GI pricing practices market study: over-reaction or a long time coming?

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Today, the FCA published the interim report of its general insurance market study.[1] A year in the making, it diagnoses complex problems and lists possible remedies.

But how easy will it be for the FCA to address its concerns? And what can insurers do now, in response to these concerns?

While the scope of the market study is home and motor insurance, we expect the lessons learned and proposed remedies to set the scene for FCA supervision of other insurance markets in the years to come.

What are the FCA's concerns?

The FCA found that the home and motor insurance markets are 'not working well for consumers', with particular concerns around firms' complex pricing practices that allow them to raise prices for consumers that renew.[2]

It estimates that 6m consumers paid 'high margins'[3] in 2018. Further, the FCA states that insurers discourage shopping around, resulting in consumers not switching, negotiating or researching their options.

In addition:

- there is evidence of price walking, as new customers typically pay lower premiums, and tenure is associated with steadily increasing margins;
- home insurance policies which are set up to auto-renew tend to have higher prices (than those which are not set up auto-renew);
- one third of consumers who paid high prices showed at least one characteristic of vulnerability;
- underwriters and intermediaries earn profits primarily from products such as add-ons and premium finance.

Importantly, however, while insurers are profitable, there is no evidence that these profits are excessive.

What will the FCA do?

In addition to its focus on ensuring good governance, the FCA is actively considering 'supply-side' remedies. Some of the strongest ones (in terms of changing the current market) include:

- **price regulation**, through restricting or banning pricing practices such as margin optimisation based on renewal likelihood;
- **automatic switching** of consumers paying high prices to lower-priced products with equivalent cover;
- **restricting or banning auto-renewal**, or making auto-renewal opt-in only;
- 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 customers.

The FCA does not elaborate on how these remedies will help some consumers at the expense of others; or explore whether the remedies could damage competition in the market.

How can insurers respond?

- Proactively monitor and improve pricing practices by examining the whole distribution of consumer outcomes, rather than focusing on averages.
- Investigate consumer segments where there are significantly higher margins.
- Ensure clear communication and protection of vulnerable customers.

The Oxera framework[4] has been used successfully as a tool by senior decision-makers in financial services to develop such business models. This tool has helped insurers move towards more sustainable business models.[5]

We encourage all insurers to engage with the debate actively, as any remedy will need careful design.

[1] FCA (2019), 'General insurance pricing practices: interim report', October.
[2] Ibid. para. 1.5.
[3] The 'high margin' threshold is set at a premium 50% above the competitive premium, given the market average margin.
[4] Oxera (2019), 'Fair ground: a practical framework for assessing fairness', *Agenda*, March.
[5] Find out more about Oxera's Agenda campaign, 'Beyond the Bottom Line'.