<u>Financial Inclusion Commission Response</u>
<u>FCA Consultation Paper 20/19: General insurance pricing practices market study</u>
<u>22/01/2021</u>

About the Financial Inclusion Commission

The Financial Inclusion Commission (FIC) is an independent body made up of experts from financial services, businesses, the charity sector, academia and parliamentarians from all major parties https://www.financialinclusioncommission.org.uk/

Our mission is to champion financial inclusion as a policy priority for public bodies, businesses and civil society, and challenge exclusion wherever it occurs. Our vision is for a financially inclusive UK where financial services are accessible, easy to use and meet people's needs over their lifetime, and where everyone has the skills and motivation to use them.

Financial exclusion remains a significant challenge for 21st century Britain which prides itself on being a global leader in financial services.

Just over a million people in the UK do not have a bank account, one in four households lack insurance protection and one in five adults would not be able to cover more than one month of living expenses if they lost their source of income.

Financial inclusion is the means by which people can make their money work well for them, enabling them to maximise opportunities, move into employment, become more self-reliant, and enhance physical and mental wellbeing. Financial inclusion contributes to greater social mobility and levelling up, a more effective welfare system and greater national resilience from economic shock.

This means a United Kingdom in which:

- every adult is connected to the banking system, through having access to – and the ability to make full use of – a transactional account of his or her own;
- every adult has access to affordable credit from responsible lenders;
- every adult, young person and child is encouraged and enabled to save, even in small or irregular amounts, to share in the importance of a common savings culture, to help build up resilience against financial shocks and as an additional resource for retirement;
- every adult has access to the right insurance cover for his or her needs, at a fair price;
- every adult has access to objective, affordable and understandable advice on credit, debt, savings and pensions, delivered via the channel most suited to that individual;
- every adult and child receive the financial education he or she needs, starting in primary school and carrying on throughout life and into retirement;
- the overall level of pensions provision – state plus private – in the UK, does not lag behind other developed countries, especially for the low paid;
- every adult will have a clear picture of what their income in retirement is likely to be, so they can plan and get 'no surprises'.

For more information about this response please contact Commissioners Laurie Edmans or Martin Coppack via Commission@ukfinclusion.org.uk

Introduction

The Financial Inclusion Commission welcomes the consultation on general insurance products pricing which provides an important opportunity to examine the way in which insurance pricing is regulated. As noted, general insurance products are crucial for giving customers protection when things go wrong and insurance is therefore integral to financial inclusion. Ensuring that these products work well for customers through fair value products is important to helping as many customers as possible access these insurance products. This package of measures goes some way to achieving this through tackling the complex and often opaque pricing techniques for home and motor insurance including through price walking.

Whilst overall we think these proposals are strong, we are concerned that these measures will have a negative impact on those on low incomes who will lose out as a result of not being able to shop around. Furthermore, there remain far too many people who remain excluded from the market, or who can't or don't access cover they would benefit from. Whilst dealing with the issue of the 'loyalty premium' is important, we are concerned that this focus excludes review of the bigger picture around insurance and inclusion, including the 'poverty premium'.

Access and inclusion

People need access to insurance products that meet their needs at an affordable price. For this to happen the market needs to be able to accommodate the needs of people on low incomes and the characteristics that are often associated with low income – often referred to as consumer vulnerabilities.[1] However, a Catch-22 situation has emerged where those who most often have the greatest need for protection are locked out due to:

- not being able to afford appropriate insurance because they are deemed to be a higher risk;
- not being able to access insurance that meets their needs because they are 'non-standard';
- being locked out of insurance altogether.[2]

Even where good value insurance is available – for example, inexpensive household contents insurance for social housing tenants - take up is poor. This represents a different kind of access problem – where the decent value products needed are available and affordable, but, for whatever reason, are not getting through to the customers who would benefit from the protection they give. The lower the take up, the smaller the pool, which compounds the problem.

There is a strong correlation between the detriment individuals face today and the shift away from pooled risk – from both the state (reduction of state safety nets) and the market.

