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The FCA's pricing proposals: help or hindrance?

On 28 May 2021, the FCA published its final policy statement on its pricing restrictions for UK insurers, which will come into force in October this year. However, the impact on insurers' freedom to price and ability to manage customer lifetime value through pricing is still in question.

Three unresolved questions:

1. How much will a new business quote for an existing customer be influenced by the final price of renewal business? The new regulations leave enough space for the two prices for a single policyholder to be justifiably different.
2. Will companies constrain prices at the individual customer level or across "types" of customer?
3. What will the impact of managing the value of one sub-book of business (through price) be on other sub-books? Will price dislocation management become a necessary tool in the UK market?

Making choices – how should insurers interpret the FCA regulations?

There are several considerations for insurers when implementing the FCA regulations:

- What are the practical implications for pricing teams?
- How exactly should the regulations be applied?
- Which customers/markets become more (or less) attractive?
- How will other insurers respond?

We cover these in more detail in our recent report on price walking here. However, potential loopholes mean that there is another choice for insurers. Do you follow the letter or the spirit of the regulation?

Following the spirit

If you choose to follow the spirit of the pricing regulations, you must decide exactly what the FCA is asking you to do, which isn't entirely clear. Interpretations cover the full spectrum, ranging from the narrow (avoiding inconsistent individual customer pricing quotations over a limited time) to the broadest (assuring similar profitability across the entire back book, especially by tenure.) As a result, some companies are choosing to take a more conservative approach. This will lead to uncertainty, strategic adjustments, and a lot of price turbulence. There will be a wider range of prices in the market, with some companies enjoying a competitive advantage through choosing to "sail close to the wind". Almost without a doubt, there will be more confusion in the market, not less.

Following the letter

A company may choose to follow the letter of the regulations, with the final version of the rules allowing significant leeway for insurers to largely continue pricing as they've always done. For example, the restriction to renewal prices is only required to be in place for 24 hours after the renewal offer is made. Some insurers know that their most loyal customers are not inclined to be shopping in this window and as a result, their prices may be minimally impacted.

If insurers take this limited view, they must be wary of what will show up in FCA reporting. The FCA has made it clear that they intend to clamp down on companies who attempt to "frustrate the intended outcomes" of the legislation. This could be difficult for the regulator to do – for example, what recourse do they have against a company which prices keenly, has followed the rules, but whose renewal prices still seem higher than those on new business? Could the regulator argue that even though an insurer has followed their specific pricing remedies, it didn't have the result intended, so that is considered to be contravening the rules? This might be difficult to police and enforce.

Companies must also balance their risk and compliance against profit. Being seen to not follow the regulation could be hugely damaging to the brand and could disrupt its relationship with the regulators.

What are the key implications? Is a fallout with the regulators brewing?

It seems reasonable to ask whether this is an example of well-intended regulation missing the mark – like the early attempts at gender equality legislation. Lots of legislation, requiring a lot of reporting but not resulting in any meaningful change. There are three key areas that companies must increase their focus on in the next 6-12 months.

1. Risk and Compliance – protecting the brand

There is the real possibility of "accidental" non-compliance, where an insurer attempts to follow the FCA's regulation but ends up with unintended results. As the FCA's premise is that too many insurers cheat loyal customers, there is already brand damage, which could get worse if you are seen to circumvent legislation, even if you may be offering the best prices.

Expect further contentious interaction with regulators. Those with already poor regulatory relationships will suffer as they will have less choice over the path that they take.

2. Strategy – remaining competitive in a changing market

With six months to go until the legislation kicks in, will we see a further drive to reduce motor insurance prices (after the pandemic-related reductions)? The next two years are likely to be rocky as insurers attempt to find the most competitive strategy and rapidly correct it when they are out of line. Some insurers may not survive; the new regulation potentially favours new start-ups at the expense of existing insurers, except that new insurers will eventually develop a large back-book themselves if they are successful.

3. Operations – driving innovation

Customer services and experiences could be a way that insurers may differentiate themselves going forward. There could be a continued push for other, better sources of data that enable insurers to price more keenly (which is now even more crucial given the waning impact and instability of credit data due to COVID-19) or to understand the actions of their key competitors by using behavioural or psychometric data.

We should see more changes to products, but will this be product innovation or just product change to circumvent rules?

> *Insurers with the agility and ability to think and change direction quickly will have a huge advantage. This is likely to be the most significant change in the industry and will take years to shake out.*

Is this just the beginning?

One clear impact of the FCA's pricing restrictions is increased and continuing regulation, resulting in greater interaction and workload for both insurers and the regulator.

What is not clear is whether this will achieve fair pricing practices and protection of vulnerable customers.

"Own goals" were significantly impactful during the recently concluded Euro 2020 tournament. With further heavy regulation of one of the most heavily regulated industries, you have to wonder whether the FCA has just added to that tally.

At FTI Consulting, we believe that agent-based modelling approaches will be an important tool for insurers going forward. We explore this in more detail in our recent report 'FCA Pricing Restrictions – Are the Good Days Over?' which can be downloaded here.

Have your say

Complete our 5-question survey here to join the debate and understand how other UK insurers are responding to the regulations.

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