General Insurance Pricing Practices Market Study Final Report

Annex 3: Analysis informing the proposed pricing remedy

September 2020

1 Introduction

1.1 This Technical Annex is published alongside the General Insurance Pricing Practices Market Study Final Report, Consultation Paper and Cost Benefit Analysis (CBA) on a proposed package of remedies. It provides an overview of a broad range of analyses completed after the publication of the Interim Report (MS18/1.2) with the aim to further our understanding of general insurance pricing practices in the retail home and motor insurance markets and the resulting harm.

1.2 In 2018, we published the outcomes of a thematic review on home insurance pricing practices where we identified differentials in the margins firms earned between consumers of equivalent risk and cost to serve. In 2019 our Interim Report concluded that firms use complex and opaque pricing techniques to identify consumers who are more likely to renew and from whom they can earn higher margins.

1.3 Our Final Report sets out our position on how these pricing practices lead to harm and puts forward a proposed package of remedies for addressing that harm.

1.4 The results presented in this Technical Annex informed the design of the remedy package, and in particular the proposed direct restriction on home and motor insurance pricing aimed at preventing firms from price walking consumers that renew with them year on year.

1.5 The key insights discussed relate to two broad areas.

- **Outcomes for consumers**. After the Interim Report, we undertook additional analysis to deepen our understanding of the determinants of the high level of observed price dispersion for both new and renewal contracts in home and motor insurance. We further investigated the extent to which low introductory prices for new contracts are predicated on the ability to later price walk consumers. We also explored the potential impacts of different remedies on the outcomes for different groups of consumers, to account for the observed heterogeneity in characteristics and sophistication.
- **How firms could change their business models in response to potential remedies**. That is, we focused on firms' strategic interactions and incentives, particularly the implications of the extensive level of heterogeneity observed in the market in terms of business models, cost structures, and distribution arrangements. This allowed us to explore the risks of unintended consequences and compare alternative interventions.

1.6 The analyses discussed are based on:

- the information and data collated for the Interim Report as discussed in the Consumer Outcomes Technical Annex, Consumer research report and technical report, Financial Analysis and BMA Analysis Annex;
- insights obtained after the Interim Report from stakeholders' feedback and direct firm engagement (Annex 1), intelligence gained from firms and results from numerical simulations (Annex 2) developed to inform the CBA.

1.7 In the following, we describe our approach, the findings and how the analyses are linked to other parts of the Market Study. The structure is as follows:

- A recap of our methodological approach and the main data used (Section: Our approach)
- A description of our understanding of how consumers and firms interact in the home and motor insurance markets. (Section: Consumer and firm interactions in home and motor insurance markets)
- A set of analyses aimed at furthering our understanding of price walking (Section: How we looked at price dispersion and price discrimination)
- A set of analyses of consumer outcomes (Section: Characteristics associated with higher margins and longer tenure)
- A discussion of implications of the proposed pricing remedy on firms’ business models (Section: Business model implications for firms)

2 Our approach

Methodology

2.1 To inform our understanding of price walking as a key driver of harm in the home and motor insurance markets and identify the most appropriate intervention we pursued two related approaches and used the insights obtained from each work strand to inform the others.

2.2 Firstly, we developed a numerical simulation and used it to explore the impact of alternative interventions on two key market outcomes: average prices for consumers of different tenures and numbers of consumers switching. The process of developing the simulation framework helped advance our understanding of key strategic market interactions. However, to make our simulations practical, we have had to adopt several simplifying assumptions. The details are discussed in a separate Annex. Outputs of the numerical simulation fed into the CBA.

2.3 Secondly, we developed a wide range of empirical analyses to further our understanding in two broad areas: consumer level outcomes and firms' strategic interactions and incentives. Those are discussed in this Technical Annex.

2.4 Our analysis is informed by an understanding of the economic literature on price discrimination and the analysis of competition in markets where consumers vary in their level of sophistication.

2.5 To further our understanding of outcomes for consumers:

- We used transaction level data to further explore year on year changes in margins, prices and costs. This allowed us to understand more about price walking and its relationship with low introductory prices and observed levels of price dispersion.
- We extended our analyses on consumer characteristics and explored in more depth how various characteristics relate to tenure.
- We completed our analysis of the relationship between price walking and the sale of add-ons and premium financing along with the core insurance cover.

2.6 To understand the implications for firms' business models of different interventions and minimise the risk of unintended consequences:

- We used a range of qualitative and quantitative information (financial data, business model information and transaction level data) to further explore how different firms rely on price walking. This informed our assessment of the likely impact on competition for new customers.
- We further explored the relationships along the vertical chain and the role of Price Comparison Websites (PCWs) and analysed the scope for potential savings in total acquisition expenditure.
- We conducted additional analysis to explore the implications of the coronavirus pandemic.

Data

2.7 The analyses described in this Annex are based on the following data sources:

2.8 A "transaction level dataset" – described in the Consumer Outcomes Technical Annex MS18/1.2 Annex 1. This dataset contains policy level data from over a 5-year period (2014 to 2018) provided by a total of 24 legal entities (insurance and intermediary firms) across home and insurance markets on a sample of approximately 15% of their policies). The dataset contains nearly 7 million observations for over 2 million unique policies for home insurance and 10 million observations for nearly 4 million unique policies for motor insurance. The technical annex referenced describes the sampling methodology adopted as well as the sample adjustments performed to obtain subsamples of the dataset characterised by a representative distribution of tenure in each year.

2.9 A smaller dataset obtained by linking policy level information from the transaction level dataset to the information collected via a consumer survey described in the Consumer research report and technical report ("joint dataset").

2.10 Since the interim report we have also been able to assess findings from the FCA's 2020 Financial Lives Survey (a survey of over 16,000 UK adults providing information on the financial products consumers have, their experiences engaging with financial services firms and their attitudes around dealing with money and the financial services market).

2.11 For the analyses presented in this annex we also refer to:

- Financial data information, as described in the Annex 2: Business Models and Financial Analysis Technical Annex of the Interim Report.
- Qualitative information, for instance business strategies or firms' roles along the value chain, submitted by firms in reply to the request for information that informed this market study.
- Data from public sources, in particular: English indices of deprivation 2015 and ONS Pen Portraits data.
- Qualitative information collated in response to the Interim Report and during extensive engagement with firms.

3 Consumer and firm interactions in home and motor insurance markets

How consumers engage in the market

3.1 When looking at current market outcomes in Chapter 6 of the Interim Report, we found considerable variation in margins across consumers.[1] We found that new business customers typically pay lower margins than a renewing customer for the equivalent expected risk, and that, on average, consumers pay higher margins the longer they stay with the same provider.

3.2 We also found that there was substantial variation in the margins charged to customers of similar tenure and risk by the same firm. So, while tenure is an important factor influencing the margin charged by individual firms, other factors are relevant too (see Figure 16 from the Interim Report).

3.3 To understand why margins vary so widely in the home and motor insurance markets we look firstly at how consumers engage in the market and how this provides opportunities for firms to price discriminate between different types of consumers.

3.4 In home and motor insurance we observe two main types of price discrimination: different margins are charged to customers who have different *preferences* for one brand of insurance over another, and margins vary according to differences in a customer's *awareness* as to the competitiveness of the price offer made by insurance firms.

