Awhi Fleming
General Insurance Policy
Financial Conduct Authority
25 The North Colonnade
Canary Wharf
London E14 5HS

26 February 2016

Dear Awhi,

**AFM Response to Consultation Paper CP15/41,** *Increasing transparency and engagement at renewal in general insurance markets*

1. I am writing in response to this consultation paper, on behalf of the Association of Financial Mutuals. The objectives we seek from our response are to:

    - Comment on the proposals and highlight the risks of focusing your efforts on greater transparency mainly on price.

2. The Association of Financial Mutuals (AFM) represents insurance and healthcare providers that are owned by their customers, or which are established to serve a defined community (on a not for profit basis). Between them, mutual insurers manage the savings, pensions, protection and healthcare needs of over 30 million people in the UK and Ireland, collect annual premium income of £16.4 billion, and employ nearly 30,000 staff[1].

3. The nature of their ownership and the consequently lower prices, higher returns or better service that typically results, make mutuals accessible and attractive to consumers, and have been recognised by Parliament as worthy of continued support and promotion. In particular, FCA and PRA are required to analyse whether new rules impose any significantly different consequences for mutual businesses[2].

[1] ICMIF, http://www.icmif.org/global-mutual-market-share-2013
[2] Financial Services Act 2012, section 138 K: http://www.legislation.gov.uk/ukpga/2012/21/section/24/enacted

4. AFM and its members are committed to making their products transparent and to providing the highest levels of service and satisfaction. In addition, their mutuality means they are owned by their customers, and only accountable to them, and this instils higher levels of trust, greater customer loyalty, and broader/ deeper engagement.

5. This results in high levels of satisfaction. For example, the independent website and consumer champion, Fairer Finance, ranks 50 car insurance providers across a range of key criteria[3]. Of the 50 providers, five of the six highest performers are mutuals or not-for-profit insurers (the other being a broker). Similar analysis by Which? places the four mutuals in their analysis of 30 insurers in the highest ranked positions[4]. Both websites rank insurers on the basis of product quality, service and transparency rather than cost. The results are similar on home insurances, pets and healthcare.

6. None of this should suggest mutuals are complacent about their treatment of customers. We accept that more can be done to improve transparency and engagement, and welcome FCA's consultation and research. In our view, a consumer that is properly engaged when buying (or renewing) any financial services products is much less likely to mis-purchase, or be mis-sold. We live in an age where consumers are increasingly being expected to make decisions on their own behalf, particular for products like general insurance, which are perceived as being largely commoditised. Engagement therefore is vital, but it also implies many things, including:

    a. being able to properly assess the need the customer is looking to address;
    b. that the product meets that need(s);
    c. that the features are relevant and appropriate;
    d. that the provider is reliable and able to deliver appropriate service through the lifetime of the product; and
    e. that the price is fair.

7. We consider that the proposals in the consultation show an unhealthy preoccupation with price. Price is an important dimension, but it is only one of the elements by which a consumer should judge that the product is appropriate. Focusing increased transparency mainly on price risks encouraging the consumer to make an inferior decision, based on simplified criteria. As a recent report by the ICAEW states:

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[3] http://www.fairerfinance.com/ratings/car-insurance
[4] http://www.which.co.uk/money/insurance/reviews-ns/car-insurance-companies/car-insurance-company-reviews/

*"simplified information means that customers might miss important details and not get the value they expect. People might pay too much, by over-estimating the value of their property, or not get the cover they want if the customer does not understand what is and is not protected. The problem is that most people only find out when it is too late and their insurer can't pay out[5]".*

8. FCA accepts that insurers may, in addition to setting out the current and previous price, want to explain how price has changed since the last renewal. We would expect all insurers to need to do this, as a stark comparison of price will generally not explain what has changed over time. The consultation considers the impact of changes such as the loss of a first year discount, but there is a myriad of other factors. Recent research from the ABI show car insurance prices have risen recently as a result of changes in the underlying rate of tax (insurance premium tax rose from 6% to 9.5% in late 2015), as well as the costs of insurance fraud, and the impact of vexatious claims. And there are many other factors that affect the price of insurance at any time, including the broader market environment, and changes in the policyholder's circumstances. Statements setting out the reasons for the differences in price might therefore become lengthy and cumbersome, and this might have a counterproductive effect on the consumer's engagement and capacity to complete the necessary transaction.

9. A critical concern for AFM members, who tend to be small providers, is the cost-benefit analysis, which for this consultation assesses that the compliance costs for each organisation will average £350,000. There appears to be limited scope for proportionality in this cost, so for a small mutual this will be a substantial new cost to bear, which inevitably will be passed on to policyholders. This might in itself increase the price of renewal by a material amount, and therefore become part of the explanation set out in the previous paragraph on how prices have changed.

10. It is apparent from FCA's research that the perceived benefits to consumers will not match the costs to insurers. Insurers might therefore seek to recoup some of that extra cost by means other than a price increase: the result might be that insurers try to distort the renewal price, by reducing service or removing features, in order to keep the quoted renewal price close to the previous figure. Alternatively, the information might drive a consumer to a price comparison website, where they may be enticed to purchase a product

[5] ICAEW: "Audit insights: insurance", February 2016
http://www.icaew.com/~/media/corporate/files/technical/audit%20and%20assurance/audit%20and%20assurance%20faculty/publications/audit%20insights/audit%20insights%20insurance.ashx

with a large one-year discount, and a poor match of product features to customer needs, or else to select on the basis of branding and sales techniques rather than product quality.