As a result of consumer segmentation in the insurance market, and insurance premia reflecting (or attempting to reflect) the risk profile of individuals, the cost of insurance for low income and vulnerable consumers has gone up. As more risk is carried by the consumer rather than the insurer, or not pooled via cross-subsidisation, this has increased low-income individuals' exposure to the poverty premium along with associated access issues.

Research carried out by NatCen Social Research found that one of the four main drivers of the poverty premium in insurance was cost-reflective pricing: insurance premia can be higher for

[1] https://www.fca.org.uk/publication/occasional-papers/occasional-paper-8.pdf
[2] https://www.fca.org.uk/publications/occasional-papers/occasional-paper-no-17-access-financial-services-uk

households living in low-income areas, as these areas are considered riskier and are subject to a higher premia from the insurer.[3]

There are some protection products that are mandatory, such as car insurance. Recent research carried out for Fair By Design by the University of Bristol[4] found that in 2019 area-based premia, particularly car insurance, were the largest contributor to the overall poverty premium faced by low-income consumers. Customers who live in a higher-risk area (20th percentile Indices of Multiple Deprivation (IMD) area) paid nearly £300 per year more on average, if they had insurance, than those who lived in a lower-risk area (50th percentile IMD). In 2016, this figure was only £74, which shows a striking increase.

The risk transfer, to individuals from institutions, in reality means that low-income consumers' "insurable needs" will either be limited to more expensive coverage (which may impact that consumer's financial health and/or ability to pay) or become so unaffordable that insurance becomes a lower priority. For example, research from the Joseph Rowntree Foundation found that low-income households were less likely to have contents insurance, and that many of these households had previously had a policy but let it lapse due to financial constraints."[5] This may in turn lead to what WPI Economics has called the "latent poverty premium": where an uninsured item becomes lost or faulty, and needs replacing – which overall will cost the individual more than if they could afford to insure it. [6]

Furthermore, the Financial Lives Survey, carried out by the Financial Conduct Authority, found that 39% of those with earnings up to £15,000 per year had contents insurance, compared with 75% of those with earnings between £50-70,000, and 71% of those with earnings between £30-50,000.[7]

We believe the main driver of this phenomenon is individualised pricing and a lack of a joined-up approach between government and regulator to intervene. Trust in the industry is a further factor. As observed by the authors of an FCA Occasional Paper on access to financial services, "as insurance moves further towards individualised risk-pricing, some people will pay lower premia than they did as part of a larger pool. Others may see their premia rise, be priced out of the market completely or even deemed uninsurable. In the face of increased segmentation, whether to protect consumers from high personalised insurance premia and refusal of cover is often characterised as a social policy rather than a commercial decision". [8] This issue is compounded by a withdrawal of the welfare state and a lack of a joined-up approach between government and the regulator to address the needs of those that struggle to gain access to affordable products that meet their needs.

As a result, consumers who are deemed by insurance companies to be high risk or 'non-standard' may find few options open to them. In our paper, *Improving Access to Household Insurance*, we

[3] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/782513/natcen_report.pdf
[4] https://fairbydesign.com/research/university-of-bristol-the-poverty-premium-a-customer-perspective-november-2020/
[5] https://www.jrf.org.uk/sites/default/files/jrf/migrated/files/spr348.pdf
[6] https://www.barrowcadbury.org.uk/wp-content/uploads/2019/04/Insurance-and-the-poverty-premium-WPI-Economics-final.pdf
[7] Analysis based on the 2017 FCA survey (https://www.fca.org.uk/publications/research/understanding-financial-lives-uk-adults), detailed here: https://www.barrowcadbury.org.uk/wp-content/uploads/2019/04/Insurance-and-the-poverty-premium-WPI-Economics-final.pdf
[8] https://www.fca.org.uk/publications/occasional-papers/occasional-paper-no-17-access-financial-services-uk

found this may become apparent "only after a lengthy, sometimes distressing, search." Furthermore: "If they can find products, these consumers may end up paying a high price for a product that doesn't fully meet their needs, choose to go without cover or even fail to disclose their circumstances fully with the risk that any subsequent claims may not be paid. What is clear is that there is a supply gap for consumers who want to purchase cover and find they are categorised as 'non-standard' risk. This leads to a coverage gap for those who should have cover but don't."[9]

The move towards more individualised pricing is an inevitable consequence of greater ability of insurers to access and act on individual data. This genie cannot be put back in the bottle. What is needed, therefore, is appropriate intervention to make sure that, first, its application is fair and second, where appropriate and practical, compensating actions are taken to restore some of the lost benefits of greater pooling. The outstanding example of the latter is the approach taken with the establishment and operation of Flood Re.

