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Fair's Fair?

The future of pricing

IFoA GI Pricing Research Group

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Poll Question 1 –
What is the best economic system?

1. Free market capitalism unfettered by regulation except to maintain fair trade and competition
2. Semi-free market capitalism with limited regulation to protect consumers in core services
3. Mixed economy with core services under state control and a moderately regulated market economy
4. Semi-socialist economy with core services and key industries under state control and a heavily regulated market economy
5. Socialist planned economy with most economic activity under state control

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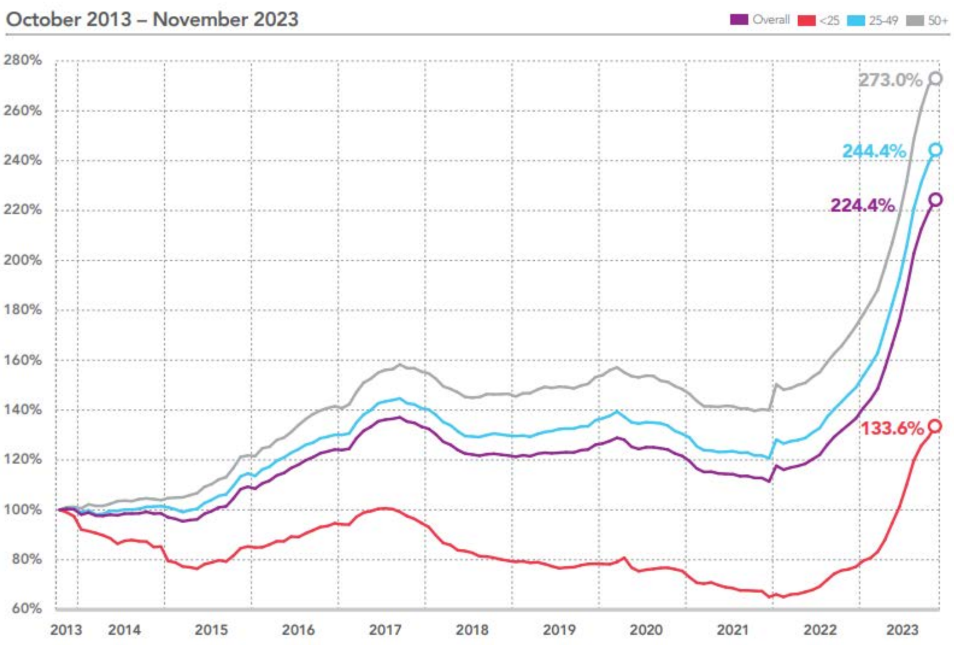
Insurance Price Inflation

- Recent inflation and contribution to cost-of-living crisis:
  - Inflation 2022-2023 38.6% p.a.
  - (+45.7% for under 25s)
  - vs 5.2%pa avg CPI inflation
- But prices have been flat to down since 2017
- And longer-term price rises look more benign:
  - 3%-6%pa 1995-2014 (AA Premium Index) vs avg CPI inflation of 2.2%pa
  - 2014-2021 2.3% p.a. (see chart to right) vs avg CPI inflation of 1.5%pa
  - Telematics has lowered prices for <25s (-4.2% inflation 2014-2021)



Motor insurance premium index *Source: Consumer Intelligence*

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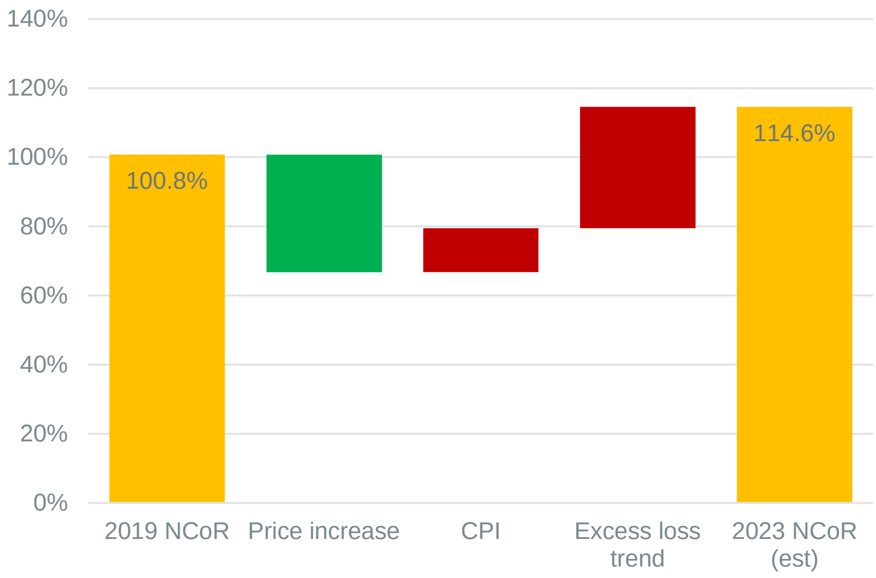
Insurance Cost Inflation

