Regulation Whitepaper

Europe's Big Bang on Pricing

What can Europe learn from the UK as they face a pricing overhaul?



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Executive Summary

European insurers face a big bang moment in their pricing. The European Insurance Occupational Pensions Authority (EIOPA) recommended in March 2023 a ban on price walking – the practice of increasing premiums on renewals based on non-risk factors.

The UK's ban on price walking started in January 2022. The impact and costs of the Financial Conduct Authority's ban have been dramatic.

UK insurers will take a significant hit on revenues in home and motor, with customers saving up to **£11.2bn**[i] from lower prices during the first ten years of the price walking ban.

France, with **€24.1bn**[ii] premium in motor alone, a similar market size to the UK, could also suffer a significant loss of revenues to its insurers.

European insurers will have to make seismic shifts in their product and pricing strategies.

They will have to reprice entire books of business. They will have to make a strategic decision on whether they want to attract new business or to maintain renewal back book profitability.

Insurers will become more reliant than ever on risk factors to define pricing, as well as other data, such as customer product tenure.

Other resulting impacts of the UK ban have included:

- ✓ A sharp increase in new products, typically stripped-down cheaper products free from a back book of renewals
- ✓ Insurance companies increasing their prices for new customers to comply with the FCA's rules
- ✓ Others decreasing their prices for existing customers to avoid breaching the rules
- ✓ Reports of insurance companies increasing their prices for add-on products, such as breakdown cover or legal expenses, to offset the impact of the new rules

Despite the FCA's best intention to save customers money, so far prices have increased rapidly.

Coinciding with a general inflationary environment, motor insurance premiums have risen **21.1%**[iii] in the 12 months since the introduction in January 2022 of the General Insurance Pricing Practices (GIPP), which banned price walking.

This compares to just a **3.1%**[iv] increase during 2022 in France.

The UK price rises continue at pace into 2023. In April, the typical cost of annual car insurance was **£613**[v], up **£81** on what drivers paid in 2022.

These price rises have encouraged the media to report headlines on how customers can save money – one report found a customer could save **£388**[vi] by avoiding auto renewal, and instead, shopping around.

European insurers will need best-in-class pricing systems that can adapt quickly to the volatile and unpredictable market that will follow.

This white paper looks at the UK experience with price walking regulations, and applies the lessons learned in order to guide European insurers as they adapt their strategies, practices, staffing and technology to survive and thrive in this new world.

Lessons Learnt From the UK

During the first month of the ban starting in January 2022, UK insurance companies were making pricing changes daily and even hourly to remain competitive. In that month, **84%**[vii] of car insurance and **90%** of home insurance brands put through price increases for new business to bring them in line with prices quoted to customers at renewal.

The pricing overhaul is reverberating through the whole insurance chain. As new products in the UK increased sharply following the ban, 'brand stacking' took place on price comparison websites. This is when customers see multiple options from the same insurer or broker stacked up in their rankings, resulting in players outside of the rankings facing potential loss of market share to the more dominant players at the top of the aggregators' listings.

With insurance price comparison sites in Europe on the rise, one in eight[viii] French people aged between **18** and **24** now purchase motor via aggregators. Insurers must consider the potential impact on profitability should they fall outside the comparison website ranking.

As well as product variations, European insurers will likely find new ways to fill revenue shortfalls. In the UK, just two months after the price walking ban started, administration charges were on the rise. For example, one price comparison site found there was a **13%**[ix] growth in car insurance products charging a **£60** renewal fee between March 2022 and March 2023.

Inside companies, actuarial scientists and programmers will be a key resource. Professionals with deep technical pricing ability, as well as understanding of insurance and customer implications, will also be required.

None of this will come cheap: the estimated cost of GIPP compliance in the UK is **£1bn**[x].

Technology systems will therefore need to act as governance processing tools. Data management is key, as data should be captured and fed into reporting requirements in line with new, and for some, onerous reporting requirements demanded by regulators.