3.5 Consumers vary widely in their brand preferences – some prefer to stick with a brand they know and trust, while others are more willing or able to shop around and choose a different brand to obtain a lower priced deal. These preferences can also include consideration of switching costs – some consumers may prefer to renew with their current provider not out of loyalty to the brand, but rather to avoid the costs of shopping around for a better deal.

3.6 Consumers also vary in their awareness of the pricing strategies of firms and of the competitiveness of their price offer. For example, our consumer survey in our Interim Report found that while many consumers were aware that most firms engage in price walking and that price changes on renewal may not be cost related, the majority gave responses which indicated a lack of awareness of firms' pricing strategies and the competitiveness of renewal price offers.

3.7 Those consumers who are more aware are more likely to understand that the margin they will pay is likely to increase over time if they do not switch or negotiate frequently. Although these consumers often benefit from switching to a more competitively priced deal, these pricing practices are likely to cause consumers to search and switch (or negotiate) more frequently than they would otherwise choose to do in the absence of price walking. This avoidance action incurs costs, both financial and those associated with inconvenience.

3.8 Conversely, consumers who are less aware of these pricing practices are more likely to believe that their renewal price offer is broadly competitive. As a consequence,

[1] Note that here we use the same definition of customer margin introduced in the Interim Report. See Annex 1 para 2.9.

these consumers will often accept renewal price offers that, with more transparent pricing practices, they may otherwise have rejected. These pricing practices therefore provide an opportunity for firms to raise margins to these consumers without inducing search and switching.

How firms optimise their revenues

3.9 In Chapter 4 of the Interim Report we discussed how most firms adopt pricing practices that set different prices at new business and renewal. Firms typically aim to predict the likely behaviour of consumers when setting the price, taking account of their competitors' pricing. We also discussed the adoption of "margin optimisation" - the process where firms adapt the margins they aim to earn on individual consumers - and "lifetime value modelling" - the practice whereby firms assess the net present value of a customer to help them choose prices that will be profitable over the lifetime of the customer relationship.

3.10 This margin variation reflects attempts by firms to vary prices according to the individual consumer's preferences to remain with their brand, and by the consumer's awareness of the competitiveness of the price offer.

3.11 Neither consumer preferences nor awareness are perfectly observable by firms. Firms, however, can and do use a broad range of techniques and data to make inferences on customer preferences and awareness. For instance, firms may set prices based on customers' observable characteristics that correlate with (are proxies for) brand preferences, switching costs, and the likelihood that the individual customer will shop around for a better deal (for example, how far in advance customers shop for their policy).

3.12 Firms also offer a range of products and brands characterised by different price points which have different appeal to different customer types. Consumer preferences and awareness may also be correlated with the use of different sales channels.

3.13 In addition, firms may charge otherwise similar consumers different margins at different times of year in response to changes in competitive conditions. Margins may also be influenced by firms' risk diversification strategy. For example, if firms are attracting too many (few) consumers of a particular risk-type they may choose to increase (reduce) margins.

3.14 We also found that firms' margins may be based on expectations of how long a customer (or a cohort of customers) will keep renewing after they have first purchased their insurance contract. Pricing can also vary based on the potential for the sale of additional products.

3.15 Expectations around future profitability play an important strategic role in firms' pricing strategies. Insurance contracts are often characterised by repeated purchases and it may be profitable for firms to quote a lower initial price in the expectation of generating higher future profits either through price walking or sale of additional products.

3.16 Firms can also actively influence consumers' preferences and awareness and therefore the margins that can be earned. For instance, firms can invest in making a brand more appealing or they may smooth price changes if they believe a sharper change at renewal would trigger more shopping around and increase the chance of the customer leaving.

3.17 Pricing to account for the overall lifetime profitability of the customer introduces further complexity. Firms may offer a lower initial price with the intention of charging higher prices to those consumers who will later renew. The level of price change may vary depending upon the firm's understanding of the consumer's pricing awareness as well as the consumer's preferences.

3.18 All the aspects mentioned above are deeply intertwined. For instance, when a prospective buildings insurance customer is referred by their mortgage provider for a quote, that might be an (imperfect) signal for lower price sensitivity and lower propensity to shop around at renewal. It could also convey (imperfect) information on the number and type of competing quotes that customers might have been exposed to (eg as opposed to a customer asking for a quote via a PCW). The same characteristics a firm can use to obtain an indication of a customer's willingness to pay today may also be used to obtain an indication of the customer's possible future value to the firm. The extent to which this knowledge and sophistication can translate into extra profits depends on the strategic interaction with competitors.

Market dynamics and outcomes and the rationale for the proposed direct pricing intervention

3.19 The description above highlights the extent to which the prices consumers pay are personalised (price discrimination) and the complexity of the strategic interactions between firms.

3.20 In the Interim Report, we discussed how price discrimination can have different effects on the nature and intensity of competition. It can intensify competition by allowing firms to offer discounts to their rivals' customers. This increase in competition benefits consumers as a whole, insofar as it reduces the average price paid for insurance. However, not every consumer necessarily benefits from this increase in competition.

3.21 Price discrimination can also dampen competition, increasing the average price paid by consumers. This is most likely to happen where higher prices are charged to those consumers who lack awareness that the deal they are offered is not competitive, while lower prices are offered to more informed consumers.

3.22 Since the interim report, we have focused on: (i) disentangling the different sources and types of price discrimination, and in particular, between price discrimination based on consumer preferences and that based on consumer awareness; and, (ii) understanding what effects price discrimination has on the intensity of front-book competition; and, (iii) what effects different remedies would have on competition and – in particular – if price sensitive consumers would still be able to obtain good deals.

3.23 Under our proposed pricing remedy, when a firm offers a renewal price to a consumer, that renewal price should be no greater than the equivalent new business price that the consumer would be offered by the firm. Details of the proposal are discussed in Section 3 of the Consultation Paper.

3.24 The implication of the proposed intervention – in combination with the other components of the remedy package – are described in the Consultation Paper.

3.25 In broad terms, our proposal to introduce a pricing restriction for home and motor insurance, has two distinct impacts:

- a ban on price-walking for new and existing customers (ie firms cannot increase the renewal price to consumers over time other than in line with changes in risk), and
- a reset of prices for existing consumers, as their renewal price would be no higher than the equivalent new business price

3.26 Firms would be permitted to set new business prices at the level they choose, taking into account any risk factors they believe are relevant, as well as non-risk related factors - such as their customers' expected price sensitivity – and their own cost of serving customers. However, if a new business consumer is assessed on that basis, the firm must also use the same basis for calculation of their renewal offer price.

3.27 The proposed remedy will create a constraint on firms' pricing by linking front book (new business) prices and back book (existing customer) prices. Competition for front book customers should more directly constrain the price that can be charged to renewing customers.