- But this is not profiteering – in 2019 (pre-COVID) the industry was running at around break-even…
  - On an earned basis, prices in 2023 are 51% higher than in 2019
  - On a similar earned basis, CPI in 2023 – including the post-COVID spike – was 19% higher than in 2019
  - If loss trend were equal to CPI, then net combined ratio would have fallen to 79.4%, but instead…
- …now the EY estimated net combined ratio for 2023 is 114.6%
- That implies an excess loss trend over CPI of 9.6% p.a.
- Could the industry do more to control costs – are they really incentivised to do so?

- EY projected net combined ratio for 2024 is 100.4% allowing for an additional 10% rate movement in the year (~21% on an earned basis)

UK Motor Net Combined Ratio Waterfall



Sources: EY estimates, UK Govt CPI data, Consumer Intelligence

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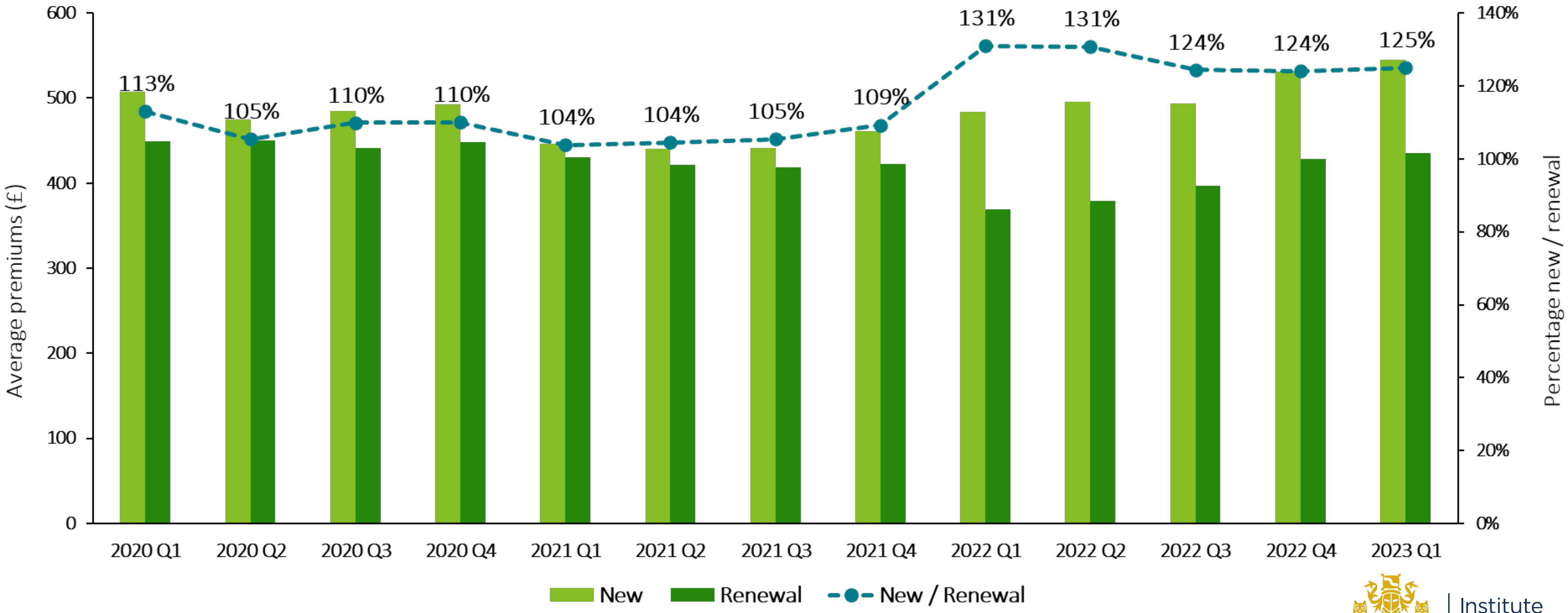
New and Renewal Premium post GIPP