To stay onside with the regulators, insurers will need to monitor and have oversight of distribution, with broker commission data collected. Even if national regulators do not implement EIOPA's recommendations, insurers should take immediate action to ensure they remain complaint with the IDD.

Specifically, they should begin testing for detriment to vulnerable groups, such as the elderly, who may be subject to price walking. A remediation plan should be drawn up and considered. The price walking ban is coming fast down the tracks, and to remain ahead of the competition, those insurers most prepared and ready to act fast will have the edge.

EIOPA Regulation

EIOPA released the 'Supervisory statement on differential pricing practices in non-life insurance lines of business', on March 16 this year.

Differential pricing is when insurers, upon obtaining new business, increase prices at renewal based on non-risk and non-expense factors. EIOPA is concerned that with the growth of artificial intelligence and machine learning, insurers are using data to unlawfully discriminate against customers, falling foul of the Insurance Distribution Directive (IDD).

EIOPA highlights, within differential pricing, the following as ‘price walking’ practices:

- ✓ Repeatedly increasing prices for the same customer at renewal stage based on their low propensity to shop around
- ✓ Repeatedly increasing prices for the same customer at renewals based on their low price elasticity, also known as willingness to pay
- ✓ Advising or nudging a customer to buy an insurance product, in some cases included in a bundle of products, because of a low initial price, then applying sudden and significant price increases at renewal based on reasons unrelated to underwriting risk or cost of service

Importantly, EIOPA does not rule out differential pricing completely if companies can implement robust procedures to protect customer interests.

EIOPA outlined an action list for insurers on product oversight and governance, advising:

- ✓ Product approval process: Products must ensure fair customer treatment and be approved at the highest level needed
- ✓ Target market: Insurers should identify customers most vulnerable to poor treatment, such as the elderly
- ✓ Product testing: Products must be tested thoroughly and be well understood by customers
- ✓ Product monitoring and review: Using metrics to monitor and review products, ensuring fair customer treatment
- ✓ Documentation: Processes put in place to ensure compliance documentation and record keeping
- ✓ Distribution channels: Manufacturers must give distributors sufficient product information and a high-level explanation on the pricing of products

Countries Prepared for Action

Even before the EIOPA guidance, national regulators worldwide had been carrying out activity on price walking.



France - The Autorité de Contrôle Prudentiel et de Résolution (ACPR) issued guidelines and has recommended that insurance companies disclose information about their pricing strategies and provide clear explanations to customers



Sweden - The Swedish regulator, Finansinspektionen, analysed home and motor insurance, concluding in July 2022 there was a pattern of 'unjustified and unfair' premium increases on loyal policyholders to fund discounted new customers



South Africa - The Financial Sector Conduct Authority (FSCA) introduced regulations that require insurance companies to provide customers with clear and transparent information about pricing and product features



Ireland - The Irish regulator, the Central Bank of Ireland, following a review in 2021, believed there was 'material concerns on the application of pricing walking' which 'erodes trust in the insurance industry'



United Arab Emirates (UAE) - The Insurance Authority of the UAE introduced guidelines aimed at promoting fairness and transparency in insurance pricing

Alongside these countries, concerned regulators in Germany, Italy and the Netherlands have also undertaken activity, such as market studies, to find if there is harm in differential pricing.

All the regulators are watching EIOPA's guidance closely. It is likely the guidance will be adopted in some, if not all, European countries.

Insurer Profitability at Risk

Pricing

European insurers should prepare themselves for a highly volatile and unpredictable first year in pricing if their national regulators adopt a price walking ban.

In the UK, in the first month of the price walking ban starting in January 2022, new premium quotes for new customers rose in home by **8.4%**[xi] and in motor by **5.7%** in the first five places on price comparison sites, according to data and insight provider Consumer Intelligence.