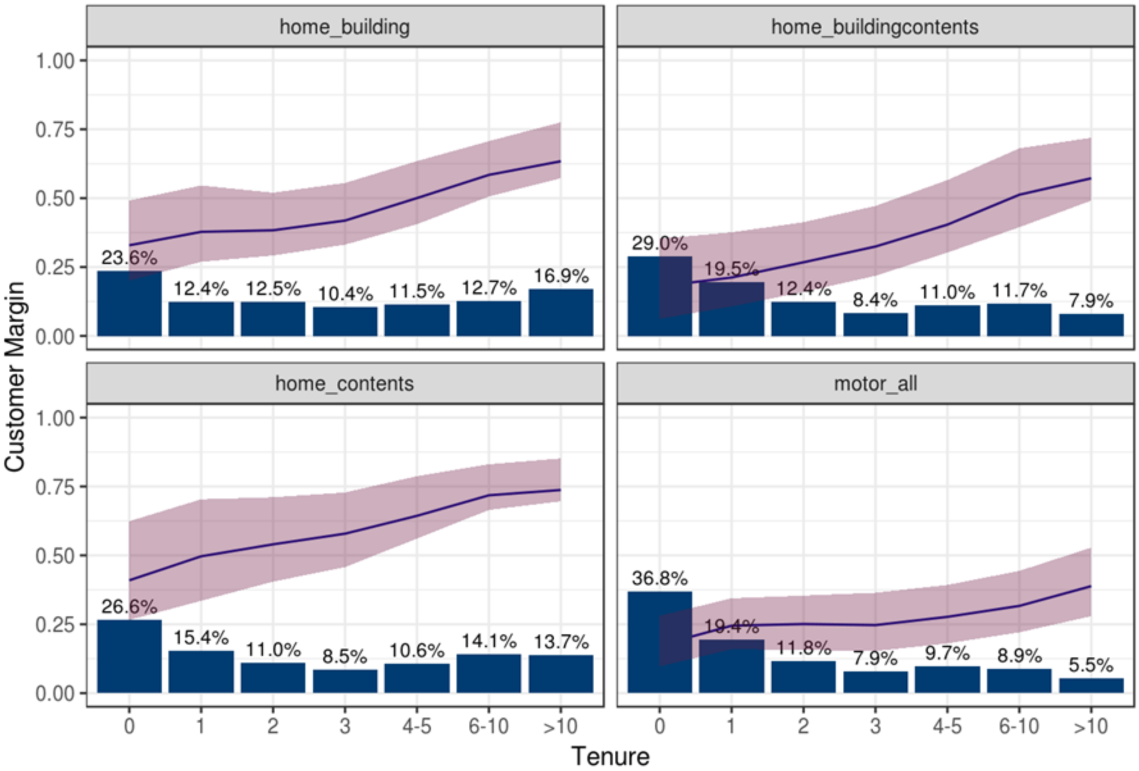
3.28 Because of the importance of front book competition to ensure the effectiveness of the proposed remedy, we undertook empirical analyses to assess whether price sensitive consumers would still have sufficient incentives to shop around for good deals and firms would still have sufficient incentives to compete for new business by offering those good deals. These are discussed in the following sections.

4 How we looked at price dispersion and price discrimination

On average, consumers pay higher margins the longer they stay with the same provider, and the difference is material

4.1 In our Interim Report, we identified that firms use complex and opaque pricing practices that result in very large differences in premium for customers of the same risk (as measured by the expected claims cost on the policy). We also found that, on average, consumers pay higher margins the longer they stay with the same provider. Figure 1 below (Figure 16 from the Interim Report) shows the margins firms in our data sample charged to customers by length of tenure, as well as the distribution of margins across tenure.

Figure 1: Customer margins by tenure, 2018



Source: FCA analysis of policy data provided by firms. Note that two different datasets are used in the plot above: the line representing the average margins and the shaded area representing margin dispersion (the interquartile range) are computed using 2018 data from the full transaction dataset. The bars, instead, are derived from the tenure-adjusted subsample for 2018. Refer to Annex 1 to the Interim Report for additional details.

4.2 These differences in margins translate into material differences in the policy prices paid by consumers. Table 1 below provides an illustration of the scale of this effect. It shows by how much the price of a typical insurance policy[2] would increase if it were renewed with the same provider each year.[3]

[2] For a customer of median expected claims costs in our sample.

[3] Figures in Table 1 are computed as follows. We use our adjusted dataset to compute, for each market, the typical risk (median expected claims costs on core policy) across all tenures. This is £85 for home building policies, £127 for

4.3 For a typical risk, a motor insurance customer that has been with their provider for more than 5 years will expect to pay a premium that is on average £85 higher than a new business customer with the same risk. The typical new business motor policy costs £285. For home insurance, the difference is an increase of £108 over a new business price of £130 for buildings insurance. For combined buildings and contents insurance the increase is £122 on top of a new business price of £165, and the increase is £82 on top of a new business price of £56 for contents only insurance.

4.4 The number of consumers who have been with their insurance provider for more than 5 years is 5.1 million for motor insurance, 0.6 million for buildings only insurance, 3.0 million for combined buildings and contents insurance, and 1.4 million for contents only insurance, therefore the increase will affect 10 million policies across home and motor insurance.

4.5 Differences in annual insurance prices, accumulate over time, adding up to substantial sums of money. For example, over a period of ten years, a customer of typical risk who renewed with the same provider every year would expect to pay £817 more for home buildings policies, £1,043 more for combined building and contents policies, £666 more for contents only policies, and £782 for motor insurance policies compared to a customer who pays the new business price each year.

4.6 In providing these illustrations we have assumed that a customer's risk does not change over time. The illustrations are therefore only indicative of the magnitude of the differences in prices paid by consumers who renew with the same provider each year compared to those who switch annually. It is also important to note that these illustrations are based on existing industry pricing structures. As discussed in the Final Report and the CBA – we expect our proposed pricing intervention will lead to a rebalancing of prices across tenures.

combined building and contents policies, £31 for contents only policies and £233 for motor policies. We then use the observed typical margin on new business policies (median customer margin on core policy) to obtain the implied premium on a new business policy for a typical risk. We then derive the implied premium for typical policies renewed a different number of times (tenure) multiplying the implied premium on a new business policy by the ratio of margin for renewal contracts of specific duration to new business contracts. With all the implied premiums, we then compute the difference in pound values.

Table 1: Premium differentials over time (renewals) for policies of the same risk, by type of product

Market	Tenure	Proportion of policies by tenure	Ratio of margin to new contract	Implied premium for typical risk (£)	Premium difference compared to new policy of same risk (£)	Cumulated difference (£)
Home building	0(new)	23.6%	1.00	130	-	-
	1	12.4%	1.08	140	11	11
	2	12.5%	1.10	143	13	23
	3	10.4%	1.18	153	23	47
	4	6.6%	1.32	172	42	89
	5	4.8%	1.52	197	67	156
	6	3.9%	1.67	217	87	243
	7	3.2%	1.80	234	104	347
	8	2.3%	1.78	232	102	449
	9	1.8%	1.74	226	96	545
	10	1.6%	1.97	255	125	670
	>10	16.9%	2.13	277	147	>817
Home combined building contents	0	29.0%	1.00	165	-	-
	1	19.5%	1.05	174	9	9
	2	12.4%	1.13	186	21	30
	3	8.4%	1.23	203	38	68
	4	6.3%	1.28	211	46	113
	5	4.8%	1.42	235	70	183
	6	3.5%	1.56	258	92	276
	7	3.0%	1.71	282	117	393
	8	2.2%	1.83	303	137	530
	9	1.7%	1.92	317	152	682
	10	1.3%	2.04	338	173	855
	>10	7.9%	2.14	353	188	>1,043
Home contents	0	26.6%	1.00	56	-	-
	1	15.4%	1.25	70	14	14
	2	11.0%	1.32	74	18	32
	3	8.5%	1.46	82	26	58
	4	6.0%	1.74	97	41	99
	5	4.6%	1.95	109	53	152
	6	3.5%	2.15	120	64	216
	7	3.4%	2.34	130	75	291
	8	2.9%	2.56	143	87	378
	9	2.3%	2.60	145	89	467
	10	1.9%	2.72	152	96	563
	>10	13.7%	2.85	159	103	>666
Motor	0	36.8%	1.00	285	-	-
	1	19.4%	1.14	324	39	39
	2	11.8%	1.16	330	45	84
	3	7.9%	1.15	329	44	128
	4	5.6%	1.20	343	58	186
	5	4.1%	1.24	353	68	254
	6	3.0%	1.25	356	71	325
	7	2.2%	1.28	364	79	403
	8	1.6%	1.32	376	91	494
	9	1.2%	1.32	376	91	585
	10	1.0%	1.32	376	91	676
	>10	5.5%	1.37	391	106	>782