Source: Deloitte Analytics based on ABI Premium data, Deloitte Motor Insurance Seminar July 2023

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The Poverty Premium

- 17.5m people in the UK are in financially vulnerable circumstances
  - 18% of these cancelled or reduced the amount of insurance bought in 2022
  - 49% (8.6m) struggling to afford necessary insurance protection
- For these people, insurance is both more essential – a loss event can be financially catastrophic – and more expensive
- Insurance is the biggest single contributor to the overall “poverty premium” – the extra that low-income households pay for essential products and services:
  - “Poverty premium” for motor insurance alone estimated at an average £300
    - more expensive distribution channels
    - need to pay monthly rather than annually or use “premium credit” services (estimated additional cost of £160)
    - not choosing the best products, e.g. single-item insurance over a contents policy
- Take-up rates are low for the very segment who need insurance most

Sources: Fair4All Finance, Social Market Foundation “Insurance and the Poverty Premium” March 2023

Ethnicity Penalty

"Areas with a high number of people from ethnic minorities saw higher prices, ***even when road accident and crime levels were similar***" *– BBC Verify 26 Feb 2024*

We need to understand what is going on here

Protected characteristics like race (and sex and disability) do also correlate with poverty attributes

From the FCA Consumer Duty:

Prices can differ for different groups but:

- *Price charged should offer fair value for each group*
- *Should have regard to whether any customers with vulnerability and/or protected characteristics may be disadvantaged*

Car insurance quotes higher in ethnically diverse areas

26 February 2024

Share

By Maryam Ahmed, BBC Verify

Car insurance quotes were a third more expensive in some areas of England with the biggest minority ethnicity populations, BBC Verify has found.

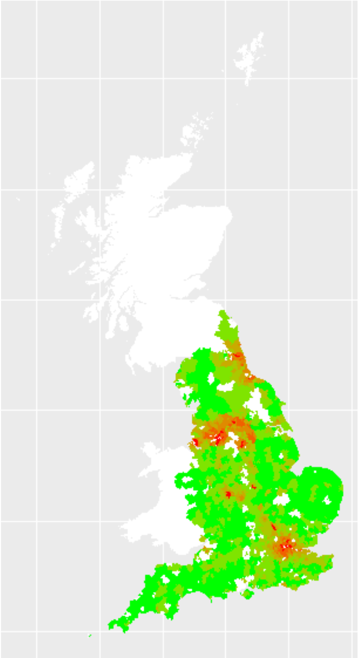
We collected thousands of quotes based on identical driver information, but with different addresses.

Areas with a high number of people from ethnic minorities saw higher prices, even when road accident and crime levels were similar.

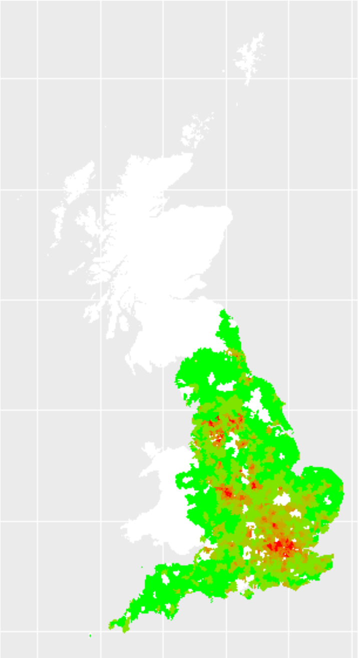
The insurance industry body said ethnicity was not a factor in pricing.

But Citizens Advice said the findings added to evidence of an "ethnicity penalty".

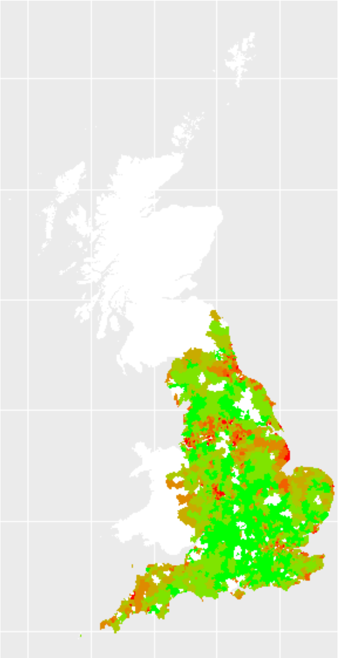
Postcode Analysis



Price
(Rating Area)