Above all we would like to see:

- A joined-up approach between the regulator and government on who owns the problems and how the problems should be addressed.
- Action to bridge social and regulatory policy by both the regulator and government so adequate interventions can be put in place.

Three practical steps to enable this are;

1. The FCA should investigate the underwriting approaches of insurers to determine whether they are fair and reasonable and do not discriminate unnecessarily, not only against protected characteristics of the Equality Act, but against other factors that affect low-income consumers, for example, on the basis of where a person lives. This would create the knowledge needed for informing the best and most appropriate interventions in the future. This will provide clarity on how far market interventions can address the problems people living on low incomes or in vulnerable circumstances face in today's insurance market.

2. The government should work with the industry to develop appropriate social policy interventions, for example, whether the successful Flood Re model could be employed to cover more people living on low incomes or in vulnerable circumstances who are priced out, or excluded from other forms of insurance.

3. There is a need for an examination of the way in which general insurance products, particularly those which are not mandatory, are distributed, to examine whether low levels of take up, and resulting hardship are in any way due to regulatory constraints, such as the inability to 'bundle' household cover with rent.

[9] https://financialinclusioncommission.org.uk/wp-content/uploads/2020/09/Financial-Inclusion-Commission-Improving-access-to-household-insurance.pdf

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Questions

1. **Do you have any comments on the proposed implementation period?**

   The proposals appear sound to us.

2. **Do you have any comments on the possible impact of our proposals on people with protected characteristics under the Equality Act 2010?**

   We welcome the FCA's determination that careful cognisance should be taken of the needs and particular vulnerabilities of people with protected characteristics. However, we believe that this fails to examine the big issue around individualised risk and whether the way in which the availability of much more data is being used by insurers is fair.

   We are also concerned that there could be an unintended negative consequence on fairness as firms look to balance any reductions in income through other avenues once these new regulations are implemented. **We believe there needs to be a wider examination of the issues which impact access and inclusion in the insurance market, particularly around individualisation of pricing. The FCA should investigate the underwriting approaches of insurers to determine whether they are fair and reasonable and do not discriminate unnecessarily, not only against protected characteristics of the Equality Act, but also against other factors that affect low-income consumers, for example, on the basis of where a person lives. This would create the knowledge needed for informing the best and most appropriate interventions in the future. This will provide clarity on how far market interventions can address the problems people living on low incomes or in vulnerable circumstances face in today's insurance market.**

3. **Do you have any comments on our proposal to apply the rules on which we are consulting to firms based in Gibraltar and firms in the temporary permissions regime?**

   We fully support these proposals. We believe the rules should be applied to firms based in Gibraltar and firms in the temporary permissions regime. It would enable arbitrage if they were not.

4. **Do you have any comments on our proposal to ban price walking?**

   We support the proposals, although we are concerned that these measures will have a negative impact on those on low incomes who will lose out as a result of not being able to shop around.

   However, on balance, we think that the clarity which the measures will bring is likely to be beneficial. In addition to the general benefits identified in the paper, we believe it is conceivable that one of the other beneficial consequences of the measures to emerge might be the redirection of the considerable amounts of effort and expense which go into promoting the products.

   At present, most of the promotion of these products is aimed at encouraging people who have cover to move from one provider to another, most often by stressing cost saving by switching. This does little or nothing to deal with the problem – outside of mandatory motor insurance – that there are large gaps in coverage for people who would benefit from having protection against otherwise unaffordable losses arising from, for instance, fire, flood or burglary. Our report ('Improving access to household insurance') in November 2017, showed the scale of need and of under provision in that market. For example, two-thirds of households in social housing have no household insurance, despite the number who cannot afford to meet relatively minor losses and the availability of good quality cover at low cost.