This was the single biggest monthly change since 2013, when Consumer Intelligence started collecting the data. However, the price rises were far from homogenous. On price comparison sites' first five places[xii], drivers over **65** had an **8.1%** rise, compared to drivers aged between **17** and **19** with a **3.4%** drop.

One reason for this discrepancy could be because insurers have an increased appetite for young drivers now using telematics. Telematics also offers a rich source of data at a time when price walking has restricted the use of data insurers had relied on previously. Drivers using telematics can reduce premiums by proving they are low risk.

Saving customers money is what the FCA hopes to achieve in the long term. The FCA's models project that a motor customer who had renewed with an insurer five times or more could expect to save **£56**[xiii] each time they renew over a ten-year period. This was set against a UK motor policy which typically costs **£285** in 2020.

With such significant changes in pricing ahead, European insurers affected by the ban should carefully consider which strategy best suits their needs. If the insurer has a large back book of business, they may be cautious about being competitive on new business pricing. This will allow them to charge more for renewal customers, keeping profitability up in a core segment.

The opposite may be true of market participants that have set up in recent years, such as insurtechs, potentially using reinsurance capacity. Without the historic back book, they may seek to build a customer base by pricing more competitively for new business.

Whichever group they want to target, new or renewing customers, European insurers will need to be agile. In France, around **54%**[xiv] of people purchase home insurance directly from insurers, and it is even higher at **60%** for motor.

The ability to make pricing changes for most customers is faster than it has ever been with the growth of direct insurance in Europe. To remain competitive, insurers will need responsive pricing systems that can react quickly to fresh incoming data.

Products and Sales

Another key consideration will be around whether insurers adapt by creating product variations. This could be tiered products or additional coverage, for example roadside assistance, rental car reimbursement, or glass replacement.

A ban could lead to revenue shortfalls, but the introduction of new products and additional coverage presents the opportunity to offset these gaps by implementing additional administration fees.

For example, in the UK, set up fees are on the rise, and likely to escalate further with the price walking ban. Financial analyst firm Defaqto says **48%**[xv] of standard comprehensive motor policies now include a setup fee, compared to **21%** five years ago.

The average fee is **£40**, which has gone up **25%** since 2018. A caveat is that European insurers will have to be transparent and communicate carefully why the fees are rising to remain compliant with regulators.

Another major advantage to creating new products is that they are unencumbered by a large customer back book, meaning insurers can set prices competitively enough to attract new customers.

Importantly, insurers could make the case to their respective regulators they are acting in the customers' best interests by creating new products. New products can mean 'value for money' for customers.

In the UK, insurers successfully launched tiered products following the FCA announcing its intentions in 2021 to curtail price walking with the General Insurance Pricing Practices regulation.

Some insurers rolled out products with base coverage - essentials - to attract customers through cheaper premiums. The essentials were marketed as a price-led choice against higher coverage, but more expensive propositions. Tiered products also came under banners such as silver, gold, platinum and extra.

> ***"It's those people that were prepared to go out and shop around, get a new business deal and move their motor insurance every year. They're the ones that aren't getting the new business discounts anymore. What it seems to have done is to push prices up, overall."***
>
> – EXPERT VIEW: DAVID WILLIAMS, AXA INSURANCE, MANAGING DIRECTOR UNDERWRITING AND TECHNICAL SERVICES, 2016 - 2022

One company, Saga, launched a three-year fixed product on home and motor. The price was guaranteed for three years, only changing if there was a claim, increase in insurance taxes by the government, the customer making a change to the policy, or a driving conviction handed down.

However, in the UK, new products have created some competitive challenges, especially for those using price comparison websites. With so many new products, this has led to brand stacking, according to data from Consumer Intelligence.

In January 2020 nearly a third **(32.2%)**[xvi] of consumers looking for new car insurance quotes saw at least three brands from the same group in top five positions. By January 2023 this figure had risen to **45.3%**. Within that, the proportion of groups getting a clean sweep of top five positions more than doubled from **2.4%** to **6.7%** in the three years.

