



Society of Actuaries in Ireland

**Delivering good customer
outcomes from pricing**

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With you today



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CBI findings

“The primary objective of this Review is to ensure that customers are being treated fairly, given the increasing sophistication of big data and modelling techniques within the insurance industry. “

Differential pricing practices

- While a number of firms maintain that they do not utilise differential pricing in their pricing practices, the CBI observed that the majority of firms do utilise differential pricing through various techniques.
- Firms have a responsibility to understand fully the impact of pricing practices on their customers.

Governance and controls

- Inadequate governance and controls arrangements, including insufficient evidence that firms have the level of ownership and oversight expected when they apply differential pricing practices.
- The controls in place to quantify or monitor the impacts of differential pricing on consumer groupings in advance of pricing model implementation was not always clearly documented.

Culture and conduct

The CBI acknowledged that while firms have developed pricing policies, which clearly impact customers, there was insufficient evidence of a consumer focussed culture in respect of pricing decisions and practices.

CBI immediate requirements

Assessment of pricing methodologies

- Assessment of pricing methodologies against the Central Bank’s definition of differential pricing.
- If a firm does not consider its pricing practices to fall under the definition of differential pricing, the rationale for this should be clearly documented and agreed by the Board.

Governance and controls including responsibility at Board level

- Put a robust governance framework in place, where Board and management structures are designed to ensure a firm’s pricing practices are well-governed, controls operate effectively and appropriate oversight is in place, with roles and responsibilities for pricing activities clearly defined.
- The Board should take ownership of the firm’s differential pricing practices and be fully informed of the impact of those practices on their customers.

Embedded customer protection risk framework

- This framework should form an integral part of the pricing process, and will assist firms in determining if their pricing processes, including the deployment of new pricing models and monitoring of existing models, is ensuring fair treatment of customers in line with the Consumer Protection Code 2012 (the “Code”).

Adherence to the Code

In pricing, complexity & competition has driven risk...

The development of personal lines pricing capability



The dawn of pricing civilisation

- Total cost approach
- One-way pricing, at best, judgement led



Multivariate

- Generalised Linear Modelling methods
- Predictive modelling
- The hunt for new rating factors



Demand based

- Risk and retail pricing
- Explosion in optimisation
- Growth in enrichment



'Anything goes'

- Beyond GLMs and to Machine Learning
- Vast data enrichment
- Individual pricing

Customer prices that are disconnected from the underlying claims cost or cost to serve

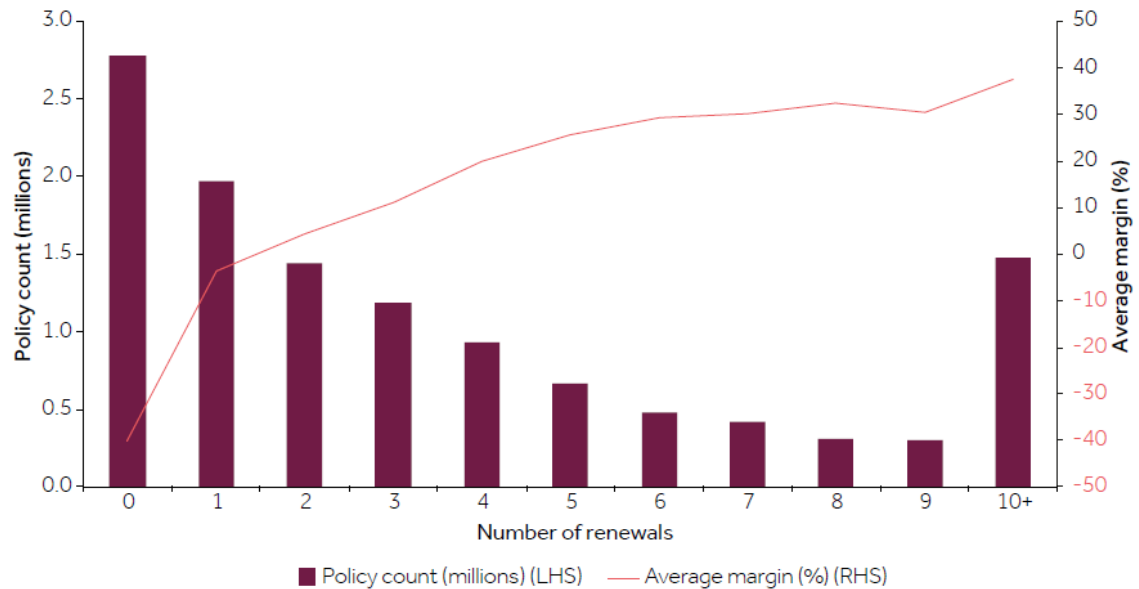
Variations in price between customers that cannot be easily explained

An 'ivory tower' culture in pricing teams with the assumption that 'buyer beware' is reasonable

...resulting in evidence of variation in customer outcomes...

The 2018 FCA Thematic Review of pricing practices in household insurance identified cross-subsidy between customer segments, with a link between long-standing customers, who are more likely to be vulnerable, and higher margins

Not necessarily evidence of “poor” customer outcomes, but drives the need for further scrutiny



Source: FCA Thematic Review of Household Insurance Pricing Practices (TR 18/4)

FCA Market Study on GI Pricing Practices

FCA Thematic Review and Dear CEO letter (Oct '18)

- Identifies issues with pricing practices and potential for consumer harm.
- FCA expectations in relation to pricing strategies, governance, oversight and data clearly set out.



CMA response to Citizens Advice Super Complaint (Dec '18)

- Recognises issue and, in insurance notes the FCA Market Study.
- Recommends consideration of price interventions which limit price walking.