Ethnic Diversity
(% Non-White)



Index of Multiple
Deprivation

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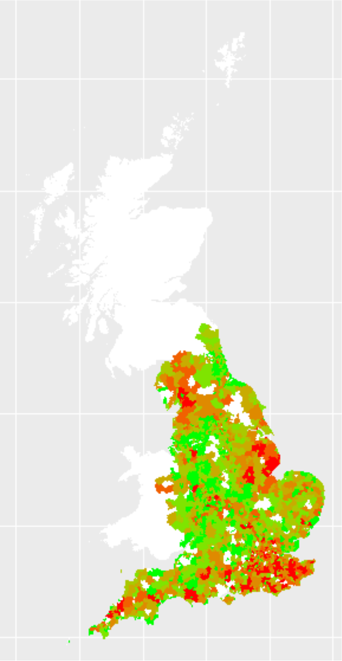
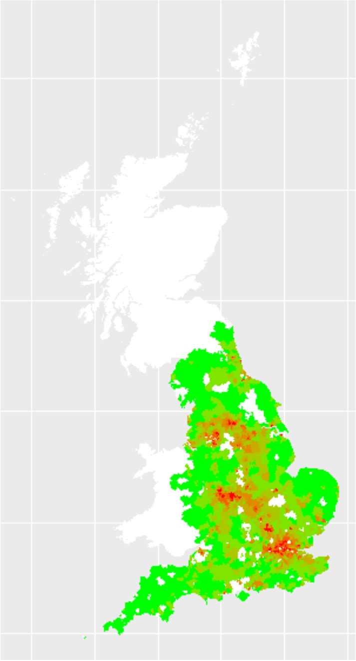
Sources: Bespoke research for rating areas, UK government statistics

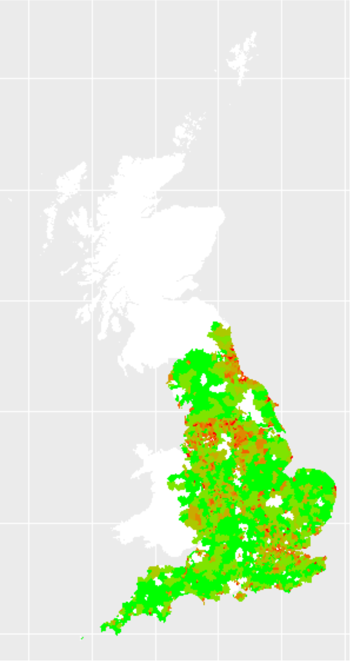
Postcode Analysis



RTA Rate



Vehicle Crime Rate



Other Crime Rate

After allowing for the other factors shown here, there is still a statistically significant ethnicity factor affecting the rating area allocation.

Clear also that prices are higher in deprived areas.

Important Disclaimers:

- This is not a TAS-compliant analysis.
- Clearly geographical rating is a more complex process than we have carried out here.
- We are in no way suggesting this is deliberate discrimination.

Nonetheless, focusing on outcomes, it does look like there is a problem here that at least demands further research.

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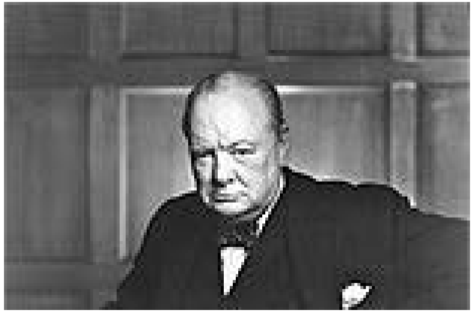
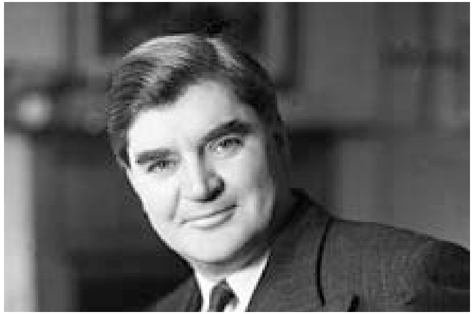
Sources: UK Department for Transport statistics, Police.UK

Poll Question 2 –
What is the best health insurance system?

1. Private health insurance with no government involvement and risk-based pricing
2. Private health insurance with regulated pricing and underwriting and backstop provision for some sectors
3. Mixed solution with limited universal coverage supplemented by private health insurance
4. Universal healthcare with mixed funding (social insurance / co-payments)
5. Universal healthcare free at point of use funded from taxes





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What do we mean by “fair”?