Brand stacking can be attributed to product variation resulting from the cost-of-living crisis, and importantly, the introduction of the price walking ban. What this means for European insurers who sell via aggregators is that any company lacking capabilities in pricing systems will lose market share if they cannot adapt quickly.

Another challenge in creating new products is that if European regulators follow the example of the UK, there will be limits to the number of new products insurers can create.

UK insurers must genuinely believe they can write enough business to pass the premium income threshold test, and document those reasons in a way that satisfies the respective regulator. If the thresholds are not met, the book of business must close.

The FCA declared that a firm that has not sold, or does not expect to sell, on an annualised basis, more than **15%**[xvii] of active policies under the product to new business customers, should define that book as closed.

Weighing the pros and cons of creating new products, overall there is likely to be a considerable advantage for European insurers to set up new products and provide additional coverages.

Product variations are a way for insurance companies to provide more flexibility and customisation to customers, while also managing their risk exposure and ensuring that pricing is appropriate for the level of risk associated with each policy, mirrored by Deloitte manager Patrick Hullegie.

Data

EIOPA emphasizes the tie between premiums paid by consumers and underwriting risk or cost of service. This means that risk models, and the risk data that comprises them, will take on even more significance in pricing customers.

With this increased onus on risk factors, European insurers are unlikely to rule out any segment of risk data. Certainly, UK insurers kept all their data options open.

Instead, differential pricing constraints should increase the focus on data where customers are at risk of unfair treatment.

The largest, and arguably, the most vulnerable group is elderly customers. They are less likely to shop around, and therefore, prone to being the subject of price walking.

Insurers will need to investigate their age data to understand the extent of differential pricing on this customer segment. Other data gaining significance will be customer tenure and the extent that tenure is itself a risk factor.

> ***"Often we see these kinds of regulations as a burden, but also I think it can be an opportunity for insurers to put their customers at the core of their business and also to potentially differentiate from each other."***
>
> – EXPERT VIEW: PATRICK HULLEGIE, MANAGER ANALYTICS AT DELOITTE NETHERLAND

> ***"Risk models are critically important. They always have been. How good they are and how good you are at refreshing, implementing, and monitoring them has always been a route to competitive advantage. That's been dialed up because of the new regulatory constraints."***
>
> – EXPERT VIEW: KENNY LEITCH, RSA PRODUCT AND PRICING DIRECTOR, UK, 2019 - 2021

Insurers must be confident around their assumptions on any tenure risk effect they take into customer prices, and should attempt to remove any time and/or process change effects which can manifest themselves as tenure.

If the key assumptions do not play out as expected, insurers may have to raise both renewal and new business pricing on that customer group. This will potentially cause both new business volumes and retention to fall, negatively impacting sales.

European insurers will likely have to prioritise tenure as an even more important consideration when seeking to put customers into cohorts. Additionally, insurers should be clear on the difference between restricting renewal prices to a maximum of the new business equivalent, and what the effect of this is on margin.

Using the UK as an example, the FCA has stated it does not want its pricing rules to restrict the way firms set margins for new business. They can have different margins for different cohorts of new business, and they can change new business pricing at any time, meaning they can have different margins at different times on the same book.

Margins for renewing policies can be higher, and are likely to be higher, than for an equivalent new business policy – and that's allowable. This is as long as the renewal price on the book does not exceed equivalent new business.

With the increased complexity required around data collection and analysis on customer duration, insurers will need systems which can allow for the utilisation of multi-period lifetime value models to enhance risk calculation and pricing. Multi-period forecasting, price optimisation, and simulation capabilities will ensure new business price and renewals are in harmony.

There is no doubt the pricing changes will be challenging for Europe, but having the optimal technology solutions will mean insurance companies remain both market competitive and compliant with regulators.

