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Fairness in the Pricing of Personal Lines Products

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Introduction

- Today is intended to provide an overview of the issues associated with fairness in personal lines pricing
- It is not a technical session but is intended to provoke your thoughts about the steps firms should be taking to manage risks associated with the issue
- We cover three broad areas:
 - An overview of the background and context to the subject
 - Issues we believe firms should be considering
 - Some suggested practical next steps



A hyper-simplified history of pricing in personal lines products



The dawn of pricing civilisation

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

Multivariate

- GLM 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



So, today there is...

- A disconnect between the underlying cost of the product and the actual price charged to the customer
- Variation in price from factors that cannot be easily explained to the person on the street
- A culture of
 - a) transparency of price = absolution of responsibility, and
 - b) the use of data which may be wrong, or at least, not well understood

Which is, arguably, all “OK” with good governance, risk management and control



From the headlines...

Fleeced by the Insurance Spies:

Firms are plundering your personal data to work out the maximum they can charge you and rip you off on renewals

Daily Mail, 26th May 2018



...a barometer for the consumer landscape in which we operate



“Elderly, loyal – and charged 10 times more for insurance”

theguardian

“It’s time to end the great home insurance rip-off”



“Motorists fork out £1,000 more to insure their car if their name is Mohammed”

theguardian

“Facebook forces Admiral to pull plan to price car insurance based on posts”

Insurance Times

“Insurers facing price intervention on personal lines amid huge pressure on government”

Daily Mail

“Insurers ripping Britons off”



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The regulatory landscape is shifting...

Use of “big data” in pricing

Value Measures & Renewal Transparency

Citizens Advice super-complaint to CMA

Value in GI distribution chains

Vulnerable Customers & FOS

FCA market study of General Insurance pricing practices



Recent developments (1) – ABI / BIBA Guiding Principles & Action Points

Key points

- Tendency to shop around should not lead to excessive pricing differences
- Board and Senior Management focus
- Approach to pricing for longstanding customers reviewed to assess whether it delivers fair outcomes
- Complaints where there are excessive differences between new and renewal prices will not be able to be defended



Observations

- Clear will from the industry to tackle issues arising for long-standing customers
- Variation in approach between firms is noted. In this context, can “excessive” be clearly defined?
- Fair outcomes for longstanding customers – is it reasonable to take into account other dimensions of “value for money” than just price?



Recent developments (2) – Citizens Advice Super-Complaint

- Citizens Advice are a designated body that can raise a super-complaint if they have evidence of significant harm to consumers
- Home insurance identified as one of five areas that give rise to a “loyalty penalty” collectively estimated at £877 per year
- Acknowledges that insurance markets are complex and that policies vary widely – the cheapest is not necessarily the best. But notes that pricing practices are closely guarded and are therefore opaque
- And, critically, people in vulnerable positions are more likely to be penalised



The regulatory environment isn't the only driver for change...

Consumer pressure

- Consumers “fed up” with loyalty penalised
- Fuelled by growth in PCWs and proposition innovation
- Debate moving into a wider set of stakeholders

Use of Data

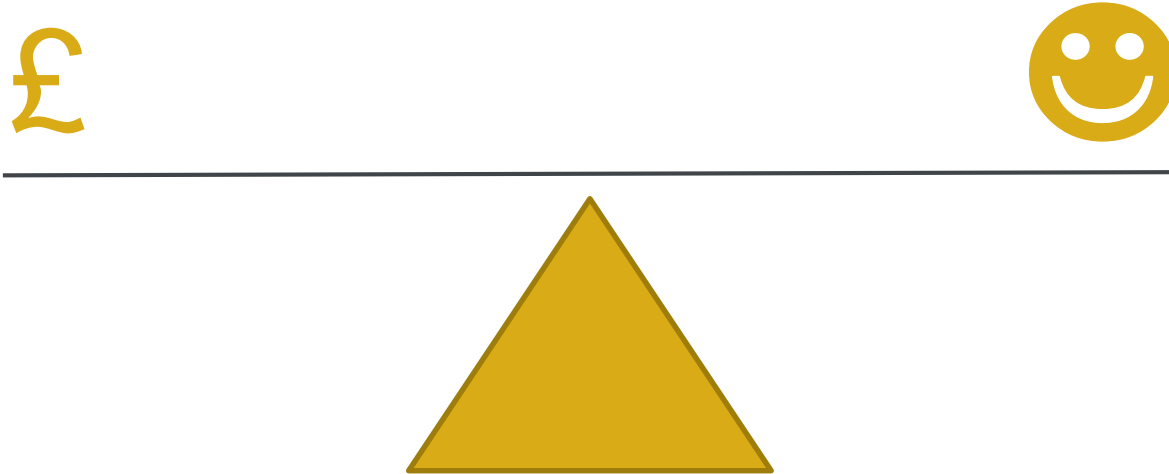
- Growing mistrust over how data is used...Cambridge Analytica the “canary in the coal mine”?
- Right to be forgotten
- Permissible uses of data

Emerging Analytics

- Is the “black box” getting bigger and darker?
- Are current control environments fit for purpose?
- Can strategy be successfully codified?



