased for new business customers, of which there are roughly 500,000 in the Irish market each year. It will also marginally reduce costs for renewal customers, but the average cost will remain exactly the same. I argue that because competition will be reduced on the new business side, availability may be reduced.

We would welcome a review of this issue. Our sister company in the UK has led the market there with Aviva Plus. Interestingly, this initiative, which has been in operation for 12 months, involves making a commitment to customers who take out the company's product that their renewal price will be no more than the new business price. Despite that product being available, the company sells more on its standard product with a lower price point than it does on the Aviva Plus point. Customers, therefore, are choosing not to go down the route of level pricing. They still want to go for the cheapest price in the majority of cases. When our UK colleagues test a product that may well work within the Irish market, we will look at bringing in something similar. We are working closely with our underwriting colleagues in the UK and reviewing with interest their offering.

Deputy Pearse Doherty: I will get a chance to come back in later.

Deputy Michael McGrath: I welcome the witnesses and thank them for their attendance. This an important engagement and an opportunity for us, on behalf of the people we represent, to hold the insurance companies to account, tease out issues and get some answers. I will start by continuing with the issue raised by Deputy Pearse Doherty regarding differential pricing, as it has been described. How does it work in practice? What is it?

Mr. Brian Mahon: It is a costing initiative. We use it, as many other industries do, to supplement new business pricing in the market. It allows us to be more competitive within that market. In my experience, in the area of broadband, for example, I pay four times the new business price for broadband. I am also paying 70% more for my bank charges than a new business customer would pay at the same bank. Similarly, in utilities, I am paying about 30% more. That is my experience. Differential pricing is not, therefore, uncommon across a number of industries. We do it to stimulate competitiveness within the market. From the point of view of insurers, differential pricing is not a profit-generating initiative but more of a means of generating new business. If it was removed, it would be beneficial overall for the insurance industry. That is why we are pushing in the UK to see if we can road test that product. We would then be selling on key differences, such as brand, product and financial stability. Those would be the main reasons customers make decisions.

Deputy Michael McGrath: I would like to bring this issue down to the level of Aviva policyholders who get their renewal notice in the post. In effect, Mr. Mahon is stating that if they just renew at the premium quoted on the renewal documentation, they will probably pay more than they would if they were a new customer or simply went online to get a new quote, which might well come from Aviva Ireland.

Mr. John Quinlan: I will come in here. The question concerns customer fairness. Pricing

sophistication is trying to get the right price for the right risk. There is a secondary issue of new business versus renewal pricing. The theory behind this is that we are trying to do is stimulate competition and new business flows by offering a lower new business price. How is that fair for me as an existing customer? Over the course of my time as a customer with Aviva - we have an average policy duration of between five and seven years - he or she would expect to pay the identical amount, notwithstanding that he or she might have come in on a cheaper price point.

Can people tweak the system, as was done with fronting, by going back in and claiming to be a new business customer? Yes, that is possible. The level of that difference for us is 3%, on average. It can be higher or lower, depending on individual circumstances. It is something we are looking at. We have launched a big pilot in the UK. It is not really working as we thought it might and other companies have not followed suit. We await the findings of the FCA to see if this becomes mandatory. If that is the case, we will welcome that in this market because we will go-----

Deputy Michael McGrath: That is fine. If we break this down to brass tacks, however, is it not the case that loyal customers, those policyholders with Aviva who renew year in and year out and do not ask questions, are the biggest losers? They are not availing of the cheaper premiums that would be available if they were new customers. Is it not that simple at the end of the day?

Mr. John Quinlan: I do not think so and there are a number of reasons for that statement. Some 85% of our business comes through brokers who do their own checking of cover and pricing. We have a high retention rate. People will look at an opportunity with a new business promotion. It can involve utilities, banks, etc. With a company such as Aviva, however, customers will look to see if they will be treated fairly over time. They will want to know if their premiums will average out to be the same as they would have been if they had shopped around every year.

Deputy Michael McGrath: Is it not the case that Aviva is taking advantage of consumer behaviour? To take the example of motor insurance, many people get their renewal policy in the post. That document will still not tell them what they paid last year. It is necessary to check up on that information. Customers look at those policy renewal documents and think that the figure presented is roughly what they paid the previous year. Most people are busy and just renew the same policy. They do not even ring up to try to get a reduction. If they do ring up, however, and state they had contacted one of Aviva's competitors and were offered a policy some €100 cheaper, then Aviva will probably match that competing policy. That is the reality. Is the lesson here that loyalty is punished?

Mr. John Quinlan: In the media, for many years and certainly going back to 2014, we have seen a call for people to shop around for all types of utilities and financial services products. If trust or loyalty is broken with customers, the company involved will lose those customers. People have that ability to shop around. As I stated, some 85% of our business comes through brokers. We retain our customers because we treat them fairly. We are more than happy to change the practice, if that is provided for in legislation. All companies would need to be involved to bring that about and ensure that the 500,000 people who benefit from a new business discount or quote every year maintain those savings. We got a detailed set of questions from Deputy Pearse Doherty that we will come back to and answer fully.

Deputy Michael McGrath: We have seen this issue in the banking system as well. The witness referred to it in utility companies. Of course, they do it. They offer a better deal if

one is a new customer signing up whereas if one is locked into a contract, one cannot avail of that until the contract expires. This is not the only industry that is doing it. Banks are doing it for the biggest transaction that people have in their life, which is their mortgage. They are not proactively trying to tell a customer he or she could get a better deal, even by switching to a different product with that bank or by switching bank. That is not happening.

It is a job for all of us to address the issue of inertia among consumers and we will do that. We also have an issue in ensuring that there is fairness in the way that the industry treats its customers. Mr. Charlie Weston wrote, in January of this year: "It is hard not to conclude that loyalty is for losers." It is hard to argue with that conclusion.

Mr. John Quinlan: I am not sure that is the case when one looks at our pilot in the UK where people choose to go down the road of our new business approach in the knowledge that over time it will move to an average of someone who is an existing customer.

Deputy Michael McGrath: Mr. Quinlan is saying this is the reality of commerce and let the buyer beware.

Mr. John Quinlan: It is customer choice.

Deputy Michael McGrath: The consumer needs to shop around and he or she will probably achieve a saving if he or she shops around.

Mr. John Quinlan: I am not sure that is the case. I am not sure that is a conclusion that I would draw. The research we are doing in the UK will give us empirical evidence on which to base that consumer behaviour and, moreover, on how we ensure we treat customers fairly.

Deputy Michael McGrath: I assume the same policy applies with Zurich and AIG.

Mr. Anthony Brennan: It does. I would point again to what Mr. Quinlan said about brokers because we get over 90% of our business through brokers. It is a commercial reality. It is the way the marketplace works. However, I would point out that, similar to Aviva, in a five-to-seven year duration, one is looking at a 15% to 20% switch rate. If one looks at those other industries we talked about, such a switch rate would be a very high one for those industries. We are making it easy for customers to move around. The broker community enables that.

One of the challenges, if one looks at this, is it seems easy to say one can legislate for it but when one starts to figure out how it would work in practice, it would create all sorts of other loopholes that would make it more difficult. The effect it would have on the marketplace in the short term is difficult to know.

Deputy Michael McGrath: Is the broker obliged, on receiving the renewal quotation from the insurer, to shop around for that consumer and adviser him or her that the broker can get a better deal elsewhere?

Mr. John Quinlan: They do that.

Deputy Michael McGrath: Does it happen in practice?

Mr. Anthony Brennan: Brokers would not only look at price. It is important to say that price is one element. The quality of the product that they have and the sustainability of the business they are dealing with, being around for many years to pay their claims, is also an important factor that a broker would take into account.

Deputy Michael McGrath: In practice, I have come across older people in particular who would happen to show me what their renewal is, maybe on home insurance. They might have been with the same firm for 20 years. They are paying through the nose because they never did anything about it. They never made an inquiry. That is the reality. There are such customers out there and the insurers are benefiting from that. Anyway, I will move on.

Mr. Declan O'Rourke: We are a little different in that our renewal premium on average is considerably lower than our new business premium. We try to reward our loyal customers. We know much more about them and we can price the risk differently. Also, during the period when prices increased, we probably capped many of our increases for existing customers as opposed to bringing them straight to market rates.

Deputy Michael McGrath: Deputy Pearse Doherty spent much of his time on fraud. I will not go into it in any great detail. Mr. Farrell referred to 500 cases being referred to the Garda over the past four years.

Mr. John Farrell: Three years.

Deputy Michael McGrath: Plus a further 100 this year. Is that right?

Mr. John Farrell: Yes.

Deputy Michael McGrath: There were 600 cases, let us say, in the past four years. How many of those have ended with a conviction in the courts?

Mr. John Farrell: Very few. One could probably count them on one hand. Two.

Deputy Michael McGrath: Two.

Mr. John Farrell: The number is very low.

Deputy Michael McGrath: What do the gardaí tell Mr. Farrell in private about their ability to take these cases the distance if they believe they are fraudulent? We are not involved in the detail of those investigations. We do not know exactly what is going on. Maybe they are not fraudulent. I would assume, if Mr. Farrell refers them, he is fairly sure that those cases are fraudulent.

Mr. John Farrell: There are two issues. This is why it requires genuine engagement among all stakeholders. First, the gardaí are incredibly hardworking professional and dedicated people but we must have dedicated gardaí in this area for effective change to happen. That is why we supported the call for a dedicated fraud area within the Garda, and we would repeat that support. We would very much like to see a dedicated unit.

Deputy Michael McGrath: Is it not the truth that they are swamped? They are drowning in cases across all areas of fraud-----

Mr. John Farrell: We need to give them more help.

Deputy Michael McGrath: ----and they cannot handle it. How many of those 600 ended up in court? Mr. Farrell stated two ended up with a conviction, but how many went to court?

Mr. John Farrell: Less than a dozen. We have the additional problem, and the challenges, of going to court. I have covered some of the examples. There must be a more effective deterrent. It is too easy in this country for people to go into court, submit a fraudulent claim and

walk out the door.

Deputy Michael McGrath: What happens in those cases in relation to the legal costs? If one is in the High Court for three weeks defending a case, the claimant eventually walks away and does not bring it to the end point. The insurer must pay its costs. What happens to the costs of the claimant?

Mr. John Farrell: The costs of the claimant are not visible to us and we do not know if the plaintiff's solicitors or legal team get paid or not. That is not something we would be made aware of. What we know is the costs that we have paid. Ultimately, when we say we have paid, the reality is our policyholders pay these costs. The reality is our policyholders will pay these costs through increased premiums or we must get these costs back from the fraudster, which, of course, is difficult to do. We attempt to do that but often these are not people of substance from whom we can recover costs. We urgently need greater and more dedicated resources in the Garda to work with us and we need to work on a more effective deterrent for fraud cases in the courts.

Deputy Michael McGrath: All the insurers gave a profile of the make-up of premiums, with typically, 60% to 65% going on awards for settlement. How much is going on legal costs? Did they give that figure?

Mr. John Quinlan: I gave a typical example of motor premia. Out of the €100 in premia, €19 represented legal fees or 30% of that €65.

Deputy Michael McGrath: In awards in the area of motor insurance, 30% of those awards are accounted for in the round by the legal costs.

Mr. John Quinlan: That is correct.

Deputy Michael McGrath: Would that be broadly similar?

Mr. Anthony Brennan: It is slightly lower for us. They are closer to 25%

Mr. Declan O'Rourke: It is important to look at that a little differently. If one looks at a typical whiplash case, when one zones in on one case there could be up to 70% legal costs on the case. On average, it is 25%.

Mr. Anthony Brennan: I would highlight as well that where cases are settled through the Personal Injuries Assessment Board, the typical costs are 5% to 6% but the costs of going to court tend to be more in the 40% plus bracket on almost every case that goes through the court process.

Deputy Michael McGrath: Can I get a handle across the personal injuries awards, whether it be motor insurance or in the liability area, such as public liability? The settlement channels are court, the Personal Injuries Assessment Board, PIAB, and out of court settlements. Can Aviva give the committee the broad profile in percentage terms of how its personal injuries claims are settled through those three channels?

Mr. John Farrell: Yes. Broadly, in volume terms, we would expect on the motor side to settle approximately 40% direct, 20% through the injuries board and approximately 30% through various stages of litigation. If one looks at that in value terms, it is a little different: approximately 15%, by value, would be settled directly; 5%, by value, through the injuries board; and the vast majority, 80%, would go through some form of litigation-type process, not neces-

sarily to full court but involving a litigation-type process.

Deputy Michael McGrath: And Zurich?

Mr. Anthony Brennan: I will ask the chief claims officer.

Ms Siobhán Corbett: If we look at the claims that we settled in 2018, approximately half of those settled via litigation and the other half were either via the injuries board or we settled them out of court directly with no solicitor involved on our behalf.

Deputy Michael McGrath: Would Zurich have a similar issue that, in value terms, it is far higher in court?

Ms Siobhán Corbett: Litigation is a much higher proportion, in terms of value, of the total amount.

Deputy Michael McGrath: And AIG?

Mr. Declan O'Rourke: It is: pre-PIAB, 25%; PIAB, 20%; post-PIAB pre-litigation, 12%; litigation, 400%; and trial, 2%.

Deputy Michael McGrath: In value terms, would it be leaning higher towards the litigation and the courts?

Mr. Declan O'Rourke: Correct.

Deputy Michael McGrath: Those figures are by far the highest.

Mr. Declan O'Rourke: The difficulty is we all want to support the Personal Injuries Assessment Board, PIAB, and make it successful but the economic incentives for solicitors to move business out of PIAB process are significant in terms of the fees for them. We would love to see 90% of those cases settled through the PIAB process, if possible.

Deputy Michael McGrath: Ultimately, until we get to a point where the court awards just match the PIAB awards, people will continue through the journey.

Mr. Declan O'Rourke: And the legal fees.

Deputy Michael McGrath: That is the bottom line.

Mr. Declan O'Rourke: The economic incentives are the major issue, in particular, for the plaintiff's solicitor and the claimant.

Deputy Michael McGrath: We got all the numbers for turnover and profitability given by the witnesses earlier. Are there inter-company flows of management charges with the companies' international groups, which the figures given would be net of, which would impact on the figures presented to us?

Mr. John Quinlan: Our figures are for a stand-alone business.

Deputy Michael McGrath: Okay.

Mr. John Quinlan: Any services we get from the group are on a third party, arm's length basis. We seek to minimise our costs by using the group where we can.

Deputy Michael McGrath: Those figures are not distorted in any way-----

Mr. John Quinlan: Absolutely not.

Deputy Michael McGrath: ----- by flows internationally within the group.

Mr. John Quinlan: They would only be improved.

Deputy Michael McGrath: Let us be very clear on that.

Finally, do any of the witnesses' firms offer insurance to the leisure sector, in particular bouncy castle businesses, outdoor activity centres or playzones? Are any of witnesses' firms offering cover in that space?

Mr. Brian Mahon: We operate in the leisure sector and have a 10% market share in it. We primarily focus more on hotels. We are one of the largest providers of cover for sports clubs and sporting associations in the country and our connection with the Football Association of Ireland, FAI, and the Irish Rugby Football Union, IRFU, has only served to cement that. That would be our specialist area within the leisure sector. There may well be others who specialise in the areas the Minister described. We might have a handful of cases but it would not be our core segment.

Deputy Michael McGrath: I assume it is similar for AIG and Zurich and that they are not operating in that sector.

Mr. Anthony Brennan: Other than providing for a handful of long-term customers, Zurich is not operating in the leisure space.

Deputy Michael McGrath: That sector is currently at the coalface of the insurance crisis and the issue is not even about affordability, rather it is the non-availability of insurance with the effective withdrawal of LeisureInsure from that space. As those businesses' insurance renewals come up and no policy is offered to them, they face closure. Many have closed and many more will close. Have the witnesses any hope to offer that sector that it is an area of business their firms would be prepared to consider and to write business in or is their message that until the personal injuries climate is improved they will not be prepared to consider it? What is the bottom line?

Mr. John Quinlan: I am happy to give the Deputy feedback on that question. We are absolutely looking to cover these areas when we can. I spoke to a leading Lloyds broker this week to understand what was going on from a Lloyds' perspective. Lloyds would have been a safety valve for the giving of cover, often at higher prices. I can give the Deputy verbatim the feedback I got. Lloyds itself is struggling to retain some of its capital providers. The Minister of State, Deputy D'Arcy, was over in its offices recently. It has introducd a newe syndicate-in-a-box initiative where over a three-month period one can become a writer of business. However, what is happening is that under a new regime they have to write for underwriting profit. We have seen many syndicates which wrote business here not getting their business plans approved. Amlin Insurance had business of £250 million sterling, a chunk of which would have been Irish business, which will no longer be written. It has not got permission to do so. C.V. Starr and R&Q Insurance were also affected. The fact that Excel Insurance and AXA Insurance - AXA being the general insurance company in Ireland and one of the biggest in the world - cannot see a way to write their leisure insurance business gives us an indication of the real challenges. The sector that will benefit most immediately from the reforms we are calling for

will be the leisure sector. In the medium term we would be prepared to work, certainly at Insurance Ireland level, on alternative approaches to give some sort of cover here but it is complex. It is not without its challenges.

Deputy Michael McGrath: How would Mr. Quinlan's firm do that?

Mr. John Quinlan: There are many different alternative risk transfer type models I could reference. I know a particular Lloyds broker was speaking to the Minister, Deputy Coveney, about certain vehicles for this particular sector. There is always a way but there is a level of risk that needs to be retained by the customer. Each and every excess is there already. We are talking about a crisis where no cover is being given and we need to come together to see if we can address it and maybe even accelerate reforms in this particular area.

Mr. John Farrell: I would add that in our statement we called for two principal measures to be taken. We called on the Minister to sign the proposed judicial council into effect immediately without any further delay. We also called out the additional problem people face in the small and medium enterprise market where the issue is not only the size of the awards but the automatic entitlement to compensation. That is the "compo" culture. We have seen examples of that where a person can sit down at a table in a restaurant and simply knock his or her knee off the leg of a table and get an award of thousands of euro. We are calling for the law of negligence to be reviewed to ensure it is put back into a more affordable and sustainable area where genuine negligence is compensated for but simple accidents are not.

Deputy Michael McGrath: To be clear on this, are any of witnesses involved in any discussion or process at industry level currently to ensure there is the supply of insurance cover to that sector?

Mr. John Quinlan: Not that I am aware of.

Deputy Michael McGrath: There is nothing under way in which Mr. Quinlan is involved through-----

Mr. John Quinlan: Only my engagement with the said brokers in the Lloyds market who approached us to see if there is something we could do and that took place only during the past two weeks.

Deputy Michael McGrath: On the timeline for the key reform all the witnesses are seeking - they have all pointed to the awards being the key issue - we have been teasing this out in the Oireachtas during Question Time with the Minister for Finance and so on but I am not filled with confidence that this will happen quickly. There are still sections of the Judicial Council Act that have not commenced. As to when a judicial council will be up and running, perhaps it will be by the end of the year. The personal injuries committee then has to be set up, which would probably take a further few months, and it would then have to draw up the personal injuries guidelines. I do not get the sense there will be any great solution to this quickly from the process that is under way. Is Mr. Quinlan's feedback to us that this is the only way to do it in terms of a game changer which would result in a more competitive insurance market for consumers and, ultimately, improve the availability of insurance and reduce premiums for consumers?

Mr. John Quinlan: That would certainly be our view.

Deputy Michael McGrath: That is where it is at.

Mr. John Quinlan: Absolutely. As we have seen recently with overseas insurers traditionally passporting into our market, their pulling out of the market completely is a big concern. When we consider what happened on the back of the Setanta Insurance collapse with the collapse of Gable Insurance, Enterprise Insurance and Qudos Insurance, many of these businesses look at Ireland and wonder what is going on. We need to change that and make it more attractive to existing players because we have all got parent companies that we have to convince to keep our capital here and we want other capital to flow in equally.

Deputy Michael McGrath: In the context of Brexit - I am sure all of the witnesses' firms have their regulatory status in order and so on - do the witnesses envisage there will be any dislocation in terms of the insurance market here in the event of a no-deal Brexit at the end of October? We have replies to parliamentary questions that show there is a number of firms that have not aligned their regulatory status and, therefore, they will lose the right to passport in the sale of insurance services in the Irish market from 1 November. What is the witnesses' sense of what potentially might happen in a no-deal scenario to the insurance market in Ireland?

Mr. John Quinlan: It is a risk which the deputy governor of the Central Bank has called out in the terms of the preparedness of insurance companies writing business in Ireland. It is an absolute risk. It is a real concern. I know that around the Insurance Ireland table all the big firms have planned for a hard Brexit but there is a concern. One of the feedbacks from Lloyds is that the concern about Ireland in terms of volatility, levels of profitability and Brexit really dampen down enthusiasm to write business here so it is a concern.

Mr. Brian Mahon: I would add that we have restructured our business to be Brexit ready. As part of that we have facilitated more than 600,000 Irish customers who were with a provider which was not going to be ready for Brexit when it was to happen on 1 April. From 1 February we have taken on board and are servicing those customers to give them an option post a hard Brexit.

Deputy Michael McGrath: I thank the witnesses.

Chairman: Does Deputy Pearse Doherty want to come back in?

Deputy Pearse Doherty: Yes. I have a few questions. What is each of the witnesses' firms premium per licensed vehicle?

Mr. Brian Mahon: Our average premium is about €650.

Deputy Pearse Doherty: What was it in terms of an increase on last year's premium?

Mr. Brian Mahon: We have reduced our premium in 2018 and 2019 by 14%

Deputy Pearse Doherty: What was it in 2018?

Mr. Brian Mahon: In 2018, it would have been 2% higher.

Deputy Pearse Doherty: It was 2% higher.

Mr. Brian Mahon: In 2017, it would have been 12% higher again.

Deputy Pearse Doherty: Okay. What is premium charged by the other witnesses' firms, starting with AIG?

Mr. Declan O'Rourke: Our average is €660 at the moment. It is a drop from what it was

last year. I cannot remember the exact figure, but it is a smaller drop than that.

Deputy Pearse Doherty: Are these 2018 figures?

Mr. Declan O'Rourke: Yes.

Deputy Pearse Doherty: What about Zurich?

Mr. Anthony Brennan: I do not know. I do not have the numbers with me but I know there has been a single digit reduction from 18% to 17%.

Deputy Pearse Doherty: Those figures are in line with the industry average. Insurance Ireland's estimate for 2017 indicated an average premium of €680, which is up by 50% in the past four years. The Central Statistics Office tells us that motor insurance premiums have reduced by a much higher percentage. The percentages that the witnesses have told us here are very small - 1% or 2% in some cases.

Mr. Anthony Brennan: I am not sure how the CSO number is calculated. I think it overestimated the increases. The Deputy said 50%. The CSO said it was 70% and it is now showing 24%. I can only speak for my own company. We did not see a 70% increase and we did not see a 24% reduction. It is a basket of currencies and it may need to be looked at again. The Insurance Ireland fact file gives the information across the whole industry.

Deputy Pearse Doherty: The fact file shows that it went up by 6% in 2014, by 12% in 2015, by 22% in 2016 and by 6% in 2017.

Mr. Anthony Brennan: That sounds like the market we were in.

Deputy Pearse Doherty: The CSO and Government tell us that insurance premiums have dropped by 23% in the past three years.

Mr. Anthony Brennan: I cannot comment on exactly how it is calculated.

Deputy Pearse Doherty: Mr. Brennan's experience is that it has not dropped that much.

Mr. Anthony Brennan: Not to that level.

Deputy Pearse Doherty: What proportion of the witnesses' motor insurance business auto-renews?

Mr. Brian Mahon: It is about 20% in Aviva's direct book and it is much smaller in our broker book.

Mr. Declan O'Rourke: AIG invites renewal in all cases.

Deputy Pearse Doherty: What percentage renews with the company?

Mr. Declan O'Rourke: Probably 70%.

Mr. Anthony Brennan: Zurich invites renewal and approximately 70% renew.

Deputy Pearse Doherty: Those are people who do not contact the company and just renew their policy. It is 20% for Aviva?

Mr. Brian Mahon: It was 20% a couple of years ago. I checked the number and it is 10%.

Deputy Pearse Doherty: Does that mean that Aviva loses 90% of its customers?

Mr. Brian Mahon: The terms of our renewal are on a roll-over direct debit so there is no action from the customer to renew the policy.

Deputy Pearse Doherty: How many policyholders renew?

Mr. Brian Mahon: It tends to be approximately 80% for motor insurance.

