WHAT THE FCA'S PRICING PROPOSALS REALLY MEAN FOR THE INSURANCE INDUSTRY

Kate Collyer, Chief Economist at the FCA, has hinted that the current pricing remedies could be just the start of a wave of regulation. How are insurers likely to be affected and how should they respond?

By Ben Johnson, Managing Director of the Insurance practice, Sheffield Haworth

The FCA's current pricing remedies are about much more than just pricing. The regulator has made it clear that insurers must become more customer-centric across all parts of their business and all parts of the distribution chain. Here's what insurers need to know now so they can prepare.

All the signs point to the FCA's current push on pricing remedies being the start of a long, evolutionary wave of regulation to nudge the insurance industry towards becoming more consumer centric and value focused.

The recent history of similar regulation in banking suggests what the roadmap may look like. Insurers will have to review not just pricing, but also their products, their use of consumer data, how they communicate to consumers, their claims service, and even their business models.

For this article, I spoke to several key insurance insiders off-the-record to gauge the industry's response. I also got contributions from James Yerkess from Hal Consulting and Ian Hughes from Consumer Intelligence. Yerkess has done a lot of work on value and pricing regulation within the banking sector. Hughes has carried out decades of research into consumers' attitudes to insurance.
Here's what they all have to say about what the FCA wants to achieve. As well as what forward-thinking insurers can do now to get ahead of the regulatory curve.

Insurance pricing and the FCA: when are the rules changing?

In September 2020, the Financial Conduct Authority published its General Insurance Pricing Practices Study and then began an open consultation with the industry, inviting companies to submit feedback.

The FCA's Pricing Practices Study proposed a package of measures to "improve competition and ensure firms offer fair value products in the future". These measures include:

- An end to price walking and other common auto-renewal practices.
- Better product governance.
- Reporting requirements for insurance businesses to submit statistics annually for retail home and motor insurance.

The FCA closed this consultation on 25th January 2021 and plans to publish its policy statement at the end of May 2021.

Firms will then have four months to implement any proposed systems and controls (SYSC) rules and product governance rules published in the policy statement. After that, they will have until the end of the year to implement whatever pricing and auto-renewal remedies and reporting requirements are in the policy statement.

The FCA's pricing intervention: "a business model shift that's likely to challenge a lot of insurers"

One well-known insurtech thought leader I spoke to welcomes the intervention. "This is seen as the nuclear option, the regulator getting involved," he says. "But that's because there are serious questions for the industry about how we've been missing loyalty when dealing with customers."

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The essential challenge for motor and home insurers is to move away from competing purely on price when acquiring customers and then punishing loyalty by raising premiums at renewal.
"As an industry, we have spent far more time and energy attracting customers than we have retaining customers," he adds. "The question is how we move away from that – as well as how we communicate and the narrative around this. That's a business model shift that's likely to challenge a lot of insurers."

How are insurers responding so far?

In a recent poll for Consumer Intelligence, 84% of firms said they were responding to the FCA proposals – mostly with changes to their underwriting, compliance, and product lines.
Yet, according to several industry observers, many insurers are missing something crucial about the recent FCA proposals – the Fair Value element.

What the FCA really wants to achieve: it's about more than just pricing

According to Ian Hughes, CEO of Consumer Intelligence, the phrase "Fair Value" is the key to understanding what the FCA wants to achieve. The FCA's paper explains that the regulator's pricing intervention is, among other goals, intended to "provide long term fair value (reflecting both price and quality) for all customers throughout the duration of their relationship with the firm."

As Ian says: "When the FCA first published a document about pricing and auto-renewals four or five years ago, that document didn't have a single mention of the term 'Fair Value'. But in the September paper they mention it 102 times."

"When it comes to Fair Value, I'm not sure insurers have clocked that at all."

He worries that insurers are in danger of missing this point, adding: "When it comes to Fair Value, I'm not sure insurers have clocked that at all."

James Yerkess agrees: "I think many insurers don't yet fully grasp why the FCA was asking for certain metrics in its pricing study in September," he says.

"If the FCA only cared about pricing, it wouldn't ask for these metrics. But if you think of them as being used by the regulator to track and promote deeper aspects of Fair Value over the longer term, then they start to make more sense."