Big Shifts Needed Inside Companies

Resourcing, Processing, and Governance

The impact on resourcing requirements will depend on the characteristics of the individual insurer. For larger, established insurers with wide distribution, the impact will be significant. They may have schemes of business around multiple niche lines that need significant analysis.

The complexity will require project managers being appointed across both commercial and retail, ensuring deadlines are delivered, pricing is compliant, and products tested to a sufficient degree to ensure customers are being treated fairly. Key members of the board executive team will need to take responsibility.

IT programmers and actuarial staff, especially those with experience in insurance, will come under demand in the employment market.

[xviii]According to the Bureau of Labor Statistics, the demand for actuaries will increase **24%** from 2020 to 2030 and data scientists will grow **36%** between 2021 and 2031.

> ***"We had separate programs running for months and months to make sure we were compliant. That was the big cost. Afterwards, it was a case of employing more actuarial staff and we felt we needed more actuarial staff going forward anyway."***
>
> –EXPERT VIEW: DAVID WILLIAMS, AXA INSURANCE, MANAGING DIRECTOR UNDERWRITING AND TECHNICAL SERVICES, 2016 - 2022

Insurers should identify whether they have the right existing staff in place. This will be especially important in ensuring that pricing and algorithms are compliant.

Staff must have both a deep technical knowledge of pricing practices, such as predictive modelling optimisation, as well as a professional understanding of insurance and the implications for the customer.

Investment in people will be one of the most important aspects of the pricing changes.

Pricing Systems: The Big Rethink

At such a challenging time, it is critical for any European insurer affected by the ban to look at their pricing systems not only as a key to remaining competitive, but also as a regulatory compliance toolkit.

Technology systems in pricing should offer the necessary methodology to find the optimal compromise between new business and renewal prices that fulfill the regulatory expectations.

On reporting and governance requirements, companies will need a software technology package that can provide the analysis and documentation, which, upon request from the regulatory authority, can evidence no detrimental impact on vulnerable customers. This will be important as regulators become increasingly active.

> ***"Using the right technology can enable innovation, efficiency, and sophistication but doesn't remove a company's stewardship responsibilities. Staff act as the custodians of that technology. This requires the right combination of leadership, industry knowledge, and analytical skills to manage, maintain, and utilize it effectively."***
>
> – EXPERT VIEW: AARON WRIGHT, EARNIX, DIRECTOR OF STRATEGY

Regulators will look to an individual – a person of a sufficiently high level – who has attested that the company is regulatory compliant with all its pricing obligations. In the UK,[xix] the FCA contacted firms **1,151** times within the first six months of the new rules in 2022. The bulk of these (1090) were for attestations.

Regulators will be closely watching for non-compliance. The FCA contacted firms **24** times over potentially failing to follow the new rules.

Data management will be key in meeting the elevated regulatory load. Built-in processes should record approval from the correct individuals, document it and have it readily available for deployment in reports to satisfy compliance and any regulatory requests.

If an insurer's current technology falls short in these areas, they may have to implement a system to meet these requirements, with the capability of rapid deployment into a company's existing IT architecture. This will be an essential requirement considering the likely deadlines that will be imposed by the national regulator on becoming compliant with differential pricing.

A system with advanced API capabilities that can seamlessly connect into the company's IT infrastructure is a distinct advantage in meeting regulatory timelines and compliance requirements.

In summary, insurers must have a system that can deliver optimal and compliant pricing, while also being a governance deployment system. Any new provider should be capable of rapid deployment to meet these needs.

> ***"We had to rebuild the models because the whole price elasticity piece was so embedded. We had something like over 200 rating factors, and some of those would have reflected price elasticity as much as your accident risk."***
>
> – EXPERT VIEW: DAVID WILLIAMS, AXA INSURANCE, MANAGING DIRECTOR UNDERWRITING AND TECHNICAL SERVICES, 2016 - 2022

Testing, Monitoring, and Communication

Testing and monitoring products will be a challenge for European insurers, but they will have a head start by learning from the UK experience.