Deputy Pearse Doherty: If I were to go onto the companies' websites, disregarding the incentive for new business and that reduction which may be anything from 10% to 20%, and got a renewal quote from the company, entering exactly the same details into the website, would it exactly match if I disregarded the 10% or 20% offered at the time?

Mr. Brian Mahon: More than one third of Aviva's customers would receive a lower renewal price than the new business price. Others would get the same price and others would receive more. As we pointed out, there is an average of approximately 3% across the piece. A third of our renewal customers get lower prices than our new business price.

Deputy Pearse Doherty: So for a third of the renewal quotes from Aviva, if the customer went onto the website, they would get a better quote.

Mr. Brian Mahon: I am talking about direct business. For brokers-----

Deputy Pearse Doherty: I am talking about direct motor insurance. That is disregarding the incentive for new customers.

Mr. Brian Mahon: We do not discount. We just have new business at a different rate.

Deputy Pearse Doherty: Why can they get a better rate on the Internet?

Mr. Brian Mahon: It is not just the Internet. Our call centre customers would also avail of that.

Deputy Pearse Doherty: Aviva is sending out a renewal quote to its customers. People who have already been with the company have the same details, contact the company through the Internet, and a third of them get a better rate. It is not related to new customer incentives.

Mr. Brian Mahon: There are many different variables with different customers. We try to achieve our target retention rate of 80% and different customers will get different prices.

Deputy Pearse Doherty: Can I ask the other companies the same question?

Mr. Anthony Brennan: We do not offer online motor insurance.

Mr. Declan O'Rourke: As I said earlier, our renewal premium is lower than our new business, on average. We occasionally have offers online that are usually time barred. There are many factors as part of a renewal premium. Some of our business is capped. We know a lot about the claims and such. On average, our renewal premiums are lower than our new business premiums. There could be differences.

Deputy Pearse Doherty: What percentage? We know that one third of Aviva's customers would be better off going on to the Internet instead of accepting the renewal quote.

Mr. Declan O'Rourke: I do not have that number right now. We do not tend to look at the

business like that.

Deputy Pearse Doherty: I want to go back to dual pricing. What I heard from the industry was that this is the incentive that is offered for new business. It is a good line but that is not what dual pricing is about. It is about identifying behavioural change and punishing loyalty. It is not about incentives for new businesses but the fact that the companies employ people who have skills related to the behavioural attitudes of their customers and looking at algorithms to identify people who are more likely to renew automatically, and punishing them with higher premiums. Would that not be a fair summary of what dual pricing is?

Mr. Declan O'Rourke: That is what it would be considered to be in the industry. It is not something AIG does.

Deputy Pearse Doherty: Does Aviva do it?

Mr. Brian Mahon: We do not have any dedicated personnel for differential pricing. A good number of our customers receive a lower price at renewal than new business. Some receive higher but on average, it is 3%. It is not to generate profit but a profit neutral initiative to generate competition in the market and try to attract more customers.

Deputy Pearse Doherty: Mr. Mahon says Aviva does not have anybody dedicated to this practice.

Mr. Brian Mahon: That is correct.

Deputy Pearse Doherty: Did Aviva not recently advertise to recruit a head of price optimisation?

Mr. Brian Mahon: That was for a head of actuarial function, on the reserving side.

Deputy Pearse Doherty: I have the document here and can read it to Mr. Mahon. One of the skills required was understanding the behavioural attitude of the customers.

Mr. Brian Mahon: We did not hire someone to lead on price optimisation. We have a team within Aviva and, on average, half of one full-time employee per month would look at our retention and renewal models.

Deputy Pearse Doherty: Here is the document. Aviva was hiring a "GI Pricing Team Leader". The job is described as expired because it is now filled, for a person that Mr. Mahon tells me does not exist. The description states that a number of price leads are being recruited in both the personal and commercial lines, so there was not just one but a number. It goes on to state that Aviva would like the applicant to have knowledge and experience of the full range of standards, risk modelling, customer behaviour modelling and price optimisation.

Mr. Brian Mahon: The Deputy has described a pricing team leader. That is not a dedicated price optimisation person, which is the question the Deputy asked. They have some of the skills but a number of skills are required for our pricing team.

Deputy Pearse Doherty: The document also states that Aviva would like the applicant to, "Support the UK based Technical Pricing & Analytics function in the development of best in class technical pricing and customer behavior models for the Irish market." Do the witnesses want to have another try?

Mr. John Quinlan: These are models that are used by every insurance company.

Deputy Pearse Doherty: That is fine but do not tell me that there is nobody working on this within the industry.

Mr. John Quinlan: We have nobody working to optimise pricing to penalise loyal customers. That is absolutely not true. We outlined a process where, to stimulate competition in the marketplace, there can be a difference between a new price offer and a renewal, but over the lifetime of the policyholder, the customer will pay the same amount. Can a person play the system by pretending to be new versus renewal? Potentially. We have seen fronting in the past. It is not our intention to treat our loyal customers unfairly.

Deputy Pearse Doherty: I am not asking about the incentives for new customers, which is common in the industry. Why is Aviva recruiting people who need experience in customer behavioural models? Is Aviva recruiting people who have to have experience in customer behavioural models? Is it not the case that the Financial Conduct Authority, FCA, report, which Aviva is involved in across the water, states that if people renew with an insurance company they are likely to be penalised in their premium? Let me quote some statistics: a person who renews four times with the same company will pay on average 20% more as a loyalty premium. That will be 28% if they renew five times and up to 40% if they renew over ten times. This is a result of price customisation or what is called dual pricing, something that Aviva has just recruited.

Mr. John Quinlan: We have led the research on this in our biggest market, the UK. We have a dedicated team on Aviva plus where renewals and new business are exactly the same. That pilot is one year old. The figures are not encouraging in terms of getting more business. People like to shop around and they like the dynamic of going in with a lower new business price knowing that they will pay more over time. We are certainly not hiring people to play any fast tricks with consumer behaviour. There is a broad definition of consumer behaviour, including where people live, fewer buying houses, new types of cover, etc. It certainly is not to penalise our customers in any way.

Deputy Pearse Doherty: Does Mr. Quinlan accept that if a person renews with the company on average, because of these algorithms and because of identifying customer behaviour, he or she will pay an additional 20% on the premium?

Mr. John Quinlan: I could not accept those figures without doing the research that underpins them.

Deputy Pearse Doherty: They are the FCA's figures.

Mr. John Quinlan: I cannot accept them when I have not reviewed them.

Deputy Pearse Doherty: Would he suggest that is broadly what the FCA is examining? Has he heard, for example, that if a person renews ten times or more he or she is likely to be paying an additional 40%?

Mr. John Quinlan: I have not reviewed the research yet.

Deputy Pearse Doherty: Aviva is operating in Britain. On 1 April 2017 what new rules came in for policyholders?

Mr. John Quinlan: I am not aware.

Deputy Pearse Doherty: On 1 April 2017 was it not the case that new rules stated that customers who renew over four times with an insurance company will have to be prompted again to shop around, even though there is a requirement for every renewal policy to be prompted, but those who renew on four occasions or more need to be given an additional prompt by the insurance company to shop around for better value?

Mr. John Quinlan: I am not aware of that. I apologise.

Deputy Pearse Doherty: That has been introduced because of this information. Does Aviva do any work with Milliman, an actuarial and consultancy firm?

Mr. Brian Mahon: No, we do not.

Deputy Pearse Doherty: Are the witnesses familiar with its work?

Mr. Brian Mahon: Yes.

Deputy Pearse Doherty: It is a reputable organisation and it states that optimisation algorithms, which the witnesses agree that Aviva has, can push prices up for loyal customers who have been renewing their policies with the same insurer for a few years because the model perceives them to be less price sensitive. Is that not the model? Is that not why Aviva is talking to people with expertise in behavioural analysis, is that not the point of big data mining? The company targets individuals using these algorithms to say that this individual has renewed several times, is less price sensitive and therefore it can charge an additional premium.

Mr. Brian Mahon: We are focusing on the additional premium. Over 33% of our customers get a premium reduction and within that analysis customers are identified who receive lower prices than our new business pricing. It does come back to our wish to achieve our target retention rate. We want to achieve our average differential which is 3%. From a loyalty point of view we are monitoring very closely what we do in the UK. We would be more than happy to replicate that. Even without that we brought in a new loyalty programme over two years ago whereby we award a 15% discount for multiple product holdings and free travel insurance to our renewal customers. We do believe in rewarding loyalty within our customer base.

Deputy Pearse Doherty: Would Aviva also be open to following the practice in Britain which prompts those who renew a policy on four occasions or more to shop around?

Mr. Brian Mahon: If that was to come into this market we would support that and we are already supporting the new disclosure requirements which are coming out on 1 November for renewal regulations.

Deputy Pearse Doherty: My insurance contracts Bill will come to the Dáil for Report and Final Stages before the end of the year. It is hoped to require all insurance companies to notify their premiums over the past three years, and the claims that have been made, to bring transparency for motor and other lines of insurance. Would Aviva welcome that?

Mr. John Quinlan: We would certainly welcome full transparency. It is critical that we do not lose sight of the real issues. That is my greater concern. Full transparency from the industry is critically important and we would certainly welcome that.

Deputy Pearse Doherty: What about the other companies?

Mr. Brian Mahon: In respect of that Bill we would really appreciate a longer lead time to

bring that in.

Deputy Pearse Doherty: We understand that a lead time will be required for information technology systems to facilitate some of this work.

Mr. Anthony Brennan: All renewal notices will show last year's premium, extending that to three years-----

Deputy Pearse Doherty: Only in motor insurance, not public liability.

Mr. Anthony Brennan: We have no particular objection but there are practical points. Anything that makes the Irish market different from other markets can make it more difficult for other insurance companies to come in here. For example, the insurance disc which we are all used to and causes us no problem might be a source of friction for an insurer looking into the Irish market.

Mr. Declan O'Rourke: We would support it. I think when there is a broker involved that happens anyway in business insurance. For individuals and consumers we would have no problem with doing that.

Senator Maria Byrne: I apologise for not being here earlier, but I was in the Seanad.

I was at a meeting of a voluntary group last Friday and the cost of insurance for all community and volunteer groups was raised. The group found that when it applied for insurance for a men's shed or whatever it was almost treated as a commercial entity. Are there any plans to treat community and voluntary groups differently when they apply for insurance?

Mr. Anthony Brennan: Unfortunately, the challenge is that from the point of view of the claims environment they are no different from commercial organisations. We have recently seen claims against community groups which might not have been made years ago. The environment today is that people do take claims even against a group of people who have put their time in for free, doing valuable work for their community. That makes it very difficult for us to price any other way than by considering the cost of claims that these groups will incur and allow for that. It goes back to delivering on the cost of claims. Reducing those will help the community groups.

Mr. John Farrell: We would support that. That is why we called specifically for a review of the law of negligence because too many claims are being paid out. There are two significant problems, first, the cost of the claims in this country, which is 4.4 times that in England and Wales. That has been validated by the excellent work of the retired judge, Mr. Nicholas Kearns. Second, an additional problem for the groups the Senator speaks about is the sheer frequency of claims and the fact that every accident now requires compensation. It is part of the "compo" culture. We are calling for a fresh review to determine what can be done so that payments are made only where actual negligence happens. That is critical to help in that area.

Deputy Pearse Doherty: The witnesses have to acknowledge that the frequency of claims has been reduced by 25% over the past four years. There are arguments the witnesses can make but they need to talk about it in facts instead of spin. I am sorry to interrupt.

Mr. John Farrell: I referred to the reduction in frequency of motor claims. That has not been our experience in the area of liability. We have seen increases in the frequency of liability claims and in their cost. It is a twofold problem that underpins why groups the Senator refers

to have such real problems in the affordability and availability of insurance. Until we address that as a real problem these groups will be left in trouble.

Mr. Declan O'Rourke: We have to consider the claims. Two of my children fractured their fingers this summer playing hurling and camogie. They went to the local clinic, the finger was strapped up and they were back playing in a few weeks. A fractured finger is not a big deal but if someone is responsible for it or it happens in a play centre or a men's shed, according to the book of quantum in Ireland, a fractured finger with no long-term complications is worth €17,500. One can expect to spend €10,000 on the complainant fees, while the defence fees will be €3,000, all for a fractured finger that will be fine in a few weeks in uncomplicated cases and which thousands of children get playing hurling every Sunday. Two of my kids had them this summer.

Chairman: I assume there was no claim arising. That should be made clear.

Mr. Declan O'Rourke: Yes. There was an argument that they wanted to get back more quickly. A private clinic tries to get people to have an MRI and one has to tell them an X-ray is fine as it is not so serious. We sought the view of our claims managers throughout Europe of what would happen in their country. In comparison to the 17,500 whiplash cases in Ireland, there were 4,100 in the UK and the legal fees were €932. A lawyer needs to find ten broken fingers in the UK to pay for one in Ireland. Germany has more people in its court system and not so much of it is outsourced to lawyers but the injury value was €1,500 while legal fees were €250. In a men's shed, a broken finger is a common injury and the book of quantum has to change as regards these awards.

Senator Kieran O'Donnell: I have been looking at previous profit figures. Is AIG Insurance part of the AIG Europe group?

Mr. Declan O'Rourke: Yes. We are a branch of the European business.

Senator Kieran O'Donnell: Mr. O'Rourke said there were €30 million in losses on €280 million of premiums. Is there a group management charge from AIG Europe that is distorting the figures?

Mr. Owen Kelly: We pay 3% as a global service fee to our parent in Europe.

Senator Kieran O'Donnell: So the figure for losses of €30 million is not distorted.

Mr. Declan O'Rourke: No. The fee is for listing, for a financial strength rating or compliance-----

Senator Kieran O'Donnell: AIG is a bit of an outlier in the insurance industry in Ireland in that it made a loss of €30 million in 2018, while all the other insurance companies appear to have made substantial profits. Is this because it is a member of AIG Europe?

Mr. Declan O'Rourke: No. It has nothing to do with it.

Senator Kieran O'Donnell: My next questions are for Aviva and Zurich. In 2018 the normal target margin was 5% but Aviva made 11.4% and Zurich 8.98%. Aviva made superprofits of €33 million and Zurich €12 million, which are 6% and 4%, respectively. Axa was before us, as were FPD and Allianz. In total, the five companies other than AIG made superprofits of over €122 million in 2018. We have spoken about claims and legal fees but, given that the companies are making margins way in excess of their target margins, why are they not reducing

fees? They are saying they will only reduce premiums when they keep the 5% margin. Why are Aviva and Zurich not passing back these superprofits, of €33 million and €12 million, respectively, to customers in the form of reduced premiums? Why do many customers feel they are being ripped off by insurance companies?

Mr. John Quinlan: We have discussed transparency this morning. We often pay claims seven years down the road and we are not making superprofits. If we were, there would be far more competition from companies interested in participating in the Irish market. Our figures for 2012-18 suggest we are making a 97% core, which is 2% below our target. It was 101% in 2012 but 92% in 2018. For motor insurance we wrote €1.2 billion between 2012 and 2018 and made a €14 million underwriting profit, €71 million in total, which is a gross return of 1.7% and nothing like 5%. Our liability was €400 million.

I was asked about claims increases but we lost €37 million on that figure at underwriting level, and lost €10 million of the total, yet I am trying to convince the group to stay with Ireland and to keep deploying capital. We are certainly not making supranormal profits. We need to make sure we are here to pay the claims of the future. Quinn Insurance cost us €2 billion because the premiums were not right. We will pass back profits as soon as we can see the reductions in average claim cost.

Senator Kieran O'Donnell: Mr. Quinlan is putting all the onus back on fraudulent claims and legal fees. How long does it typically take for an insurance claim to be settled?

Mr. John Quinlan: It depends on the claim. Property claims have a very short timeline.

Senator Kieran O'Donnell: Is it less than six years?

Mr. John Farrell: On average, liability takes six years but we are dealing with some claims that are 15 years old.

Mr. Anthony Brennan: We had a 6% margin in 2018. On top of that is investment income, which is the money we put aside to put back into our business and into reserves we all need to hold. A lot of claims take a long time to pay back so I would not describe our figures as superprofits. There have been reductions in home and motor insurance but not liability, which is a problem for us and a challenging area. The reductions will feed through to lower margins in the years to come and the danger of us of getting back into a boom and bust cycle, in which we compete strongly with each other, is that we drive the margin down to a level at which we start making losses again and require premium increases. Customers want stability. They all want reductions in premiums but they do not want big increases followed by big reductions. We plan for a sustainable level of profit and we plan three years ahead. I look at the profit level in three years' time and it will be a bit lower than 2018, which means I need to grow my business. I want to get into more lines of business because that will mean the cost of claims becomes more reliable and more predictable.

Senator Kieran O'Donnell: The general public are being told by insurance companies that it is a tough environment but according to the 2018 profits, five or six companies were making a very health profit. The average person will ask why their premiums are so high. It is a legitimate question and I ask the insurance company to look at premiums for hard-pressed customers, though I accept they have to make a profit. They need to ensure cover is provided across many areas, because people in leisure, crèches and the SME sector cannot get insurance. That is unacceptable.

Chairman: We will consider the Senator's points in the context of a short report, after these sessions.

Deputy Eugene Murphy: A lot of the discussion before I had to leave for another meeting centred on fraudulent claims, which seems to be a massive issue. Fraudulent claims, however, involve not one person but two. What responsibility do the insurance companies have to the legal representative of a claimant when an allegedly fraudulent claim comes before them? I would welcome a response from each of the witnesses to that question.

Mr. John Farrell: Is the Deputy asking if the insurance companies have a responsibility with regard to the legal representative of the claimant?

Deputy Eugene Murphy: Yes. In most cases, a claimant will have a legal representative. Where a claim is identified as fraudulent, do the insurance companies have any responsibility in regard to the legal representative in that case or is that a matter for the law?

Mr. John Farrell: In the first instance, we have deployed substantial resources in this area. We have employed 30 dedicated staff to handle specifically fraud cases, backed up by a network of 50 personnel to carry out comprehensive investigations. Fraudsters need enablers. They cannot put forward fraudulent claims on their own. They need and get assistance from various professionals. We would ask those professionals to look closely at claims to ensure there is proper behaviour and that in addition to us they are carrying out significant investigation into claims. In terms of the cases getting to court, it is a little difficult to believe that some of the people who are involved were not aware that there were grounds for suspicion.

Deputy Eugene Murphy: In how many cases per annum to date has it been expressed in court that a legal representative did wrong?

Mr. John Farrell: I cannot recall where it has been said in court that a legal representative had done wrong.

Deputy Eugene Murphy: Mr. Farrell is saying they are not being held responsible.

Mr. John Farrell: My point is that if the fraudsters were not enabled with professional assistance, they could not bring these claims through the system and they certainly could not get them paid. We have deployed our resources and made our investment. We will make a further investment, but we need help in this area. We call on the various professional organisations that provide professional assistance to examine what is going on and to carry out investigations similar to those carried out by the insurance companies so that they can address these suspicious events.

Deputy Eugene Murphy: When an insurance company receives a case from a legal representative which appears to be odd or out of the ordinary, does the insurance company have a responsibility to immediately bring that matter to the attention of the Law Society?

Mr. John Farrell: Where we become aware of a matter which is potentially fraudulent, which we believe would be of material assistance to the Garda, we are required to make that report under section 19. In the past, we have exercised that responsibility.

Deputy Eugene Murphy: I would welcome a response on those issues from the other witnesses.

Mr. John Quinlan: From memory, the first time I heard a judge comment on the role of

a professional was in a recent case presided over by a female judge, which was a gross case of fraud. We would welcome tighter restrictions on all professions in terms of bringing cases and a duty of care to ensure that there is no exaggeration of claims and no sense of fraudulent behaviour.

Mr. Anthony Brennan: It is an adversarial system. We are in the business of paying valid claims. All claimants are entitled to representation. We have to assume that claimants are going to be professionally represented. It is an adversarial process and we do not always agree with the people on the other side of the bench. For us to report to the Law Society would be very difficult. These issues are more appropriately addressed to the courts, to which one or two cases have been referred recently.

Mr. Declan O'Rourke: We have never seen any solicitor taken to task in regard to any particular representation.

Deputy Eugene Murphy: Do all of the insurance companies represented today provide flood insurance?

Mr. John Quinlan: We do.

Mr. Anthony Brennan: We do.

Deputy Eugene Murphy: How difficult is that in the context of climate change? In my constituency, people who have been hit by flooding have made claims which, in fairness, have been paid but they are now finding it difficult to have their insurance renewed, even where there may have been works carried out by the local authority and so on.

Mr. Brian Mahon: We work closely with the Office of Public Works, OPW, and the local authorities in regard to areas where works have been carried out. We need greater information sharing on the part of the OPW in regard to works carried out such that we can recognise them. We have had some representations from various Members of the Oireachtas. Once we are able to verify that works have been done, we are more than happy to reinstate cover if we are not offering it in a particular area.

Mr. Anthony Brennan: There is a process in place in terms of working with the OPW. The OPW is doing some great work but it needs to share the information with us as quickly as possible to allow us to update our understanding of the risk involved. Where permanent defences have been installed, it is much easier for us to step in and offer flood cover again. Temporary defences cause challenges because we need to understand exactly how they will work in a period of stress.

Chairman: I thank the witnesses for their responses and for attending today's meeting.

The joint committee adjourned at 1.25 p.m. until 2 p.m. on Tuesday, 15 October 2019.

FINANCIAL CONDUCT AUTHORITY

General insurance pricing practices

Interim Report

Market Study

MS18/1.2

October 2019

How to respond

We are asking for comments on this report by 15 November 2019

You can send them to:
General Insurance Pricing Practices
Market Study Team
Competition Division
Financial Conduct Authority
12 Endeavour Square
London E20 1JN

Email:
GIPricingPractices@FCA.org.uk

How to navigate this document

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- email and share document

Contents

1 Executive summary

Overview

1.1 General insurance products are important for consumers and provide them with protection when things go wrong, for example if they have a car accident or their house is damaged. Over 45 million home and motor insurance policies were written in 2018. The retail general insurance sector is key to the UK economy, generating £24 billion of revenue in 2017. Home and motor insurance generated £18 billion in gross premiums in 2018. It is important that the general insurance sector works well and delivers good outcomes for consumers.

1.2 We launched this market study to understand whether pricing practices in home and motor insurance support effective competition and lead to good consumer outcomes. This followed a thematic review showing that consumers who stayed with the same provider for a long time paid on average significantly more for home insurance than newer consumers. We were concerned about the potential harm this could cause to consumers.

1.3 The general insurance sector has been an area of focus for us over recent years. For example, we have introduced new rules in relation to the Insurance Distribution Directive and to increase transparency and engagement at insurance renewal. We have also looked at value in the general insurance distribution chain and value measures regarding the quality of general insurance products.

1.4 Stakeholders have also raised concerns about outcomes from general insurance pricing practices. In September 2018, Citizens Advice made a super-complaint about loyalty pricing to the Competition and Markets Authority (CMA). Home insurance was one of five markets included in the super-complaint. The CMA published its response in December 2018. It recommended the FCA look at ways to tackle price walking and other harmful business practices in home insurance.

1.5 We found that these markets are not working well for consumers. Firms use complex pricing practices that allow them to raise prices for consumers that renew with them year on year. This is called price walking and the fact firms do this is not made clear to consumers. When we asked for consumers' views on price walking we found that, whether they shop around or remain with their provider, they think price walking is wrong.

> It [price walking] is not fair, it makes me feel cheated.
>
> Market study consumer research: Comment from in-depth interview with an individual consumer who regularly shops around

1.6 Our other key findings are:

- Insurers often sell policies at a discount to new customers and increase premiums when customers renew, targeting increases at those less likely to switch.
- 6 million policy holders paid high prices in 2018. If they paid the average for their risk they would have saved £1.2bn.

- We estimated the cost of attracting new business is £2.3bn per year and will be borne by all consumers through higher prices.
- Longstanding customers pay more on average but loyalty is not the only issue – high prices were paid by some consumers who had been with their provider for less than 4 years.
- 1 in 3 consumers in our consumer research who paid high prices showed at least one characteristic of vulnerability, such as having low financial resilience or capability. For consumers who bought combined contents and building insurance, lower income consumers (below £30,000) pay higher margins than those with higher incomes.
- People who pay high premiums are less likely to understand insurance or the impact that renewing has on their premium.
- Most firms, when setting a price, include their expectations of whether a customer will switch or pay an increased price. This is not made clear to the customer.
- Firms engage in a range of practices that could make it more difficult for consumers to make informed decisions and could raise barriers to switching.
- Firms earn profits primarily from activities other than underwriting, such as add-ons, premium finance, fees and charges or investment income.
- Many consumers who switch or negotiate their premium can get a good deal.