How do we know the FCA wants Fair Value? Because it says so…

In March, Consumer Intelligence hosted a webinar with Kate Collyer, Chief Economist of the FCA, to emphasise what Fair Value means for the insurance industry.

On the webinar, Collyer defined Fair Value as "the overall benefit I as a consumer get relative to the total cost."

"Fair Value should be central to a firm's culture and purpose."

"At all times, consumers must have confidence that they'll get Fair Value," she said, adding that, "Fair Value should be central to a firm's culture and purpose" and that, "consumers don't feel they are getting Fair Value."

We've been here before: lessons from 9 years of banking regulation

started. The regulator began by looking at pricing and that evolved into looking at Fair Value."
He cites the example of the Retail Distribution Review in 2012, which sought to achieve transparency around the costs and fees associated with financial advice. It was followed by the Markets in Financial Instruments Directive in 2017 and the Payment Services Directive in 2018.
These rule changes increased competition across the sector and led to the rise of new market entrants. The same pattern is likely to be replicated across insurance, James believes.

"This is really about customer-centricity."

The language around transparency and providing value to customers the FCA used to introduce these regulations is almost exactly the same as that being used now for insurance. As Collyer said on the March Consumer Intelligence webinar:
"We'll be looking for a demonstrated commitment to Fair Value by firms evolving to simpler and more transparent pricing models, and for firms to look at governance regularly and holistically."

"The regulator wants to use these proposals to create a value ecosystem in insurance as it has in banking, and it's using price to start the ball rolling," Yerkess says.

"This is really about customer-centricity," he adds. "The regulator has even quantified this value ecosystem with a number – that the proposed pricing remedies represent a value transfer back to consumers worth between £3bn and £11bn over the next 10 years. That means they're taking it very seriously."

Insurers will have to change, just as the banks did

Responding to my question about the potential risks to insurers who aren't able to change fast enough, Yerkess says: "The regulator will move them faster. This is not a possibility, it's a reality. We saw that happen in banking and that's what will happen here."

"Not doing anything in the banking sector resulted in worse financial implications for some banks because they got fined."

We should be in no doubt that the FCA intends to be as strict with insurers as it was with banks, Yerkess says, adding: "Not doing anything in the banking sector resulted in worse financial implications for some banks because they got fined – or had to implement costly remediation exercises."

Collyer's comments during the March webinar support this view. "We'll be monitoring closely to see how firms adapt their models," she said, later adding: "The reported data will mean we can work out what's going on – and take follow-up action with the appropriate firms."

For Yerkess, the FCA's reporting requirements are the key.

"The first round of data collection will be the beginning of this journey towards Fair Value," he says. "The FCA will get a landscape of what is out there across the insurance sector. Then, as they did in banking, they'll start looking at value and pricing quartile management – ranking the performance of insurance companies comparative to each other."

This represents a possible threat for those within insurance organisations who will be responsible for signing off the pricing remedies and submitting data to the FCA.

"You're signing for your organisation to say you're providing Fair Value – but at the moment you're potentially signing blind in terms of how you compare with the rest of the industry," he says.

"If in the first submission of the reporting metrics you rank in the bottom or lower quartiles then it is highly likely the regulator will end up paying you a visit. They will ask you to evidence your process for Fair Value assessment and governance. So how confident are you really that you're providing Fair Value and do you have the evidence to support your decisions?"

How the FCA pricing remedies are likely to affect insurers

1. CHANGING MANAGEMENT STRUCTURES

Insurers are already looking at underwriting, compliance, and product lines. However, the experience of the banking sector suggests that Fair Value will affect everything – including communications, marketing, and branding.

As James Yerkess says: "You can see in banking over time that the management structures and renumeration models changed. Customer value management became a key phrase within the banks. They moved away from seeing Fair Value as a governance team, pricing team, or product team issue. It became about the holistic measurement of customer value management across all parts of the business."

2. BETTER CLAIMS SERVICE

Insurers will certainly have to look at their claims services, thinks Ian Hughes. "Claims goes to the heart of Fair Value," Hughes says. "The real value you get as an insurance consumer is in the service you get when you make a claim. If insurers do that well, then they're delivering Fair Value. After all, it doesn't matter what you charge. If making a claim is a terrible experience then it's never going to be Fair Value."