Everyone pays the same

- Good risks cross-subsidise the bad
- No incentive to reduce/manage own risk
- Anti-selection: low-risk individuals may not buy (if that is an option) due to poor value

Hyper-personalisation

- Everyone pays according to their risk
- Incentivizes self-management of risk
- Prices may be unaffordable for higher-risk customers

Impossible to pinpoint an individual’s true risk

Need to pool risk (data) at some level to predict losses – which will create “unfairness” at the individual level

How much of the individual’s risk is under the individual’s control?

Is it “fair” to discriminate for things that are not?

Are even genuine risk factors “fair”?

Society determines that it is unfair to discriminate for certain factors – whether they drive risk or not.

Can you control your risk/premium (motor example)?

In your control	Out of your control	Already unfair
Mileage	Age	Race
Previous Convictions	Credit Score	Religious Beliefs
Additional Drivers	Licence type & years held	Sexual Orientation
Quote date	Where you live?	Gender
Cover, Excess, Class of Use	Previous Claims experience?	Disability
The Car you drive?	Payment method?	
Marital Status?		
Occupation / Employment Status?		

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Linked with Affordability / Poverty Premium

In your control	Out of your control
Mileage	Age
Previous Convictions	Credit Score
Additional Drivers	Licence type & years held
Quote date	Where you live?
Cover, Excess, Class of Use	Previous Claims experience?
The Car you drive?	Payment method?
Marital Status?	
Occupation / Employment Status?	

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Does IoT / Telematics Help?

- Clear incentive to reduce your risk and gain immediate premium benefit
  - Fire Prevention / Home Security / Flood Alarms / Motor Telematics
- Reduces requirement for use of ‘un-controllable’ factors
  - Age, Licence details, Credit Score, Where you live etc
- Brings factors with-in Customer control
  - Speed, Aggressiveness, Attention / Distraction
- But still some argument for factors out of customer control
  - Where you drive linked to where you live / work
  - When you drive linked to work schedules

How to achieve a "Fair Price"

- Blissful ignorance
  - Ensure the model is unaware of the unfair factors by excluding them from the model specification / input data
  - Result is discrimination by proxy when unfair factors may correlate with "legit" factors
  - This is the current default approach

- *Does this **really** satisfy the FCA Consumer Duty?*
  - *price charged should offer fair value for each group, and*
  - *should have regard to whether any customers with vulnerability and/or protected characteristics may be disadvantaged*

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How to achieve a “Fair Price”

- Explicit equalisation
  - Include all the factors – both legit and unfair – in the model spec and data
  - Then strip out the discriminatory effects by averaging outcomes across the unfair factors
  - We would have to gather all the discriminatory data to achieve this… even if legal, it would be very difficult to explain to customers

- Is there a practical compromise approach?

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Actuarial role

- Pricing is not a reserved role for actuaries
  - (except second line actuarial function role on underwriting and pricing adequacy)
  - In the first line, we need to be commercial and value-adding
  - There may be a case for a “policing” role – but we don’t want that to become our only role in pricing
  - We don’t need self-imposed regulation that applies only to actuaries
- Do we have clarity on what we need to do for FCA Consumer Duty “price and value” compliance within existing actuarial standards etc.?
- The sweet spot for actuaries may be “commercial within clear regulatory constraints”

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Poll Question 3 –
What is the best motor TPL insurance system?

1. Non-compulsory private insurance with unregulated pricing and underwriting
2. Compulsory private insurance with lightly regulated pricing and underwriting
3. Compulsory private insurance with lightly regulated pricing and underwriting with a social insurance backstop
4. Social insurance funded from regulated insurance prices incorporating cross-subsidy
5. Social insurance funded from vehicle or road taxes

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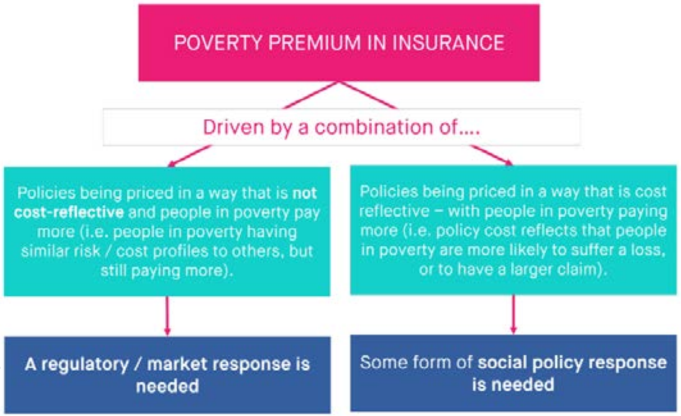
Solutions? Cost reflective vs non-cost reflective

Insights from the Social Market Foundation report on the Poverty Premium

Are there market responses that could remove the need for a regulatory response?



