Institute and Faculty of Actuaries

Approaches to managing the Conduct Risk associated with General Insurance pricing practices

James Hillon
Director, KPMG

What today is (and isn't)

✓

- A summary of some (personal lines) environmental context
- An overview of drivers for action
- A potential framework firms may wish to consider
- Just my view

✗

- A technical session
- A judgment over what represents good and bad practice, recognising that this is a matter for individual firms to consider

You have the opportunity to lead this debate…but you will lose this opportunity if you don't act

Before we get going, let’s talk about some pricing dilemmas

- Is it fair for:
    1. Any price to be offered to a customer at new business?
    2. Profit maximisation to be at the core of a pricing strategy?
    3. Premiums to vary depending on how close it is to the renewal date?
    4. Premiums to vary by time of day the quote is obtained?
    5. Premiums to vary according to postcode?
    6. Premiums to vary according to postcode, using socio-demographic data?
- Insurers should be held to a “higher standard” than e.g. travel companies

From the headlines…

Fleeced by the Insurance Spies:

Firms are plundering your personal data to work out the maximum they can charge you and rip you off on renewals

Daily Mail, 26th May 2018

Institute and Faculty of Actuaries

…a barometer for the consumer landscape in which we operate

"Elderly, loyal – and charged 10 times more for insurance"

"It's time to end the great home insurance rip-off"

"Motorists fork out £1,000 more to insurer their car if their name is Mohammed"

"Facebook forces Admiral to pull plan to price car insurance based on posts"

"Insurers facing price intervention on personal lines amid huge pressure on government"

"Insurers ripping Britons off"

This isn't just about keeping out of the papers

Customer Engagement	• Price key to customer experience • Alongside claims, critical to customer sentiment • Customers want fairness, transparency and simplicity
Commercial Performance	• A key lever in meeting your commercial objectives • It can be easy to resort to the "easy" options when the pressure is on • But, how well defined are your "red-lines"
Intense Scrutiny	• The FCA want to see "high quality, good value products…[that are] competitively priced" with an emphasis on transparency • FOS are increasing their demands of firms with the potential for significant precedent • Political support for price controls is gaining ground in other sectors

The regulatory landscape is shifting…

- Thematic review of pricing practices in Home Insurance underway
- Focus on fair treatment of existing customers
- Treatment of vulnerable customers in the spotlight
- Concerns over use of “big data”
- Concern over behaviours that are driven by “soft” market conditions

Institute and Faculty of Actuaries

…but regulation isn't the only driver for change

Consumer pressure	Use of Data	Emerging Analytics
• Consumers "fed up" with loyalty penalised • Fuelled by growth in PCWs and proposition innovation • Debate moving into a wider set of stakeholders	• Growing mistrust over how data is used…Cambridge Analytica the "canary in the coal mine"? • Right to be forgotten • Permissible uses of data	• Is the "black box" getting bigger and darker? • Are current control environments fit for purpose? • Can strategy be successfully codified?

Institute and Faculty of Actuaries

Do the ABI / BIBA Guiding Principles & Action Points drive meaningful action?