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In other words, Fair Value is "a much more holistic concept that goes across the entire organisation".

3. TRANSPARENT COMMUNICATION

"One thing that isn't often being discussed a great deal at the moment is the communication aspect," Yerkess adds.

"If you look at how the communication piece developed across banking to create a value ecosystem, all the call scripts changed, all the letters to customers changed. All the information changed that went out to customers explaining how value was created. Pricing was only one small component of that. Brand positioning and marketing also changed to reflect and promote these communication and messages shifts."

Insurers will not only have to look at changing their pricing practices and their products. They also need to communicate more clearly with customers. But this is not just a threat – it also offers potential opportunities for insurers to increase business.

Yerkess cites the example of cross-border payments in banking. "Yes there's an element of pricing in there. But what made the difference was when banks communicated to customers what they were charging for, and that it cost more to send transfers over the weekend."

Before the regulator forced banks to communicate their charges more transparently, customers didn't know. The effect of the regulation in this area was to stimulate the rise of competition and new entrants such as TransferWise – now called Wise. Transfer charges fell, and revenues rose across the board – including for incumbents – as more customers transferred money more frequently.

How this is likely to affect distribution – is this the end for price comparison websites?

Within the industry itself there's a lot of buzz around what the end of renewal pricing increases might mean for the future of price comparison websites. The insurers we spoke to questioned how price comparison would continue if there was no need to compare prices anymore. Some cited the fact that Admiral sold its price comparison site Confused.com in December 2020 as evidence of an uncertain future for the whole price comparison model.

One industry insider I spoke to thinks the future could be different for price comparison websites, saying: "It will be interesting to see how they change. Why would a consumer continue to use a price comparison website when they know that by law the price of their premium can't go up beyond what's reasonable? But it's been 20 years in getting to this point, so the question now is how quickly they will evolve."

Some of the smaller insurers we spoke to are worried about a future with less price comparison. On average, they generate around 80% of their business from price comparison websites. Any change that risks this revenue stream is a major concern for them.

Yet Kate Collyer, Chief Economist of the FCA, made clear on a Consumer Intelligence webinar in March that the FCA expected price comparison to continue. For the FCA, comparing prices between providers would still be key for consumers to be able to judge whether they were getting Fair Value. Collyer was also clear that the FCA expects its remedies to stimulate more competition in the market, including the possibility of new market entrants.

Many in the industry recognise that price comparison is here to stay, since consumers have become used to using them over the last 20 years. Even in the case of the sale of Confused.com, it's worth remembering that Admiral sold the site to Zoopla. Presumably, Zoopla believes price comparison has a future. Otherwise, why would they have paid £500m to acquire it?

The contacts I spoke to from within price comparison websites think that consumers will continue to use their services. They've also been looking into how to alter their algorithms so consumers will be able to compare policies based on other factors, such as service levels or customer reviews.

How should insurers respond?

1. See this as an opportunity

From all the industry observers I spoke to, the overarching message is the same: see this change as a potential positive rather than a threat or a technical compliance exercise.

One insurtech thought leader I spoke to is excited to see how the pricing remedies might change the industry for the better. "There's lots of opportunity here," he says. "How do we as an industry react to this? What things will we have to go and do in order to make this work for all parties?"

Ian Hughes agrees, saying: If you think customer plus commercial plus compliance, there is a win-win-win. What banking shows us is there is a win-win-win, but you have to think positively about all three."

"Giving good claims service causes such loyalty that people don't bother to shop around."

He gives the example of improving claims service as one area where insurers could see huge benefits moving forward.
"We did an outcomes analysis looking at who are the people who don't shop around at renewal and who've been with their insurer for more than four years. It's the people who've had a good claims experience!" he says.

"People who've had a good claim are the ones who don't even bother to shop around. Giving good claims service causes such loyalty that people don't shop around – in a market where 85% of people shop around."