Who pays for a social policy response? Are the government giving this consideration currently? When will this be on the political agenda? Who should be lobbying for this to be on the agenda?

Is the insurance market 'too complex' for 'blunt regulatory responses' – did GIPP work?

Does the regulator/government/market need to focus on defining the challenge more clearly before exploring solutions? Is this too urgent to wait?

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Recommendations from the social market foundation report

Recommendation	Risks	Opportunities
FCA to investigate and publish poverty premium data annually, including the “market” (non-cost related) and “social” (cost related) split, on a firm-by-firm basis	Customer and regulator reaction will increase reporting and administrative overheads and then ultimately costs for insurers. Could increase barriers to entry for new competitor brands in the market impacting availability.	Greater transparency and insurer engagement with findings could bring increased trust and understanding of insurance market. Could provide insight back to insurers to inform a more consistent view of fair pricing without collusion?
FCA to conduct a Market Review of single-item insurance cover and take significant action if found to be detrimental to (especially low income) customers	Could paint insurers as greedy and unfair driving further distrust if reported as punishing low income customers?	Could identify market themes that individual insurers cannot identify from their own portfolios and support ‘fairer’ metrics?
Government to undertake interventions where a social policy response is identified such as: • State-backed insurance products • Insurance Vouchers • Stricter regulation on pricing • Reduction in Insurance Premium Tax (IPT)	We have a very commercial home insurance market in the UK which gives a wide choice for customers – stricter pricing regulation might reduce this choice. Increased regulatory burden on pricing might increase costs which could undermine any perceived savings (echoes of GIPP?). State-backed insurance products inevitably require funding – would this come from a subsidy and if so who would pay? Would this be perceived as fair?	Reduced IPT is something the ABI have been lobbying for consistently and so this would be perceived as a good outcome by the market? Where the cost of insuring individuals is unaffordable to insurers – by supporting this with a state solution and removing from the wider pool arguably remaining policies should be affordable?

Flood Re as an example – Postcode Re? Health Re?

- The social market foundation report argues that insurance should be seen as an essential and the take up and cost for low-income families considered in a similar way to that of energy, fuel and food. The IFoA report on the poverty premium suggests one solution is the creation of reinsurance schemes like Flood Re, such as Health Re and Postcode Re. Could this help?
- Flood Re was created to solve a market failure and there are wide ranging examples of other protection gap entities being created around the world to step in when insurance fails but mainly for natural catastrophes. What we have considered in this presentation is not a natural catastrophe. The Flood Re challenge was widely supported by MPs motivated by terrible lived flood experience for constituents. Would it be more challenging to engage in 'fair' criteria to get common agreement when considering Postcode or Health? How aligned are MPs on the definitions of health/postcode poverty and what would be the journey to get alignment?
- Part of the reason 'Flood Re works'* is because it allows the market to continue to function competitively and choose the policies to cede to the scheme in line with their own view of risk rather than mandating or defining the 'unaffordable/high risk' portfolio – could the same be facilitated for Postcode Re or Health Re? Or could 'success' be achieved differently if defining the portfolio to be subsidised distinctly?
- Flood Re is funded by a Levy on all household insurers and so largely works by subsidising the higher cost of the high flood risk portfolio across all household insurance policies. How would this balance be struck for Postcode Re or Health Re?
- Where is it our responsibility as an actuarial pricing community to engage in this challenge? How can we best use our skills to explore and define the problem at hand? Which recommendations from the social market foundation report might it be useful for us to explore as a community?

*feel free to debate but not the point here...

Call to action

- In this presentation, we have summarised the issues and posed some difficult questions
- We need to be proactive in addressing this:
  - Regulatory action feels inevitable and actuaries may end up looking like the “bad guys” (again?)
  - On the other hand there may be a real opportunity for the profession to carve a leadership role in the future of pricing, where commerciality meets serving the public interest
- Will you rise to the call?

Scan the QR code, go to https://forms.gle/rqTfZM1UHxFW8a2N6 or add your email in the Q&A to register interest

Questions

Comments