1.7 Our statutory objectives are to make relevant markets work well by protecting consumers, promoting competition and protecting and enhancing the integrity of the UK financial system. These objectives form the basis of this market study's aims. Linked to these objectives, our goal is to ensure that in general insurance markets:

- Consumers can trust firms to deliver fair value and treatment for all consumers.
- Firms put fair value and treatment of customers at the centre of their pricing practices.
- Firms do not engage in practices that make it difficult for consumers to make informed decisions and act to get better deals.
- Consumers who do not switch are not unreasonably penalised.

1.8 It is important that customers purchase good value general insurance products. Value is driven not only by price but also by the quality of the product. Consumers should be able to trust that firms will provide them with a quality product that delivers on reasonable expectations of performance.

1.9 Industry has acknowledged the need to tackle concerns about pricing practices and has been taking some steps to do this. However, we think that FCA intervention is also likely to be required. In the immediate term, we will continue work to address the problems we have uncovered including to:

- ensure firms improve the governance, control and oversight of pricing practices.
- deliver the changes required from firms following implementation of the Insurance Distribution Directive.
- continue improving transparency and engagement at insurance renewal. We introduced rules to do this in 2017, and publish our evaluation of the impact of these alongside this report. We estimate consumer savings of £185 million per year due to this intervention.

1.10 We are also considering a range of industry wide measures to reform these markets so they work well for consumers in the future.

How firms set prices for home and motor insurance

1.11 Broadly, the price for home and motor insurance is made of 3 elements. These elements amount to the overall retail price paid by the customer (excluding insurance premium tax). Figure 1 below summarises this:

Figure 1: Summary of how most firms in our sample set prices

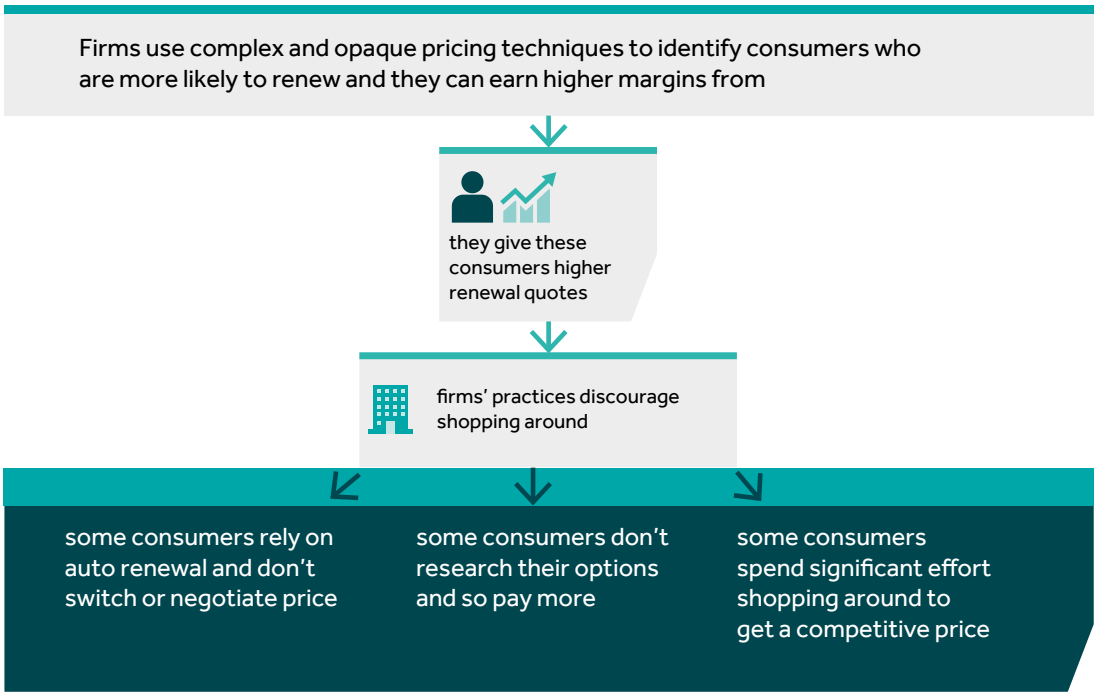
Source: FCA analysis of information gathered from firms during the market study

1.12 Our thematic review on home insurance pricing practices identified differentials in the margins firms earned between consumers of equivalent risk and cost to serve. So this market study has focused on how firms set margins for customers and not how firms assess individual consumers' risks (underwriting). The degree of capability and sophistication, coupled with the nature of the firm's strategy in optimising the margin across all business varied. However, only one firm in our sample applied a uniform margin to all its business.

What we are concerned about

1.13 Overall, our analysis raises significant concerns that these markets could work better and are not delivering good outcomes for all consumers. Our concerns about how this leads to harm is in Figure 2 below:

Figure 2: Analysis of how pricing practices may lead to harm



Source: FCA analysis

Action we are considering

1.14 We summarise the potential remedies that could tackle our concerns below, and discuss them and those that we propose not to consider further in more detail in Chapter 7. We will continue our work to tackle immediate harm from pricing practices alongside longer-term changes to make these markets work better in future.

1.15 We will look carefully at which remedies can achieve this in the most effective and proportionate way. Some of the remedies we are considering could be more interventionist. We will keep these under review. We will consider if there is a case to remove them should they successfully tackle harm and the market has developed sufficiently so that they are no longer required.

1.16 We will look closely at how firms could change their business models in response to potential remedies, for example reducing the quality of core insurance products or increasing the sale of add-ons to consumers that may offer little additional value. These types of practices would also result in poor outcomes for consumers and we would not expect to see firms use them.

1.17 We will consider the potential impacts of remedies on the outcomes for different groups of consumers. Many consumers can get lower prices if they actively shop around and switch. We do not want to remove these benefits for these consumers.

1.18 We will use our research on international comparisons of general insurance markets in other countries to provide insights into potential remedies to address concerns we have identified in this market study.

Our remedies will fit with wider regulatory efforts to improve consumer outcomes

1.19 We will use the full range of our tools to take a holistic approach to tackling our concerns. Any remedies that may emerge from this market study will fit with our ongoing work in general insurance markets.

1.20 Good governance over pricing outcomes for consumers should be central to firms' pricing practices. In October 2018, our Dear CEO letter to firms about retail general insurance pricing practices set out our expectations, including on governance, control and oversight. We have reviewed firms' responses to this letter, and there is a wide variation in the nature, extent and quality of firms' oversight of pricing practices. We have seen some examples of improved practice by some firms. However, this remains an area that requires significant improvement.

1.21 We implemented the Insurance Distribution Directive (IDD) in the UK on 1 October 2018. This introduced new conduct of business requirements for insurers and distributors. These rules include new requirements on firms to act honestly, fairly and professionally in the best interests of consumers, and new requirements for product approval and oversight. Our rules also require firms to provide customers with appropriate information so they can make informed decisions about taking out a contract.

Remedies to tackle high prices for consumers who do not switch or negotiate

1.22 We are concerned about the harm to customers who do not switch or negotiate and are paying higher prices than customers of equivalent risk and cost to serve.

1.23 We recognise that how prices are set for home and motor insurance is complex. Any intervention that changes price setting could impact the way the industry is structured and how competition works. We are considering supply-side remedies despite these complexities.

1.24 The options we are considering include:

- Limiting pricing practices that allow firms to charge higher prices to consumers who do not switch, for example, restricting or banning margin optimisation based on consumers' likelihood of renewing.
- Automatic switching of consumers paying high prices to lower priced products that provide equivalent cover.
- Requiring firms to engage with customers to give them information about alternative deals and identify those who may need help in moving to better priced products with equivalent cover.
- Expanding or strengthening our existing product governance requirements.
- Requirements for firms to provide data tracking their actions to improve pricing practices and monitoring pricing differentials between their customers.

Remedies to address practices that could discourage switching

1.25 In addition to continuing our work in the immediate term to address problems we have uncovered, we are considering action to address practices by firms that discourage switching or do not support effective competition. In doing so, we will take account of the CMA's principles for healthy competition and acceptable behaviour by firms. These were set out in the CMA's update on its response to the loyalty penalty super-complaint.

1.26 Potential remedies to these practices could include:

- A ban or restriction on the use of auto-renewal of insurance policies, including where there has been a change in the price.
- Making auto-renewal opt-in only.
- Making it easy to decline auto-renewing policies at the time of purchase and at renewal.
- Ensuring that firms make it as easy to exit a contract as it was to sign up.

1.27 In developing any potential remedy, we will carefully consider the impact on the potential advantages of auto-renewing insurance.

Remedies to make firms be clearer and more transparent in their dealings with consumers

1.28 Complexity and lack of transparency around how firms set prices is unlikely to help consumers make informed decisions.

1.29 We see firms being clear and transparent in their dealings with all consumers as key to well-functioning markets. Firms are already required under our rules to communicate with consumers in a way that is clear, fair and not misleading. They are also required to disclose last year's premium at each renewal, so that it can be easily compared to the new premium offered. To further improve transparency and aid consumer engagement, we are considering:

- Requiring firms to be transparent about their pricing strategies and the reasons for price increases.
- Requiring firms to publish information about their price differentials between their customers. This may increase competitive pressure and public scrutiny that could prompt firms to improve their pricing practices.

Long term reform of the market by harnessing the benefits of innovation

1.30 We will also look at ways that retail general insurance markets could be positively affected by future developments and innovation. Developments such as Open Finance and the increasing use of consumer data have the potential to transform the way consumers interact with financial products. Currently, price comparison websites (PCWs) help consumers shop around and compare prices. However, consumers need to actively provide their data to benefit fully from these services. We are considering further work on uses of data and analytics across sectors and will communicate more details in due course.

1.31 We believe Open Finance has the potential to revolutionise the way financial markets work for consumers, delivering significant consumer benefits and spurring better competition and more innovation. We recognise it could take some time for the potential of Open Finance to be fully realised, and will depend on consumers engaging with it. But we want general insurance markets to be part of these transformations to ensure they work well for the future. We will take this forward as part of our advisory group on Open Finance. This group will inform our Call for Input on our strategy towards Open Finance which we will publish later this year.

Next steps

1.32 We would welcome stakeholder feedback on the following questions:

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

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?**

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?**

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?**

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?**

1.33 Please send views on the above questions to GIPricingPractices@fca.org.uk by 15 November 2019. We will take these views into account in our final market study report. We will also be engaging directly with stakeholders to discuss this interim report shortly. We are grateful to firms and other stakeholders who have provided information that has informed this interim report.

1.34 We plan to conduct further analysis, including of potential remedies and their associated costs and benefits before we publish our final market study report. We aim to publish our final market study report, alongside a consultation paper on any proposed remedies, in Q1 2020.

2 Our approach to this market study

Our approach to this market study

2.1 The scope of the market study is home and personal motor insurance. We have focused on understanding how competition works in these markets by looking at:

- The structure of the general insurance sector. This includes the providers of home and motor insurance, their roles in supplying these products and associated add-on products and premium financing, and the different business models.
- How firms set prices and treat their customers in this process.
- Whether pricing practices support effective competition in delivering good consumer outcomes.
- Outcomes from pricing practices, including the scale of any price differentials between consumers and who is paying higher and lower prices, including whether they may be vulnerable.

2.2 We have used our analysis of these areas to inform whether pricing practices raise concerns and whether we should take any action. In assessing this, we have used the framework set out in our Approach to Competition. We have used what the evidence tells us as part of our framework for assessing concerns about price discrimination.

Scope of the study

2.3 Our market study builds on our thematic review of home insurance. It focuses on pricing practices for home and motor insurance. It does not include other general insurance products such as health, pet and travel insurance. However, where possible, we will identify lessons from this market study that are relevant to other markets that we regulate.

2.4 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 PCWs. Not all of them set the price consumers pay for insurance, but they do influence the dynamics of competition and pricing outcomes for consumers. The scope of this market study includes all of the parties described in this paragraph.

Issues the market study has looked at

2.5 Our assessment of whether markets work well for home and motor insurance customers looked in particular at three key broad areas, set out below.

How firms set prices and treat their customers

2.6 We have assessed how firms treat consumers in pricing home and motor insurance, and the impact this has on competition and consumer outcomes. We looked 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.

2.7 We also examined consumers' perspectives and attitudes to their experience and the fairness of pricing outcomes in the motor and home insurance markets.

Whether pricing practices support effective competition

2.8 We also sought to understand the impact of pricing practices on competition in the home and motor insurance markets. We analysed whether pricing practices support effective competition that delivers good outcomes for consumers. In doing this, we have been guided by the FCA's Approach to Competition. We have examined whether these practices:

- lead to price discrimination that intensifies or dampens competition.
- work in the interest of only some or all consumers.
- raise the cost of providing insurance either through generating excessive search and switching costs for consumers or increasing customer acquisition costs for firms (or both).
- lead to firms making high profits.
- increase or restrict consumers' access to insurance.
- create barriers to existing and new firms developing innovative business models and different pricing strategies.

2.9 We also examined consumers' understanding of general insurance pricing practices, and their shopping around and switching behaviour, to help us understand its impact on competition.

Consumer outcomes

2.10 We wanted to get a deeper understanding of firms' pricing practices by assessing how firms set prices and how competition works in each market. We looked in detail at consumer outcomes from pricing practices, including the proportion of consumers that may pay very high prices and who they are. We have looked at:

- the differences between prices paid for each of motor and home insurance by different consumers compared to the cost of providing them with insurance.
- how many consumers in each market are affected by paying higher prices.
- the characteristics of consumers paying higher prices, especially the extent to which they may be vulnerable.
- why some consumers end up paying higher prices.

Evidence we gathered to support out analysis

2.11 Our interim findings are drawn from multiple pieces of analysis including:

- Analysis of data gathered from insurers, intermediaries and PCWs on:
  - Information on firms' business structures, pricing models and strategies.
  - Policy level data over a 5-year period (from 2014 to 2018) from 24 price-setting insurance and intermediary entities identified by their firm reference number (FRN). The sample covers 17 insurers for home insurance and 18 for motor insurance. The data include general information on the insurance policy (for example inception and duration, characteristics, sales channel), price and cost information (of core policy, addons), ancillary fees and information on the policyholder. The dataset contains nearly 7 million observations for over 2 million unique policies for home insurance and 10 million observations for nearly 4 million unique policies for motor insurance. The market share of the insurers based on Gross Written Premium (GWP) in our sample represent 76% and 91% of the motor and home underwriting market respectively. We selected the intermediaries to be representative of the different types of business models in the markets. In terms of market share of the intermediated market, the intermediaries in our sample represent 23% of home insurance and 69% of motor insurance.
  - Financial information and management accounts. We analysed this to understand the range of business models which firms use across the supply chain for home and motor insurance, how firms generate revenue and their profitability. We collected annual financial data over a 6-year period (2013 to 2018) from 17 insurers, 12 intermediaries (which includes both price setting and non-price setting intermediaries) and 4 PCWs.
  - Information about firms' policies and strategies for ensuring they treat customers fairly, the communications they provide to customers at renewal and the contractual terms used.
  - Responses from firms to a range of other important questions. These included how firms compete for new and existing consumers, potential barriers to entry and expansion, and recent and future market developments. We used responses from 17 insurers and 12 intermediary firms for this analysis.
- Consumer research that combined (across 18 insurance companies):
  - Online surveys of over 3,500 and 6,800 home and motor insurance customers.
  - Computer Assisted Telephone Interviewing of over 600 customers each for both home and motor insurance.
  - 10 in-depth phone and face-to-face interviews to explore in more detail consumers' experiences, behaviours and perceptions.
- Combined analysis covering a matched sample of consumers from the customer transaction data and those who responded to our consumer research. This analysis looked in more depth at the characteristics of these consumers and the outcomes they get from pricing practices.
- Research looking at pricing practices for general insurance in other countries. We analysed the similarities and differences between how these markets operated compared to the UK, and the resulting consumer outcomes. This was primarily to inform our consideration of potential remedies.

- We commissioned research by Deloitte looking at future developments in general insurance pricing. The scope of the work was to look at:
  - what new business models are developing in the motor and home insurance markets.
  - the likely key changes over the next few years that will impact on general insurance pricing practices.
  - how market developments might impact the types of remedies that might be most effective in addressing potential harm from pricing practices.

2.12 We also drew on other FCA work to inform our analysis, particularly the previous thematic review on pricing practices for home insurance, our review of firms' responses to our Dear CEO letter on pricing practices for general insurance, and our evaluation of rules to increase transparency and engagement at insurance renewal.

Structure of this report

2.13 The rest of this report is structured as follows:

- Chapter 3 sets out the market overview and our analysis of:
  - The structure of the general insurance sector, and the home and motor insurance markets. This includes the different firms in the supply chain and their business model and distribution channels for home and motor insurance.
  - The current market environment.
  - Future market trends and innovation.
- Chapter 4 sets out our analysis of how firms set prices for home and motor insurance and how they treat customers.
- Chapter 5 sets out our analysis of whether pricing practices support effective competition.
- Chapter 6 sets out our findings on consumer outcomes from pricing practices.
- Chapter 7 discusses the potential remedies we are considering to address harm we have identified.

2.14 We have also published a number of annexes to this report:

- Annex 1: Consumer outcomes technical annex
- Annex 2: Business models and financial analysis technical annex
- Annex 3: International comparisons
- Annex 4: Consumer research report
- Annex 5: Consumer research technical report
- Annex 6: Future trends in general insurance pricing research report

3 Market overview

The general insurance sector

3.1 Our Financial Lives Survey shows that most UK adults (82%) have one or more general insurance products. Retail general insurance products include home (buildings and contents), motor, pet, travel, home emergency, breakdown, mobile phone and gadget insurance. According to our Financial Lives Survey, the most commonly held products are motor insurance (61% of all UK adults) and combined home buildings and contents insurance (49%).

3.2 The home and motor insurance markets generated around £18 billion in gross premiums in 2018 (ABI Household Insurance Premium Tracker), and made up 75% of the total retail general insurance sector in 2017 (ABI General Insurance Product Distribution). Many consumers need these products and drivers are legally required to have third party motor insurance.

3.3 Retail general insurance plays an important role in providing consumers with protection if something goes wrong, for example if their home is damaged or they are involved in a car accident. Sales of these products generated over £24bn in gross premiums for insurers in 2017 with the home and motor insurance markets accounting for 75 per cent of this (ABI General Insurance Product Distribution).

3.4 The home and motor insurance markets are not highly concentrated. We estimate the Herfindahl-Hirschman Index (HHI) is 589 for motor insurers and 862 for home insurers, with the top 5 insurers accounting for around 48% of gross written premiums (GWP) in motor and 57% of GWP in home. For both motor and home there is a long tail of smaller firms.

Home insurance

3.5 While there is no legal requirement to buy home insurance, mortgage contracts generally require borrowers to have buildings insurance (unless they already have buildings insurance through a leasehold arrangement). The sum insured must typically be enough to meet the property rebuilding cost. In 2018, over 18m policies were written for premiums worth almost £5 billion (ABI Household Insurance Premium Tracker Q1 2019 (GWP)). 16% of UK households would like to have contents insurance but see it as something they cannot afford and 13% do not want or need insurance (Office of DWP Family Resources Survey, 2016-2017).

3.6 Consumers can choose to insure their home, its contents, or both. 66% of policy holders have a home policy with combined buildings and contents coverage (ABI Household premium tracker 2018). Additional features, cover or services, such as accidental damage, home emergency and legal expenses, can be included in a policy or can often be bought as an 'add-on' for an extra premium. Premium finance is another ancillary product. It allows consumers to pay their premium in instalments (typically monthly) rather than in a lump sum upfront – consumers usually pay more for this option.

Motor insurance

3.7 Motorists are legally obliged to hold a valid insurance policy to cover third party risks. In 2018, over 27 million UK motor insurance policies were written for premiums of just over £13bn (ABI Quarterly Motor Premium Tracker).

3.8 Consumers can buy policies that also cover fire and theft or comprehensive cover. 94% of policyholders have comprehensive cover (Mintel 2019). Extra features, cover or services, such as a courtesy car, motor legal expenses, roadside assistance, or windscreen repair or replacement, can be included in a policy or can often be bought as an 'add-on' for an extra premium. As with home insurance, consumers can also use premium finance for motor insurance.

Providers of home and motor insurance

3.9 Providers of home and motor insurance can play different roles in supplying cover. Figure 3 below shows these and the activities that firms can carry out in each role:

Figure 3: Types of roles firms play in supplying home and motor insurance

1.	Insurers	Design, manufacture, underwrite and distribute insurance products.
2.	Intermediaries (excl. PCWs)	Possible activities: Design, manufacture and distribute* insurance products but NOT underwrite risk.
3.	PCWs	Intermediated platform which allows consumers to compare insurance products.

* Some intermediaries only provide their brand name and customer base and earn commission or part of the premium.
Source: FCA analysis based on information gathered from insurers and intermediaries

Different business models across firms

3.10 Price setting roles can vary across the supply chain, but broadly fit into the following categories:

- the insurer may set the retail price that consumers pay.
- the insurer may set a net rated price, with an intermediary setting the retail price consumers pay.
- the insurer may delegate authority to an intermediary to set the net rated price (known as delegated underwriting authority) and the retail price.

3.11 A net rated price is the price provided by an insurer to an intermediary who then sets gross rated price (final retail price paid by the consumer pre-Insurance Premium Tax (IPT)). The net rated price usually includes the risk price plus a profit and expense margin. The intermediary adds its own commission or expenses to the net rated price to arrive at the final retail price.

3.12 As well as carrying out different roles in supplying home and motor insurance, firms also have different business models with insurers having much more stringent capital requirements than intermediaries. Figure 4 summarises the range of business models we see across insurers and intermediaries. We found that firms in our sample may use one or more of these business models.

Figure 4: Summary of different business models across firms

Category	Value proposition	Key revenue sources
A. Multi-channel end to end provider	• mass market multi-brand/product insurer selling through different channels • well-known brand with large customer base	Premium, Investment, Premium financing, Add-ons & Fees/ charges
B. Direct and PCW only insurer	• mass market multi-brand/product insurer selling directly either through PCWs, online, phone or through own Appointed Reps	
C. Intermediary only insurer	• mass market insurer which designs and manufactures the product but only sells through intermediaries • may not earn revenue from ancillary products	
D. Niche insurer	• niche market insurer which targets specific groups of consumers • flat margin with no discounting for new customers • often sold through intermediaries	
E. Intermediary with own smaller insurer group	• intermediary which looks, acts and behaves like an end-to-end provider (usually operating via delegated authority) • operates via panel of insurers which includes own smaller insurer • well-known brand with access to customers	Commission, Premium, Premium financing, Add-ons & Fees/ charges
F. Partnerships intermediary	• intermediary whose primary business is not GI, eg banks, building societies, car dealers and big-name retailers • premium white-label brands with established customer base	Commission, Add-ons & Fees/ charges, Premium financing
G. Downstream only group	• intermediary which only underwrites through a panel of insurers • may own intermediaries further down the chain (eg PCW)	
H. New entrants	• generally an intermediary or Managing General Agent aiming to underwrite in future • usage-based, short term insurance products • Insurtech – personalised app-based subscription, connected home insurance	
I. Standalone PCWs	• PCWs which are not part of a group and provide an intermediary platform that allows consumers to compare products	Cost per acquisition

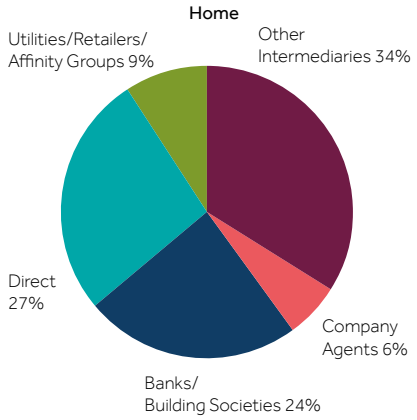
Source: FCA analysis based on information gathered from insurers and intermediaries[1]

Distribution channels for home and motor insurance

3.13 Different events can trigger consumers' purchase of motor and home insurance, including buying a car or home or renewing of an existing policy. Consumers can do this directly with insurers in person, over the phone or via the insurer's website, or indirectly through a PCW. They can also purchase cover through an intermediary.

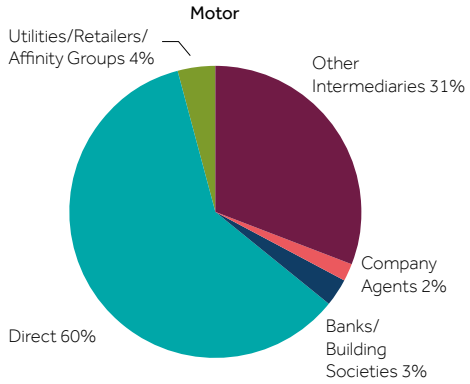
1 A managing general agent (MGA) is a specialist insurance intermediary that has delegated authority from an insurer. This delegated authority allows an MGA to perform certain functions ordinarily handled by an insurer such as taking on risk, pricing and settling of claims.