It could be a good by-product of the measure if the result were to change the emphasis of marketing efforts from increasing a provider's slice of the cake, to increasing the size of the whole cake.

Notwithstanding this possibility, we believe the FCA should undertake to monitor and report on whether the measures do or don't change the balance of marketing efforts from switching providers to encouraging more people, who have the need and for whom it is appropriate, to obtain cover.

Furthermore, although we recognise the balance of harms, we are concerned that there could be a negative impact. For example, for those who shop around, they will end up paying higher premia. This could particularly affect some of the least well off, as some of the best managers of money are those who have to make what they have work as hard as possible. This could lead to exclusion from insurance products as some consumers may be unable to afford insurance if the effective subsidy they get from the current pricing practices, is withdrawn. **There is a need for the FCA to monitor this closely and identify whether this is happening, and the extent to which it occurs.**

By extension, we believe more must be done to provide insurance cover for people who live on low incomes or in vulnerable circumstances, who are priced out or excluded. We recommend that the government should work with the industry to develop appropriate social policy interventions, for example, whether the successful Flood Re model could be employed to cover these people who are priced out, or excluded from other forms of insurance.

5. **Do you have any comments on how our proposal would apply to products that are no longer actively marketed?**

We agree with the proposed inclusion of products that are no longer marketed. This view is supported by the way in which, prior to the advent of Flood Re, some insurers who were obliged to continue cover even though they had withdrawn from actively offering products, increased their premia to a multiple of previous rates. Further, some insurers took measures clearly designed to discourage policyholders from maintaining cover, which they were obliged to provide, when replacing cover elsewhere was very difficult or even impossible. We believe the FCA need to be vigilant for actions which could have similar results.

6. **Do you have any comments on our proposals to address practices that aim to frustrate the intended outcomes of the pricing remedy?**

The proposals appear sound to us.

7. **Do you have any comments on our proposal to require senior manager confirmation that the firm is complying with the pricing remedy?**

   The proposals appear sound to us.

8. **Do you have any comments on our proposal for firms to retain documentation to show how they are satisfied that their pricing model complies with our rules?**

   The proposals appear sound to us.

9. **Do you have any comments on our proposals for multi- product discounts?**

   The proposals appear sound to us.

10. **Do you have any comments on our proposal to apply the pricing restriction rules to all stages of the price setting chain?**

    We support the drive of the proposal but believe that the complexity of the chain could lead to opportunities for arbitrage, and that the FCA should be vigilant about this. In particular, the effect on small intermediaries is a concern.

11. **Do you have any comments on our proposal to apply the pricing restriction rules to additional products?**

    The proposals appear sound to us. We believe it is important in order to prevent opaque cross subsidies.

12. **Do you have any comments on our proposal to enhance the product governance requirements concerning product value?**

    The wording of the final bullet of para 4.5, in which firms are required to 'take steps to ensure that the product is distributed to the target market' seems rather oddly worded. Should it be couched as ensuring that the product is not distributed to inappropriate markets?

    We particularly support the stress placed (in paragraph 4.12) on the need to meet obligations under the Equality Act and avoid discriminating against actual or potential customers due to protected characteristics.

13. **Do you have any comments on our proposal to apply the product governance rules to products regardless of when they were launched?**

    The proposals appear sound to us.

14. **Do you have any comments on how we propose to apply the product governance rules to non-investment insurance products and products sold as part of a package?**

On non-investment insurance products we believe that the application of the rules to insurances of the person is worthy of separate consideration.

We agree that the rules should apply to products sold as a package, including premia finance.

15. Do you have any comments on our proposals for ongoing product reviews and remedial actions firms must consider where it is identified that the product is not providing fair value?

There isn't anything magic about 12 months. Mandating that period, regardless of whether there is likely to be any significant variation in potential downside to policyholders seems to place bureaucratic process ahead of cost considerations and level of exposure to risk of significant downside to customers.

We believe that, provided vigilance is maintained, there is no particular reason why the cycle of product review should be mandated as annual for every product. It is important not to build unnecessary bureaucracy into the processes of firms, as the cost must emerge as increased costs for the policyholder.