On product testing, European insurers will need a system to flag up the risk of customer detriment. UK insurers had a traffic light system to flag risk level when testing. Yet underpinning that traffic light system was the use of certain metrics used during product testing and monitoring.

UK insurers used loss ratios as a test metric, also considering the level of administration fees and charges a customer ultimately pays for. There will naturally be variations in loss ratios between product types and customer groups, but loss ratios significantly outside the norm should be put into traffic light systems and checked to ensure there is no customer detriment.

Claims acceptance rates should also be considered, comparing rates against different customer groups and product lines. In the UK, the FCA has published publicly available company league tables based on this metric on personal lines products.

> ***"It really starts with insurers thinking hard about what they want to do. They should start to monitor and include not only expected profit or expected new clients as KPIs, but they should also include these kinds of measures into their approval process."***
>
> – EXPERT VIEW: PATRICK HULLEGIE, MANAGER ANALYTICS AT DELOITTE NETHERLAND

In addition to the UK experience, European insurers can turn to EIOPA's guidance. On product monitoring and review, EIOPA highlights the need to monitor the metric of differential premiums paid at renewal by long-standing customers versus new customers with the same risk and expense.

EIOPA also recommends monitoring the differences in ratio of actual premium paid and the technical premium between customers with the same risk and expense.

European insurers distributing through brokers may offer brokers a net rate proposition - where brokers take the net price given by the insurer and then add, or even subtract, the commission to create the final price.

Some UK insurers wanted broker data on commissions spreads - maximum commission, minimum commission, and average commissions - with brokers having to sign in writing that they understood the compliance requirements. Agents or brokers who claim responsibility for communication should be aware of the insurer's requirements for communication. Insurers with direct customer relationships should explain the changes in a clear and understandable way.

There is a lot to consider in terms of testing, monitoring and communications, yet that challenge can be lessened by using both EIOPA's guidance and the learnings from the UK.

Conclusion

European insurers should be acting now on the guidance laid down by EIOPA. Even without national regulators implementing EIOPA's guidance, insurers risk falling foul of the IDD.

Importantly, they should be exploring the extent to which vulnerable groups are being treated unfairly in relation to differential pricing.

A remedial action plan should be considered to act on any findings of customer detriment as the price ban in European countries will cause a lot of turbulence.

There is a consensus in the UK that so far, the price walking ban has contributed to higher prices on average for customers alongside disagreement around what the ban has achieved.

Product expansion in the UK has created debate as to whether the market has more value-for-money propositions or is now inhabited by a confusing array of products barely different from their predecessors with the aim of maintaining commercial profitability.

European insurers should also consider whether their products offer 'fair value' to customers. If Europe follows the UK, this will be a major focus.

The FCA has demanded insurance companies be ready for the July 2023 Consumer Duty regulation deadline by demonstrating their products show 'fair value'. If Europe follows the UK's lead on fair value, this will require even more resourcing and effort on compliance.

This is why European insurance companies should consider whether products offer fair value, comparing and testing their product lines on certain metrics, such as claims acceptance rates.

Insurance companies should consider whether they have adequate staff to implement changes and work out the staff structures needed for the product and pricing changes.

Technology should be in place to price optimally and in compliance with any regulatory-imposed changes. Systems should have the right data management and reporting capabilities for governance processing.

The EIOPA guidance, while a potentially significant change for insurers that comes with risks, is also an opportunity to build stronger relationships with customers and create a diverse suite of commercially-profitable, value-based products.

Above all, it can lead to greater customer protection for those most needing it.

> ***"Don't wait until you are six months into implementation and realise you have a big IT issue. Try to run a few processes end to end and flush out the issues."***
>
> – EXPERT VIEW: KENNY LEITCH, RSA PRODUCT AND PRICING DIRECTOR, UK, 2019 - 2021

Appendix

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