Figure 5: Home insurance distribution by channel for insurers



Source: ABI General Insurance Product Distribution 2017 (GWP)

Figure 6: Motor insurance distribution by channel for insurers



Source: ABI General Insurance Product Distribution 2017 (GWP)

3.14 Figure 5 and 6 above shows the proportions of policies distributed through different channels for motor and home insurance. Consumers are more likely to buy motor insurance direct from insurers or specialist intermediaries (includes PCWs). Retailers, lenders and mortgage brokers are more likely to distribute home insurance, often selling it alongside a mortgage, and have a greater share of this market.

The role of PCWs

3.15 Often, consumers buy insurance from an insurer or intermediary after comparing prices on a PCW. PCWs provide an online comparison service to customers on a range of products and are an important distribution channel for both motor and home insurance. 13% of all home insurance policies and 31% of all motor insurance policies are sold through PCWs. Our analysis looks at how PCWs are earning their revenue, their marketing and acquisition cost, and profitability.

3.16 PCWs earn revenue primarily from referral fees. Our international comparisons work also highlighted that the use of PCWs is comparatively high in the UK compared to other countries. This is driven by relatively strong engagement with these sites from both consumers and firms, which is not always the case in other countries.

3.17 As PCWs are such an important distribution channel, they could affect the dynamics of the market in several ways:

- Intensify price competition at new business: All PCWs order search results by price (lowest to highest) with key product features and the brand also displayed. This ordering makes price competition more intense at new business.
- Additional costs to providers: PCWs earn revenue from acquisition fees paid by product providers when consumers click through to a provider's website and buy a motor or home insurance product. They also earn revenue from affiliate marketing agreements. The cost per acquisition (CPA) varies by products and providers. Consumers do not need to pay PCWs to do a price comparison. But because providers of insurance pay PCWs when there is a sale, these costs need to be accounted for in the price paid by the consumer for the policy.
- Vertical integration: Of the four largest PCWs, two are part of groups that also include large insurers or intermediaries. Both are operated at arm's length with the aim of managing potential conflicts of interest.

3.18 The CMA's market study on digital comparison tools (including PCWs) found that consumers use these tools to save time, money and to find a better deal. The Government's response to the CMA acknowledged that digital comparison tools are 'mostly a force for good and that they make it easier for consumers to shop around and improve competition, spurring lower prices, higher quality, innovation and efficiency'.

Current market environment

3.19 The motor insurance market was relatively soft for much of 2018, meaning that insurers have excess capacity to underwrite business. This can put pressure on firms to lower premiums to attract consumers who are shopping around.

3.20 Motor insurance premiums peaked in 2017 when the Ogden rate was reduced to minus 0.75%. This is a discount rate that insurers use to calculate the net present value of future costs/losses a claimant will incur due to personal injury or death. Premiums gradually fell throughout 2018. This is likely to have been driven in part by the Civil Liability Act 2018 reforms on whiplash which, amongst other changes, set a fixed amount on whiplash compensation claims.

3.21 As part of the Civil Liability Act 2018, the government also legislated to revise the Ogden rate upwards from minus 0.75%. The market was expecting a revision of the Ogden rate to 0%, but the July 2019 announcement only increased the rate to minus 0.25%. Some motor insurers have warned that premium rates may rise because of the announcement, which is expected to squeeze firms' profitability.

3.22 The home insurance market is also soft, but is more stable in terms of premiums than the motor insurance market. Firms told us that this is because of relatively benign weather conditions since Q2 2016. However, storms and flash flooding followed by a very hot summer in 2018 did result in a spike in subsidence claims which damaged firms' profitability. Firms' profitability is expected to continue to be squeezed in 2019 because of the soft market conditions and an increase in weather-related claims.

3.23 The impact of a soft market is that profitability for both insurers and intermediaries is squeezed due to lower premiums. However, PCWs are less likely to be affected by market pricing changes as they charge a fixed fee per policy acquired through their comparison site.

Future market developments and innovation

3.24 Some firms have indicated that they are making changes to their business strategy and pricing practices to drive fairer outcomes at renewal for existing customers. At least two firms have tested or launched products designed to increase the transparency of renewal pricing. One includes a commitment to ensure that a renewal price is at least as competitive as an equivalent new business price. The other fixes the customer price for 3 years.

3.25 General insurance pricing is increasingly using customer data. This could potentially lead to benefits to consumers. For example, if it enabled insurers to assess risks more accurately, they could price insurance more accurately and offer insurance

to consumers previously seen as too risky to insure. However, it also brings risks. More accurate pricing may lead to some consumers being considered too risky and becoming uninsured. It could also allow firms to more accurately identify individuals who they could charge higher prices to, for example by being able to more accurately identify those less likely to switch.

3.26 We also looked further at emerging new business models and how they could impact on pricing. Some of the key developments identified were:

- On-demand insurance: Allows consumers to buy coverage when they need it and only for as long as they need it.
- Usage-based insurance: Pricing based on how individual consumers act or use insured assets. For example, using telematics to monitor when and how a consumer drives.
- Value added services: Some insurers include non-insurance products alongside insurance. For example, providing discounted equipment or accessories.
- Auto-switching: Using artificial intelligence to automatically shop around for the best deals on a consumer's behalf. The technology can then switch the consumer to the better deal, saving them time and effort.
- Embedded insurance: Insurance that is included within another product. For example, insurance included when a car or mobile phone is purchased.

4 How firms set prices and treat their customers

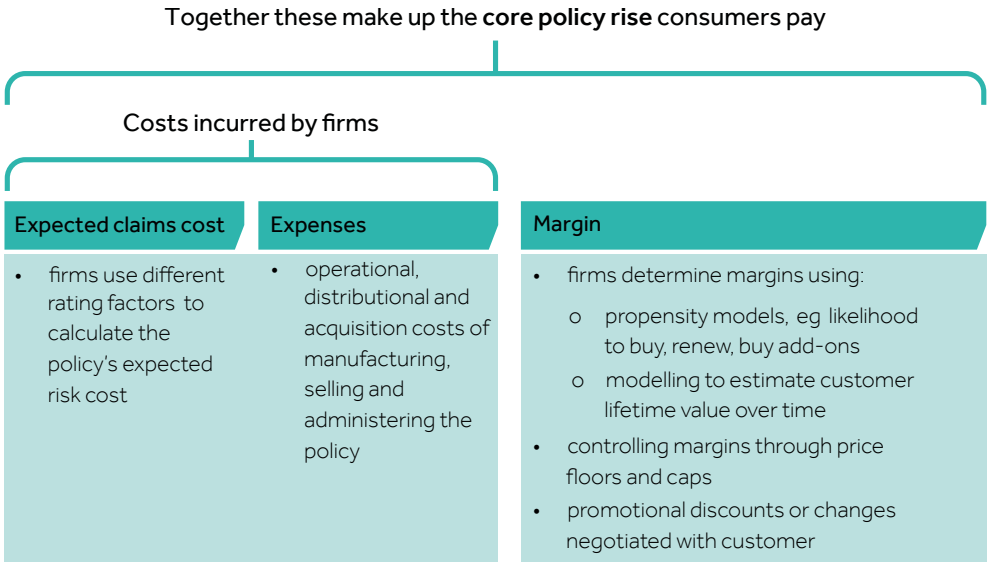
4.1 Most firms adopt pricing practices that set different prices at new business and renewal. Firms typically aim to predict the likely behaviour of consumers when setting the price, taking account of their competitors' pricing.

4.2 When firms offer a new business price, they may take into account the long-term profitability of the consumer. This will depend on the potential income from selling ancillary products such as add-ons, premium finance and the likelihood that a consumer will renew in the future at a higher price and continue to buy the add-on products. New customers typically benefit from low prices for core home and motor insurance policies, which are sometimes below cost. Firms seek to recover any initial losses by increasing the customer margin (the amount of the price charged above or below the cost of underwriting the risk and serving the policy), and thus the price, at renewal. After they make back the initial discount, many firms continue to increase customer margins on renewal. This is referred to as 'price walking'. Most firms in our sample operate a price walking strategy.

4.3 As firms set prices in this way, prices for renewal customers can after a few years become considerably higher than those charged for new customers and also the cost of supplying the insurance. Consumers who do not respond to price increases at renewal by switching or negotiating the price with their provider usually pay more, even if it costs the same to supply them with insurance.

4.4 Most firms in our sample who have a role in setting prices told us they apply the same pricing practices to motor and home insurance. Figure 7 summarises the way most firms in our sample set prices, and the components that make up the retail price that consumers pay (excluding IPT). Consumers can also buy optional ancillary products or take premium finance which can increase the total price consumers pay.

Figure 7: The components of price (excluding IPT)



Source: FCA analysis based on information gathered from insurers and intermediaries

4.5 A firm's pricing model often determines the number of renewals required before the price reaches target margins (as well as the level of any initial discount for new customers). Most firms in our sample use some form of cap, such as on margin or commission, to limit how much prices charged to individual customers can rise above costs.

4.6 We also found that firms vary in the level of complexity and sophistication of their pricing. A small number of insurers and intermediaries charge the same margin to each customer group, for example when distributing through a particular channel or partner. In these cases, firms are more likely to seek a profitable margin on both new and renewal business.

4.7 Insurers also tend to have very limited information on customers with legacy products the firm no longer sells. As a result, firms may price walk these customers using a common increase every year. This could mean these customers pay much higher prices than if they were switched to a new product with equivalent cover.

Margin optimisation

4.8 Margin optimisation is a process where firms adapt the margins they aim to earn on individual consumers. Firms' pricing strategies can change over time and the aim of the optimisation process will depend on the strategy they are seeking to achieve. Examples include maximising profit, retention, conversion or customer numbers. Both insurers and intermediaries, with delegated underwriting authority to undertake risk pricing, typically use different pricing models in risk pricing and margin optimisation. In our sample, most firms used lifetime value and propensity models (conversion, retention, and ancillary product models) as part of their pricing.

4.9 The main propensity models we saw from firms in our sample were:

- Conversion models: These assess the expected number of sales of both the core policy and ancillary products compared to the number of quotes at new business. Firms model the impact of changes in the price on conversion rates for different consumers or groups of consumers.
- Retention models: These assess the expected number of sales of both the core policy and ancillary products compared to the number of quotes at renewal. Firms use these to model the expected impact of price changes on customer retention rates as a core input to assessing the price they wish to charge (including as part of lifetime value modelling).
- Ancillary product models: Firms offer ancillary products (add-ons) or premium finance alongside a core insurance policy. Firms may incorporate predictions of ancillary income into their pricing decisions.

4.10 We found that firms used margin optimisation for both new business and renewal pricing.

4.11 Firms set prices to maximise growth or profitability, taking account of a consumer's willingness to pay, likelihood to buy/renew or buy add-ons. The information used in the model includes customer characteristics gained both from information provided by the customer and wider externally available information. Firms also take account of other factors such as the distribution channel, or product purchased, to estimate how likely a customer will be to buy and renew at different price levels over time. If the renewal price is too high, consumers are more likely to buy from a rival.

4.12 While margin optimisation, a form of price discrimination, may be profitable for an individual firm, it does not necessarily benefit consumers. Consumers who are more price sensitive pay less, while those who are less price sensitive pay more. In addition, price discrimination can increase or reduce price competition (and lower or increase average prices to consumers), depending on the type of price discrimination deployed. This is discussed in more detail in chapter 5.

Lifetime value modelling

4.13 Lifetime value modelling (LVM) allows firms to assess the current and future value of a customer or customer segment. Firms assess the net present value of a customer to help them choose prices that will be profitable over the lifetime of the customer relationship. The lifetime value of a policy is calculated by combining expected income from the core policy, including from potential renewals, with relevant add-on income and then deducting costs. The resulting values inform pricing decisions and help firms to estimate the level of acquisition and marketing spend.

4.14 The lifetime value model uses historic data to assess the future value of various distribution channels and brands when deciding policy. This can also allow firms to determine the aggregate possible losses on core underwriting, for example on new business, while ensuring that their pricing strategy is profitable overall. Where lifetime value models directly inform pricing, they use customer conversion and retention information as a direct input.

4.15 We found that lifetime value models the firms in our sample used assume a longer tenure for home insurance than motor insurance. A shorter lifetime value means that firms need to meet overall profitability targets in a shorter timeframe.

Price testing and benchmarking

4.16 Firms also monitor the prices their competitors set and use price testing to continuously test the impact of small changes in the prices charged in the market on consumer conversion and retention rates. This helps firms to understand market competitiveness and maintain an up-to-date understanding of consumer behaviour affecting propensity and hence pricing models.

How firms treat consumers

4.17 As well as understanding how firms set prices, we looked at how firms treat their customers and consider them when setting prices. We looked particularly at:

- How firms consider outcomes for different groups of consumers. This includes how they treat consumers who are vulnerable or paying very high prices.
- Whether firms provide consumers with clear and accurate information when they renew their insurance. We looked at the impact firms' practices have on consumers' ability to make informed choices and act to get better deals.
- The impact of contractual terms, such as auto-renewal.

Consideration of outcomes for different groups of customers

Use of rating factors and customer data

4.18 Firms use numerous rating factors in their pricing models gained from both internal data (including data direct from the consumer) and externally derived information/data sets. The number of factors used by firms in their pricing models ranged from under 50 to over 400.

4.19 Firms apply risk rating factors to data on customers' risk characteristics to calculate the expected claims cost. Most also use optimisation rating factors to optimise the final price based on customers' propensity to purchase, renew or buy ancillary products or services. Among the factors used by firms to set final price or optimise margins, we found the following:

- Factors that are also used for pricing risk, such as whether a property has a smoke detector, the number of children in the family or policyholder age. These data are usually supplied by customers when buying insurance.
- Factors possibly unrelated to risk including, for home insurance, customers' occupation, where they shop and what else they buy. This data may be supplied by customers, or obtained with their consent.
- Factors relating to customers' buying and media habits, including their browser type, time of day and also the month they buy the policy.
- Factors relating to credit scores, including credit search history. The data are obtained from credit agencies.
- The type and level of cover purchased, including whether a home policy includes accidental damage and whether the policy auto-renews.
- The brand (of insurance) chosen by the customer.

4.20 Firms told us that they may use additional customer information they gather over time to price renewal business more accurately. A few firms also use these additional data to manage their customer book and sometimes identify and decline renewal to some higher-risk customers. The additional customer data that firms acquire over time can be used in optimisation rating factors, leading to an increase or decrease in the renewal price. Customers may not always be aware of how their personal data and data from external sources are used in calculating the price of their policy.

4.21 A few firms in our sample have reviewed the rating factors used in their pricing models. These firms have changed or discontinued the use of factors that, for example, unintentionally correlated with potential vulnerability.

4.22 Identifying vulnerability throughout a policy could be difficult as the annual nature of policies means contact is likely to be only once a year. Firms use certain factors as indicators of a customer's vulnerability. Examples include age and whether they have switched or negotiated their premium in recent years. Some firms may freeze prices or waive fees in the event of a change in personal circumstances where a customer is temporarily in a weaker position leaving them particularly susceptible to detriment.

Use of pricing constraints

4.23 Most firms use constraints when setting renewal prices. These constraints are the main way that firms have responded to concerns about pricing practices that result in some customers who continuously renew with the same provider paying increasingly high margins.

4.24 We have seen a growing use of caps on margins earned from individual consumers. The aim of this is to reduce margin, meaning less profit for insurers and reduced commission for intermediaries. Some firms with large books of existing customers are reducing margins to within these caps. However, firms have usually chosen to make these changes over multiple renewals. This reduction is affected by firms' wish to smooth the rate of price change, and agreements with others in the supply chain that may limit the pace at which margins can be reduced.

4.25 The majority of firms have applied further constraints to protect potentially vulnerable customers. These include capping the age or tenure used in optimisation models, comparing the loss ratios for vulnerable customers to other customer groups or removing price optimisation for customers over a certain age.

Treatment of legacy customers

4.26 Some customers hold policies that are no longer sold to new customers (legacy products). There can be significant differences in price between these legacy products and those sold to new customers. This can be because legacy customers with long tenure are less price-sensitive and hence less likely to shop around even if prices are increased at renewal. Some firms have also attributed the price differences to their holding less current information about these customers; or be due to differences in levels of cover.

4.27 A few firms have recently started reviews of these legacy products to see where there are differences between the prices or cover. As part of these reviews, some firms with large books of legacy customers are prioritising identifying and reviewing of customers paying the highest margins. These projects include:

- migrating all legacy customers onto new products through brand consolidation;
- suspending interest on instalment payments;
- offering new business prices to all customers on closed products, while matching the existing terms and conditions of the legacy policy; and
- implementing a target operating ratio to align all back-book customers with new business prices.

Governance and control over pricing

4.28 Since we published our thematic review and Dear CEO letter on general insurance pricing practices, we saw some evidence of firms focusing more on how they consider customers in their pricing practices.

4.29 Most insurers and price setting intermediaries in our sample have pricing frameworks in different stages of development and implementation. Some of these set out how they intend to treat customers when setting prices and using customers' personal data.

4.30 There has been a rise in monitoring pricing outcomes through the management information given to pricing committees and boards. Most of these currently only involve the broader treatment of customers such as complaints, claims and customer service feedback. Some firms have given their pricing committees specific responsibilities to consider the impact of pricing on different customer groups.

4.31 In some firms, pricing management information has not been fully rolled out and the reporting packs given to boards suggest metrics that will be added in the future. The few remaining firms did not provide us with evidence that they have developed management information to understand the effect of pricing decisions on different groups of customers.

4.32 Our review of firms' responses to the Dear CEO letter on pricing practices also shows that the nature, extent and quality of responses varies widely. While some firms have improved their practices, firms need to significantly improve their, governance of pricing practices.

Price negotiation at renewal

4.33 When consumers receive their renewal invitation, some firms are open to negotiation on price if their customer contacts them. Other firms have a policy of quoting a single renewal offer with little or no room for negotiation. These firms said that this approach can help them treat their renewal customers consistently. Others said they would rather lose a customer than reduce their offer below a certain threshold.

4.34 The firms that allow customers discounted renewal prices have procedures that control how much discretion is allowed. For example, front-line staff can offer a system-generated discount, where the decision is based on factors including the renewal premium price, number of additional products held and the customer's lifetime value. One firm takes customer retention into account when setting the performance objectives of customer service staff.

Provision of information

Differences in price between new and renewal customers

4.35 Most firms charge different prices to new and renewing customers for reasons other than risk or cost to serve. The main reason firms give for increasing price at renewal is to recover the losses that they incur giving introductory discounts to new customers, sometimes at below cost. This practice is widespread in the market, but is not always apparent to customers.

4.36 There are a couple of firms that are looking to show more clearly where quotations include new business discounts or offers, such as explaining customers how they operate, or at renewal if customers question the price. However, they do not generally explain the fact that prices are likely to increase.

4.37 PCWs sometimes show where prices are introductory or include a discount, though this is not a consistent or widespread practice. We understand that some PCWs have conducted experiments to indicate where quotes include introductory offers but had recorded low levels of customer recall and engagement.

Renewal communications

4.38 We have implemented rules to increase transparency and engagement at renewal. These rules mean that when customers receive a renewal quote, it should set out the price they paid last year alongside the new quote. They should also be reminded to check that the cover still meets their needs.

4.39 Our rules do not require firms to explain in renewal communications why the price has changed. However, some firms included reasons for price changes, such as cost increases or changes to IPT rates. None included reasons linked to firms' pricing practices, such as the end of an introductory offer.

4.40 A number of firms told us that customers who are unhappy with their renewal offer could contact them and negotiate on terms. However, this was not mentioned in any of the renewal documents we reviewed.

4.41 Consumers who originally purchased via a PCW can be stimulated to review their options at renewal. Some PCWs contact previous customers with alternative premium indications a few weeks before the renewal. These sometimes contain promises of free gifts or vouchers to customers who switch.

Impact of contractual terms

Auto-renewal

4.42 Many policies contain auto-renewal clauses. Under them, unless the customer tells the firm otherwise before the renewal date, the policy will renew on the terms in the renewal invitation. This is widely known as auto-renewal. Customers can still renegotiate, amend, switch or cancel their cover up to renewal date.

4.43 Many firms emphasised the importance of auto-renewal in reducing the risk of consumers being left uninsured if they forget to renew their policy. For motor insurance, this would lead to contravening the legal requirement for valid third-party motor insurance to drive in the UK.

4.44 Our analysis of firms' data shows that auto-renewal is linked to higher prices for home insurance. We found no evidence of this link in motor insurance.

4.45 A few firms use auto-renewal as a predictor of customers' willingness to pay, in their calculation of the final price for renewals, with at least one charging higher margins to auto-renewing customers as a result. Customers choosing to auto-renew may not be aware that this could impact their premiums at future renewals.

4.46 Some communications that firms sent to customers at renewal used language that might mean customers did not have to actively make a renewal decision. For example, some auto-renewal notices stated prominently that customers need take no action if their details had not changed.

4.47 All the firms in our sample offered auto-renewal when the customer originally took out the policy. Most of these auto-renewals were on an opt-out basis, meaning customers would have to make an active choice to opt out of auto-renewal. Although accepting auto-renewal appears to require minimal effort, customers need to put more effort into contacting the firm if they wish to cancel it. In most cases, we saw firms requiring contact by phone to cancel auto-renewal, even if policies were originally taken out online.

5 The impact of pricing practices on competition

Introduction

5.1 This chapter considers whether pricing practices for home and motor insurance support effective competition that delivers good outcomes for consumers. We highlight the key features of competition in the home and motor insurance markets. We then consider whether pricing practices:

- lead to price discrimination that intensifies or dampens competition.
- work in the interest of only some or all consumers.
- raise the cost of providing insurance either through generating high search and switching costs for consumers or increasing customer acquisition costs for firms (or both).
- lead to firms making high profits overall.
- increase or restrict consumers' access to insurance.
- create barriers to existing and new firms developing innovative business models and different pricing strategies.

Features of price competition in home and motor insurance markets

5.2 The key dynamics we see in both the home and motor insurance markets are:

- Price discrimination by optimising the margin. Nearly all firms set different prices to new and renewal customers (through discounts to new business) and customers of different tenure (by price walking). They also set different prices to different customers of the same tenure based on their estimated willingness to accept a given price offer (through price optimisation).
- Prices also vary depending on the distribution channel and the competitiveness of the market at any point in time.
- Price is perceived to be the most important reason for choosing a provider, although brand is a strong contributory factor for a substantial minority of customers.
- A lack of pricing transparency (including reasons for price changes) means that consumers are unable to know how competitive their price offer is unless they search.
- Less engagement with the non-price (qualitative) elements of a policy due to a lack of available information for consumers to make decisions about quality.
- Consumers undertake different degrees of search at renewal. Some search extensively for the best deal each year. Others may search more periodically or are only prompted to search or negotiate when they become aware that their offer may not be competitive. Others renew without shopping around.

- Consumers who compare prices and negotiate or switch where necessary tend to get a better, or potentially significantly better, deal than those who do not shop around and renew with the same provider each year.

Price discrimination can intensify or dampen competition

5.3 Price discrimination can have different effects on the nature and intensity of competition.

5.4 It can intensify competition by allowing firms to offer discounts to their rivals' customers. This increase in competition benefits consumers as a whole as far as it reduces the average price paid for insurance. However, not every consumer necessarily benefits from this increase in competition. This is because price discrimination also changes the nature of competition. Consumers who are more willing or able to switch brands to get a good deal pay lower prices than those with higher switching costs or a stronger preference to remain with their current brand.

5.5 However, price discrimination can also dampen competition, increasing the average price paid by consumers. This is most likely to happen where higher prices are charged to those consumers who lack awareness that the deal they are offered is not competitive, while lower prices are offered to more informed consumers. Examples of where price discrimination can dampen competition include where higher prices are charged to consumers who are less aware of current pricing practices because they:

- lack financial knowledge or access to the internet and so do not or cannot easily shop around to check they are being offered a competitive price
- trust their current firm (e.g. based on its brand) to offer a competitive price and so do not see any need to shop around
- do not engage in decision making for a variety of reasons, e.g. because they intend to search but forget, lack awareness about the potential benefits of shopping around for a better value deal, or they just lack confidence to do so.

