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# General Insurance Market Add-ons Market Study – Remedies: value Measures

IFoA response to the Financial Conduct Authority

24 September 2015

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Institute and Faculty of Actuaries

Joanne Davis
General Insurance Policy
Financial Conduct Authority
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24 September 2015

Dear Ms Davis

**General Insurance Add-ons Market Study – Remedies: Value Measures**

The Institute and Faculty of Actuaries (IFoA) welcomes the opportunity to respond to the FCA's Discussion Paper on remedies for General Insurance Add-ons. The IFoA's GI Board has led the work on drafting this response. We have focused our response to areas where we can bring actuarial insight.

**General Comments**

The IFoA supports the FCA's aim of delivering better consumer outcomes by using transparency to bring about market change. The IFoA suggests that shining a light on poor value products would better help achieve this aim. In that regard, we would encourage the FCA to recognise that the provision of information does not in itself ensure better outcomes. The customer will be more likely to recognise the value of the information if it is relevant and accessible. It is important to convey to the customer, as we emphasise in specific comments, that low price does not always equate to good value.

We have included as an Appendix to this letter an extract from the IFoA's response of 8 April 2014 to the FCA's MS14/1.[1] The IFoA would encourage the FCA to reconsider our comments in respect of appropriate consumer disclosure.

We agree with the FCA's conclusion [7.2] that as the value of general insurance products is multi-faceted, designing a reliable indicator of value is not easy. In our responses to specific questions we have highlighted some of the challenges and suggested alternative measures of value.

We question the FCA's conclusion [7.3] that the claims ratio is the option that is most likely to meet the FCA's goal of introducing transparency and creating incentives to improve value. Such a measure has many limitations, can be difficult to interpret and could be more misleading than presenting a picture of "where the money goes" as suggested in the Appendix. Even if supplemented with other measures, we are concerned that these other measures are likely to highlight the limitations of the claims ratio as a value measure. There is a risk that publishing firm-specific claims ratios would obscure rather than provide transparency on value.

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

Our responses to the specific questions in the Discussion Paper should be considered in the light of our general comments above.

**Q.1 Do you have any comments on the aspects of value discussed?**

The FCA has defined value as generally being the quality or benefits of an insurance product relative to the price paid for it. We agree with the statement that the quality or benefits of an insurance product can be complex and multi-faceted and sensitive to each consumer's risk appetite and personal circumstances. Therefore, the assessment of value should incorporate the cost to consumers alongside a consideration of the product's benefits or qualities. However, consumers' personal circumstances may generate a misleading interpretation of product level information. The complex value chain for some insurance products means that focussing on one area (insurance firms and their claims ratio) may have major limitations. One potential consequence could be that the FCA's objectives are only met in a limited fashion at a potentially significant cost to firms and ultimately consumers.

We would reinforce our comments in the Appendix that the claims ratio is neither the most effective, nor single measure to use.

The three high-level lenses of product, customer and channel highlight the difficulties of using the claims ratio as a value measure. For example, claims ratios can vary significantly for:

- Discontinued products and the current product range;
- Distinct customer segments (e.g. new business and renewal business, low risk and high risk properties); and
- Different distribution channels and specific intermediaries

In many cases, the cost to the consumer is determined by an intermediary rather than the insurance firm. In particular, an intermediary may select a net premium from a panel of insurers, but will themselves set the retail price to the end customer. It is unclear what publishing claims ratios at an insurance firm level would achieve in these cases as the issue of 'poor value' may be predominantly due to the mark up charged by the intermediary. As we commented in our response to the Market Study and as noted in the Appendix, an alternative of splitting out 'Where the money goes' is a value measure that could better express this feature as it captures both the intermediaries and insurers.

The FCA has not considered 'peace of mind' as part of the value measures discussion. Publishing a plain English information sheet about the cover a product provides would help provide the consumer with more comfort about the product.

The FCA refers to the publishing of complaints data. This in itself could be viewed as a measure associated with the value of a product. One possible conclusion would be that potential customers could infer those which generate a relatively high frequency of complaint as delivering poorer value. This highlights that there are many factors involved in 'Value' to consumers and not just the average claims pay-out ratio.

**Q.2 Do you have any comments on our rationale for introducing a value measure and how we see such a measure working?**

We agree with the FCA's rationale for introducing a value measure to help focus competition on value and not merely price.