Source: FCA analysis of policy data provided by firms, full transaction dataset, subset of policies underwritten in 2018

Consumers of the same risk pay very different premiums

4.7 Figure 1 also shows a wide variation in margins charged to consumers of the same tenure. We see this both at the aggregate and at the individual firm level. Indeed, almost all firms in our sample exhibit a wide variation in the margins charged to consumers of similar risk and tenure. Firms however vary in the steepness by which they increase margins over time, and in the precise extent of margin dispersion within consumers of the same tenure and risk.

Evidence on whether consumers who have long tenure are offered lower new business margins

4.8 If firms were able to identify which consumers were most likely to be profitable at renewal (either because they had a preference to stay with the incumbent due to high search or switching costs, or because they were unaware that more competitive prices were available in the market), then firms would compete to win these profitable customers by offering them discounted new business prices. Conversely, the new business prices offered to consumers identified as being most likely to shop around and switch would be higher as these consumers would be less profitable to serve. As a consequence, the lifetime margins offered to different consumer types could be similar.[4]

4.9 To test this, we examine how the margins charged to individual customers in our data set evolved over time. For each market (home buildings, contents, combined and motor insurance), we separate individual customers into 5 groups depending upon how many times they chose to renew their policy. We then compare the average new business margin charged to consumers in each group. If consumers can be identified as being more likely to have longer tenure at the new business stage, and if competition is effective, we would expect consumers who had longer tenure on average to be charged lower new business margins.

4.10 Our data set covers the period 2014-2018. To ensure we follow individual consumers for the longest period possible we restrict our analysis to consumers who were new business customers in 2014. This allows us to observe up to a maximum of four renewals for each individual customer. The results of our analysis are summarised in Table 2 and Figure 2 below.

4.11 In Table 2 no clear pattern of margins emerges. For motor insurance, margins fall progressively from an average (median) of 16% for customers with no renewals, to 11% for those who renew four times in our sample. For home buildings only insurance, we see a broadly similar pattern, although the margins for customers who renew 4 times are higher than those who renew 3 times.

4.12 However, there is some evidence that customers who switch every year do not receive the lowest new business prices. For motor insurance and home building insurance, regular switchers do not appear to be offered the lowest new business prices. However, there is very little evidence that longer tenure customers are offered lower new business prices to compensate for future higher prices. For combined building and contents insurance there is no apparent relationship between new business margins and tenure, while for contents only insurance median margins are higher for customers who renew 4 times than those who renew 0 times.

[4] Competition would be less effective in reducing the new business price to consumers who are identified as having a strong preference for a particular brand.

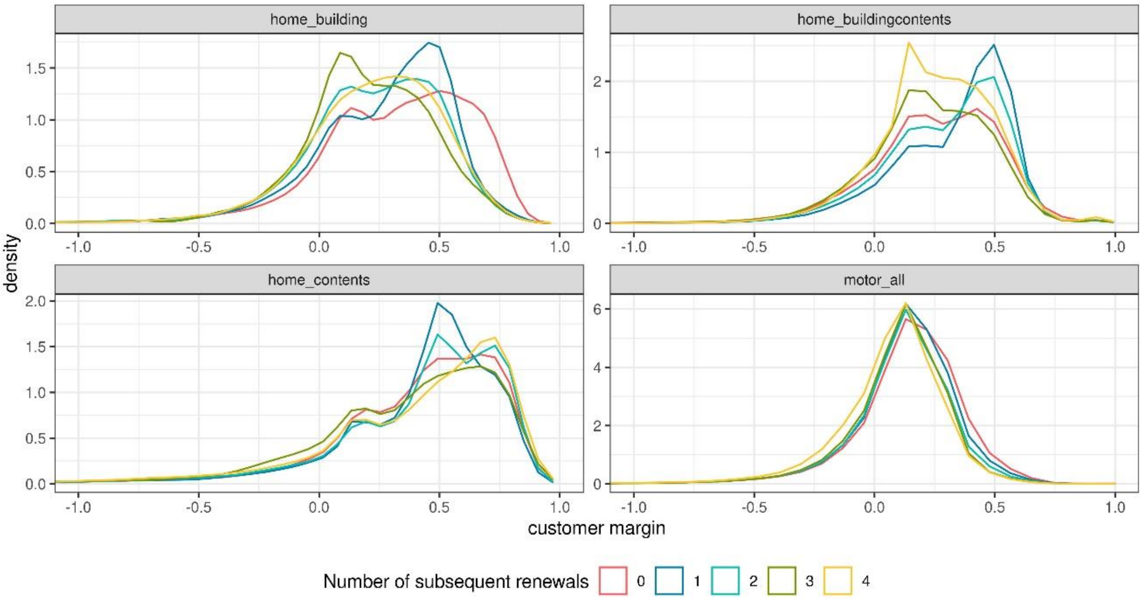
4.13 When we look more closely at the data and consider the full distribution of margins (Figure 2), we observe considerable variation in margins, irrespective of how long the customers ultimately held their policy. Part of the variation observed in Figure 2 could be explained by differences across firms. Margin variation may also result from changes in competition conditions throughout the year. The key feature captured by Figure 2 is that the distributions of margins are very similar for customers of different tenures, particularly for motor insurance.

Table 2: Customer margin on new business policies underwritten in 2014, by number of subsequent renewals

Market	Number of subsequent renewals	Mean margin	Median margin
Home building	0	28%	36%
	1	22%	32%
	2	17%	25%
	3	14%	19%
	4	18%	25%
Home combined building contents	0	23%	27%
	1	32%	40%
	2	28%	34%
	3	21%	23%
	4	25%	26%
Home contents	0	38%	49%
	1	40%	49%
	2	40%	50%
	3	34%	45%
	4	38%	51%
Motor	0	14%	16%
	1	12%	13%
	2	11%	11%
	3	9%	11%
	4	6%	11%

Source: FCA analysis of policy data provided by firms, full transaction dataset, subset of policies underwritten in 2014

Figure 2: Distribution (density) of customer margin on new business policies underwritten in 2014, by number of subsequent renewals



Source: FCA analysis of policy data provided by firms, full transaction dataset, subset of policies underwritten in 2014

4.14 We performed the same analysis at firm level and observed considerable heterogeneity across firms. The analysis highlighted differences in firms' likely ability to identify ex-ante the stickiest consumers, and price keenly at new business to win those contracts, and/or in learning about customers' propensity to renew (or induce it) and exploit it to earn higher profits at renewal. This heterogeneity would be consistent with the observed degree of heterogeneity across firms in customer base composition by tenure and in the steepness of the curve that describes the evolution of margin over tenure.

