



CBI review of differential pricing in the private car and home insurance markets

Phase One Observations

September 2020

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What has happened?

1

The CBI review of differential pricing in the Motor and Home insurance industry has been underway for a number of months, reflecting the fact that the topic is a long-standing industry issue. It follows a thematic review of pricing practices through the work of the Cost of Insurance Working Group and the joint committee on Finance, Public Expenditure and Reform, and An Taoiseach.

2

On 8 September, the CBI issued a "Dear CEO" letter setting out initial observations from the conclusion of Phase One – Market Analysis.

3

The letter sets out key concerns arising in relation to differential pricing practices. The letter sets out the expectation from the CBI that the Board and Senior Management has full responsibility to understand the impacts of such pricing practices on their customers.

4

The CBI are commencing Phase 2 focusing on assessing the degree of differential pricing, they have however set out their immediate expectations in relation to pricing practices, governance, control and culture.

5

The CBI also underline the relationship of pricing practices and other regulatory requirements, such as the Consumer Protection Code 2012. More specifically the CBI expects firms to be able to demonstrate how their pricing practices adhere to the following requirements of the Code:

- Act honestly, fairly and professionally in the best interests of their customers and the integrity of the market;
- Act with due skill, care and diligence in the best interests of their customers; and
- Make full disclosure of all relevant material information, including all charges, in a way that seeks to inform their customers.

6

The CBI intend to publish an interim report setting out findings and observations from the first two phases. A third phase will be informed by these findings, the output of which will be a report or consultation on proposals or reform.

What have they found?

1

The CBI have identified that there are weaknesses of varying degrees in firms, raising concerns that some firms may not be adequately considering the effect of their pricing practices on their consumers, potentially leading to poor customer outcomes.

2

A number of firms maintained that they do not utilise differential pricing in their pricing practices. The CBI observed, however that the majority of 11 firms being reviewed do utilise techniques such as price elasticity modelling, retention/lapse modelling, conversion rate modelling and the use of models that facilitate the flexing of sales remuneration.

3

There were varying degrees of awareness of pricing practices at Board and Senior Management level. In many cases, it was not evident that the impact of differential pricing practices on their consumers had been appropriately considered.

4

The controls in place to quantify or monitor the impacts of differential pricing on consumer groupings in advance of pricing model implementation was not always clearly documented.

5

The CBI acknowledged that while firms have developed pricing policies, which clearly impact customers, there was insufficient evidence of a consumer focussed culture in respect of pricing decisions and practices.



What are the CBI proposing?

1

The CBI's fundamental concern is that some firms may not be adequately considering the effect of their pricing practices on their consumers. This may lead to practices whereby customers with a similar risk and cost of service are charged different premiums, for reasons other than risk and cost of service.

2

The CBI have set out the areas they require the Board and Senior Management teams to consider and respond accordingly.

- Assessment of pricing methodologies against the CBI's definition of Differential Pricing¹.
- The Board should be responsible for differential pricing practices and be fully informed of the impact of those practices on their customers.
- Ensure Board and management structures are designed to ensure a firm's pricing practices are well-governed, controls operate effectively, and appropriate oversight is in place, with roles and responsibilities for pricing activities clearly defined.
- Ensure that a fully embedded consumer protection risk framework is in place to manage conduct risk and drive positive behaviours in line with the Consumer Protection Code 2012.

¹The Central Bank defines differential pricing in insurance services as a circumstance or practice whereby customers with a similar risk and cost of service are charged different premiums, for reasons other than risk and cost of service. This includes the use of any modelling technique or the application of a non-risk adjustment during the pricing process which leads to customers with a similar risk profile and cost of service being charged differing premiums.

Next steps

1

The CBI have commenced Phase 2 of the review – Quantitative Analysis and Consumer Insight.

2

In parallel, the CBI is undertaking a consumer insights exercise to further develop their understanding of how consumers engage with insurance providers.