We note that currently the FCA does not intend to require firms to provide consumers with value measures during their purchasing journey. We would encourage the FCA to keep the reporting requirements proportionate. Aiming the reporting of transparency value measures at consumer bodies rather than consumers themselves could be a useful first stage. The FCA may wish to consider how to leverage existing published measures.

The FCA suggests that price comparison websites might incorporate the indicators (value measure) into their own sales journey [2.20]. For this to be effective and act as a balance to the current price focused nature of many of these websites, the value measure chosen should be a reasonably clear measure of value.

**Q.3 Do you have any comments on the proposed scope for a value measure?**

We agree that publishing at a product level is likely to produce a measure that is proportionate in its cost and complexity.

Publishing at a product level will have limited applicability to a consumer's purchasing journey. If the FCA extends its requirements to the purchasing journey then there would need to be a further assessment of both the value measures most appropriate for this purpose and also the appropriate level of granularity.

**Q.4 Do you agree with the proposed product granularity and split by add-on and stand-alone sales? Do you think we should further split data by distribution channel?**

In general, any further split of data is likely to increase cost and complexity. This should be weighed against the expected increase in benefit from doing this. Additional disclosures concerning the product level measures might be a cost effective way for providing additional granularity.

The suggestion of splitting by distribution channel may help to address the issue raised earlier of net pricing; however, the cost-benefit analysis of this suggestion should also be considered carefully. There may be a particular challenge assessing niche products where the 'peace of mind' factor is more important

**Q.5 Do you believe the measures discussed can meet our objectives, and why? Do you have a preferred option?**

The measures the FCA have discussed are
- Claims ratio as a stand-alone value measure;
- Claim frequencies, claim acceptance rates and average claims pay-outs as a package; and
- Claims ratio and claims acceptance rates

The IFoA does not consider that these measures would meet the stated objectives. Given the complexity of the insurance value chain these measures may not directly shine a light on poor value. They may highlight differences in firms due to different business models, different products and covers and customer segments. For example, the claims ratio experience by insurers selling building insurance is particularly affected by the location of the properties it insures. A low claim ratio relative to other insurers can be because the storm experienced by other firms did not affect the properties it underwrites to the same degree. By way of another example, the third party claim frequency for a young driver motor portfolio will be significantly higher than that of the industry average.

More generally, the use of average claim payments will fail to highlight the potential wide range of claim payments that can take place in individual claims. Section 4.26 provides one example of this with medical expense cover under travel insurance policies noted as paying out claims of over £0.5m in certain cases although such claims are infrequent. This ability of policies to occasionally pay out very substantial amounts is more aligned with the 'peace of mind' aspect of value which the discussion paper has chosen to exclude from its assessment of a value measure. Examples of this can be found in motor insurance where a severely injured claimant could have a multi-million pound claim, or in home insurance where a severe flood could produce an individual claim pay out of many hundreds of thousands of pounds.

**Q.6 Do you have any comments on the proposed calculations? What challenges do the calculations raise, and how might these be overcome?**

Given the different data, methods, models and assumptions used to estimate claims ratios, it would be difficult and potentially costly to require firms to adopt a prescribed basis of calculation of claims ratio.

We would recommend, subject to testing that the results meet the FCA's objective, that calculations are based on firms' current approaches. However the approaches firms currently use may not have been applied at the level of granularity proposed by the FCA.

The proposed calculations report the claims ratio based on the previous one year of experience. For some products which are very dependent upon external influences, (e.g. weather in home insurance) this is likely to give relatively volatile results from one year to the next. In years when there is relatively good weather, the 'value' measure proposed may appear to indicate 'poor value', as it fails to capture the extent of the protection offered throughout the past year.

**Q.7 Do you have any comments on our proposals for reporting?**

We have considered this in more detail alongside our response to question 8.

**Q.8 Do you have any comments on our proposals for publishing and contextualising data?**

We would encourage the FCA to consider publishing market averages or ranges for the value measures as a first step. This would allow an assessment of the consequences of publishing additional transparency measures before measures for individual firms are published. Market level claims ratio information for some products is already available (e.g. PRA returns, ABI statistics and industry research groups). This information could be published or referenced on the FCA website or other appropriate forums. We would also encourage the FCA to consider any future information that firms will publish as a consequence of Solvency II disclosures.

As there are multiple reasons for different claims ratios, contextualisation might serve to highlight that the claims ratios are not comparable, as opposed to helping users to be able to compare them as a value measure.