4.15 Taken together this evidence suggests that - while in some cases insurers might be able to identify ex-ante the most profitable customers and compete more keenly to win their business, firms are not generally able to identify consumers well enough, or the compensation in new business price is not large enough, to explain the patterns in the margin distributions that we see. This is key to understanding the likely harm that is arising from price walking. Longer term customers will on average pay a higher lifetime average price, as rival firms often lack the information to be able to identify and target those customers with deep discounts, while, for their part, these customers tend to be less willing or able to seek out lower priced firms.

A large proportion of consumers who pay higher margins at new business continue to pay higher margins when they are of long tenure

4.16 As further evidence of the nature of the distribution of margins, we analyse whether – within each firm - customers' relative rankings in the ordering of margins, premiums and expected claims costs are stable over time or, instead, if there is *reshuffling* – changes in customers' relative rankings over time. In other words, do consumers who pay relatively high new business margins continue to pay relatively high margins at subsequent renewals?

4.17 This information allows us to obtain further insights both into the type of price discrimination practised by firms, and the impact on competition and consumer outcomes. For example, a high stability in ranking is consistent with weak competition to win profitable long tenure customers, whereas a reshuffling of rankings is consistent with more intensive competition. Ranking stability is also consistent with price discrimination that is based on characteristics that are more stable over time, whereas we would expect to see more reshuffling where firms learn about consumer type over time (which can give firms an informational advantage over rivals).

4.18 To perform this analysis, we focus on the cohort of consumers who display the greatest willingness to renew in our sample – consumers who were new business customers in 2014 and who renewed their policy in each year until 2018. This cohort is deliberately chosen to be a group of relatively homogenous consumers in terms of price sensitivity and awareness, while preserving as much variation as possible across consumers in terms of preferences.

4.19 Within each firm, we rank polices by customer margin and, separately, by premiums and by expected claims cost and repeat the process for each market. That is, customers of different firms are ranked independently from each other. For each firm, we then group ranks in ten deciles. Grouping in deciles has two purposes. First, it reduces the noise in movements in rankings. Second, it allows combining all firms in one graph even though different firms have different numbers of policies in our sample.[5]

[5] Without grouping, if a firm had 20 observations in our sample, its policies would be ranked from 1 to 20, while another firm with only 15 policies would not have any policy whose rank takes values from 16 to 20.

4.20 We plot this data on a 10 by 10 grid. The axes represent the rank (decile) of the same insurance policy at two different times (years). Each tile represents the proportion of policies over the total (frequency) that are characterised by a specific combination of rankings at two points in time. Tiles are color-coded (white = lower proportion of observations, red = higher proportion) and labelled with the frequency.

4.21 For each product (buildings insurance, contents insurance, combined building and contents insurance, and motor) we present two different panels – one comparing 2014 to 2015 (ie how much relative rankings within each firm have changed after the first renewal) and the other comparing 2014 to 2018 (to illustrate changes in rankings after 4 renewals). We present this analysis for customer margins on the core policy (risk-adjusted measure of price), for premium and for expected claims costs.

4.22 For instance, in Figure 3, the bottom left tile of the home buildings only grid shows the proportion of policies that – when measuring customer margin - were in the lowest decile of the ranking distribution in 2014 and remained in that decile in 2015. This is 7.5% of all customers in our sample that bought a new policy in 2014 and renewed it every year until 2018. The tile in top left corner represents the set of customers who ranked in the lowest decile in 2014 and jumped to the highest decile in 2018 (close to zero).[6]

4.23 If rank ordering remained perfectly stable over time for all firms, we would then see all observations uniformly distributed on the main diagonal. Each tile on the main diagonal would have 10% of total observations, while all others would have none. Figure 3 shows that ranks change with the first renewal and continue to change after the fourth renewal. However, there is a relatively strong degree of persistence in the ordering of margins such that – for home buildings and home contents insurance - half of the consumers in the highest 10 per cent at new business are still in the highest 10 per cent on their fifth year with the same policy. The proportion is slightly lower for combined building and contents insurance and for motor insurance.

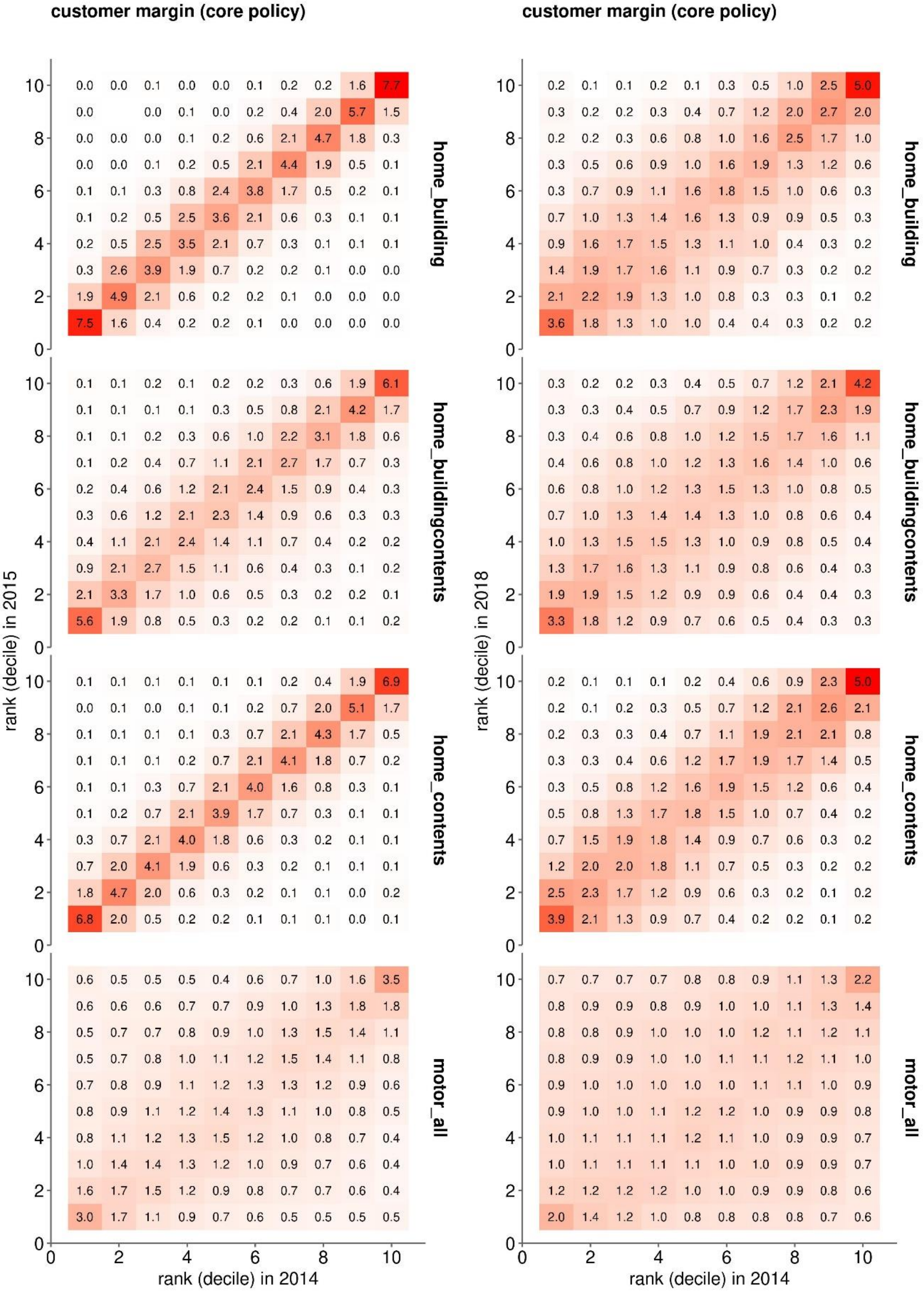
4.24 From a theoretical perspective, there are various reasons why observed margins could depart from perfect rank stability. One reason could be that firms identify ex-ante the customers least likely to switch or negotiate, and price keenly at new business to win those contracts by offering deep discounts to win those contracts. However, our previous analysis (Figure 2) suggests that firms are limited in their ability to identify a consumer's likely tenure up front and adapt their prices at new business accordingly. Furthermore, Figure 3 only includes customers that have started their current policy in 2014 and kept renewing until 2018, and therefore are relatively homogenous in terms of stickiness.