At its most simple, this is about creating the right balance...



...in the context of your own firm



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To achieve this balance, a clear appetite for conduct risk is required, along with a definition of “fair” or “value”

- Some example appetite statements from published annual reports (our emphasis):
 - [we have] no appetite for material risks resulting in reputational damage, regulatory or legal censure, poor customer outcomes, fines or prosecutions
 - We therefore strive to eliminate any systemic unfair customer outcomes as a result of failures in the product, marketing, sales or service delivery systems and processes, or cultural shortcomings
 - [through our] strategy, culture, product design and service delivery, [we] aim to deliver fair outcomes to [our] customers and ensure that they are at the core of everything [we do]
- Are these sufficiently precise and / or helpful?



Defining “value”

- Margin?
 - Retail v technical price?
 - Loss ratio
 - Average v outliers
 - At what point is this excessive?
- Other dimensions of value:
 - Product
 - Service & Access
 - Experiential
- How to measure and monitor?
- Different customer segments may have different value equations



A brief detour into other sectors

- Banking sector perhaps more advanced in thinking (albeit with a start point of more straightforward pricing)
 - “omni-channel” pricing appears relatively common
 - Front-book v back-book pricing programmes
 - Regulatory intervention has driven transparency around pricing
 - Cap on high cost credit products
- Energy sector has seen the most direct intervention
 - Price cap for 1m most “vulnerable customers”
 - Extending to all customers on standard variable tariffs
 - Maximum mark-up over the wholesale cost
 - Increased emphasis on encouraging shopping around
 - Whilst value equation simpler (standard product), what precedent for insurers?



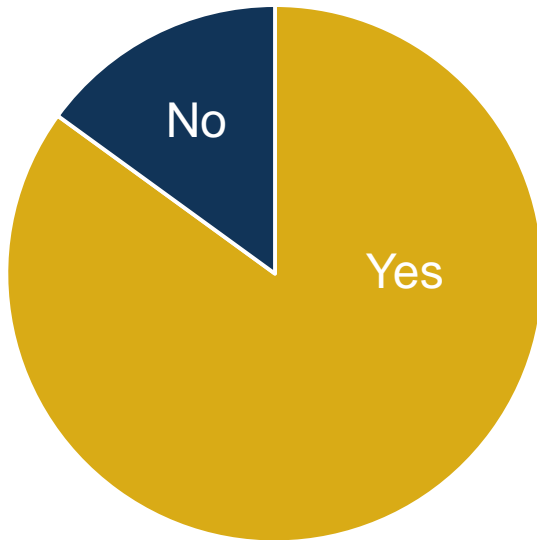
Some practical challenges to consider...

- Insurance policies not always comparable in cover ... are there any obligations if a customer switches to a less suitable product?
- How to stay on the right side of appropriate communication – at what point do firms run the risk of customers being “bombarded” or feeling “scammed”?
- Relative responsibility of distributor / manufacturer relationships?
- Risk of proxies in data used in rating?

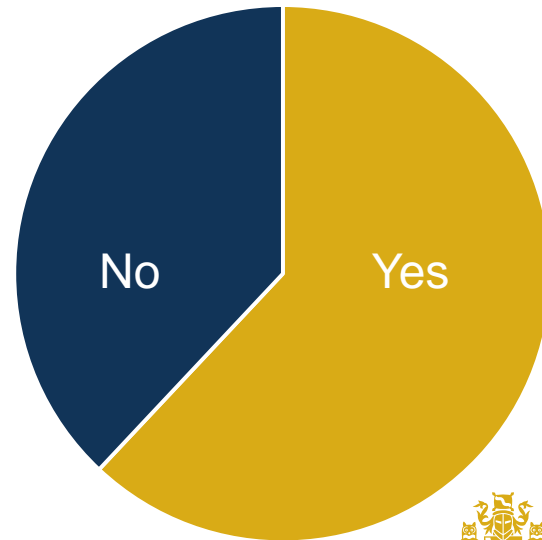


Some themes we are observing

Do you have controls on the profitability of renewals?



Do you have controls on the profitability of add-ons?



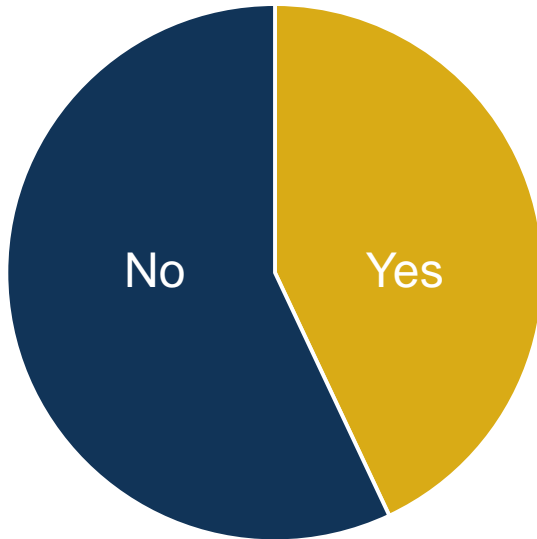
Source: KPMG Personal Lines Pricing Maturity Benchmarking



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Some themes we are observing (2)

Do you have an explicit definition of vulnerable groups?