11. Either way there will be a greater focus on price by consumers, and for insurers in collecting more information in which to provide competitive prices to targeted audiences. Commentators, such as ICAEW already highlight the risk that, outside a perfect market, too great a focus on data and prices will means more consumers become uninsurable, so that the net result might not be advantageous to society as a whole:

    *"But this means some people may be so high risk they are priced out of insurance altogether and we get 'uninsurables'. This can easily be due to factors people can't control. These might be to do with where you live, genetic conditions or new developments like cyber risk. Society needs to decide what we do about that. With terrorism risk in major cities or the recent flood disasters, the government stepped in so insurance is still available to people who need it. Should the government intervene to ensure insurance remains accessible even to people who represent a higher risk[6]?"*

12. The absence of analysis of product lines other than motor and home insurance has encouraged FCA to make simple assumptions about likely consumer behaviours. The main assumption is that consumers of medical, pet or travel insurance behave in the same way as consumers of home insurance. We do not consider this will be the case, as motor and home insurance is quasi-compulsory, and other products are optional.

13. For a quasi-compulsory insurance, it is easy to pass on an extra cost, such as an increase in tax, or the costs of implementing the proposals in this consultation; but that is not true of other products. One possible outcome of providing extra information, and on encouraging people not to renew with the same provider, is that they will perceive the transaction time and costs associated with renewing will be significant for a product which is optional, and could therefore elect not to renew: the loss of benefits to consumers and the contraction in the market are additional costs not factored into the analysis.

14. Another area the paper has not fully addressed is the different experiences between consumers renewing general insurance contracts in different ways. The consultation proposals are focused on consumers that auto-renew and where the renewal reminder posted by the insurer is the main prompt. For consumers that renew with the

[6] ICAEW: "Audit insights: insurance", February 2016

help of an insurance agent, or broker, the experience may well be different.

15. Included within the group that show lower levels of engagement may be consumers with home insurance arranged via their mortgage lender, where there is the potential for generating good levels of income for little service given, and where the assumption that the insurance is a condition of the mortgage will discourage active engagement and shopping around. Those lenders that operate from a panel of home insurers might seek to move the provider after four years, to avoid the need to issue a reminder to shop around. We consider FCA should extend the rules to consumers who buy insurance from the same broker for a number of years, even where the provider has changed.

16. We have responded to the specific questions raised in the consultation below.

17. We would be pleased to discuss further any of the issues raised by our response.

Yours sincerely,

Chief Executive
Association of Financial Mutuals

## Responses to specific questions

*Q1: Do you agree with our proposal that firms should disclose last year's premium on renewal notices?*

The solution put forward is an inefficient one, as the costs to firms is greater than the benefits to consumers. For small insurers and mutuals in particular the transition costs are excessive and disproportionate.

We would have liked to see FCA set out a range of possible options and test these. For example, where the issue FCA seeks to address is consumers moving from a discounted first year rate to a higher future rate, one option open is to exercise more control or transparency on the level of the first year discount. In mutual businesses, there is a greater appreciation of the need to support customers for the long-term, and to treat existing customers fairly. FCA might also have considered removing auto-renewal as the default on the initial application form.

*Q2: Do you agree with our proposal that the premium displayed should be the premium the consumer started the year with, but that firms can include other information, such as mid-term adjustments?*

As we highlighted above, insurers will need to provide significant explanations for the changes in premium, of which mid-term adjustments is only one.

*Q3: Do you agree with our proposal that firms should also provide information to consumers to check the proposed policy continues to meet their needs and to shop around?*

We agree that the need to verify the product meets the policyholder's need is a key consumer responsibility. It is not clear currently how well this is performed by consumers, but we consider it is less likely via auto-renewal.

Shopping around is not necessarily the right solution to the need to verify a product meets the customers needs. It is very often the detailed product features which are not always clear, for example on a price comparison site, that might render the product obsolete. A better solution to the need to verify the product meets the policyholder's needs might be to encourage a consumer that is uncertain to contact the provider or to use a broker or agent.

*Q4: Do you have any comments about this additional disclosure? Do you have any suggestions for the proposed message to consumers?*

This statement might be improved by more strongly caveating that "you may be able to save money". Where for example the policyholder's health has declined, or due to age, they may not be able to obtain similar cover from another provider. For pet insurance it is often the case that there is a lifetime limit on the amount of cover that can be claimed, or that pre-existing conditions will not be covered by a different insurer, or will attract a higher rating, meaning that often this statement will not be correct. We suggest adding clarity, such as 'in certain circumstances', avoids overpromising the situation.

*Q5: Do you have any comments on how the disclosure should be presented to the customer?*

No additional comments, other than the extent of explanatory statements that will be necessary, as described above.

*Q6: Do you agree with the proposal to apply the measure to all situations where a general insurance policy is renewed with a retail consumer with the exception of policies with a term of less than a year?*

Subject to comments above, we agree.

*Q7: Do you have any comments about our proposed implementation of 1 January 2017 for the disclosure measures?*

We suggest there should be a soft landing for any change, or a longer transitional. The changes will present challenges for insurers in generally, due to the significant demands of Solvency 2 implementation. In particular, for product lines that are no longer open to new business, the skills needed to change disclosure documents might not be readily available so a short timescale will lead to significantly higher costs.

*Q8: Do you have any comments on the proposed non- Handbook guidance?*

No additional comments.

*Q9: Do you have any comments on our cost benefit analysis?*

We comment above about the disproportionate impact of the implementation costs, and that benefits will not match costs, particular for products other than car and home insurance.