4.25 A second reason could be that rank ordering of risk-adjusted prices could be driven by changes in the underlying risk. The analysis for expected claims costs (Figure 4) shows that relative costs do vary, but also that they appear more stable than margins. This is true not just for home – where we have observed very little year-on-year variation of expected claims costs – but also for motor insurance, where year-on-year changes are more substantial.

4.26 A third reason could be that firms only have imperfect ex-ante knowledge of consumer characteristics and preferences (eg brand preference and price sensitivity) and, therefore, cannot perfectly discriminate when offering a new contract, but can instead learn over time and adjust their pricing accordingly.

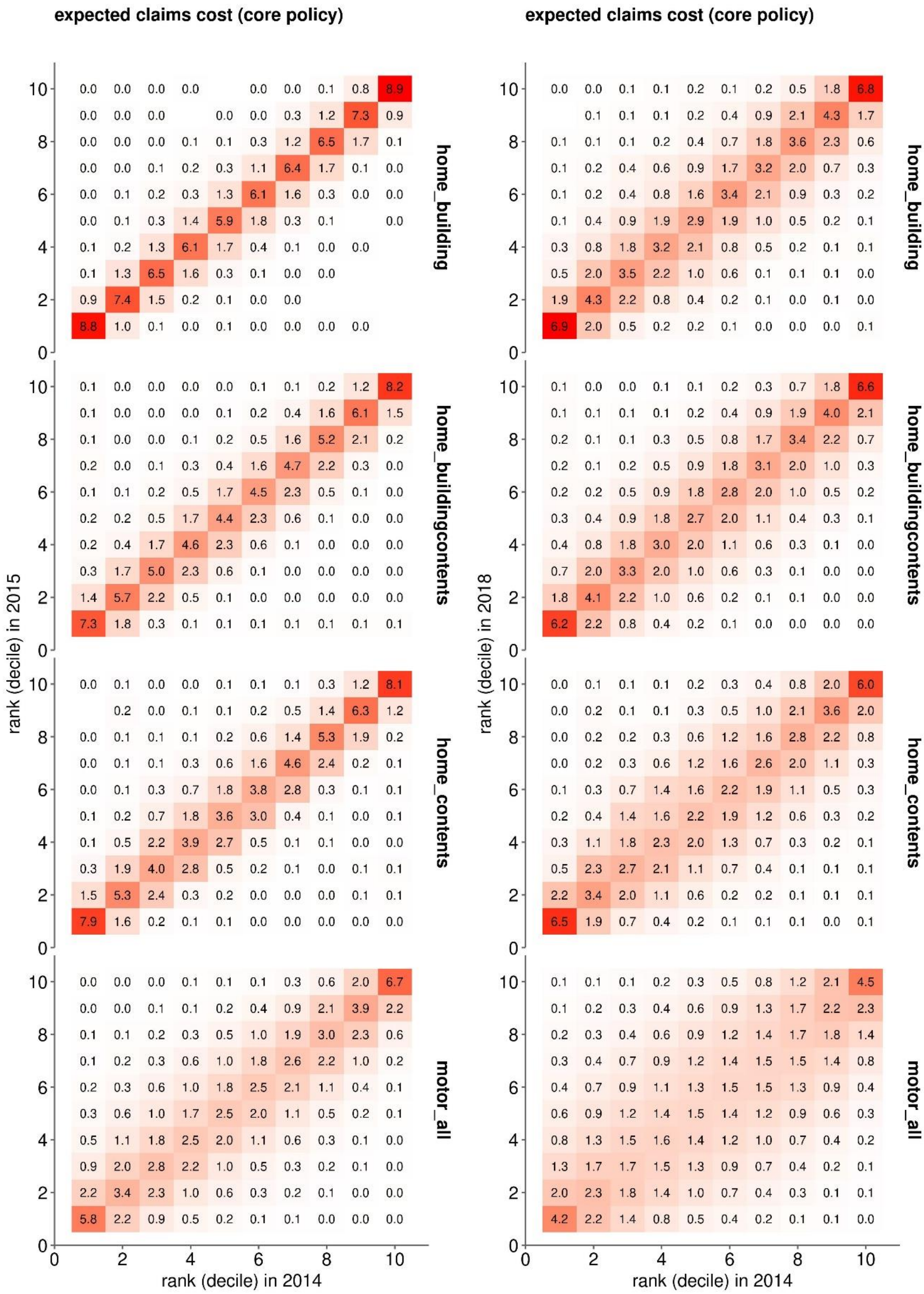
[6] Labels are rounded. when the label reads 0.0, it means that the proportion of observations characterised by that particular combination is lower than 0.04%, but still not exactly 0.

Figure 3: Rank stability of margin over time for policies underwritten in 2014 and renewed until 2018