2. Look into new customer-centric business models with lower operating costs

James Yerkess points out that the banks' shift from pricing to Fair Value ended up being advantageous. "Banks have evolved by shifting from price-centric thinking to value-centric thinking, and, in the process of doing so, reducing their operating costs and lowering attrition."

This should be the same for insurers, he says, pointing to a specific example from banking of how insurers might respond positively.

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"It will be interesting to see what insurers do to embrace mobile-centric opportunities to change their operating model to where they can deliver better value to customers while reducing operating costs," he says.

"Imagine a mobile-centric or mobile-only insurer, with no call centres, no phone calls, no claims lines. Just quality online support to deliver that. Imagine what that would do for the operating base! Revolut and Wise have been successful at doing this in the cross-border payments space, so why would the same development not evolve across the insurance sector?"

3. Leverage third party data more effectively

Another example he cites is greater use of open banking. "The amount of information you need to apply for new banking products and services has shrunk considerably because of open banking," he says.

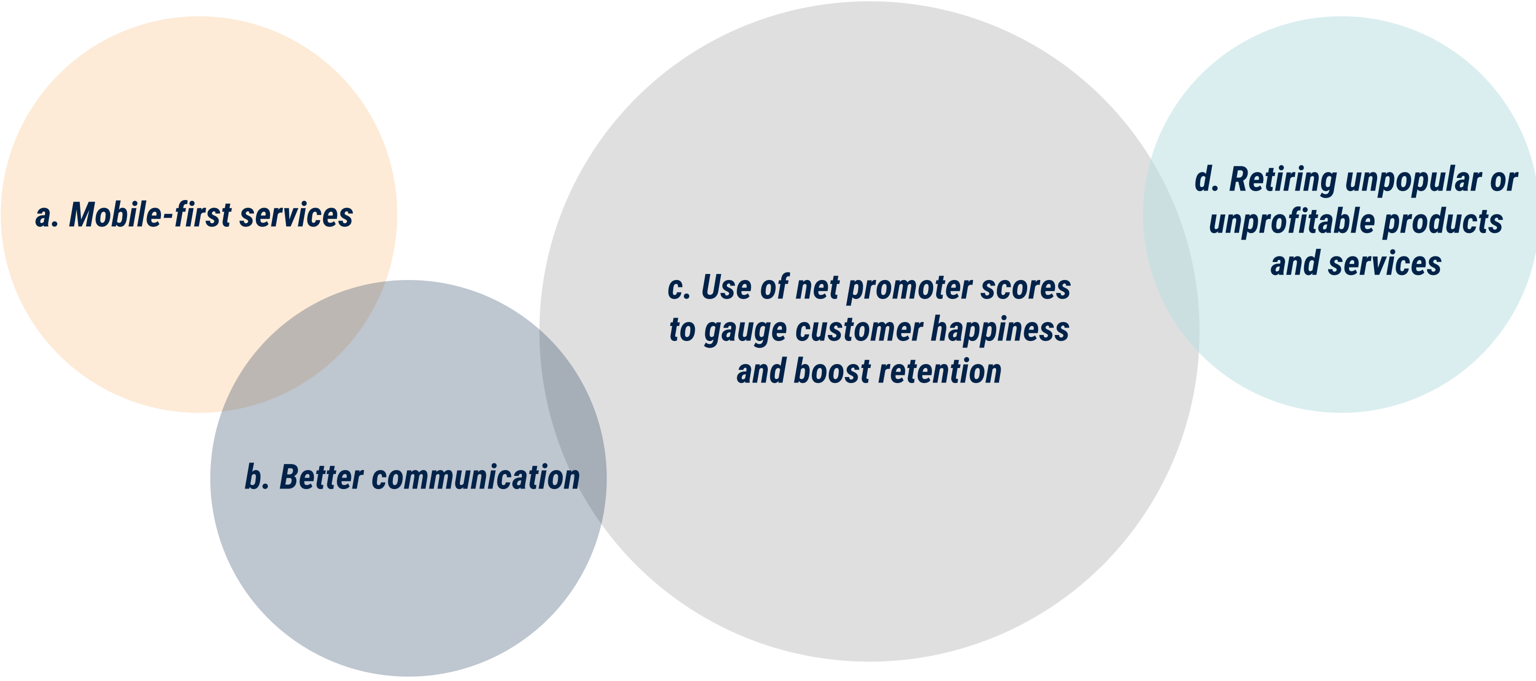
"When I'm applying for car insurance, why do I have to enter my car registration? Surely my insurer could hook me up on open banking to the DVLA – all they need is my permission upfront for the DVLA to share that," he adds.