3

In the meantime, and irrespective of the final findings, the CBI has set out clear expectations on firms:

- They expect documented evidence that the actions set out have been fully considered and that firms have a clear understanding of their differential pricing practices and the impact on customers.
- Where gaps/weaknesses are identified, firms should develop and implement actions to address these and to mitigate any risk to customers immediately.
- Firms should also be able to demonstrate how their pricing practices adhere to the requirements in the Consumer Protection Code 2012.



KPMG initial reaction

1

It is yet unknown if the output of the CBI will be a report or consultation on proposals for reform. We expect, however that the final findings will be significant and it is clear that any potential actions could be far-reaching.

2

While the programme for government, agreed in June, pledged to work to “remove dual pricing” from the insurance market, an intervention in pricing practices is fraught with the risk of unintended consequences, for example on market competition, which the CBI will seek to avoid.

3

We believe much of the regulatory, media and consumer scrutiny over pricing practices stems from the complexity of approach and, in particular the separation of the pricing of the risk cost and the customer demand.

- Therefore it is reasonable that the CBI will examine options to seek to limit the impact of practices in this area.
- Nonetheless, it is important to recognise that increased use of data in insurance pricing has led to considerable benefit in terms of more accurate pricing and extended reach of insurance. The CBI will need to carefully weigh up the potential loss of these benefits if it seeks to remove or limit the use of data and optimisation in insurance pricing.

4

Insurers need to review and update their risk assessments in light of conduct risks and challenges identified by the CBI. Firms who can successfully embed a customer centric approach in their practices will be better equipped to effectively respond to regulatory expectations in the future.

5

We believe that firms now more than ever need to continue to take steps to improve pricing practices with particular emphasis on:

- Ensuring governance and oversight is fit for purpose and there is sufficient consideration of customer outcomes throughout the pricing process.
- Defining pricing strategy clearly and balancing customer and commercial outcomes appropriately.
- Reviewing constraints in pricing models to ensure that they are appropriate and can be justified.
- Driving a positive and customer-focused culture.

How KPMG can help you?

With our combination of Actuarial, Regulatory and Risk expertise KPMG is uniquely placed to support you in the months ahead. We can work with you on:

1

Review of current CBI expectations of firms and initial assessment of your response to CBI actions

2

Review of pricing strategy

- Comment on the documented pricing philosophy / strategy
- Comment on the degree to which it covers customer outcomes and defines what fair outcomes from pricing look like
- Review how pricing strategy is cascaded to those responsible for implementing it and test how well this is understood in practice
- Review how customer outcomes are considered in pricing decisions and undertake testing of whether these are considered in practice
- Review the extent to which pricing decisions are escalated and how customer outcomes are communicated in this escalation
- Review and comment on pricing strategy relative to the code

3

Review of pricing governance

- Review and comment on pricing governance framework
- Test extent to which framework is followed in practice
- Review and comment on extent of Board and Executive involvement in pricing, including the degree to which there is effective oversight of the outcomes from pricing

4

Differential pricing

- Consider and comment on extent to which pricing philosophy considers

cross-subsidy between customer cohorts

- Review and comment on extent of cross-subsidy in pricing (e.g. between new and renewing customers or between core and ancillary products)
- Review and comment on plans to address cross subsidy that is outside of any appetite in the pricing strategy
- Review and comment on extent to which MI considers cross-subsidy

5

Review of pricing models and MI

- Review of the modelling environment including appropriateness and reasonableness of the data used, and review of the pricing models including rating factors used and appropriateness and justification of constraints
- Review and comment on MI designed to provide oversight of pricing, including extent to which it considers customer outcomes
- Review and comment on extent to which senior management and Board review MI including testing in practice whether sufficient challenge is obtained
- Review and comment on extent to which issues associated with pricing had been detected in MI

6

Culture

- Undertake a high-level review and comment on extent to which values have been embedded into the Pricing team
- Support in Conduct Risk Framework reviews, incorporating Consumer Protection Risk Assessment (“CPRA”) and the appropriate embedding of these frameworks into firms’ business and operating models with emphasis on pricing frameworks and the “reasonable expectations” of both consumers and other stakeholders.

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