5.6 So the impact of price discrimination on competition depends on why some consumers are charged higher prices. Price discrimination is more likely to have beneficial effects on competition where consumers make informed decisions about whether to search and switch. It is more likely to have negative effects where consumers lack awareness about the competitiveness of the price they have been offered or the ability to act to get better deals. Both types of price discrimination may take place at the same time so that the net effect on competition may depend on which type of price discrimination dominates.

5.7 The competitive effects of price discrimination also depend upon which firms can identify profitable customers. If, for example, all firms can identify which consumers are likely to be the most profitable, then they will compete hard to attract these customers by offering them highly competitive prices. But, if only the current firm can identify which consumers are the most profitable, rival firms will not be able to offer these customers with lower prices and so competition will be less effective.

5.8 Competition tends to be more effective when firms are able to 'find' profitable consumers, than when profitable consumers need to 'find' firms in order to secure competitive prices. The reason for this is that some consumers may not be aware that

they are paying high prices (and are therefore profitable), so they may feel they do not need to search.

5.9 Firms have told us that they price discriminate based on the propensity of a customer to renew their insurance product and their lifetime profitability. In effect, this implies that consumers are offered prices based on their estimated price elasticity of demand (or consumers' sensitivity to changes in price). We use price elasticity here in the sense of the willingness to pay for the products from a particular firm or brand, rather than for the product more generally.

5.10 However, a consumer's price elasticity of demand is based on a range of factors including the consumer's:

a. switching costs
b. brand preference
c. awareness of the competitiveness of the product they have been offered

Assessment of whether firms price discriminate for home and motor insurance based on switching costs or brand preference

5.11 Consumers may be making informed decisions to pay higher prices to stay with their current provider to avoid the effort of shopping around or because they value their current brand. However, a rival firm could offer a competitive price which would trigger a consumer to change provider. This means firms can still compete for these customers by offering discounts at new business.

5.12 If price discrimination is happening based on a consumer's informed preference to stay with their current supplier, then we would expect to see a positive relationship between customer margins and switching costs and/or brand preference.

5.13 We estimated individual consumer switching costs using a technique known as contingent valuation. We asked respondents to estimate the amount they would be willing to save to switch provider or spend to avoid switching. We provide a more detailed explanation of how we calculated search and switch costs in the Consumer research – technical report.

5.14 We examined whether consumers with the highest switching costs were more or less likely to be charged a higher margin. We find no evidence of any positive relationship between switching costs and margin in either home or motor insurance. These results may reflect the fact that switching costs are difficult to estimate and that firms do not directly track them.

5.15 However, our consumer survey shows that consumers who knew they could get a better deal but did not think the potential savings were worth the hassle of shopping around paid higher margins than those who believed their deal was amongst the lowest price on the market. For home insurance, the median margin paid was 14% points higher, and for motor 5%.

5.16 We ranked consumers by the margin they paid and split these into ten equal sized groups (deciles). The group who paid the highest margins (top 10% of sample) we defined as "highest", and the group who paid the lowest margins (bottom 10% of sample) we defined as "lowest". We use this definition throughout this report.

5.17 We also see a link between margins and some measures of brand preference. For example, firms often offer substantial discounts to customers of rival firms to encourage them to switch away. These discounts – which are often made online – are naturally targeted at those consumers who are considering switching. These consumers may simply be more aware of the benefits of search. But they may also be more prepared to switch brands to get a good deal. For example, our consumer survey found that home insurance customers who were prepared to switch regularly to get a good deal were over twice as likely to be paying the lowest margins compared to customers who preferred the comfort of being with a brand they know and trust. However, we do not observe any similar relationship between brand preference and margin in motor insurance.

5.18 We also see evidence from our consumer survey that some consumers are willing to pay a premium for a trusted brand. Again, the effect is greater for home insurance where the median margin paid was 39% for consumers who prefer a brand that they know and trust compared to a margin of 28% for consumers who preferred to pay a lower price. 64% of those paying the highest home insurance margins prefer the comfort of a brand they know and trust compared to just 33% for those paying the lowest margins. For motor, this effect is less apparent 49% of those who pay the highest margins preferring a trusted brand compared to 44% for those paying the lowest margins.

5.19 These effects may simply reflect well-known brands charging higher average prices than other firms. In contrast, price discrimination based on brand preference requires a firm to charge higher prices to those of its consumers who value its brand most highly, and low prices to those who are more willing to switch brands to get a good deal.

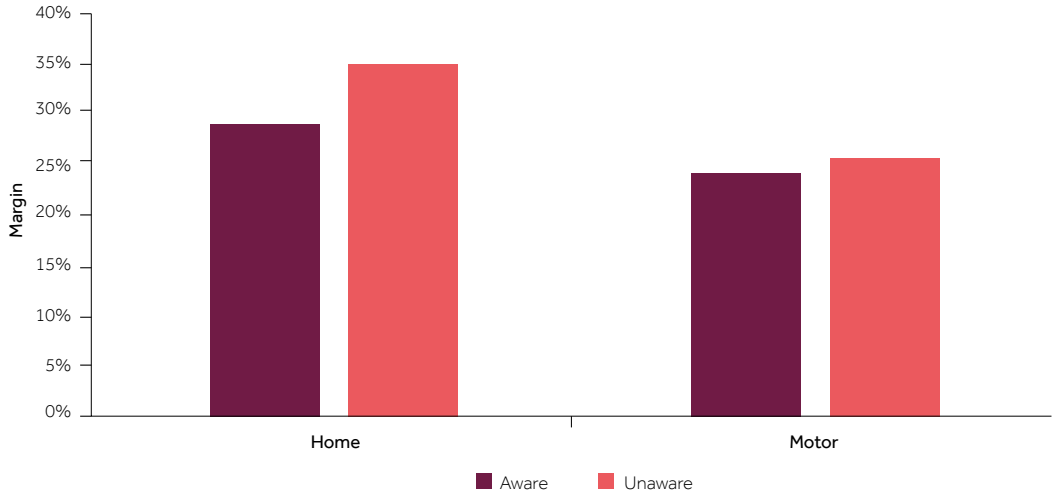
Assessment of whether firms price discriminate for home and motor insurance based on consumer awareness

5.20 We would be concerned if firms price discriminate for renewal customers based on consumer awareness. If a consumer naively believes they are getting a good deal when they are not, they will not shop around for a better offer. Consequently, this type of price discrimination reduces firms' incentives to offer lower prices to these consumers.

5.21 We found strong evidence that consumers who pay the highest margins are, on average, the least aware of how pricing practices in the home and motor insurance markets work. They are also least aware of how competitive their current deals are. This holds true in both the home and motor insurance markets, but the relationship in motor insurance was less marked.

5.22 We found that 55% of consumers in home and 57% in motor can be classified as someone who may not be aware of the competitiveness of the product they own, given current pricing practices. That is, they gave 2 or more answers to the survey that indicates they lack awareness about how pricing works in the particular market. As shown in Figure 8, for home, these consumers were paying 6% points higher margins than those not in this category. For motor, margins were 1% point higher for these consumers compared to those not in this category.

Figure 8: Differences in margins between aware and unaware consumers



5.23 We would be less concerned if firms can identify specific profitable consumers (including those with low awareness) at new business and offer that consumer much lower new business prices. Under these conditions, because of deep discounts at new business, firms would make no or low margins over the consumer's tenure.

5.24 Firms told us that they compete intensively to attract consumers who they expect to be more profitable over time (lifetime value). However, we have observed little evidence, from our initial analysis, that consumers who appear to be less aware (and so may be more profitable later in their tenure) pay different margins at new business than other similar consumers who have greater awareness. We will consider this further, including whether we can identify how much individual consumers pay over time, to inform our final report.

Conclusions on impact of price discrimination on competition in home and motor insurance

5.25 We see some evidence of price discrimination based on the willingness of consumers to switch brands to secure a better price deal. This strengthens competition as firms can compete for some customers by offering discounts at new business.

5.26 However, we find that firms also price discriminate based on consumers' awareness of how the market works and how good their deal is. Firms earn higher margins from consumers who are less aware. This type of price discrimination is likely to have a negative effect on competition because unaware consumers will not shop around for a better deal and so firms cannot compete for these consumers.

5.27 While firms have told us that they compete more intensely for more profitable consumers, our initial analysis has not found that consumers who appear to be less aware (and so may be more profitable later in their tenure) pay lower margins at new business than other consumers.

Assessment of whether competition for home and motor insurance leads to high costs for consumers and firms

5.28 The current practice of discounting new business premiums followed by increasing rates in subsequent years means that consumers must search each year to ensure they don't pay more than necessary. This means consumers pay a search cost in terms of time and effort.

5.29 As this pricing practice also increases customer switching, firms will also incur additional marketing and customer acquisition costs. While some degree of shopping around and switching can be good for competition, too much can impose unnecessary costs on consumers and firms. This can lead to higher prices overall.

5.30 It is not possible to give a precise level at which search and switching is good for competition or causes consumer harm. However, we find that firms are price discriminating primarily based on customer awareness. This forces customers either to incur the costs of becoming aware by searching each year and negotiating or switching if necessary, or risk paying with an uncompetitive price.

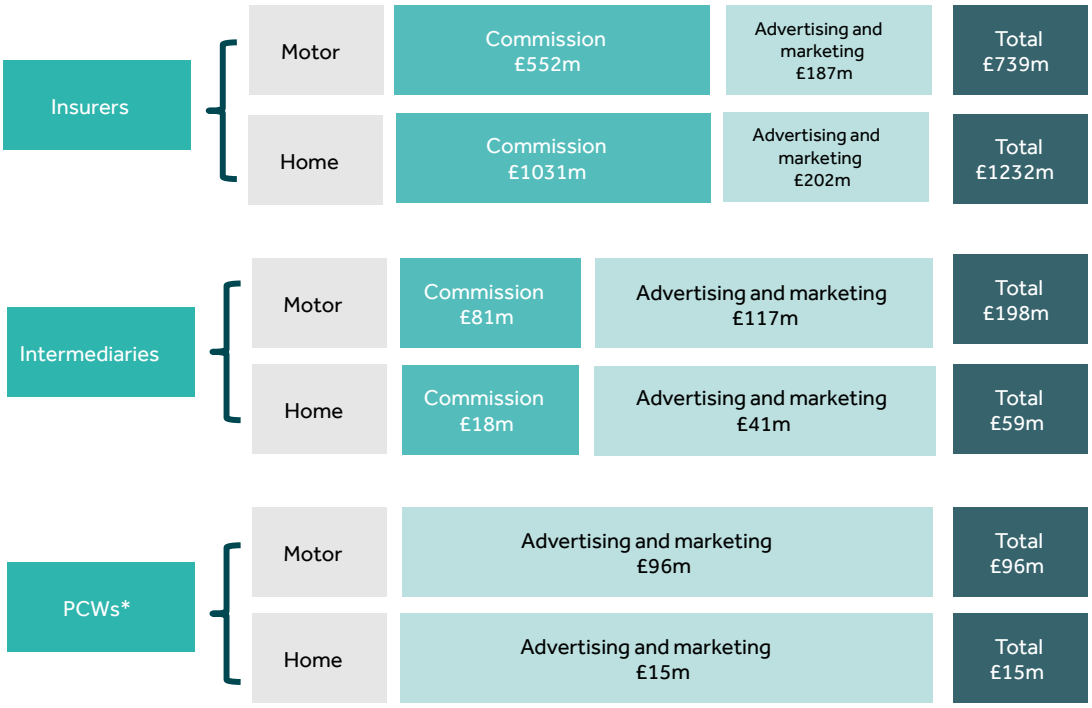
5.31 In our consumer survey, we estimated these costs using contingent valuation. Search and switching costs can have different effects on competition, so we estimated them separately. The way a question is framed can also affect consumer responses, so we asked questions in both in a positive (£ saved) and negative (£ spent) frame.

5.32 Taking an average of both the positive and negative frame results, we found that respondents' valuation of search effort was similar in both home and motor. It was £18 in home and £20 in motor. Respondents' valuation of switching time and effort was £20 per year in home and £22 in motor resulting in combined search and switch costs of £38 in home and £42 in motor, or 21% of the average premium in home and 13% in motor. These figures vary slightly with our consumer survey report due to differences in methodology and access to premium data.

	Home	Motor
Average search cost	£18	£20
Average switch cost	£20	£22
Average combined search and switch cost	£38	£42
Percentage of average premium	21%	13%

5.33 Switching also results in a cost for firms, including spending money on advertising to win new business, commissions and processing costs. Our analysis of financial data from firms in our sample shows that customer acquisition costs, including marketing expenditure, are the second largest cost to firms after claims costs. These costs expenditures are spread through the distribution chain, as shown in Figure 9 below.

Figure 9: Breakdown of acquisition costs across the home and motor insurance supply chains



Source: FCA analysis of information provided by firms

*For PCWs, the acquisition cost relates only to direct cost, as firms found it difficult to split allocate costs by motor and home.

5.34 We found that home insurers spend significantly more on acquisition cost (29% of premiums) relative to motor insurers (7% of premiums). While all firms provided figures for commission, only 9 out of 14 motor insurers and 12 out of 16 home insurers provided us with data on advertising and marketing.

Assessment of whether pricing practices lead to firms making high profits

5.35 We have analysed profitability as it can indicate whether competition is working well in the market. Many firms (insurers and some intermediaries) are balancing losses on new business customers with higher margins charged to longstanding customers. Our analysis of financial data from the firms in our sample shows that, on average, firms make positive accounting operating profit margin for both motor and home insurance. The level of profitability of certain activities varies across home and motor insurance. Due to challenges around the firms' ability to split their balance sheet items meaningfully by products, we have focused on using conventional industry performance ratios and accounting pre-interest and tax operating profit (including revenue/profit from sources like investment, add-ons and premium financing) as indicators of profitability in our financial analysis.

How firms generate revenue for home and motor insurance

5.36 Over the period 2013 to 2018, insurers in our sample earned, on average, £7 billion in premium revenue for motor and £4 billion for home. Non-core revenue contributes about £2 billion. Insurers' primary source of revenue is premiums received from policies sold to insured customers. Intermediaries primarily arrange policies for the insurer

hence their main revenue source is commission earned for the placement of policies. Both insurers and intermediaries also generate revenue from other sources, like add-ons and premium finance. We have defined this as non-core revenue.

5.37 Figure 10 below shows the different sources of revenue across the supply chain.

Figure 10: Summary of costs, revenues and sources of profit for different firms across the supply chain for home and motor insurance

	Income	Costs	Profit
1 Insurers	• Core income: Net earned premium • Non-core income: Investment income, premium finance, add-ons, fees and charges.	• Claims cost • Expenses: acquisition cost (commission paid, CPA and advertising & marketing), staff costs, other operating costs (including add-ons claims cost and default cost).	• COR: Underwriting profitability (>100% is loss making on underwriting) • Operating profit: overall profitability of the business
2 Intermediaries (excl. PCWs)	• Core income: Commission • Non-core income: Add-ons, premium finance, fees and charges.	• Expenses: commission & CPA paid, advertising & marketing, staff cost, other operating costs.	• Operating profit: overall profitability of the business
3 PCW	• Core income: Cost per acquisition (CPA)	• Expenses: advertising & marketing, staff costs and other operating costs.	• Operating profit: overall profitability of the business

Source: FCA analysis of information provided by firms

Combined operating ratio (COR) is a measure of underwriting profitability. This is computed as a percentage of the premium that the insurer pays out in claims and expenses.

Cost per acquisition (CPA) is the fee that PCWs earn when a consumer successfully buys a new product on the provider's own site after being directed from the PCW platform.

Net earned premium (NEP) is the sum of premiums written minus premiums ceded to reinsurance companies.

Accounting profits for home and motor insurance

5.38 Over the period 2013 to 2018, we observe that profitability varies depending on the activity being carried out by the firm.

5.39 For insurers, we observed that underwriting of the core insurance product is marginally profitable for home insurance and generally loss-making for motor insurance, based on the combined operating ratios provided by firms, and we also note that this is over a relatively benign weather period. There are exceptions to this; we found that in motor there are certain business models which enable the firm to earn positive profits from underwriting.

5.40 However, revenue from non-core sources led to additional profits:

- On average, home insurers receive £231 in premium per policy each year. This equates to around £8 per policy in core product underwriting profit as calculated using firms' financial data submissions. When including revenue from non-core sources, such as add-ons and investment income, the overall profit rises to £25 per policy for home insurance.

- Motor insurers receive, on average, £299 in premium per policy each year but only make £2 core product underwriting profit per policy as calculated using firms' financial data submissions. Adding non-core revenue sources, motor insurance firms earn an extra £45 profit, taking overall profit to £47 per policy. This suggests that motor insurers depend on revenue sources which are ancillary to their underwriting activity for profitability.

5.41 Large insurers with multiple brands and sales channels tend to have lower profitability. Specifically, the top 5 motor insurers by income have an operating profit margin of 11% while the remaining firms have an operating profit margin of 19%.

5.42 The average proportion of new to renewal business in terms of GWP is 50/50 for motor insurers and 20/80 for home, highlighting that a higher proportion of home customers tend to stay on with an insurer than switch. We find that firms with a higher proportion of renewal business have higher operating profit margin.

5.43 We observed that the top 5 home insurers with the largest proportion of customers paying high or very high customer margins[2] also have the highest operating profit margin when compared to the other firms in the sample. We do not see a similar trend for motor insurers.

5.44 On average, 14% of total revenue earned by motor insurers is from non-core sources. This translates to about £1.1 billion per year. Non-core revenue makes up 7% of total revenue or £346 million per year for home insurers. Motor insurers with a higher proportion of non-core revenue (e.g. investment income, add-ons and premium finance) have higher operating profit margin. We do not see a similar trend for home insurers.

5.45 We found that premium financing can be quite significant for some firms. In our insurer sample, 18% of motor policies and 11% of home policies are sold premium finance.[3] There is wide variation in income earned per policy on premium financing between firms. We see that in motor, firms earn between £3 to £110 per policy on premium financing. In home insurance, firms earn between £3 and £32 per policy on premium financing. This variation is because firms use various methods to set the annual percentage rates charged as well as the fact that there could be wide variation in premiums (e.g. young drivers will have much higher premiums).[4] Some firms also adapt the price charged to consumers based on both the customer's likelihood of taking out ancillary products. For instance, firms have told us that they are likely to charge lower premiums on the core product if the customer is likely to buy an add-on.

5.46 Information from 10 insurers showed legal expenses cover is the main add-on revenue earner for both motor and home. We note that direct and PCW only insurers have a higher proportion of add-on revenue compared to the other firms. A possible reason could be that such firms keep headline prices low in order to compete and also that add-on revenue for intermediary business will be earned by the intermediaries.

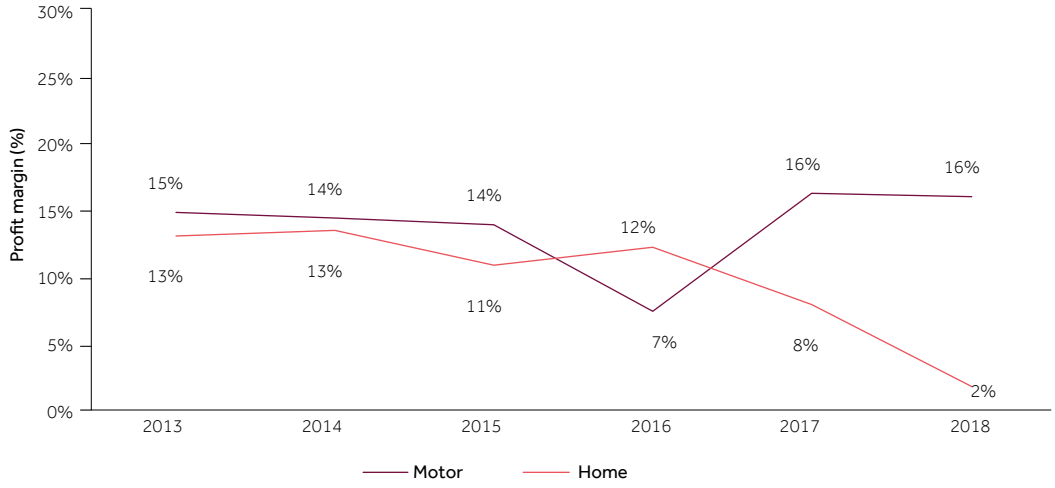
2 High and very high margins – defined in para 6.33

3 To note that some intermediaries will be earning premium financing revenue which is not being reflected in the insurers' accounts. Hence the percentages of premium financing being sold could be higher.

4 This includes: a flat charge; a variable charge dependent on risk; charge which is aligned to the Bank of England base rate and where the charge varies according to the distribution channel and policy type.

5.47 Figure 11 shows the overall operating profit margins of insurers in our sample from 2013 to 2018. This is reflective of accounting profit and does not include the opportunity cost of capital.

Figure 11: Overall operating profit margins of insurers (2013 to 2018)



Source: FCA analysis of financial data provided by firms

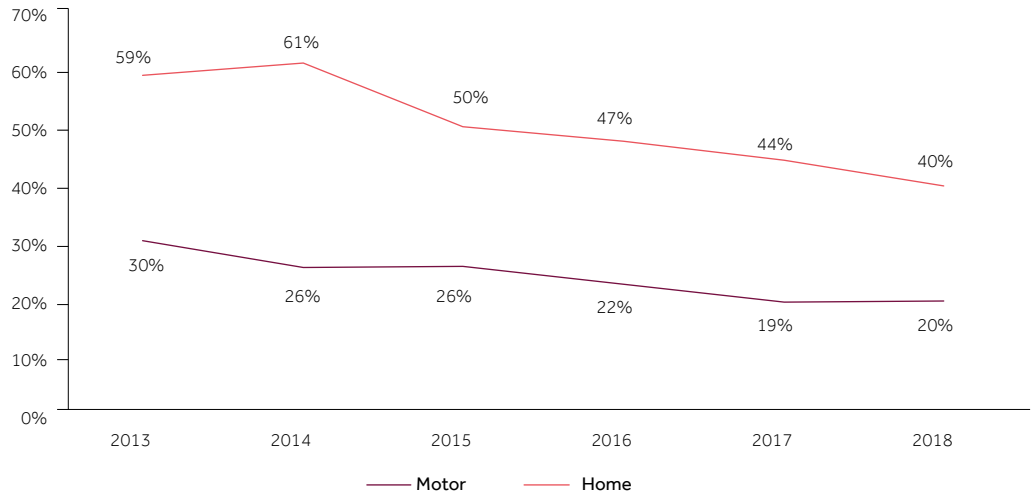
5.48 Intermediaries earn on average higher operating profit per policy than insurers:

- For home insurance, intermediaries in our sample earned £58 per policy, resulting in an average per policy profit of £39.
- Motor intermediaries in our sample earn on average £31 per policy, resulting in an average profit per policy of £24.

5.49 Motor intermediaries earn 53% of total revenue from non-core revenue compared to 25% for home. Premium financing is the highest non-core revenue earner for motor, while add-on is the highest for home. Specifically, legal expense cover is the largest component of add-on revenue for both motor and home intermediaries.

5.50 Figure 12 shows intermediaries overall operating profit from 2013 to 2018:

Figure 12: Overall operating profit of intermediaries (2013 to 2018)

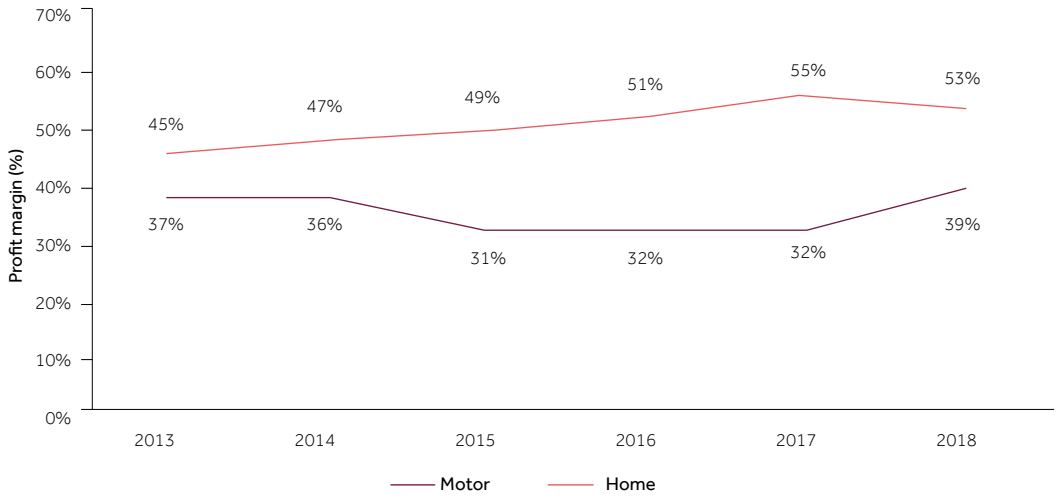


Source: FCA analysis of financial data provided by firms

5.51 PCWs earn operating profit for motor and home:

- For home, PCWs in our sample earned £45 per policy, resulting in an average per policy profit of £17.
- For motor, PCWs in our sample earned £51 per policy, resulting in an average per policy profit of £16.