"You know what car I'm driving, how long I've driven it, and you can get my MOT information so you'll know exactly what mileage I'm doing in a year. Why do I need to add that?"

Greater use of open banking and data sharing would make buying and renewing insurance a far simpler and more pleasant experience for consumers, Yerkess argues. This would provide a powerful element of Fair Value beyond pricing, as well as being likely to increase customer retention. This in turn would reduce acquisition costs and boost operating margins.

4. Learn from the examples of others

From Yerkess' comments, it's clear insurers can model their response on the banking sector, and learn from what they improved:



But there are other models to learn from too. Yerkess suggests looking to examples from other sectors and industries, including:

- How health insurers offer rewards for healthy behaviour to build customer loyalty.
- How insurers in Asia use third party data and mobile-first propositions to offer stellar service.
- How credit card providers across Asia boost loyalty with sophisticated reward schemes.
- How tech companies build loyalty – for example how Amazon uses its Prime service to reward repeat customers with better service in return for consistent, transparent pricing.

"Fair Value is used everywhere outside of insurance. Insurers only have to start thinking differently and creatively to start seeing the possibilities to provide Fair Value and have a positive impact on the bottom line," he says.

How insurers should respond – the Sheffield Haworth view

From the views shared here, the insurance industry is facing a fundamental shift in approach from pricing to Fair Value. Although not all businesses are aware of it, the fast movers are, and they're already well underway. From our perspective, the key factors insurers should consider moving forward are:

a. Focus on business transformation

As Yerkess says, the management structures within banking changed over time to accommodate Fair Value within their business models. Banks' customer value management teams incorporated elements of:

- Governance
- Pricing
- Product management
- Risk management
- Digital capability
- Transformational programs

Forward-looking insurance companies would be wise to do the same, and even potentially to model their response on that of the banks. It's also worth reflecting that most of the Fair Value fines and remediation exercises in banking were a result of poor governance or systemic failures around the ability to evidence Fair Value.

b. Focus on branding

Of the insurers we spoke to, those with the better-known, more established brands were most confident about their ability to win new customers at acquisition – regardless of any future pricing changes. The lesson here is for all insurers, brokers, and other intermediaries to focus on building their brand.

Even for smaller companies, there is opportunity. With the pricing remedies on the horizon, all insurers will be on more of a level playing field in terms of pricing. They will have to focus on providing other elements of value to consumers. New brands – even completely new market entrants – are likely to emerge.

c. Foster an innovative and creative culture

From our research, customer-centricity goes hand in hand with a more innovative and creative culture.

As more insurance businesses recognise the scale of the challenge they face over time, creativity and innovation will only become more important to success.

We expect forward-thinking insurers to expand their skillsets around customer-centricity, data science, product design and management, and business strategy.

d. Start sourcing key talent before it becomes scarce

Sheffield Haworth's global insurance recruitment data for the last six months shows that 10.8% of talent sourced from outside the insurance industry came from consultancies. 8.4% came from the banking sector, and 13.2% came from either software or fintech.

We would expect these numbers to rise going forward, as savvy insurers look to bring in outside expertise to help them plug their current skills gaps around Fair Value. We would particularly expect to see insurers source more talent from insurtech and banking as they devise new pricing models and new products, and look to embed customer value management within their organisations.

Those insurers who move first will have their pick of the talent. Those that leave it too late may struggle. Or find themselves having to pay over the odds for skills they could acquire now at a lower cost.

To sum up all of this, here's a final quote from Ian Hughes. "I think a lot of people are approaching the pricing remedies in a negative way, but you should look for the opportunity in this, because it's there staring you in the face," he says, adding: "Early adopters who grapple with this now will have a competitive advantage, beyond a shadow of a doubt."

If you'd like to discuss any of the issues raised in this paper and how they could impact your business, please get in touch:

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