It should be possible to identify products where frequent review is more or less crucial and have a review process timetable appropriate to the degree of risk to customers. Such an acknowledgement that a simple annual cycle is not axiomatically correct should be welcomed by firms.

16. Do you have any comments on our proposed requirements for product distributors?

No comment.

17. Do you have any comments on our proposals for premium finance?

We support the proposals wholeheartedly. Historically, this has been a particular problem for the more disadvantaged who have to spread payments. One of the proposals states that: *"when firms give customers a choice on whether or not to take out premium finance, they must do more than simply ask the customer to choose between paying monthly or annually".* However, it is unclear what firms are being asked to do here. We believe that as part of this firms should set out clearly the difference in cost between these two choices.

18. Do you have any comments on our proposals for senior manager responsibility for compliance with our proposed remedies?

The proposals appear sound to us.

19. Do you have any comments on our proposals to require firms to provide consumers with a range of accessible and easy options to stop their policy from auto-renewing?

We support the proposals, although we believe there is a risk that people might construe such clarity and ease as a suggestion that they should not renew, and find themselves without cover, unwittingly. It will be necessary to make it clear that if they don't renew or seek replacement cover, they are left exposed. The effect of the measure should therefore be monitored.

20. Do you agree with our proposed rules and guidance in relation to auto-renewal?

We agree.

21. Do you agree with our proposal to apply the auto-renewal measures to all types of general insurance?

Assuming that this refers to non-life insurance. We are not as certain of the need for certain types of personal insurance – such as private medical insurance, where lapsing cover may lead to conditions which would continue to be covered by the existing insurer might not be reproducible from a new one. It might well be that it is more important that the renewal process maintains important cover than encourages shopping around, if the result might be that cover is discontinued or not available from a new insurer.

22. Do you agree with our proposed scope for the reporting requirements?

We agree.

23. Do you agree with our proposed reporting granularity?

We agree with the approach, but wonder whether the definition of 'large books of business' should also have a parameter based on monetary value as well as policy count? It is also necessary to consider whether the nature of the way policies are structured might need to be reflected.

Historically, some products have been built in a way that one product might comprise 'policy parts' where technically each part is a separate policy. We are not sure whether this practice is now commonplace, but in some instances, it would be better to count 'contracts' rather than 'policies'.

In addition, there is a need to look at the scale of cost as current proposals reflect percentage rather than monetary value.

24. Do you agree with the list of metrics we propose to ask firms to report?

Our only concern is that care should be taken to ensure, as we assume it will be, that there is not duplication of reporting required elsewhere – for example by the Prudential Regulatory Authority. Where information on the same underlying factors is needed by more than one statutory body, care should be taken to harmonise reporting.

The metrics suggested seem appropriate to us, but it may be beneficial to show insurers' distribution related costs separately from 'pure' administration costs. Net and gross prices alone may not tell the whole story.

25. Are there any other metrics we should consider asking firms to report?

As mentioned above, being able to identify insurer's marketing and distribution costs as distinct from administration costs.

26. Do you agree with our proposals on reporting responsibility for insurers and intermediaries?

Broadly, we agree with the proposals and with the distinction drawn between 'price setting' and 'non price-setting' intermediaries. But, even with that distinction, we are concerned about the administrative burden placed on smaller intermediary businesses and wonder whether, if for example there might be exemptions for such businesses who only effect business on 'standard terms' with an insurer whose products and pricing meet the other tests proposed or whether there might be a de minimus exemption for particularly small firms – which often provide the most personal service.

27. Do you agree with our proposals on reporting periods and frequency?

The costs of the additional reporting appear in the cost benefit analysis, but there is no assessment of the benefit of having such reports annually as opposed to longer durations. The amounts might appear small in proportionate terms, but are not insignificant and any such costs end up being met by the consumer.

28. Do you have any comments on our cost benefit analysis?

We do not have the data to hand to comment with confidence. However, we would be interested to find out if this cost benefit analysis reflects the costs of the poverty premium.

29. Do you have any comments on the way we have estimated the impact of the pricing remedies?

As above.

30. Do you have any comments on the way we have estimated the impact of the non-pricing remedies?

As above.

31. Do you agree with the assumptions we have made in our analysis?

As above.