Institute and Faculty of Actuaries

CP15/13: General Insurance Add-ons Market Study – Proposed Remedies

IFoA response to the Financial Conduct Authority

25 June 2015

About the Institute and Faculty of Actuaries

The Institute and Faculty of Actuaries is the chartered professional body for actuaries in the United Kingdom. A rigorous examination system is supported by a programme of continuous professional development and a professional code of conduct supports high standards, reflecting the significant role of the Profession in society.

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

Alex Hughes
Financial Conduct Authority
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25 June 2015

Dear Mr Hughes

IFoA response to General Insurance Add-Ons Market Study – Proposed Remedies

1. The Institute and Faculty of Actuaries (IFoA) welcomes the opportunity to respond to the FCA's consultation on proposed remedies for General Insurance (GI) Add-Ons. The IFoA's GI Board has been responsible for drafting this response. We have limited our response to areas where we can add comment of actuarial nature.

Q.1 Do you agree with our proposal to ban opt-out selling?

2. The IFoA considers that the proposal will go some way to meet the objectives set out, namely to:
   - Enable customers to make more active and informed decisions;
   - Reduce the risk of customers purchasing products that they do not need or want; and
   - Reduce the risk that customers buy products without knowing that a purchase has taken place.

3. The consultation paper refers to the previous market study experiments. The IFoA would encourage the FCA to repeat the experiments, with the opt-in process, in order to validate that the proposed opt-in sales process will deliver the desired outcomes.

Q.2 Do you agree with the proposed scope for the ban?

4. The IFoA would welcome greater clarity in the definition of an add-on sale. The consultation paper distinguishes in section 1.20 between the 'primary product' and 'add-ons' stating that '*the primary product means the goods or service that the customer originally set out to purchase*'. However, this does not explicitly address how to treat optional levels of cover within a product as opposed to a clearly separate product fulfilling a distinctly different need.

5. The IFoA would welcome an opinion on this distinction within the scope. Our interpretation is that optional levels of cover are not add-ons and we note the more formal definition provided in the proposed amendment to the Conduct of Business Sourcebook supports this interpretation.

6. The scope allows for the auto renewal of primary products and any add-ons which have been previously actively selected. This would allow a continual and smooth auto renewal process in the future.

7. The proposal for the renewal of add-ons, previously purchased on an opt-out basis, allows firms to send a letter to policyholders reminding them of the add-on products they currently hold and of the ability to remove them on request. This would appear to be a proportionate measure as opposed to the more onerous suggestion of actively contacting policyholders to now gain their express consent.

8. However, it is not immediately clear whether all renewals are subject to this approach, or whether an initial reminder would be regarded as sufficient consent for all future renewals. The IFoA would welcome clarity to ensure consistency across firms' practices.

Q.3 Do you have any comments on the proposed Handbook guidance?

9. The IFoA has no comments on this.

Q.4 Do you have any comments on the proposed non handbook guidance?

10. The IFoA has no comments on this.

Q.5 Do you have any comments on our market failure analysis and cost benefit analysis for the proposed remedies?

11. The benefit is primarily quantified as the saving from current levels of overconsumption. However, this simplifies the assessment and omits any benefits that those previously buying these add-ons would obtain from making future claims. This omission ignores the value derived from the add-on insurance coverage.

12. The consideration of unintended consequences rejects the idea that product prices may rise as a result of the proposed changes. This appears to be solely in the context of the price of the add-on product. This is highlighted in the consultation paper by '*we have seen no evidence that products sold on an opt-in basis are more expensive than those sold on an opt-out basis*'. Furthermore, the paper states that '*we expect competitive constraints to be greater, which would tend to lower prices*'.

13. This does not consider insurers seeking to obtain a certain level of return, particularly in the motor market, where there is already a very intense level of competition. If sales of add-ons were to fall, likely reducing overall sources of margin, there may be potential rises in price elsewhere, most likely in the primary product. Hence, one possible unintended consequence of the proposal may be for motor insurance prices to rise as they are no longer supported to the current extent by sales of add-ons.

14. This could be regarded as a fairer result as it would remove any existing cross-subsidy between policyholders who have add-ons and those who do not. Removing this subsidy would then result in a fairer level of charging. However, it would then reduce, or eliminate, the quoted benefit amount (£9m to £13m per year). The additional cost would simply be spread over all policyholders.

15. If you wish to discuss any of our comments in any further detail, you should contact our Technical Policy Manager, Philip Doggart, in the first instance. He is available on 01312401319 or at Philip.Doggart@actuaries.org.uk.

Yours sincerely

Nick Salter, President
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