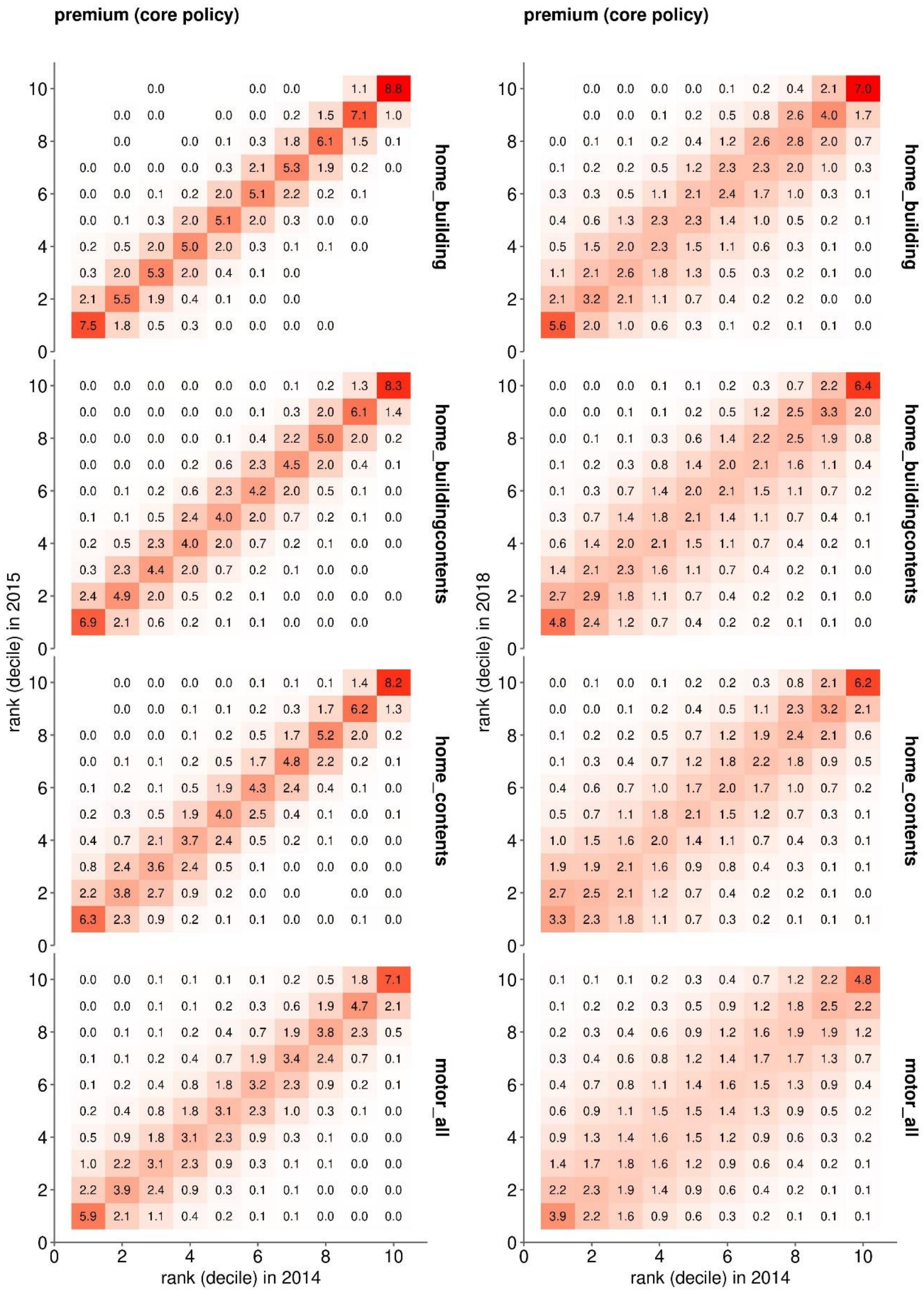
Source: FCA analysis of policy data provided by firms, full transaction dataset, subset of policies underwritten in 2014 and renewed until 2018. Low left corner for low values, top right corners for high values.

Figure 4: Rank stability of expected claims costs over time for policies underwritten in 2014 and renewed until 2018



Source: FCA analysis of policy data provided by firms, full transaction dataset, subset of policies underwritten in 2014 and renewed until 2018. Low left corner for low values, top right corners for high values

Figure 5: Rank stability of premium over time for policies underwritten in 2014 and renewed until 2018



Source: FCA analysis of policy data provided by firms, full transaction dataset, subset of policies underwritten in 2014 and renewed until 2018. Low left corner for low values, top right corners for high values

Conclusions

4.27 The evidence described above suggests that the heterogeneity of margins is the result of interactions between different features of the market. In particular, there is substantial price dispersion for new business customers that is not accounted for by price walking.

4.28 There is some evidence that customers who switch every year do not receive the lowest new business prices. However, there is very little evidence that longer tenure customers are offered lower new business prices to compensate for future higher prices.

4.29 While we expect that a remedy that prevents price walking would reduce price dispersion by evening out prices between new customers, regular switchers and long-standing customers, we also expect that a substantial amount of the margin dispersion driven by competition on brands, consumer characteristics and price sensitivity will remain. Therefore, so will consumer incentives to search and switch.

5 Characteristics associated with higher margins and longer tenure

5.1 The margin a consumer pays on their policy will depend on how active they are in the market - whether they search, switch or negotiate - and how firms set prices according to their estimate of a consumer's price sensitivity. Firms do not observe consumers' price sensitivity directly. However, they may use factors, often observable consumer characteristics, associated with price sensitivity to optimise the margins they charge different consumers. We do not directly observe many of these factors in our data.

5.2 In the Interim Report, we assessed the determinants of consumers paying high margins to understand if they shared any common characteristics. We found that after controlling for other characteristics, for both motor and home insurance, tenure (how long a customer has been with their insurer) was the most important factor influencing the level of margin. However, we also found that many consumers of long tenure do not pay high margins, perhaps because they actively negotiate a better deal with their provider. And there are also many new business customers paying relatively high margins.

5.3 In analysing the potential impacts of our proposed remedy on different consumer groups, it is helpful to consider the characteristics associated with both high margin consumers and long tenure consumers - as long tenure consumers are likely to benefit most from the remedy, while regular switchers are likely to benefit least.

5.4 We have looked at how observable consumer characteristics are correlated with both margin and tenure. It is important to note that tenure is the most important variable that we observe in explaining margins. The consumer characteristic that most significantly explains tenure is age – older consumers on average stay with their insurer for longer.

5.5 Other characteristics are less strongly correlated with tenure and margin. So, while we report statistically significant differences between sub groups, these do not tend to translate into large differences in the margins that consumers in these sub groups pay.

5.6 We use two sources of evidence to inform our analysis. Our joint dataset, described in the Interim Report, and findings from the FCA's 2020 Financial Lives Survey.

5.7 Financial Lives surveys over 16,000 UK adults, providing information on the financial products (including general insurance and protection) consumers have, their experiences and attitudes around dealing with money and the financial services market. In 2020 it surveyed 1141 motor insurance consumers, 746 home buildings and contents combined insurance consumers and 294 home contents only insurance consumers.[7]

5.8 We have assessed a number of consumer characteristics recorded within the two datasets. However, we restrict our reporting in this chapter to characteristics where a significant relationship with tenure is observed, and for which sample sizes are sufficiently large to robustly report results.

[7] To maintain a reasonable survey length, respondents are not asked detailed questions about all the financial products they hold. As such, more total survey respondents, than used to produce GI&P results, will have purchased GI&P products. Weights are applied to the data to make results representative of the UK population.

5.9 When using these datasets to identify characteristics correlated with tenure, it is also important to consider that we do not control for other characteristics which may also be related to tenure. For example, characteristics which are associated with tenure may also be correlated with age. In this case, age, rather than the characteristic itself, may explain the characteristic's correlation with tenure.

5.10 Further, in many cases, insurance policies may be jointly purchased. However, the characteristics we observe in our datasets will relate to a single individual - the survey respondent.

High margin consumers

5.11 As indicated above, in the Interim Report we found that there is a higher proportion of older consumers amongst high margin consumers. However, this is mostly driven by the relationship between age and tenure - new customers tend to be younger on average in comparison to long tenure customers.