Government response (Jun '19)

- Welcomes CMA response and supports recommendations made.
- Potential for greater powers to be handed to CMA to assess whether consumer law has been broken.

FCA Market Study Interim Report (Oct '19) & Dear CEO letter (Dec '19)

- Concludes that the market is “not working well”. 6m customers are estimated to be paying “high prices” for insurance and could save £1.2bn if they paid the “average price” for their risk. One third of customers paying high prices exhibit some characteristics of vulnerability.
- Pricing practices are complex and this can allow firms to raise prices for consumers that renew with them year-on-year.
- Most firms use pricing practices which seek to take into account behavioural factors in setting the final price. This “margin optimisation” results in issues such as those customers who are more likely to renew tending to be charged higher prices.
- Because pricing practices drive high levels of shopping around and switching, there are costs of £2.3bn added to the value chain from e.g. marketing spend and product commissions, that are ultimately borne by all customers.
- There is also evidence that customers who “auto-renew” policies are more likely to pay a high price.

Industry focus to date

1

Pricing Strategy

- Clearly articulating your pricing strategy
- Linking to your overall strategy
- Understanding extent of differential pricing, defining approach to cross subsidy and “value for money”
- Determining risk appetite for being outside pricing strategy and developing monitoring approach
- Defining approach to vulnerable customers

2

Governance, Controls and Senior Management Accountability

- Ensuring you can clearly evidence how you execute your strategy in practice and considering cultural implications
- Ensuring there is adequate governance oversight of customer outcomes from pricing
- Consideration of operational implications e.g. customer service, complaints
- Addressing Senior Management requirements

3

Management Information & Board / ExCo visibility

- Ensuring there is sufficient opportunity for discussion on customer outcomes from pricing at Board / ExCo as appropriate
- Reviewing extent to which Management Information (MI) captures customer outcomes from pricing
- Reviewing extent to which customer outcomes embedded in ExCo and Board reporting

4

Approach to the use of data

- Documenting all rating factors used in pricing models and rationale
- Reviewing third party data sources in the same way and ensure due diligence of sourced and partner data is robust
- Ensuring adequate governance in place over use of new data items

The final FCA Market Study has gone further than expected

Proposed Remedies

- The pricing remedy
- The auto-renewal remedy
- The governance remedy
- The reporting remedy

The remedies were published alongside final rules in relation to reporting and publication of value measures data

Potential Implications

The package of remedies are simple in their design, but far-reaching in their impact:

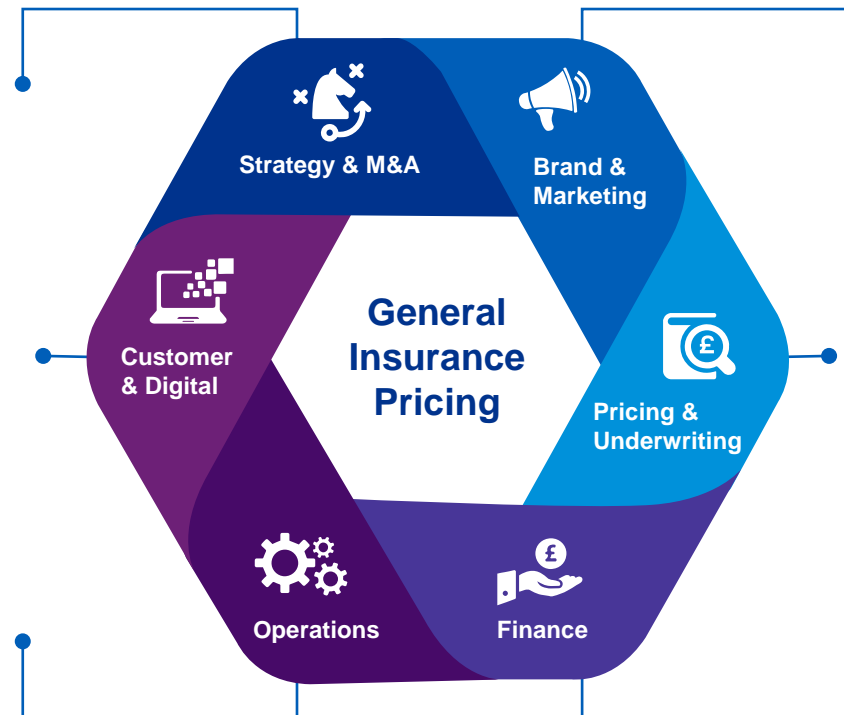
- Customer behaviour will change and costs relating to switching should reduce
- There will be a shift in the distribution landscape, with particular implications for PCWs and intermediaries
- Competition will be more focused on the “fundamentals” with pressure on cost & non-risk income
- Revised brand, product and distribution strategies. Marketing focus re-orientated
- Potential for increased barriers to entry
- There may be renewed M&A and growth in back-book consolidation

It is vital to take a connected approach to assessing the impact and deciding how to act

Assessing the implications for where & how to play, including distribution strategy

Designing the new customer experience. Driving digital to address cost pressure

Adapting to the new service proposition. Addressing the cost challenge



Determining how to evolve the customer proposition and communication strategy

Determining how to navigate the adjustment to prices and whether risk appetite changes

Identifying the impact on the business plan and capital. Setting the commercial challenge

Steps for insurers to consider

The implications for the market are profound it is clear that there will be “winners” and “losers”. Whilst there are a number of individual steps to take, it is critical to work in a connected way right across the organisation given the complexity and interplay of the themes



It goes without saying that there is much to do. For insurers in the UK, the time to start is now – we expect disruption in the market which creates risk and opportunity, and it will require careful management to navigate the transition safely

Questions and Answers





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