**Q.9 Are there measures you think we should consider for point of sale disclosures to consumers in the future?**

As discussed in the Appendix, the IFoA suggests that a pie chart, showing where the money goes, is an alternative value measure that could be considered for disclosure to consumers.

**Q.10 What costs – both type and scale – would be incurred in delivering the different value measures discussed? Are there any ways to reduce these?**

We would encourage the FCA to investigate whether firms could leverage existing processes so as to minimise their costs. For example, claims ratios are already calculated as part of firms' PRA returns, although the level of granularity does not necessarily match the level of granularity proposed by the FCA.

We would recommend that the FCA conducts research with the likely users of the published information to test how they would interpret and use the new value measures before introducing any new regulation.  This research would reduce the risk of a large and potentially expensive project being undertaken which leads to limited or misleading outcomes.

**Q.11 Do you have any comments on the alternative measures discussed?  Or do you have any suggestions for another measure might meet our objectives for this work.**

We agree with the FCA's view that reporting of the alternative measures considered (customer satisfaction rates, customer retention rates, time to settle, percentage of claims settled in full) would not be likely in themselves to meet all the objectives of encouraging firms to improve value.  However, each of these does potentially contribute to measuring the value consumers derive from insurance products.  We would support encouraging firms to monitor such measures as part of good product governance.

As discussed in the Appendix, the IFoA suggests that a pie chart, showing where the money goes, is an alternative value measure that may better meet the FCA's objectives.

**Q.12. Should we consider commission disclosure – either as a transparency measure or as a point of sale disclosure remedy?  How should such measure be calculated and by whom? What are the benefits and costs of a measure highlighting distribution costs?**

We would recommend that the FCA considers commission disclosure as a point of sale disclosure remedy.  This would provide the consumer with additional information regarding where their money goes.  However, we would encourage the FCA to also consider all possible drawbacks for consumers and firms before introducing commission disclosures.

Firms receiving commission may offer significantly different levels of service for this commission e.g. some provide claims services and therefore additional information could be provided to give context to the commission disclosure.  However commission disclosure could lead to inappropriate or misleading comparisons.  We consider that commission disclosure is less useful as a broad (e.g. product class level) transparency measure as commission levels can, for example, vary significantly by channel (and even within channel by intermediary) and by new business and renewal.

As you gave us the opportunity to discuss our response to the 2014 Market Study at a meeting with members who drafted our response, the IFoA would welcome the opportunity to meet again with you to discuss our comments in more detail.  If you wish to do so, please contact Philip Doggart at Philip.Doggart@actuaries.org.uk or on 0131 240 1319.

Yours sincerely

**Fiona Morrison**
**President, Institute and Faculty of Actuaries**

**Appendix**

Using claims ratio as a core measure of value has limitations and there may be instances where it is misleading; for example, low frequency / high average cost covers. While a very low claims ratio would seem to undermine the value of the add-on for the consumer, this may be overstating things in other cases. Furthermore, concluding that the sole reason for higher profits is the anti-competitive advantage the seller has through the point of sale mechanism of an add-on, is not necessarily the case. For example, as previously expressed, it may be reasonable for a fairly high level of profit to stem from the acquisition cost advantage from this sale. This could translate into both a better profit for the seller, and a more competitive price for the add-on, compared to a stand-alone product that needs to bear the full acquisition cost.

The IFoA would suggest a comparison of the claims ratio with a similar standalone product, rather than comparing in absolute terms, or to other general insurance products. This may provide a more accurate reflection of the impact of the sale. There is tension between what may be beneficial and what may be harmful mainly arising from the sales process.

Are there any other remedies?

The IFoA suggests that a pie chart, showing where the money goes, might be a stronger and possible alternative. This has the added benefit of highlighting where all of the money ends up rather than focusing solely on what is paid out in claims; however, for some products with a catastrophe type exposure the full benefit of the cover may not be immediately obvious.

Showing for example, x% goes to HMRC (IPT), y% to the insurer, z% to the car dealership etc. may not be a fair way to compare direct and intermediary sales, but it might be more easily implemented than claims ratios, which may be more misleading. Other industries have shown how this works; food packaging clearly sets out ingredients and nutritional information. For insurance this could include the split for claims, reinsurance, expenses, marketing and commission, with numbers on a standardised basis (e.g. reserves set at the mean level with the numbers averaged over a suitable period).

The IFoA is aware of potential overheads introduced, particularly for distributors, in setting up such a system but believes there is merit in exploring this further.