Institute
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of Actuaries

CP14/29 Guaranteed Asset Protection insurance: a competition remedy

IFoA response to the Financial Conduct Authority

13 March 2015

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Actuaries' training is founded on mathematical and statistical techniques used in insurance, pension fund management and investment and then builds the management skills associated with the application of these techniques. The training includes the derivation and application of 'mortality tables' used to assess probabilities of death or survival. It also includes the financial mathematics of interest and risk associated with different investment vehicles – from simple deposits through to complex stock market derivatives.

Actuaries provide commercial, financial and prudential advice on the management of a business' assets and liabilities, especially where long term management and planning are critical to the success of any business venture. A majority of actuaries work for insurance companies or pension funds – either as their direct employees or in firms which undertake work on a consultancy basis – but they also advise individuals and offer comment on social and public interest issues. Members of the profession have a statutory role in the supervision of pension funds and life insurance companies as well as a statutory role to provide actuarial opinions for managing agents at Lloyd's.

Institute and Faculty of Actuaries

Awhi Fleming
General Insurance Policy
Financial Conduct Authority
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E14 5HS

13 March 2015

Dear Awhi

IFoA response to CP14/29 Guaranteed Asset Protection insurance: a competition remedy

The Institute and Faculty of Actuaries (IFoA) welcomes the opportunity to respond to the Financial Conduct Authority's (FCA) consultation paper on Guaranteed Asset Protection insurance. The IFoA's General Insurance Board has led the drafting of this response, but we have limited our response to questions where the IFoA can make specific comment.

Q1: Do you have any comments on the proposed timing of the coming into force date for the finalised rules?

1. The IFoA is content with the proposed timing.

Q3: Do you agree with the proposal that the deferral period should be four days (including the day on which the prescribed information is provided) before the distributor can contact the customer to conclude the GAP insurance sale? Will there be significant differences in impact between the new and used car markets?

2. The IFoA would suggest that the only limitation on the deferral period would be whether it meets the policy objective.

Q5: Is there anything you would add or remove from the proposed list of prescribed information or amend?

3. As a general principle the IFoA considers that the provision of information, and the form in which it is presented, must meet the needs of the policyholder. If the information provided is unclear, or the means of communication is confusing, the benefits of disclosure will fall short of the ultimate objective.

4. In terms of specific information, the IFoA affirms the comment about the disclosure of commission that had previously been made in our response to the FCA's market study[1]. Providing a breakdown of how the premium is allocated to different stakeholders is likely to be information that the policyholder would find useful.

[1] http://www.actuaries.org.uk/research-and-resources/documents/ifoa-response-fca-ms141-general-insurance-add-products

Q7: Do you have any comments on our market failure analysis and cost benefit analysis for the proposed GAP remedy?

5. The IFoA has some specific observations about the calculations. Whilst these observations do not necessarily result in a significant disagreement with the conclusions drawn, they demonstrate some of the uncertainty within the calculations. It would be helpful if the FCA could highlight more clearly the inherent uncertainty and the assumptions used in the assessment of costs and benefits.

6. **The analysis is based on the current average price of add-on GAP sales (at £300) and alternative standalone policies (at £150).** The sensitivity analysis considers the changes in the £150 standalone price. There is also an explicit scenario in the cost benefit analysis where the add-on price is assumed to reduce to £250 in response to some of the loss of add-on sales as a result of the proposed measures. It may be of better use to include possible unintended consequences within the main cost benefit analysis. For example, if the proposed measure were to generate more shopping around, then those insurers providing stand alone cover should benefit. They may not need to drive demand by such a steep price differential and, hence they actually could raise the price of the stand alone policy closer to that of the add-on one. Therefore; it would be helpful to include in the cost benefit analysis a specific scenario that includes a levelling of prices for add-on and stand alone to e.g. £250 each.

7. **The waterbed effect is considered in the sensitivity analysis. The conclusion reached is that even in the presence of a 100% waterbed effect there is still a benefit in the proposal.** This could be considered in the context of general fairness in that currently, if vehicle sales prices are subsidised by the margin arising from GAP insurance, it is likely that some insurance margin is benefitting those buying cars but not purchasing this insurance. The removal of this subsidy might therefore be neutral to consumers overall, but could mean that those buying GAP add on insurance are no longer inadvertently providing a benefit to other car purchasers.

8. **The cost benefit analysis assumes 25% of consumers who currently buy add-on GAP would shop around and buy the cheaper stand alone policies. A further 25% of consumers would shop around who currently would not buy the add-on cover but would now buy a (cheaper) stand alone GAP policy**. Whilst there is some evidence given to support the former number (based on customer reasons for not shopping around), there is no justification for the latter. The sensitivity analysis however does explore different options and still shows positive outcomes for a range of values for these 2 key assumptions. This adds to the uncertainty in the cost benefit analysis which is not immediately apparent from the consultation paper.

9. **There does not appear to have been much exploration of any unintended consequences from the proposal which may result in a detriment to consumers**. In addition to what has been highlighted so far, the proposals may lead to more bundling of products making it more difficult for consumers to purchase solely the insurance they need, or reducing the transparency of what they are buying.

10. There may also be a consumer detriment whereby consumers, who would have bought the add-on GAP under the current regime, find they are uncertain in the new regime and end up not purchasing something which they later regret. Whilst this is hard to quantify and arguably should be addressed by ensuring consumers are better informed and, hence, able to make appropriate decisions, there may be a residual concern that some consumers do not follow

through with the deferred sale. This may depend upon whether the sales process after the deferral period still contains sufficient incentive for the sellers to fully follow up and conclude the sale.

Should you wish to discuss any of the points raised in further detail please contact Philip Doggart, Technical Policy Manager (Philip.doggart@actuaries.org.uk / 0131 240 1319) in the first instance.

Yours sincerely

David Hare
Immediate Past President, Institute and Faculty of Actuaries