Figure 13: Overall operating profit of PCWs (2013 to 2018)



Source: FCA analysis of financial data provided by firms

- Overall, both firms' home and motor insurance business are profitable. The level of profitability varies depending on several factors, including the activity being carried out, the firm's business model and the proportion of new and renewal business a firm has. More detail on our financial analysis is in the Business Models and Financial Analysis technical annex.

Assessment of whether pricing practices impact on consumers' access to insurance

5.52 Price discrimination can increase or restrict market access. We assessed what impact current pricing practices have on access and consumers' level of cover. Charging some consumers lower prices may mean they can afford insurance that they would previously have been unable to. However, if consumers do not know how to get better deals or shop around and this means they are quoted higher prices, they may decide to become uninsured.

5.53 However, our consumer survey found that very few people would stop buying insurance because of a market-wide price increase. 6% of home insurance respondents and 5% of motor insurance respondents said they would give up insurance (or, for motor, stop driving their vehicle) if their premiums rose above their stated willingness to pay and they could not get a better deal by shopping around.

5.54 Our analysis was limited as we only have data from consumers that are currently insured. Using 2016-2017, DWP data we found that 16% of survey respondents would like to have contents insurance but believe they cannot afford it. This 16% appears

to have characteristics which suggest they are more vulnerable than the wider population:

- 30% earn less than £300 a week (compared to the population average of 20%).
- 80% have access to the internet at home (compared to the population average of 93%).
- 74% cannot afford to make savings of £10 or more a week (compared to the population average of 32%).

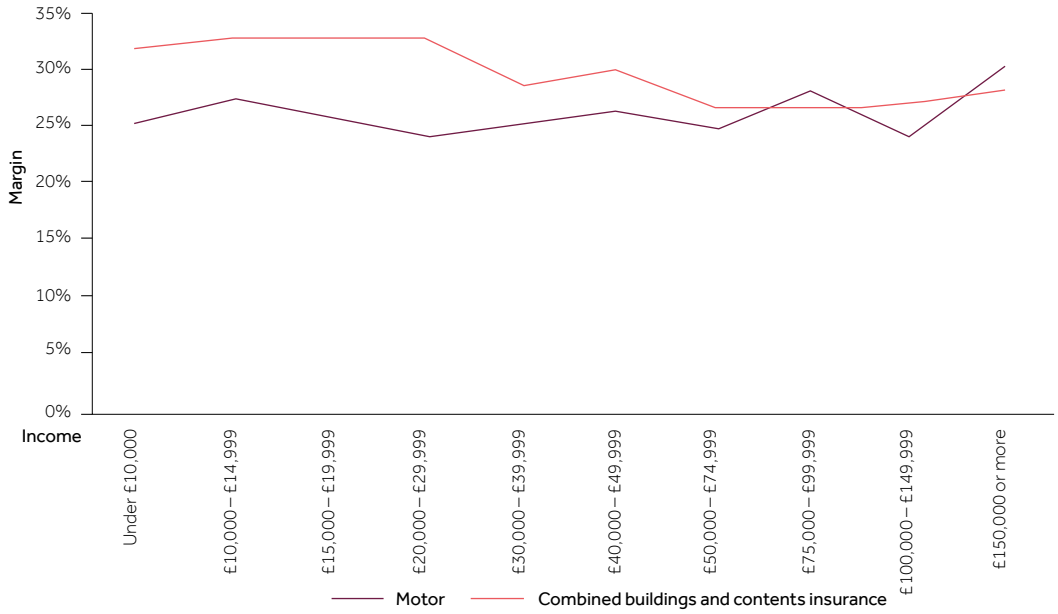
5.55 For cash-strapped households, funds for contents insurance may be competing with spend on housing, food, heating and electricity.

5.56 There is not similar data for motor and other types of home insurance customers that would allow us to understand why individuals become uninsured.

5.57 We use income as a substitute for affordability and compared this to the margin paid. We know that the overall price affects consumers' access, especially for consumers living in high risk areas, and that price discrimination is only one driver of the overall cost of insurance. But, by comparing income to margins, we control for some of this variation. If pricing practices increased access we would expect to see those whose low incomes make them less able to afford insurance paying lower customer margins.

5.58 Our results show no evidence that current pricing practices are increasing access to insurance for consumers with low income (see Figure 14 below). In fact, for combined home insurance, lower income consumers (below £30k) pay higher margins than those with higher incomes. (We do not have a large enough sample size to run this analysis for contents or buildings only insurance.)

Figure 14: Relationship between income and margin paid for insurance



Source: FCA analysis of consumer survey and policy data

5.59 We also looked at how price changes would affect access. Our consumer survey found that if there was a significant increase (50%) in the renewal price, 1% and 3% of customers in the motor and home insurance market respectively might drop out of the

market instead of shopping around. So current pricing practices may restrict access if prices rise significantly at renewal but this effect is relatively small.

5.60 We are concerned that vulnerable consumers may be unable to benefit from lower margin products and may be more likely to drop out if their premiums rose. In our consumer research, we found that potentially vulnerable respondents were less likely to shop around and switch (see the Consumer research – narrative report for more details). We also found that consumers who are vulnerable in two or more characteristics are more likely than average to be unaware. In home, we identified 68% of these vulnerable consumers as likely to be unaware of current pricing practices (compared to the average of 57%). In motor, we identified 64% of these vulnerable consumers as likely to be unaware of current pricing practices (compared to the average of 57%).

Assessment of whether pricing practices create barriers to entry, change and innovation

5.61 Finally, we considered whether the current form of price competition leads to barriers to entry or expansion, including barriers to innovation or different pricing practices.

5.62 There are challenges to new firms entering the home and motor insurance market, such as the level of capital required. Yet, there is evidence of entry from intermediaries, and the development of new and innovative propositions. This demonstrates that firms can overcome these barriers.

5.63 Most firms in the market have similar strategies, where they offer low prices to new customers and increase prices for existing consumers over time. New entrants told us that instead of innovating on pricing, they are focused on regaining the trust of consumers in insurance products by being more transparent as to why prices change, which may apply pressure to firms engaging in price discrimination. This indicates that the current nature of competition in the home and motor insurance markets may be a barrier to innovation.

5.64 We see some new business models emerging for home and motor insurance. For example, research carried out for this market study by Deloitte, suggests that there is a growing trend in usage-based and on-demand insurance. These trends could bring positive benefits. For example, they may encourage more consumers to get insurance by offering consumers flexibility to pay for insurance only when needed. Auto-switching has the potential to help consumers who might not otherwise shop around but could benefit most from doing so.

5.65 We are mindful that increasing amounts of consumer data are becoming available. This could be beneficial if consumers choose to share it with providers who could help them shop around and switch to better deals.[5] It may also allow more accurate pricing for individuals. However, it could also widen price differentials between consumers who actively shop around and switch, and those who do not. It is important that firms have strong governance and controls in place to ensure good outcomes for customers given the increasing use of consumer data in general insurance markets.

5 Please see the Deloitte report on future of general insurance pricing for more information regarding key business model innovations.

Conclusion

5.66 There is strong price competition for new business in both the home and motor insurance markets. This is facilitated by firms' price discriminating between new and renewal customers. Further, we saw evidence that ancillary income is a key contributor to overall profitability for both insurers and intermediaries.

5.67 We find that competition is not working effectively or efficiently in the interest of all consumers. We are concerned that firms are price discriminating based on consumer awareness. This is because:

- Consumers who are less aware of how pricing works pay higher prices. These consumers include those who have less financial knowledge, no internet access, and who trust insurance firms to offer them competitive prices.
- High costs are imposed on consumers and firms, and this is likely to raise the price of home and motor insurance overall.
- Consumers may fail to search and switch when it is in their economic interest to do so. While we find that most consumers are informed and are aware that the renewal prices offered will often be higher or not as competitive, a substantial minority of consumers are unaware. The complexity and lack of transparency about how firms are pricing makes it difficult to understand how much they might benefit through searching and switching. We are concerned that vulnerable consumers are more likely to be unaware of current pricing practices. These vulnerable consumers, therefore, may struggle to find low margin products and this could limit their access to insurance.

5.68 We find that overall firms providing home and motor insurance are profitable, although there is no evidence that these profits are excessive.

5.69 We also find no evidence that the form of price discrimination which is occurring is, or is likely to, increase access to insurance.

5.70 While the home and motor markets are not highly concentrated and there do not seem to be significant barriers to entry, we find that the current nature of competition can be a barrier to firms who want to develop innovative business models. However, over time, this may be changing as firms offer different insurance products.

6 Outcomes from pricing practices

6.1 The previous chapters have looked at how firms set prices and treat customers, and how pricing practices impact on competition. In this chapter, we consider what consumer outcomes we see from pricing practices. We look first at the customer journey and consumer understanding of the market and outcomes for different groups of consumers. We then consider the specific pricing outcomes we see for consumers using analysis of data from firms.

6.2 In parts of this chapter, we present results of our analysis separately for three types of home insurance product – home contents only, buildings only and combined contents and buildings.

Consumer journey and understanding

Customer journey

6.3 In our consumer survey, Consumer research report, 81% of motor insurance respondents and 72% of home insurance respondents said they undertook 'active' forms of search. More than half the respondents (52% in home insurance and 59% in motor insurance) reported they used two or more forms of search activity.

6.4 Approximately a third (35%) of respondents in both markets reported they had switched providers. In addition, 25% of respondents in home and 31% of respondents in motor said that they contacted their insurance providers and tried to negotiate a lower price. In most cases, negotiating seemed to be effective: 60% of respondents who tried to negotiate said they achieved lower prices for the same level of cover and excess.

6.5 12% of respondents in home and 8% of respondents in motor reported they renewed automatically without doing any research. Potentially vulnerable customers, such as less financially resilient respondents and those who were not confident managing their money were more likely to auto-renew without doing any research. In home, this amounted to 23% and 25% respectively, and in motor 13% and 16% respectively.

6.6 Respondents in motor tended to be more engaged in shopping around, negotiating with their providers and switching than in the home insurance market.

Consumers' understanding of how the market currently works

6.7 While consumers broadly appeared to understand how the market currently works, a substantial minority of respondents did not. About 90% of respondents in both markets believed that first-time customers were charged lower prices for the same product than comparable existing customers. Approximately 80% of respondents in both markets thought it was not certain that prices would remain the cheapest without shopping around. However, over a third of respondents (35% in home insurance and 31% in motor insurance) assume price rises are due to an increase in insurance costs.

6.8 Respondents who already had insurance tended to be more likely than first-time policyholders to believe that insurance providers charged new customers lower prices than comparable existing customers.

6.9 Respondents who had switched providers were also more likely than those who had renewed policies with the same provider to understand that increases in insurance prices may not be driven by rises in insurance costs.

Consumers' attitudes to how the market works

6.10 The context affected whether respondents thought loyal customers paying higher prices was fair or not. Most survey respondents (87% of home insurance consumers) thought it was unfair for a 5-year customer to pay higher prices than a comparable new customer. However, most survey respondents (approximately 80% in both markets) thought it was also fair that people who shop around save money. On the other hand, when respondents were asked to consider consumers who couldn't shop around because they were busy with a life change (such as having a new baby), 51% of motor insurance respondents (53% of home) thought it was unfair that such a consumer should pay more.

Consumer outcomes

6.11 We analysed the data to understand what margins consumers pay, and the size of the differentials between new and longstanding customers across all firms in our sample for home and motor.

6.12 We examined customer outcomes using data provided to us by insurers and intermediaries on the premium paid and expected claims cost for individual policies. This allowed us to assess how far premiums vary across customers for a given level of risk (ie a given expected claims cost). We used this information to create a 'customer margin' for each policy. This is measured as the difference between the premium and expected claims costs as a proportion of the premium.

6.13 This customer margin measures the contribution an individual policy makes to non-claims costs, expenses and profit. Therefore, it provides insights on competitive dynamics in the market. In general, we would expect competition to drive margins down.

Customer margins are higher for home insurance

6.14 We found that between 2014 and 2018, average customer margins across all consumers in our data were higher for home (38% mean, 39% median) than for motor insurance (24% mean, 25% median). Historically claims costs as a proportion of premiums (the claims ratio) have been higher for motor insurance than for home insurance. The lower average customer margins for motor in our individual policy data reflect those differences. Over the same period, customer margins for home insurance have decreased slightly, and increased slightly for motor insurance over the same period.

6.15 For home insurance policies, we see different average margins depending on the type of insurance product. In our sample, we see that contents only policies have the highest average margin 57% (64% median). Buildings only policies have an average margin of 44% (47% median). Combined buildings and contents policies have the lowest average margin 30% (32% median). We have assessed each of these products separately.

There is considerable dispersion in margins across consumers

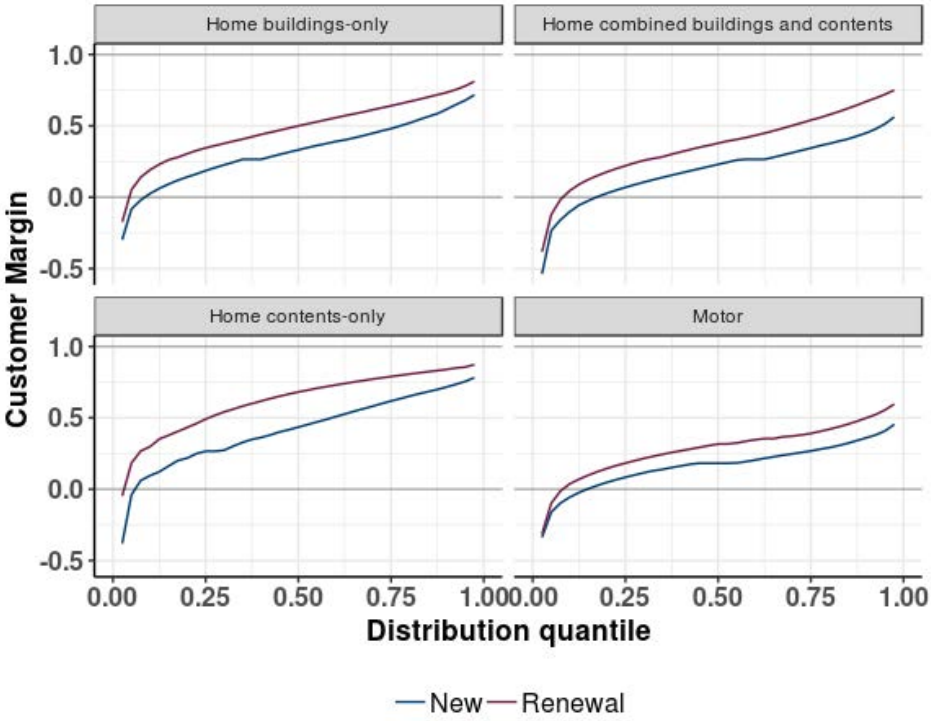
6.16 We found considerable variation in margins across customers, but it is relatively smaller for motor than it is for home (see Consumer outcomes technical annex for a detailed account of this analysis). We also found that there are a small proportion of customers whose premium does not cover the expected claims costs of the policy let alone the administration and acquisition costs associated with it (negative margin). These may be new business customers who are getting a substantial new business discount. Or they may be customers who have had a substantial increase in their expected claims cost but their premium has not yet been adjusted. In the latter case, a number of insurers highlighted that they would spread any price adjustment following an increase in expected claims costs over multiple years.

6.17 To understand in more depth the determinants of price dispersion, we looked at differences between margins for new business vs margins for renewal customers and, later, at how margins evolve over the length of time they hold the policy (tenure).

Customer margins increase with tenure

6.18 New business customers typically pay lower premiums than a renewing customer for the equivalent expected risk. For home contents-only policies, the average margin for renewing customers is 21 percentage points higher than the average margin for new customers. For buildings-only policies the difference is 16 percentage points, while for combined buildings and contents it is 17 percentage points. For motor, the average margin for renewal policies is 11 percentage points higher than the average margin for new policies. However, as shown in Figure 15, there is substantial variation in customer margins between new customers and between renewal customers.

Figure 15: Comparison of margin distribution at the market level for home and motor insurance

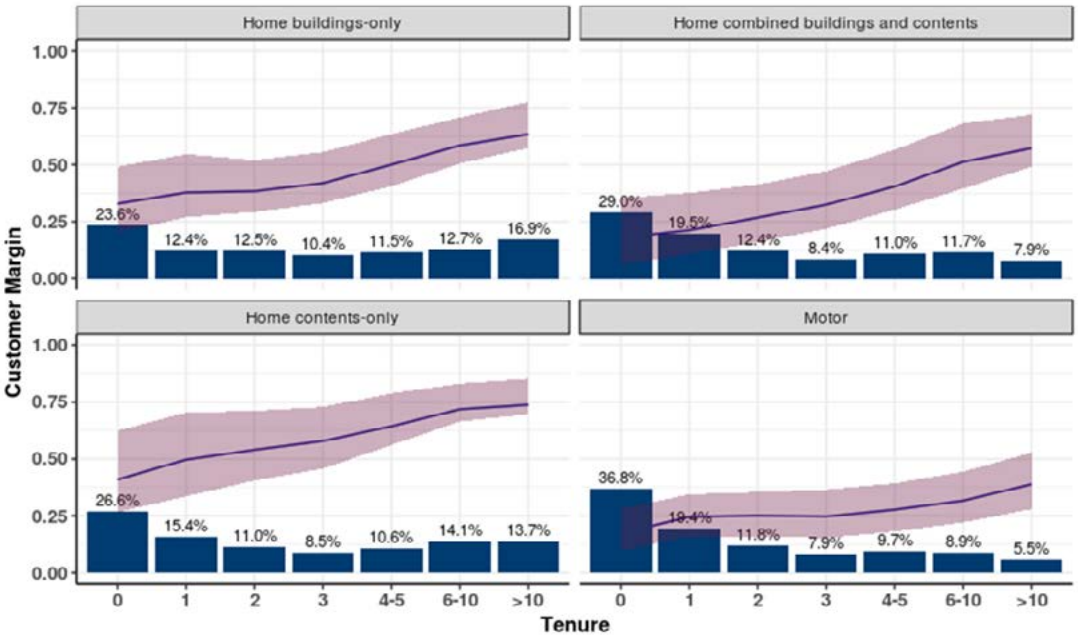


Source: FCA analysis of transaction data provided by firms

6.19 In addition to the difference between new and renewal customers we found that, on average, consumers pay higher margins the longer they stay with the same provider. Figure 16 shows the margins firms in our data sample charged to customers in our data sample by the length of tenure, as well as the distribution of margins across tenure. This is split by the products within scope of the market study (home contents only, buildings only and combined buildings and contents insurance, and motor insurance).

6.20 A customer's tenure is correlated with a number of other factors that may influence margins, such as age or whether they auto-renew. We have used regression analysis to control for a range of observable characteristics. This regression analysis indicates that after controlling for those factors, tenure is associated with steadily increasing customer margins. A customer that has been with their provider for more than ten years would be expected to pay a margin that is approximately 25 percentage points higher than a new business customer for motor insurance. For home insurance, it is 32 percentage points higher (35 percentage points for buildings-only, 25 percentage points for contents-only and 34 percentage points for combined buildings and contents respectively).

Figure 16: Margins charged by firms across customers by tenure

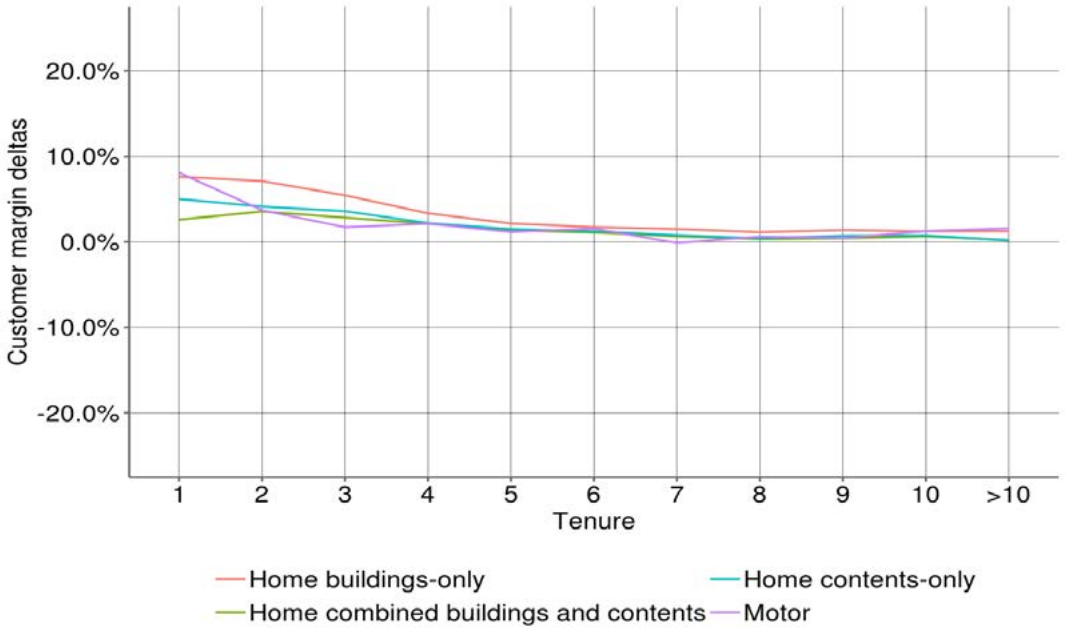


Source: FCA analysis of customer data provided by firms. The line represents the average margin at each tenure duration. The shaded area represents the interquartile range. The bars represent the proportion of policies in our sample at each tenure duration. Consumer outcomes technical annex provides more details on how the graphs are created.

6.21 The steady upward increase in average margins we see for customers of longer tenure is driven by various factors.[6] First, a firm may increase an individual customer's price year on year. Figure 17 shows that customers on average face year on year increases in their margin for the first 5 renewals. However, these gradually reduce over time so that after 5 years increases in margin are small. Second, consumers who are charged high margins are also those more likely to renew. In both home and motor, consumers who are charged high margins are 3% more likely to renew than those not charged high margins. Third, firms can identify consumers who are more likely to renew and charge them higher premiums relative to their risk. As this happens over time, the group of longstanding customers becomes composed of more high margin customers.

6 The distribution will also be affected by the trend in average new business prices over time.

Figure 17: Percentage points difference in customer margin between subsequent observations for the same policy, by tenure



Source: FCA analysis of customer data provided by firms. The graph pools all observations over the 2014 to 2018 period.

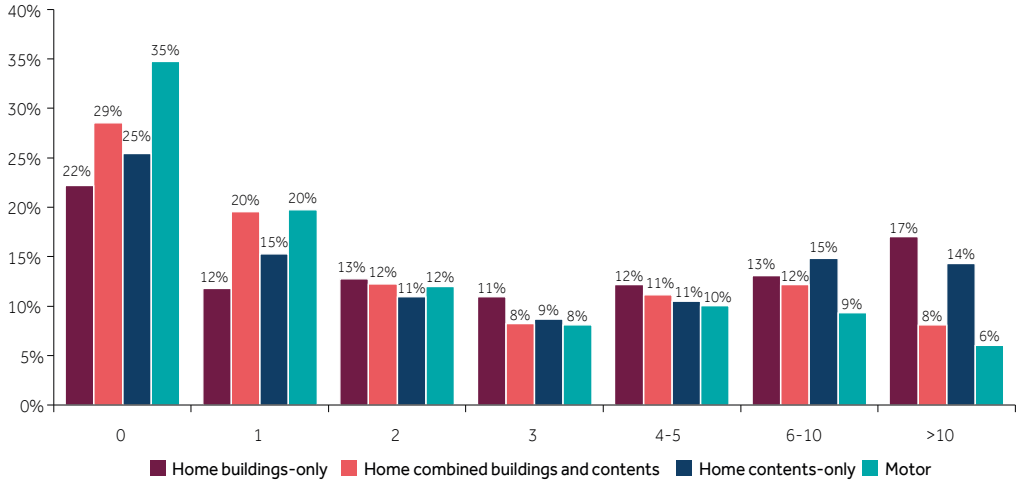
The number and composition of longstanding customers

6.22 To understand the implications of pricing practices for longstanding customers we have looked at the proportion of customers who have been with their insurance provider for a long period of time, their characteristics and the factors that influence their tenure.

