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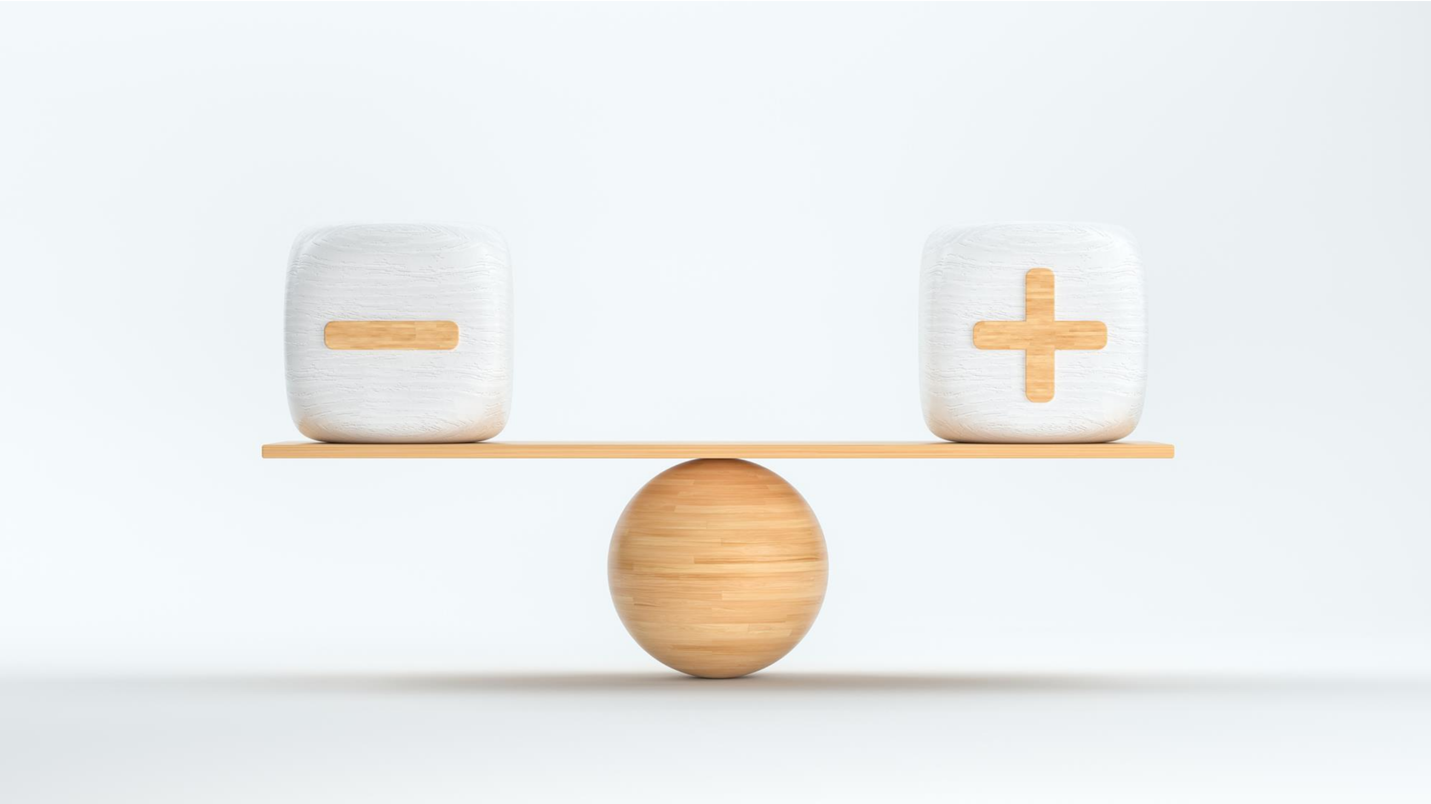

Q&A: Pearson Ham's Stephen Kennedy debates the pros and cons of the FCA pricing practices study

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Pearson Ham's director Stephen Kennedy debates the advantages and disadvantages of the FCA's General Insurance Pricing Practices Market study, who will benefit and how can the industry better prepare?