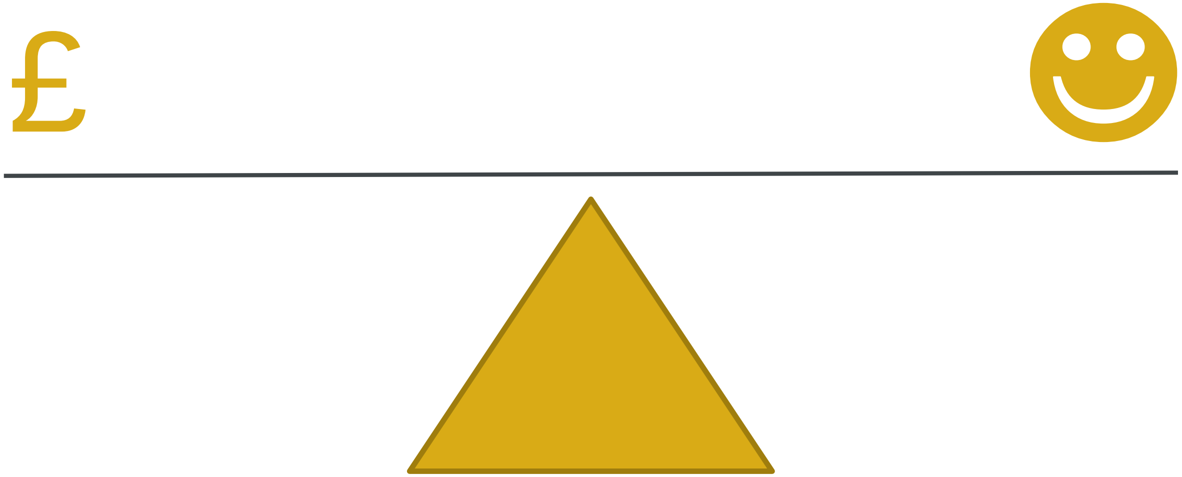
Key points

- Tendency to shop around should not lead to excessive pricing differences
- Board and Senior Management focus
- Approach to pricing for longstanding customers reviewed to assess whether it delivers fair outcomes
- Complaints where there are excessive differences between new and renewal prices will not be able to be defended

Observations

- Will FCA take this into account in review of pricing practices…and can this framework be adequately overseen?
- Variation in approach between firms is noted. In this context, can "excessive" be clearly defined?
- Fair outcomes for longstanding customers – is it reasonable to take into account other dimensions of "value for money" than just price?

At its most simple, this is about creating the right balance…



…in the context of your own firm

Institute and Faculty of Actuaries

To achieve this balance, a clear appetite for conduct risk is required, along with a definition of “fair” or “value”

- Some example appetite statements from published annual reports (my emphasis):
  - [we have] <u>no appetite for material risks resulting in reputational damage</u>, regulatory or legal censure, poor customer outcomes, fines or prosecutions
  - We therefore strive to <u>eliminate any systemic unfair customer outcomes</u> as a result of failures in the product, marketing, sales or service delivery systems and processes, or cultural shortcomings
  - [through our] strategy, culture, product design and service delivery, [we] <u>aim to deliver fair outcomes</u> to [our] customers and ensure that they are at the core of everything [we do]
- Are these sufficiently precise and / or helpful?

Institute and Faculty of Actuaries

Defining "value"

- Margin?
  - Retail v technical price?
  - Average v outliers
- Other dimensions of value:
  - Product
  - Service & Access
  - Experiential
- How to measure and monitor?
- Different customer segments may have different value equations

Institute and Faculty of Actuaries

A brief detour into other sectors

- Banking sector perhaps more advanced in thinking (albeit with a start point of more straightforward pricing)
  - “omni-channel” pricing appears relatively common
  - Front-book v back-book pricing programmes
  - Regulatory intervention has driven transparency around pricing
- Energy sector has seen the most direct intervention
  - Price cap for 1m most “vulnerable customers”
  - Extending to all customers on standard variable tariffs
  - Maximum mark-up over the wholesale cost
  - Whilst value equation simpler (standard product), what precedent for insurers?

Institute and Faculty of Actuaries

So, how to get on the front foot

Strategy

- Align pricing strategy with overall strategy
- Define what “value for money” means for your firm
- Define your conduct risk appetite for pricing in the context of this “value for money” test

Risk Assessment

- Understand the regulatory environment
- Assess the degree to which your pricing strategy is being implemented “in practice”
- Model risk exposure
- Overlay your understanding of vulnerable segments
- Develop your action plan and execute on the “front-foot”

Control Environment

- Ensure your pricing control cycle is fit for purpose
- Ensure appropriate MI is integrated into firm-wide conduct risk reporting, measuring appropriate metrics
- Undertake regular “penetration testing” of your pricing

In closing…

- A critical topic
  - perhaps one that has moved from a question of personal integrity to one of our professional integrity?
- A debate that has moved well beyond pricing teams
- A subject that requires action now, even if only to establish a clear assessment of where you stand "today"
- A need for industry "best practice"
  - Are we in a position (or is it our duty) to lead the debate?

Questions

Comments

The views expressed in this [publication/presentation] are those of invited contributors and not necessarily those of the IFoA. The IFoA do not endorse any of the views stated, nor any claims or representations made in this [publication/presentation] and accept no responsibility or liability to any person for loss or damage suffered as a consequence of their placing reliance upon any view, claim or representation made in this [publication/presentation].

The information and expressions of opinion contained in this publication are not intended to be a comprehensive study, nor to provide actuarial advice or advice of any nature and should not be treated as a substitute for specific advice concerning individual situations. On no account may any part of this [publication/presentation] be reproduced without the written permission of the IFoA [*or authors, in the case of non-IFoA research*].

Institute and Faculty of Actuaries