How many consumers fall into different lengths of tenure

6.23 Figure 18 shows how many consumers in our data sample are new business customers (year 0) through to those who had been with the same provider for more than 10 years. We see that there is a larger proportion of customers with longer tenures for home insurance than motor insurance. Buildings-only and contents-only policies are particularly affected. This is partly accounted for by a shift over time away from separate policies to combined buildings and contents cover.

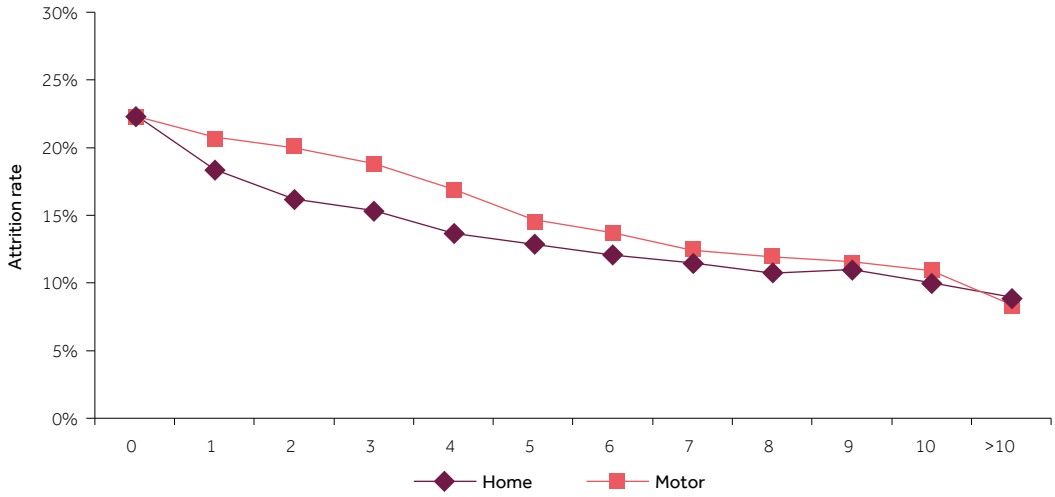
Figure 18: Proportion of consumers in sample data for home and motor insurance by tenure (years)



Source: FCA analysis of data provided by firms

6.24 Tenure composition at any point in time is influenced by switching rates, the rate of new entry and trends over time in the sale of policies. We compared the proportion of customers who do not renew with their existing provider (attrition rates), across products. Attrition rates decline with tenure for all products. Consumers with longer tenure are more likely to renew with their existing provider. More than 90% of customers who have been with their provider for 10 years renew their policy. Attrition rates are slightly higher for motor policies than for home policies, particularly in years 1-5.

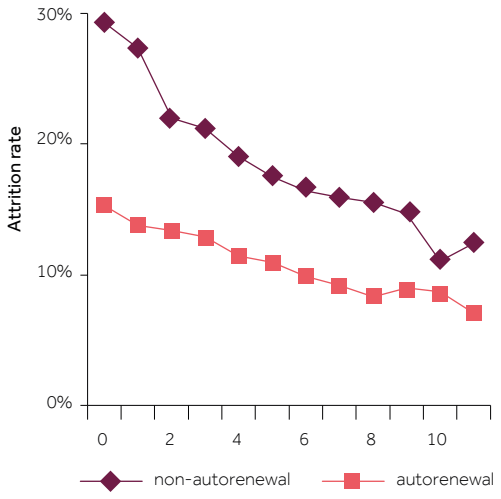
Figure 19: Attrition rate by tenure, 2017



Source: FCA analysis of data provided by firms

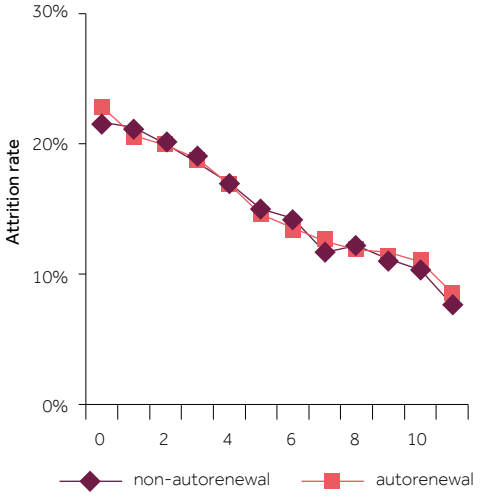
6.25 We have also examined what determines attrition rates across different types of customers. As indicated in Figure 20, we find that those home insurance customers that do not have their policy set up to auto-renew have much higher rates of attrition than customers who auto-renew. However, we find that auto-renewal does not have an effect on attrition rates for motor insurance (Figure 21). In our sample, 59% of home policies and 68% of motor insurance policies are set to auto-renew.

Figure 20: Attrition rate by tenure and auto-renewal, home insurance, 2017



Source: FCA analysis of data provided by firms

Figure 21: Attrition rate by tenure and auto-renewal, motor insurance, 2017



Source: FCA analysis of data provided by firms

6.26 Auto-renewal is the default option for most firms, so consumers must make a positive choice not to have their policy auto-renew. If a consumer is more active, they may be more likely to consider whether they want their policy to auto-renew. Less active consumers may be more likely to allow their policy to auto-renew without shopping around to see if there are better options.

The scale of high margins

6.27 What different consumers contribute to expenses and profits depends on the form of pricing a firm adopts and the consumer's tenure. With life-time value pricing models that use price walking, new customers will pay lower margins and longstanding customers higher margins. A customer paying a high margin in one year may have been given an initial discount or reduced margin in previous years. Over the lifetime of the policy a customer may pay overall an average contribution to margin. Therefore, it is important to consider this lifecycle and not just look at the margin at a snapshot in time.

6.28 There are clearly some winners and losers, even after considering a consumer's overall lifetime contribution to the policy. Someone who switches frequently may benefit from getting repeated new business discounts. They will pay consistently low margins over a long period and so make a very small contribution to insurers' expenses and profits. These margins would not even out over the overall life time of the customer relationship.

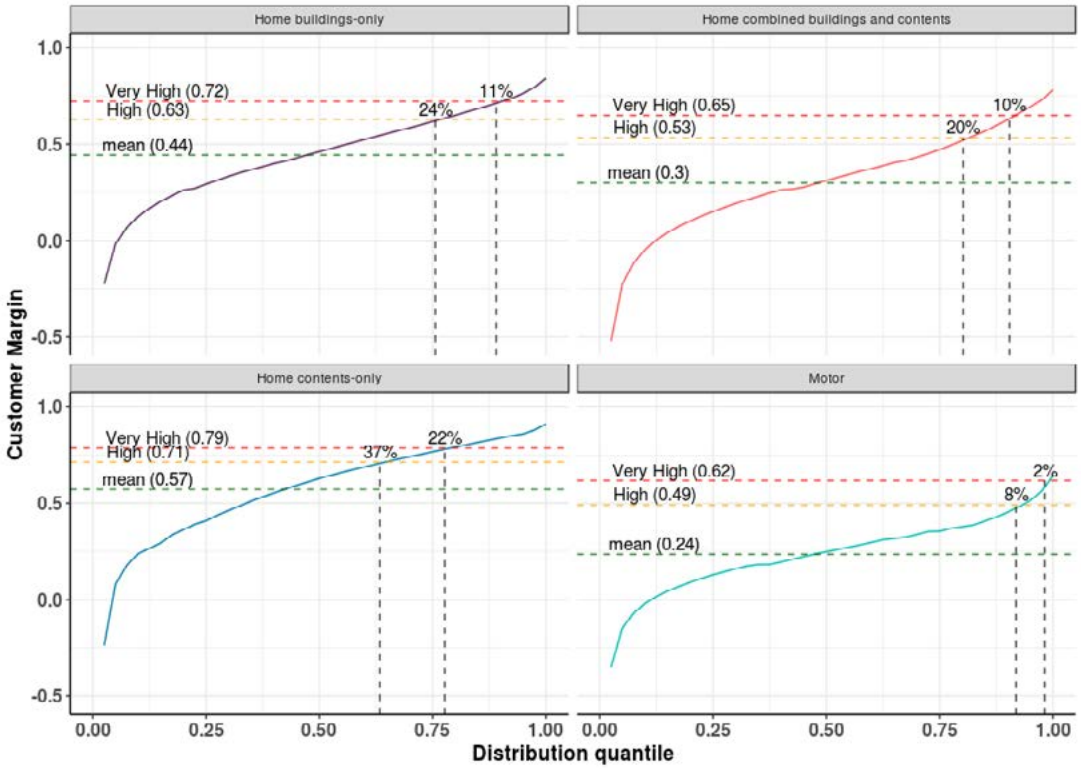
6.29 The higher the margin and the longer the customer's tenure the more likely it is that they are making a disproportionately high contribution to expenses and profits. We are concerned if a firm's pricing model relies on a small proportion of inactive consumers covering a substantial part of a firm's nonclaims costs, expenses and profits. We examined those customer contributions to establish how many consumers were paying high margins.

6.30 We first calculated the market average margin for firms in our sample for each product. If this margin was the same for all customer policies across the market, this would cover the current market level of costs, expenses and profit. We then set thresholds that were at a premium 50% above this (we term this a 'high' margin) and double the market average premium for the risk (a 'very high' margin). These are only indicative thresholds and need to be considered in the context of any initial discount for the consumer. The typical difference between the new business margin and renewal that we observe is 19% for home and 11% for motor. Longstanding customers may have been paying high margins for several years.

How many customers are paying high margins

6.31 The market average level of customer margins charged by firms varies between home and motor insurance. Figure 22 shows the distribution of margins across all consumers in the data we collected from firms, relative to the thresholds that we have set.

Figure 22: Margins across consumers in home and motor insurance



Source: FCA analysis of data provided by firms. The curves illustrate the distribution of customer margin in 2018 for each product. The horizontal lines, correspond to (from the bottom up) the market average margin, the high margin threshold and the very high margin threshold in 2018. The intersection between the distribution of customer margin and three horizontal lines, allows to identify the proportion of customers paying for policies characterised by margins at or above the threshold.

6.32 For home insurance, we estimate that 1 in 5 combined buildings and contents customers are paying high margins (a premium that is 50% above the market average premium for their risk). One in 10 policy holders are paying very high margins (a premium that is double the market average for their risk). For contents-only home insurance policies, which have a larger proportion of longstanding customers, we find that more than 1 in 3 customers are paying a high margin and 1 in 5 are paying very high margins. Overall, we estimate that for all types of home insurance policies more than 4 million home insurance customers were paying high or very high margins in

2018. If those who are currently paying high or very high insurance margins instead paid average margins, the total premiums those customers pay would fall by £750m.

6.33 The distribution of margins is flatter for motor insurance, so the proportion of customers buying policies characterised by high and very high margins is lower. We estimate that 8% of motor insurance customers are paying premiums 50% above the market average for their risk and 2% of motor insurance customers are paying more than double the market average premium for their risk. If those customers currently paying for policies with high or very high insurance margins instead paid average margins, the total price paid by those customers would fall by over £500m.

6.34 Firms have different pricing policies and so some have flatter distributions of margins across customers and others have more unequal distributions. Similarly, some firms have higher proportions of customers with high and very high margins. At this stage, we have not completed our analysis of the proportion of non-claims costs, expenses and profits that high margin customers contribute to each firm. We aim to complete this analysis for the final report of the market study. We will then feed this analysis into our assessment of harm and potential remedies.

Who are the consumers that pay higher margins?

6.35 We analysed a range of consumer characteristics to understand if there were any that were common across consumers paying higher margins. To do this we used the transaction data from firms. We also combined the transaction data with our consumer survey data. This has given us detailed insights into the characteristics of those paying higher margins, and those who are not.

6.36 The two datasets cover a range of different characteristics across consumers:

- Socio-demographic – including age, gender, postcode, region, income, employment and marital status.
- Vulnerability – In the transaction dataset we defined this based on customer postcodes and English indices of deprivation (IMD) 2015 and ONS Pen Portraits data. In the survey dataset we defined this based on questions we asked about insurance knowledge, comfort buying financial products online and socio-demographic characteristics. We also asked targeted questions in the survey against 4 drivers of actual or potential vulnerability, as set out in our recent consultation on guidance for firms on the fair treatment of vulnerable customers. These were:
  - health – health conditions or illnesses that affect someone's ability to carry out day to day tasks
  - life events – major life events such as bereavement or relationship breakdown
  - resilience – low ability to withstand financial or emotional shocks
  - capability – low knowledge of financial matters or low confidence in managing money
- Engagement with the home and motor insurance markets – for example their likelihood of negotiating or renewing with existing providers, or switching to new providers. We also looked at whether consumers were likely to auto-renew.
- Understanding of how the home and motor insurance markets work, preferences and attitudes to fairness.

6.37 We used a combination of graphical and multivariate regression analysis to test the relationship between margins and these characteristics. We give our findings from the analysis of the larger dataset first, with key findings on characteristics below.

Tenure

6.38 As shown before, many consumers paying high and very high margins are relatively long tenure customers but there are also many that are not. Approximately a quarter of home insurance customers paying high or very high margins have been with their provider for less than 4 years. Nearly a half of motor insurance customers paying high and very high margins have been with their provider for less than 4 years. This highlights that while firms' pricing practices, such as price walking, mean tenure is one of the main determinants of customer margins, there are also many other factors that determine firms' prices. This means even new business customers can pay premiums that look high relative to their risk.

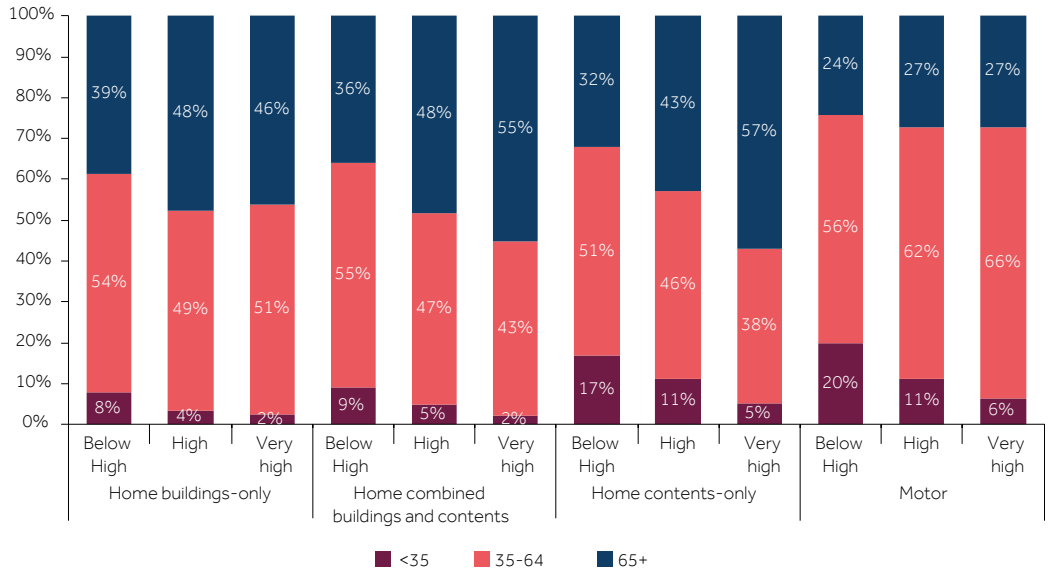
Negotiation of price at renewal

6.39 Looking at the full data set of motor policies we collected, we saw that if a customer negotiated a discount from the firm, this led to a customer margin approximately 5 percentage points lower than previously. We did not find a similar relationship for home insurance policies.

Age

6.40 In home, and to a lesser extent in motor, the proportion of older customers is higher for high and very high policies compared to below high ones.

Figure 23: Age profile of consumers by level of margin, 2018



Source: FCA analysis of data provided by firms

6.41 The relationship between age and higher margins is mostly driven by tenure. Newer customers are generally younger than those of longer tenure. After controlling for the fact that older customers have longer tenure, we did not find consistent evidence that they tended to pay higher margins than younger customers. For motor insurance, there are signs that younger drivers might be paying higher margins.

Auto-renewal

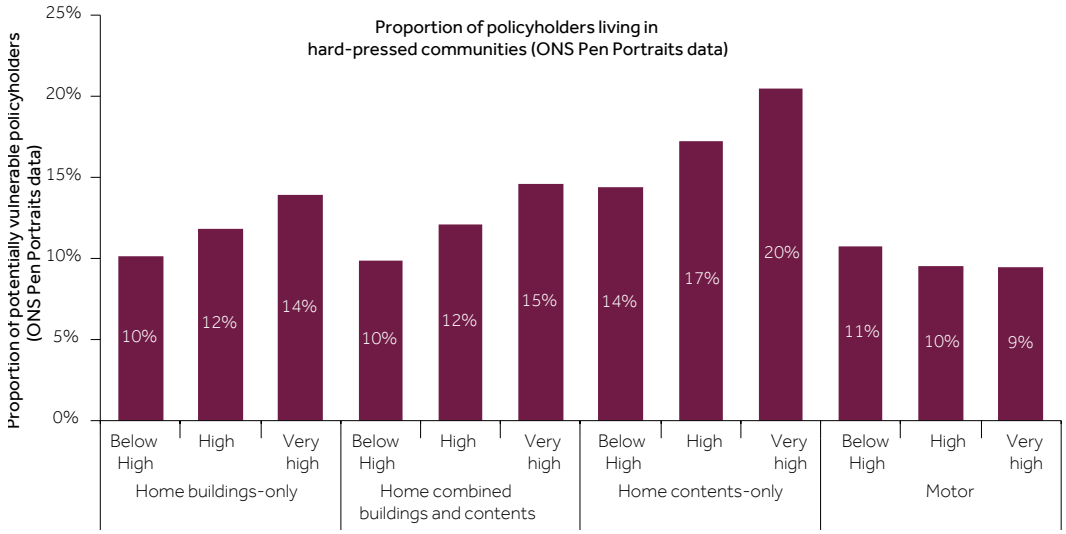
6.42 For home insurance, auto-renewing customers pay higher margins than customers whose policy is not set up to auto-renew. We found no such relationship for motor insurance.

Vulnerability

6.43 Our recent consultation on fair treatment of vulnerable customers defined a vulnerable consumer as 'someone who, due to their personal circumstances, is especially susceptible to detriment'. We have considered alternative vulnerability definitions across the range of characteristics we identify in the transaction and survey datasets.

6.44 Within the transaction dataset, we considered vulnerability using substitutes based on postcode level data, ONS Pen Portraits and the English IMD (2015). In home, we find that the proportion of customers living in postcodes classified as "Hard-pressed communities" is higher among higher margin policies.

Figure 24: Proportion of potentially vulnerable consumers by level of margin, 2018



Source: FCA analysis of data provided by firms

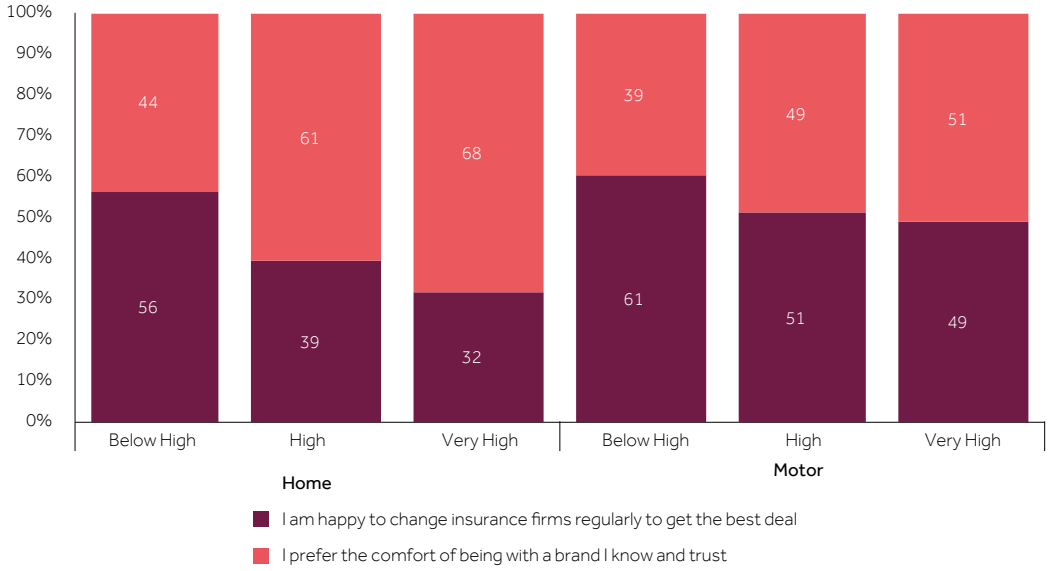
6.45 We test this relationship in a multivariate regression and find some evidence that, in home insurance, customer margins might be slightly higher for customers identified as vulnerable, although different models give different results. So we used information from the consumer survey research to explore this issue in more detail.

6.46 Within the survey dataset, we did not find that any of the 4 drivers of vulnerability identified through targeted questions were consistently more common among high margin customers. Although there was evidence that customers with these characteristics pay higher margins on average, this could be the result of other characteristics of these customers.

6.47 Considering a broader definition of vulnerability, the analysis suggests high margin home customers are less comfortable buying financial products online. Both home and motor high margin customers report lower levels of insurance knowledge in some cases. If low margin policies were only accessible to customers who were comfortable buying financial products online, or had relatively high self-reported knowledge about

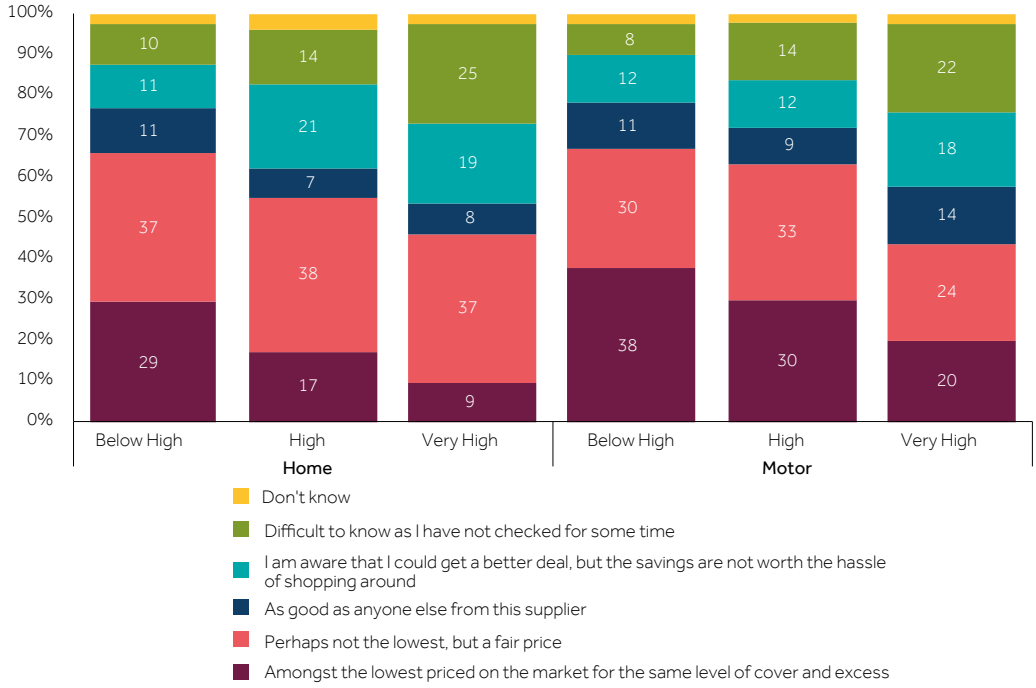
insurance products, vulnerable customers without these characteristics could be excluded from accessing low margin offers.

Figure 25: Which statement most closely reflects your preferences?



Source: FCA analysis of data provided by firms and consumer survey responses

Figure 26: How good would you say your current deal is?



