Product Pricing Final Rules – Impact Assessment

In October 2018 the FCA published a thematic report on pricing practices in the retail general insurance household sector and followed this up with a market study into general insurance pricing practices in the motor and home insurance markets. They issued an interim report in October 2019 and their final report in September 2020 together with their consultation paper on remedies. The final report confirmed that the FCA believes that the market is not delivering good outcomes for customers. They issued their final rules at the end of May 2021.

Main findings from the thematic work included:-

- Firms failing to have appropriate and effective strategies, governance, control and oversight of their pricing practices and activities, such that they are unable to reliably assess and evidence whether they are treating their customers fairly. This includes the following practices:-
  - Price-walking – some firms gradually increase the price to customer who renew year on year. This is not made clear to customers;
  - When setting a price, most firms take into account the likelihood that a customer will switch at next renewal or in the future;
  - Use of practices which make it difficult to make informed decisions or to switch including barriers to stopping automatic renewals.
- FCA analysis of data from firms shows that for a typical motor risk, on average, new customers pay £285 whilst customers who have been with their provider for more than 5 years pay £370.

The FCA is staggering the implementation of the rules as follows:-

- Systems and Controls, Product Governance and Premium Finance provisions come into force on 1 October 2021. New product governance rules in respect of annual reviews to be completed by 1 October 2022.
- Pricing, Auto-renewal and Reporting changes needs to be implemented by 1 January 2022. For the Pricing and Auto-renewal changes firms have a transitional period until 17 January 2022. This transitional period will allow firms to implement the new rules on 17 January 2022 however if there is any customer detriment between 1 January and 17 January then this will need to be addressed.

<table>
<tr><th>Proposed Remedy</th><th>Action</th></tr>
<tr><td>Ban on price-walking</td><td>Firms can only offer a renewal price to a consumer that is no greater than the equivalent new business (ENBP) price, meaning setting the price on the same basis as if the customer was presenting as new customer so only allowing a change from last due to:-

• Changes in risk
• Changes in firms margins;
• Changes in pricing policies as long as this does not result in higher prices for renewing customers

The ENBP is calculated at the point the renewal notice is issued. Cash and Cash equivalent incentives offered to new customers must be reflected in the ENBP and examples of such incentives include:-

• Monetary or percentage discount on the premium
• Retail Vouchers
• Cashback
• A free add-on
• One month free
• Points in a loyalty scheme</td></tr>
<tr><td>Closed Books</td><td>A closed book of business is defined as one where policies may be renewed by existing customers and either:-

• policies are not available for purchase by other customers, or
• where the book has been on sale for less than 5 years the firm has not sold, or does not expect to sell, on an annualised basis, more than 15% of active policies under the product to new business customers. This percentage is reduced to 7.5% where the book of business has been on sale for 5years or more.

If the number of new business policies sold is more than 10,000 per year this will not be classed as a closed book.

Firms will be required to benchmark the renewal price against a "close matched" open book policy where they have one. Where the firm does not have one then they must ensure that renewal prices do not systematically discriminate</td></tr>
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	against customers based on their tenure. Firms will be required to assess whether their books are closed once a year.
Acquisition of Books of Business	Where one of the parties to a renewal transaction is new, the business should be regarded as new business for them. So, if an intermediary re-brokes to a new insurer, that insurer is not bound by the pricing remedy until the subsequent renewal. Similarly, if a price-setting intermediary acquires a book of business from another firm, but keeps the business with the same insurer, the intermediary would regard the customers as new business customers and the insurer would treat them as renewing customers. This means that the same customer could be regarded as a new customer for one firm and a renewing customer for another firm, when renewing the same contract.
Anti-avoidance measures	Firms operating in a way which frustrates the intended outcomes of the pricing remedy would be a breach of new pricing rules. Examples include:- • arranging their business in ways that result in consumers of longer tenure systematically being offered renewal prices that exceed the price for a new customer or • the quality of service or cover enjoyed by customers of longer tenure being lower than that enjoyed by customers of shorter tenure or • charging higher fees at renewal than at new business.
Policies and records	Firms must have appropriate policies and procedures to ensure that their pricing practices are consistent with the overall intended outcomes. Firms to keep records of their considerations under the pricing remedy requirements and be able to provide documentation of sufficient detail showing how they were satisfied that their pricing model complies with FCA rules.
Attestation	Senior Manager to attest on an annual basis that the firm’s pricing model complies with the rules. First attestation will be 3 months after the rules are implemented. This will be a form completed via RegData.