What will the FCA General Insurance Pricing Practices study mean for insurance pricing?

The FCA is aiming to make competition work better, to provide long term fair value for all consumers in the future, and to improve trust in general insurance markets. The proposed measures are intended to improve the nature and intensity of competition, ultimately resulting in lower average prices paid by customers.

Essentially, there will be an alignment of pricing between new business and renewal for individual customers. This is likely to mean prices will reduce for customers who do not regularly shop around, switch or negotiate. However, the FCA has acknowledged the proposals will probably lead to some consumers paying higher prices if they currently benefit from significant new business discounts as inducements to switch. As the latter is the larger group, prices overall are likely to increase.

Optimisation will still be allowed, and price elasticity will remain an important factor in pricing but will have to be a blended view as any changes to new business prices will have to be reflected at renewal and vice versa.

How might this affect brokers?

Lifetime value models have been key to success in recent years, and brokers have invested heavily in attracting new business.

Price walking strategies have enabled them to use low or negative commission to acquire new business, with the expectation of profitability driven by outer year earnings. This approach will have to be revisited and both new business and renewal pricing set within a different set of constraints and assumptions.

In addition, proposals to curb the introduction of additional charges or fees, premium finance increases, or new add-on products deemed as offering little customer value, limit the opportunity to make up losses through alternative revenue streams.

Stephen Kennedy, Pearson Ham

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The FCA has indicated that it expects differences in firms' products, including service and quality, will maintain the incentive to search and switch in the market and this is where brokers may be able to differentiate themselves.

What should insurance providers do to prepare?

It's crucial for firms to have a clear understanding of their current positions.

This should include a review of lifetime value calculations, variances between acquisition and renewal pricing, typical year-on-year price changes, differences by tenure, and back versus front-book dynamics. From there they can carry out scenario modelling to estimate the impact of potential strategies they could adopt, factoring in how competitors might respond.

An approach will have to be designed based on the output of these assessments in the context of broader business strategies and goals, as well as product governance frameworks. Then comes the technical challenge of updating new business and renewal price setting, making any systems changes that might be needed, amending processes, and planning deployment.

However, this is bound to be an iterative process, dependent on competitor and market responses, and effective post-deployment monitoring will be vital.

Do you think this will benefit the insurance industry?

The FCA has made several assumptions around competitiveness, switching, and front-book growth, to support the proposed remedies. It anticipates a lower churn market with greater price stability, and on average lower prices. However, it also expects competition for profitable new business to remain intense.

Customers with a lower propensity to shop around and higher expected retention rates will be able to find competitive prices in the market. However, those with a tendency to switch will become less attractive to firms and prices are likely to increase.

Combined operating ratios at over 100% for both car and home insurance suggest overall prices need to increase, regardless of the new regulations. There will have to be a rebalancing between new business and renewals, which is not necessarily bad for the industry.

We may see more product development taking place, with added focus on benefits and features, and the introduction of more economy products to maintain price competition. Although the remedies are likely to increase prices, the overall approach will be a fairer one.

How might these changes affect how consumers buy insurance?

One of the key drivers of shopping around activity is year-on-year price change. Retention levels tend to reduce as quoted renewal prices deviate from the previous year, even where they drop. Following implementation of the FCA pricing remedies, we expect to see significant fluctuation between prices paid last year and renewal prices, and a subsequent increase in shopping around activity.

The vast majority of consumers already shop around at renewal, particularly for car insurance, and this has become normal behaviour. This is likely to continue, but there may be a potential drop in switching if new business prices are no longer as competitive as they once were, and savings become more difficult to find.

Customer segments more likely to switch, generally those with higher premiums, are likely to carry on doing so while the likelihood of others to shop around may reduce as the potential benefits diminish. However, changes to behaviour are likely to take several years to mature.