Source: FCA analysis of data provided by firms and consumer survey responses

Other characteristics of high margin consumers

6.48 The consumer research identified several other characteristics which are consistently found amongst high margin customers (in both home and motor markets). These include:[7]

- High margin consumers have strong brand preference. Figure 25 shows that more than 60% of high margin customers for home insurance (around 50% in motor) prefer to be with a brand they trust, rather than changing regularly for the best deal. On average, home insurance customers prefer to change regularly for the best deal (54%, 59% in motor) rather than staying with a brand they trust (46%, 41% in motor).
- Lower price sensitivity. On average, around 90% of both home and motor customers who search for a new deal are motivated by price, for high margin customers this can be as low as around 70%.
- Unaware of the competitiveness of the product they own. On average, around 55% of home customers and 57% of motor customers can be classified as those who may not be aware of the competitiveness of the product they own, given current pricing practices. For high margin customers this can be as high as 69% in home and 65% in motor.
- Lower awareness of the gains from switching or the value that their deal offers. Figure 26 shows that around 20% of home and motor customers think they could get a better deal, but the savings are not worth the hassle of shopping around, or don't know how good their current deal is because they have not searched for some time. For high margin customers, this can be as high as around 45% in home and 40% in motor.
- Lower self-reported knowledge about insurance products. On average, 21% of home customers (16% in motor) feel they have relatively low levels of knowledge about insurance products. For high margin customers, this can be as high as 30% (around 20% in motor).
- High margin home customers are generally less comfortable buying financial products online. On average, 66% of home customers are very comfortable buying insurance products online. For high margin customers, this can be as low as around 45%. A higher proportion of high margin customers reported that they prefer to buy face-to-face or over the phone, or are not particularly comfortable using their online access to buy financial products online.

Characteristics of low margin consumers

6.49 Low margin home customers generally exhibit the opposite characteristics to those paying high margins. For example, they believe there are deals to be found and they have the time and energy to seek them out. They also have better understanding of current insurance market pricing practices and self-reported knowledge about insurance products.

7 Average values from FCA analysis of data provided by firms and consumer survey responses and therefore my not match average values reported in Consumer research report.

Conclusion

6.50 The previous chapter established that competition is not working effectively for all consumers. This chapter has examined the extent to which that impacts on consumer outcomes in these markets and which consumers are affected.

6.51 We have identified that the pricing practices in these markets lead to a large number of consumers paying prices that are significantly above the market average premium for their risk. Customers who do not switch or negotiate are most likely to be impacted in this way. However, high prices are not restricted to this group, reflecting the variety and complexity of firms' pricing models. Various characteristics associated with lack of understanding, awareness or engagement in the markets are associated with high margin customers. We find that there is some evidence that potentially vulnerable consumers can pay higher prices relative to their risk for home insurance, but do not find this for motor insurance.

7 Potential remedies

7.1 Our interim findings indicate that competition is not working well in the home and motor insurance markets, and pricing practices are not delivering good outcomes for all consumers. This chapter summarises our concerns and sets out the options we are considering.

What we are concerned about

7.2 Overall, our analysis raises significant concerns that these markets could work better and are not delivering good outcomes for all consumers.

7.3 Home and motor insurance are important products for consumers and play a valuable role in protecting them from risk. The current nature of competition between firms gives many consumers an opportunity to get quality insurance products at lower prices by shopping around and switching. However, this form of competition leads to those who do not switch being significantly worse off. It also creates significant costs for both firms and consumers.

7.4 In markets, the fact that some consumers pay higher prices than others is not a concern itself. However, in the home and motor insurance markets, we think that some practices firms use, which lead to them earning higher margins from some consumers, are harmful. Behavioural economics tells us that there are various behavioural biases that can make consumers prone to mistakes. We are concerned that pricing practices take advantage of consumers who are less aware of how these markets work and how good their deal is compared to others. This means they are less likely to switch or negotiate better prices, and be worse off as a result.

7.5 We are also concerned about the lack of transparency on how prices are set. Firms do not make it clear to consumers that they earn higher margins from those less likely to switch and price walk consumers over time. Firms also engage in practices that could make it more difficult for consumers to make informed decisions about whether to switch or negotiate a better deal.

7.6 Auto-renewal can give customers convenience and some protection against the consequences of being uninsured through forgetting to renew. But we also found evidence that home insurance customers who auto-renew pay, on average, higher prices. We saw that some firms make it more difficult to cancel auto-renewal than it is to opt-in to auto-renewal. Some firms' pricing models also include as a rating factor whether or not customers have policies with auto-renewal.

7.7 The future profitability of these customers drives firms to spend significant amounts on acquiring customers and price below cost to win new business. This is likely to push up the overall price of home and motor insurance. Consumers also need to invest significant time and effort into shopping around each year so they do not end up paying high prices. These are indicators that competition could work better.

7.8 Our interim view is that we need to consider further action to tackle these concerns. In helping decide whether FCA intervention is required, we have used the FCA's six evidential questions to help assess concerns about fairness in price discrimination. A summary of our assessment is in Figure 27:

Figure 27: Analysis of evidence from market study alongside FCA evidential questions for assessing the fairness of general insurance pricing practices

Question	Evidence
Who is harmed?	Consumers who do not switch or negotiate better deals tend to pay more than consumers of equivalent risk and cost to serve. These consumers show less awareness of how the home and motor insurance markets work.
How much are these individuals harmed?	We estimate that if high and very high margins earned from consumers fell to the market average margin, the cost of premiums for these consumers would fall by £750 million for home insurance and £500 million for motor insurance.
How significant is the pool of people?	We estimate that firms earn high or very high margins from 4 million people in home insurance and 2 million people in motor insurance.
How are firms discriminating?	Firms use complex and opaque models to determine prices in ways that consumers do not understand. The fact that firms earn higher margins from customers who do not switch is not made clear to consumers. Firms also engage in practices that discourage switching and could make it difficult for consumers to make informed choices about whether to renew and acting to get better deals.
Is the product essential?	Motor insurance is a legal requirement and buildings insurance is usually a requirement for a mortgage and something consumers will often view as a necessity to protect their major asset.
Would society view the price discrimination as egregious/ socially unfair?	Concerns have been raised by stakeholders including Citizens Advice through their super-complaint to the CMA. When we asked for consumers' views on price walking in our survey we found that, whether they shop around or remain with their provider, they think price walking is wrong. Industry has acknowledged concerns about pricing practices. The Association of British Insurers and British Insurance Brokers' Association have introduced their own Guiding Principles and Action Points.

Our approach to considering potential remedies

7.9 It is important that general insurance markets work well for consumers. Our statutory objectives on protecting consumers, promoting competition and protecting and enhancing the integrity of the UK financial system underlie what we are aiming to achieve through this market study. We want to ensure that firms put fair value and treatment of customers at the centre of their pricing practices. We will use the full range of tools available to the FCA to achieve this and ensure a holistic approach to tackling our concerns in these markets. It is important that customers purchase good value general insurance products. Value is driven not only by price but also by the quality of the product.

7.10 In light of our findings, in the immediate term, we will continue our work to:

- ensure firms improve the governance, control and oversight of pricing practices.
- deliver the changes required from firms following implementation of the Insurance Distribution Directive.
- continue improving transparency and engagement at insurance renewal. We introduced rules to do this in 2017, and publish our evaluation of the impact of these alongside this report. The FCA's central estimate of consumer savings is £185m per year due to its intervention.

7.11 We are also considering a range of industry wide measures to reform these markets so they work well for consumers in the future. Our interim findings suggest there are three key areas that may require action:

- Pricing practices that take advantage of consumers who are less likely to switch.
- Practices that encourage consumers to renew and may discourage shopping around and switching to get better deals.
- Addressing areas of ineffective competition.

7.12 We discuss the potential remedies that could do this, and the benefits and challenges of implementing them, below.

Remedies to tackle high prices for consumers who do not switch or negotiate better deals

7.13 We are concerned about the harm to customers who do not switch and are paying prices that are higher than those paid by customers of equivalent risk and cost to serve.

7.14 We recognise that how prices are set for home and motor insurance is complex. Any intervention that changes price setting could impact the way the industry is structured including how competition works in a market. To address the harm we have identified we are considering supply-side remedies despite these complexities.

Restrictions on pricing practices

7.15 One potential remedy area we are considering is to limit or ban pricing practices that take advantage of consumers who do not switch or negotiate. This could be achieved in different ways including:

- Restrictions on price increases to renewing customers. For example, allowing firms to set discounts for new customers but not permit any future increases in margins beyond the first year if these customers renew. This would remove firms' ability to step prices up over time until consumers are paying prices far above costs. We could also ban price walking as a strategy for general insurance.
- Restrictions on the use of particular factors in setting prices and determining margins, for example the consumers' likelihood of switching or negotiating a better deal.
- Restrictions on the price level relative to a benchmark such as the new business price for the policy.

7.16 Our comparisons of international general insurance markets general insurance markets show how issues with general insurance pricing have been tackled in other jurisdictions. Several countries have restrictions or requirements on the rating factors that insurers' can use in their pricing models. For example, in Belgium legislation was introduced in 2014 requiring insurers to be able to objectively justify the rating factors used in their underwriting and acceptance criteria for some types of general insurance. Other approaches have been adopted by states in the US. For example, in California insurers are required to use three mandatory rating factors in the pricing of motor insurance. These rating factors must have a greater impact on the premium than any of the other factors used in the pricing model.

Helping consumers find and switch to better deals

7.17 Another option we are considering is to require firms to move consumers on to cheaper equivalent deals. Periodic automatic switching could help prevent long-term price walking. This remedy could be restricted to consumers who have renewed multiple times or who are paying high or very high prices. These consumers could be switched to the price (and level of cover) offered to an equivalent new customer with the same insurers. In considering this type of potential remedy, we are aware of the work by the Financial Services Consumer Panel on automatic upgrades.

7.18 As an alternative to automatic switching, we are also considering whether to require firms to engage with customers who have renewed the same policy consistently and who are paying high prices. This could prompt consumers to consider other options. It could also lead firms to identify consumers who they need to provide additional help to in finding and moving to better value insurance products.

7.19 Our international comparisons work revealed that switching campaigns have been used in other countries to tackle high prices for some insurance customers. For example, in Australia the consumer network 'One Big Switch' launched a campaign in 2014 to negotiate better deals on home insurance for a large group of customers that had signed up to the service. According to the consumer network, the winning offer included a 40% discount of the standard rate of a major national insurer.

Strengthening product governance rules

7.20 We will also look at whether to strengthen or change existing rules on product governance. Our existing rules include a requirement for firms to consider whether the costs and charges of the insurance product are compatible with the needs, objectives and characteristics of the target market. These product governance rules apply to products manufactured, or products where there has been a 'significant adaptation', after 1 October 2018 (when the rules came into force).

7.21 We could look to expand on these requirements by:

- Applying the requirement to all products, not just those manufactured or significantly adapted after 1 October 2018.
- Requiring firms to consider the value of the contract to the target market over time.
- Including a responsibility for a senior manager to take responsibility for the value of products to the target market.

Monitoring firms' actions to tackle concerns about pricing practices

7.22 We are also looking at ways to ensure firms are taking actions to improve their pricing practices. One option is looking at how to consistently monitor price differentials. This could include requiring firms to provide data on the average premium paid in home and motor markets across different groups of consumers. For example, firms could provide price differentials for new and renewing customers over the last 12 months. Gathering these data could assist the FCA in identifying where we need to take follow up actions with specific firms.

Remedies to tackle practices that discourage switching

7.23 We identified practices by firms that could discourage or make it difficult for consumers to make informed decisions and act to get better deals. In some cases, firms make it more difficult for consumers to cancel contracts or stop their policy from automatically renewing. We are concerned that auto-renewal is being used in ways that could discourage some consumers from switching. We found that consumers who auto-renew for home insurance on average pay higher prices than those who do not.

7.24 These practices may not support effective competition and deliver good outcomes for consumers. We will consider action to address them. In doing so, we will be mindful of the CMA's principles for healthy competition and acceptable behaviour by firms. These were set out in the CMA's update on the response to the loyalty penalty super-complaint. These are:

- Auto-renewal must be explicitly agreed to.
- Consumers are properly notified before any renewal.
- Changes to price, the product or other important terms must have the consumer's express agreement.
- It should be at least as easy to exit a contract as it was to sign up.
- Minimum terms are restrained and no longer than justified.
- No auto-renewal onto a fresh fixed term.

7.25 We will consider the extent to which each of these principles are relevant for motor and home insurance.

7.26 Potential remedies could include:

- A ban or restriction on the use of auto-renewal of insurance policies, including where there has been a change in the price.
- Making auto-renewal opt-in only.
- Making it easy to decline auto-renewing policies at the time of purchase and at renewal.
- Ensuring that firms make it as easy to exit a contract as it was to sign up.

7.27 In developing any potential remedy, we will carefully consider the impact on the advantages of auto-renewing insurance. Auto-renewal provides benefits for some consumers. Consumers who want to renew with their insurer do not need to invest time into renewing their insurance. Auto-renewal also protects consumers who have forgotten to renew insurance from becoming uninsured. This is especially important when insurance is a legal requirement as for third party motor insurance. Our international comparisons work provides insights into how this issue has been

approached in other jurisdictions. In Italy for example, automatic renewal for third party motor insurance is banned, while for most other types of general insurance, it is limited to two years. These rules have been in place since 2005 to encourage consumers to shop around and to switch provider if a better deal is available.

Remedies to make firms be clearer and more transparent in their dealings with consumers

7.28 The consumers who do not switch and are paying the highest prices for their insurance are unlikely to fully understand the implications of this. The complexity and lack of transparency around how firms set prices is unlikely to help consumers make informed decisions. We see firms being clear and transparent in their dealings with all consumers as integral to well-functioning markets. We are looking at options to ensure that this is at the centre of how firms set prices for general insurance and how they treat their customers.

Improving the way firms communicate with customers

7.29 A significant part of ensuring transparency involves improving the way that firms communicate with customers to ensure they help consumers make informed decisions about whether to renew. This could include requiring firms to make clear to consumers that renewal prices have increased because they have not switched for a number of years. It could also include requirements for firms not to use statements that could discourage consumers from switching.

7.30 Where we have previously found that consumers did not have all the information required to make decisions we have required firms to provide additional information to consumers. This type of remedy may not help all consumers, for example those who have more limited financial capability or face high barriers to switching. We therefore do not see providing additional information to consumers as the only solution to the concerns we have identified in this market study. However, ensuring firms are clear and transparent with consumers is likely to reinforce and support our overall package of remedies.

Increasing public scrutiny of firms pricing practices

7.31 We will also look at whether firms should be required to publish information about their pricing practices or differences in prices between customers of equivalent risk. Publishing such information could lead to public scrutiny and pressure on firms, prompting them to lower prices. It may also prompt consumers to consider the prices they are charged, how these prices may have changed over time and whether they should switch.

Long term reform of the market by harnessing the benefits of innovation

7.32 We will also look at ways that general insurance markets could be positively impacted by technological developments and innovation in the future. Developments such as Open Finance and increasing use of consumer data have the potential to transform the way consumers interact with financial products. Currently, PCWs help consumers shop around and compare prices. However, consumers need to actively provide their data to benefit fully from these services.

7.33 We believe Open Finance has the potential to revolutionise the way financial markets work for consumers, delivering significant consumer benefits, improving competition within financial services sectors and spurring greater innovation. For example, it could make the process of finding better deals and moving to other providers easier and quicker. In the longer term, this process could be automated. Open Finance could result in consumers receiving bespoke deals based on their financial habits, which are better suited to their needs. We recognise it could take some time for the potential of Open Finance to be fully realised, and will depend on consumers engaging with it.

7.34 We want general insurance markets to be part of these transformations to ensure they work well for the future. In July 2019, we set up an advisory group to take forward our future strategy on Open Finance. General insurance is being considered as part of this work. The advisory group consists of industry experts, consumer and business representatives, as well as academics and government departments. It will inform our Call for Input on our strategy towards Open Finance which will be published later this year.

Remedies we do not propose to focus on

7.35 There are a range of options for tackling harm we have identified. Those we are focusing on are set out above. There are some options we do not currently propose to focus on in the next phase of our work. This is because we have not seen strong evidence that they will be as or more effective in addressing harm than the remedies set out above.

7.36 We are not proposing to focus further on:

- Requiring multi-year contracts. We considered whether requiring contracts for general insurance to be longer than a one year period for all consumers could improve outcomes. Our analysis shows that consumers who pay higher prices tend to be those who do not switch provider, we do not think it is likely that increasing contract lengths will address this issue. Our international comparisons work highlights that in some countries multi-year contracts raised concerns about limiting consumers' flexibility to switch and posing barriers to entry for new firms. Some firms told us they had offered multi-year contracts to consumers but demand was limited.
- Requiring a single switching and renewal period for all consumers. We considered whether requiring this could increase engagement and motivation to switch. Similar approaches have been used in other countries. In Hungary, for example, prior to 2014 there was a statutory campaign period of one week. Firms were only allowed to change prices during that period. There was generally intense press and information campaigns to focus consumers' attention and raise awareness

to switch during that week. This statutory campaign period was removed in 2014, and it was found that this led consumers to be less motivated to switch. While this suggests that a single switching and renewal period can increase consumer engagement and switching, we do not think it is likely to address the core harm we have found where consumers who are less likely to switch pay higher prices. Further, our consumer research suggests that switching rates for home and motor insurance are already higher than in many other financial services markets, but this is not benefiting consumers who do not switch.

Our remedies will fit with wider regulatory efforts to improve consumer outcomes

7.37 Any remedies that may emerge from this market study will sit within the broader regulatory context of our other work to ensure general insurance products deliver value to consumers. More detail on this work is set out below.

The Insurance Distribution Directive (IDD)

7.38 The IDD was implemented in the UK on 1 October 2018. It introduced new requirements for insurers and insurance intermediaries distributing insurance. These rules place new focus on firms to act honestly, fairly and professionally in the best interests of customers, together with the introduction of new rules for firms in relation to product approval and oversight. Overall, these new rules support our work and should help lead to a situation where customers purchase insurance products which they need and provide good value.

7.39 When we implemented the IDD, we introduced several changes to our rules both to transpose the directive requirements and to extend the application of/add to these. Our rules require:

- product oversight and governance arrangements –
  - All firms that manufacture insurance products (e.g. have a role in creating, developing, designing and/or underwriting) must meet the product governance and oversight requirements. This sets various high-level obligations including that the design of insurance products:
    - takes into account the objectives, interests and characteristics of customers;
    - does not adversely affect customers;
    - prevents or mitigates customer detriment;
    - supports a proper management of conflicts of interest.
  - As part of this, firms must identify the target market and ensure the product is compatible with the needs, characteristics and objectives of customers in that target market.
  - The rules also place responsibilities on distributers to understand the products being sold and the target market of customers.
  - The rules require product manufacturers to consider the charging structure for each insurance product, including examination of whether the costs and charges of the product are compatible with the needs, objectives and characteristics of the target market. We believe that value is an important consideration for firms when manufacturing products, determining distribution strategies and setting their remuneration structures. We have consulted on

guidance for manufacturers and distributors of non-investment insurance products (GC19-02). This guidance consultation sets out our view of how firms should consider value when complying with the requirements on the manufacture and distribution of insurance products. We intend to publish our response to the consultation later in 2019, and our response will be informed by work on this study to date.

- the customer's best interests rule –
  - We have always expected firms to do what is right for their customers, and have set out clear rules in this regard – including the Principles for Business.
  - The IDD includes a rule which requires that all firms act honestly, fairly and professionally in the customers' best interests, which we implemented in our Insurance Conduct of Business Sourcebook (ICOBS) for non-investment insurance contracts. We have applied this requirement in ICOBS throughout the distribution process including when insurers effect contracts of insurance and regardless of any firm's position in the distribution chain whether or not they have direct contact with the end customer.
  - Our proposals in GC19-02 included the principle that "it is not in a customer's best interests to be offered an insurance product that does not provide value".
- insurance demands and needs –
  - Firms must obtain information to identify the customer's demands and needs. They must then consider this information alongside the products they have available to ensure that all products they then offer are consistent with those demands and needs. Firms must not offer customers products which do not meet their demands and needs.

Dear CEO letter

7.40 Good governance over pricing outcomes for consumers should sit at the heart of firms' pricing practices. In October 2018, we issued a Dear CEO letter to firms about general insurance pricing practices. The letter set out our expectations for firms, including on governance, control and oversight of pricing practices. We have reviewed firms' responses to this letter. We note that the nature, extent and quality of responses varies widely. We have seen some examples of improved practice by some firms. However, governance of pricing practices remains an area that requires significant improvement by firms.

Value in the distribution chain

7.41 In the general insurance market, distribution chains can involve several firms, each of which will usually be remunerated for their work. We carried out a thematic review of the general insurance distribution chains in relation to travel, tradesman and GAP/motor ancillary insurance. This found that, while we did see good practice in some firms, in other cases it was not clear that firms (both insurers and intermediaries) had considered the impact of their actions on the value of the products provided and customer outcomes. Our concerns are therefore similar to those in the market study, with some firms not considering the value of their product for customers. For example, some consumers pay high prices, which appear significantly higher than the production and delivery costs, due to high levels of commission within the distribution chain. In April this year, we published the outcomes of the review together with a guidance consultation. The guidance on which we consulted provides clarity to firms about our expectations, in particular on how we consider firms should take account of the value that the product and distribution arrangements present to consumers.

We are currently reviewing feedback to the consultation with a view to finalising it in the coming months. The guidance, when finalised, will be the first step in addressing issues, by setting out our expectations of how firms should consider value for the customer, in advance of the remedies discussed in this paper.

General insurance value measures

7.42 Our work on general insurance value measures reporting and publication is aimed at helping to address poor product value, and complements the wider work we have been undertaking in this market study and on value in the distribution chain. The value measures work was developed following the general insurance add-ons market study in 2014, and piloted over several years with insurers. In January 2019, we published Consultation Paper: General Insurance Value Measures reporting (CP19/8) setting out proposals for the reporting and publication of value measures data across general insurance. The proposals seek to make available information about the way products perform when customers make a claim. The value measures tell us about the quality of the product and it is important that this information is available to improve market transparency and competition and encourage firms to improve their products.

7.43 We received feedback from 36 respondents on our value measures proposals. We still consider there to be valuable benefits to introducing the key proposals in CP19/8. However, informed by the feedback, we will undertake further work to:

- Review the value measures metric definitions to explore ways to reduce the scope for inconsistent reporting and improve the helpfulness of the data to users
- Review the reporting proposals with further consideration of the benefits and any risks of publishing data for the 5 largest distribution arrangements for each insurer for each product they underwrite
- Reassess the cost estimates for the cost benefit analysis.

7.44 The reality is that achieving standardised value measures is a complex task. However, firms should be in no doubt about the continued importance we attach to this issue.

7.45 Importantly, we are keen to ensure that our work on value measures has regard to any remedies being considered by this market study. Taking a holistic approach to our consideration of interventions will assist us to deliver any remedies in a cohesive way. We will therefore review and develop the value measures proposals alongside the work on these remedies.

7.46 We expect to publish any value measures policy statement to coincide with the final report for this market study. In the interim, we are launching a 4th pilot of the publication of value measures data to help maintain the increased transparency of the pilot products.

Other relevant FCA work

7.47 Other FCA work will also be important in developing potential remedies. In particular:

- We have evaluated the impact of rules we introduced in April 2017 to increase transparency and engagement when consumers renew general insurance products. The results of this work, published alongside this interim report, show that increases in home and motor insurance premiums at renewal are estimated to be lower than without our intervention. There is a notable increase in the

proportion of consumers shopping around and getting alternative quotes before renewing with their existing provider. However, our intervention has not had the scale of impact on switching and negotiating that was expected when we implemented the rules.

- We published a feedback statement on fair pricing in financial services in July 2019. This set out the framework that the FCA will use to assess concerns about the fairness of a given form of price discrimination. The first application of this framework is in this market study. We have used the framework as one tool to inform our analysis. The FCA is also doing further work to embed fair pricing into our regulatory approach. We are incorporating this into the review of our principles, which is the first strand of our Handbook Review. We intend to publish a discussion paper on the review of principles in Q4 2019/20. We will report back on the next phase of our fair pricing work at that time.
- We have consulted on guidance for firms on the fair treatment of vulnerable customers. The draft guidance sets out the FCA view on what our Principles for Business require of firms to treat vulnerable customers fairly, and ensure consistency of outcomes across sectors. The consultation period has closed and the feedback will inform this market study.

8 Next steps

8.1 We invite interested parties to provide views on our interim findings and the potential remedies we are considering.

Questions on which we welcome views

8.2 This report sets out our interim findings, and the potential remedies we are focusing on in the next phase of work. We would welcome stakeholder feedback on the following questions:

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

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?**

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?**

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?**

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?**

How to respond to us

8.3 Please send your views on these to GIPricingPractices@fca.org.uk by 15 November 2019. We will take these views into account in our final market study report.

What we will do next

8.4 We plan to conduct further analysis of the issues highlighted in this report to inform our final market study report. In particular, we will look further at:

- Why some new customers and those with shorter tenures pay higher prices.
- The potential remedies we propose focusing on and the associated costs and benefits with each.

8.5 We aim to publish our final market study report, alongside a consultation paper on any proposed remedies, in Q1 2020.

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.

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