Individual and multi-product discounts	The rules will not prevent firms negotiating with a customer at renewal and offering a lower price than the quoted renewal price. Firms can still provide multi product savings however the combined renewal price for all products must not be higher than that at new business.
Chains	Where a firm is jointly responsible for setting the price they must each ensure that the part that they play in setting the price meets the rules. This includes intermediaries that take a net price and make any adjustments to determine the gross price. It does not include mere provision of commission to an intermediary and neither does it cover intermediaries which act under a delegated authority and set the renewal price based on a formulae provided by the insurer where they have no discretion to change the premium.
Net and Gross Prices	Insurers who provide a net price to the intermediary must ensure that the renewal net price is no higher than equivalent new business net price and the intermediary must do the same for the gross price.
Add On products	Rules to apply to add on products including premium finance. Renewal price for additional products, including premium finance, must be no greater than that offered to an equivalent new customer. Firms would also have to ensure that these products offer fair value.
Enhancing the requirement to ensure products offer fair value to customers	Value measures including total price to end customer and the quality of products and services. FCA expect firms implement this alongside the new PROD rules which come into effect from January 2022. Manufacturers to ensure that value is considered in their product approval process. FCA will be introducing an evidential provision making it clear that they consider certain price optimising prices are unfair e.g. pricing based on auto renewal or premium finance and vulnerability.

Extended Product rules to existing products which have not been significantly adapted. Introduce a minimum requirement to review products at least every 12 months.	Current PROD rules only apply to new products or existing products which have been significantly adapted. New PROD rules will now apply to all products. Annual product reviews for all products. Ensure this includes value measures. Cover all add ons as well.
New requirements for Product Distributors.	• Ensure that they understand the value assessment that the manufacturer has undertaken, so that they can distribute the product accordingly. • Consider the impact that their distribution strategy and process has on the value of the product. This includes considering any remuneration they receive as part of the distribution strategy, and ensuring that it does not result in the product failing to offer fair value to the end customers. The rules set out a number of matters which distributors should consider. • Provide information to support the manufacturer in their product reviews. This includes information on remuneration where this has an impact on the value of the product. • Amend their distribution processes if they identify it results in harm to customers. This should include taking appropriate remedial action.
Premium Finance – classed as an add on and therefore subject to these rules.	Additional rules include:- • Enhanced disclosures regarding information on the cost to customers and the fact it makes the product more expensive.

	• Clarity on giving the customer a choice of payment and a clear explanation of their choices not just do you want to pay annually or monthly. • Review finance arrangements to ensure that they are compliant and you are not offering finance at a higher rate than is available elsewhere.
Cancellation of Auto Renewals	Firms will be required to allow consumers to opt-out of auto-renewal using at least the same methods by which they allow consumers to purchase a new policy. Firms must ensure that the average call waiting time to cancel auto-renewal is not unreasonably longer than the waiting time to purchase a new policy. This needs to be provided when the policy is taken out and also before it renews. Provide clear information on auto renewal and what this means to the customer at point of sale and before renewal. This requirement applies to all GI policies except private heath, medical and pet insurance. Monthly products are also out of scope.
Barriers to cancelling auto renewal	Firms must ensure that they do not put in place barriers to cancelling auto renewals – examples are having long waiting periods on calls for cancellation of auto renew compared to new business calls.
Annual reports (initially these will be quarterly for the first 12 months and then move to annual)	Cover sales channel and length of time the customer has held the policy. Insurers will need to provide information on large books and closed books. Split net -rated and gross-rated.

Metrics include:

Compliance with Pricing rules

- The total and average premium charged to customers, net of Insurance Premium Tax
- Net and gross price for intermediated and affinity/partnership sales
- The number of policies sold/renewed during the reporting period
- The number of policies in force at the reporting date
- Expected claims cost
- Expected claims ratio

Identifying Instances of Customer Harm

- The proportion of customers with average expected claims ratio 10 percentage points and 30 percentage points below the average for the reporting channel
- Gross incurred claims ratio at an aggregated level
- Total prior year’s reserve releases
- Total prior year’s reserve strengthening
- The proportion of customers paying high and very high premiums, defined as a premium 1.5 times to 2 times (high) or more than 2 times (very high) the average across the product.

Monitoring the Market

- Premium finance charged to customers (total charged, number of policies sold with premium finance, APR range) Firms will need to provide information on the total amount of premium finance charged during the reporting period and the number of policies sold with premium finance.
- Additional products (total charged and number of additional products policies sold)
- Pre-contractual fees and charges (average charged, total charged and number of policies sold with charges). This will include information on all pre-contractual fees and charges separate to the premium (eg policy administration charges, brokers’ fees, partner/affinity charges)

Post-contractual fees and charges (average charged, total charged and number of policies sold with charges) including midterm adjustments and cancellation fees).