Do you understand the pricing of vulnerable groups?



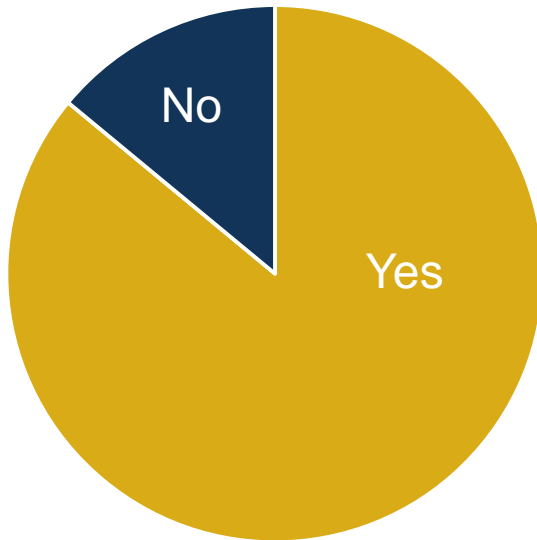
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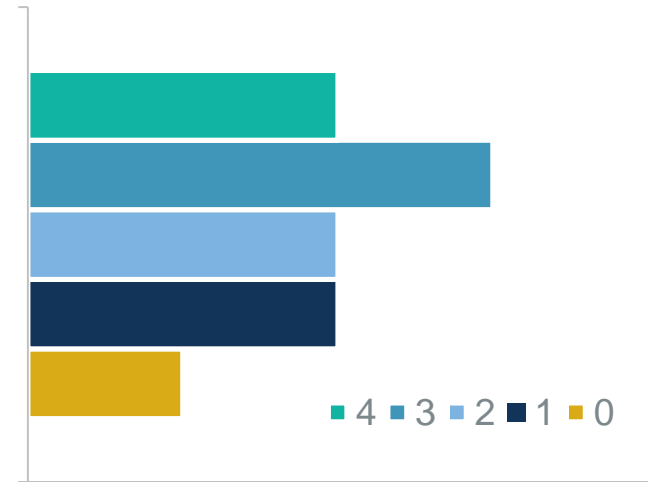
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Some themes we are observing (3)

Do you have a developed data governance framework on pricing?



How many levels of sign-off do your prices have?



Source: KPMG Personal Lines Pricing Maturity Benchmarking



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So, how to get on the front foot

Strategy

- Align pricing strategy with overall strategy
- Define what “value for money” and “excessive” means for your firm
- Define your conduct risk appetite for pricing in this context
- Clearly define vulnerability and implications for pricing
- Determine approach to customer communication

Risk Assessment

- Understand the regulatory environment
- Review and document end to end approach to use of data
- Assess whether strategy is being implemented “in practice”
- Model risk exposure
- Overlay your understanding of vulnerable segments
- Develop your action plan and execute on the “front-foot”

Control Environment

- Ensure your pricing control cycle is fit for purpose
- Address senior management oversight requirements
- Ensure the increased reporting requirements are supportable by your infrastructure
- Ensure appropriate MI is integrated into firm-wide conduct risk reporting
- Consider “penetration testing” of your pricing

A focus on governance

- Critical aspects of governance on the issue of fairness in pricing include:
 - The range of data used in pricing, and the extent to which it influences the price, with a particular focus on those factors that might be proxies for vulnerability or protected characteristics (e.g. gender, race)
 - The impact of pricing on customer outcomes, particularly those who are longstanding, or where outcomes are more “extreme”
 - Evidencing customer engagement, and testing whether the firm has gone “far enough” in seeking that engagement
- We would expect to see Board / Senior Management engagement on these issues



Some questions to ask yourself

- Do you have a clear pricing strategy, and is it articulated in the context of your overall company strategy?
 - Can you explain the extent of cross-subsidy in your pricing (e.g. new business v renewal) and are you comfortable with that?
- Do you understand what data causes prices to vary and the underlying drivers of variation (e.g. risk, shop-around propensity etc.)?
 - And does your ExCo / Board understand and agree with this?
- Does your Board and Risk reporting reflect the customer outcomes from pricing decisions adequately?
- Do you understand which customers are vulnerable and whether your pricing approach reflects this?
- Is your control environment adequate? Are your constraints adequate?



In closing

- A critical topic
 - perhaps one that has moved from a question of personal integrity to one of our professional integrity?
- A debate that has moved well beyond pricing teams
- A subject that requires action now, even if only to establish a clear assessment of where you stand “today”
- A need for industry best practice
 - Are we in a position (or is it our duty) to lead the debate?



Questions

Comments

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