5.12 Other findings on characteristics that we identified in the Interim Report to be correlated with higher margins include:

- High margin consumers exhibited various characteristics associated with lack of understanding, awareness or engagement. These consumers include those who have less financial knowledge, no internet access, and who trust insurance firms to offer them competitive prices.
- For consumers who bought combined contents and building insurance, lower income consumers (below £30,000) pay higher margins than those with higher incomes.
- There is some evidence that potentially vulnerable consumers can pay higher prices relative to their risk for home insurance, but we did not find this for motor insurance. We also did not find that any of the FCA's four drivers of vulnerability set out in our Approach to Consumers – heath, resilience, life events and capability - were consistently more common among high margin consumers.[8]

Longer tenure consumers

5.13 The Financial Lives survey results indicate a positive relationship between age and tenure across all markets. On average, older consumers tend to stay with their current provider for longer – although some of this association may reflect the fact older consumers have been purchasing insurance for longer. For motor insurance, consumers under 45 have been with their current insurer for less than two years on average. Consumers 65 and over have been with their insurer for more than four years, on average.[9] A similar relationship is observed in home insurance, where older consumers often spend even longer with their existing insurer, in comparison to motor.

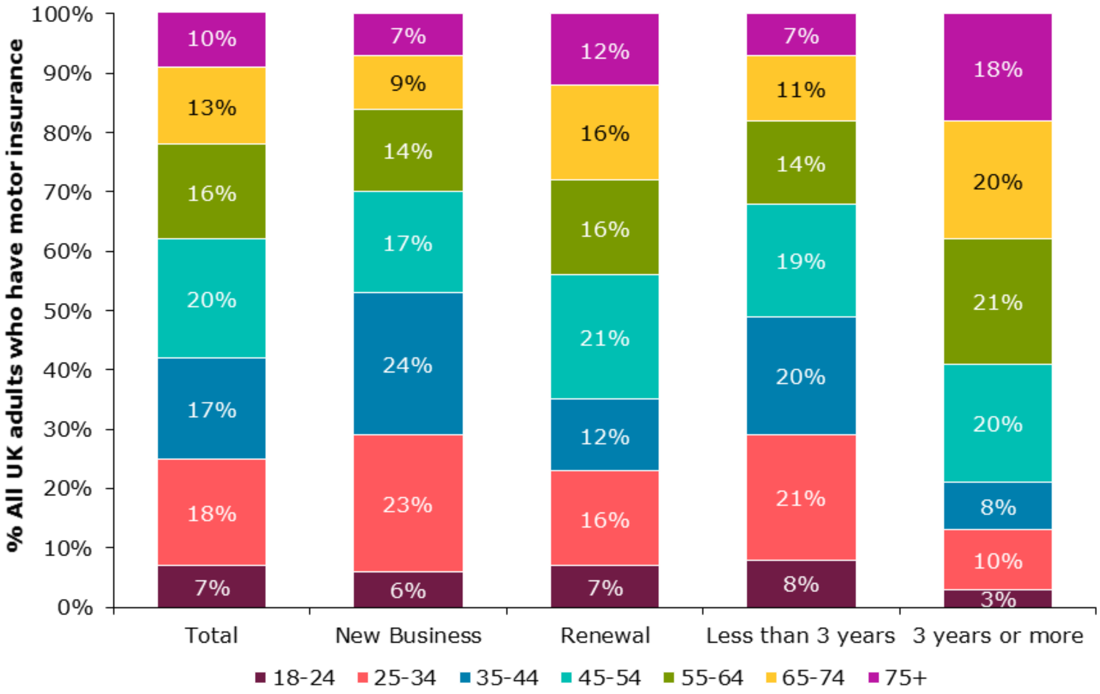
5.14 Similarly, there is also a higher proportion of older consumers amongst long tenure consumers. For motor insurance, around 51% of consumers with less than three years tenure are 45 or above. For consumers with more than three years tenure around 79% of consumers are 45 or above (Figure 6). A similar trend is observed in

[8] Also see Guidance for firms on the fair treatment of vulnerable customers

[9] In the FL survey tenure is reported within pre-defined discrete ranges, rather than requesting precise numbers. Means are calculated using the mid-point of a range, except in the case of consumers with 10 years or more tenure, where 15 is assumed. This approach has the advantage of reducing non-response, because participants feel more inclined to answer in ranges. It also reduces the impact of outliers on average values eg consumers with very high tenures. However, this approach inherently assumes that all answers in the specific range are grouped evenly around that midpoint (or 15), which may not be the case.

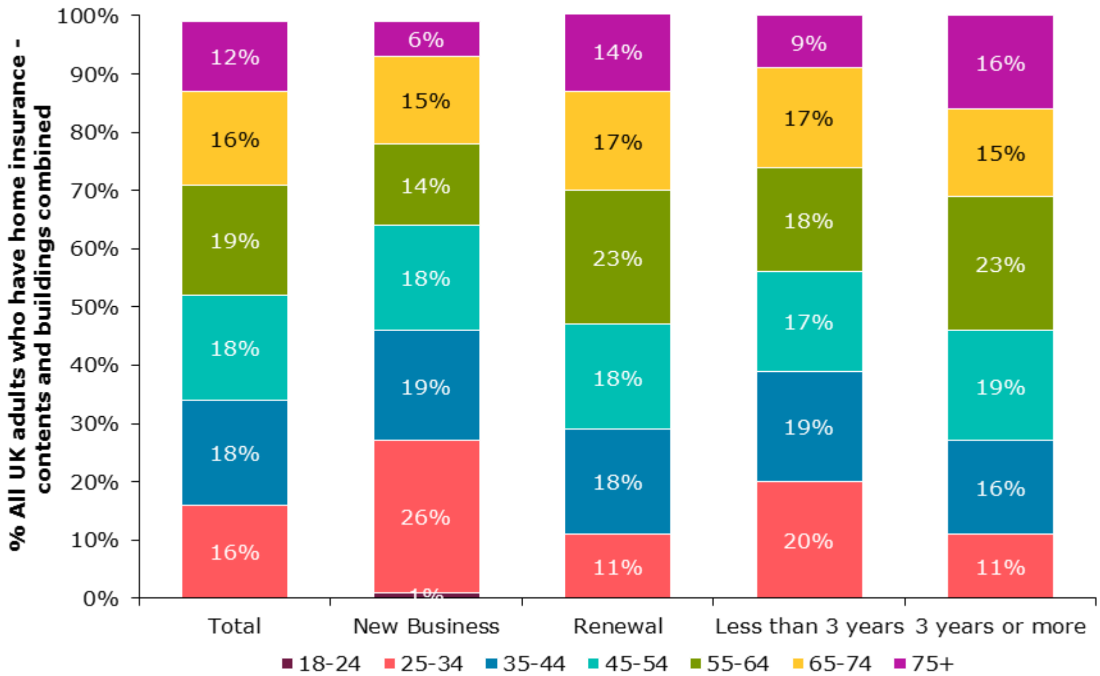
home insurance markets (Figure 7 illustrates results for buildings and contents combined). We also observe the same trend amongst consumers in the joint dataset.

Figure 6: Age distribution of motor insurance consumers by tenure



Source: FCA Financial Lives 2020. Note bars may not sum to 100 due to rounding. New Business equal to FL 'Less than 1 year'. Renewal equal to FL 'NET: 1 year or more'.

Figure 7: Age distribution of home buildings and contents combined insurance consumers by tenure



Source: FCA Financial Lives 2020. Note bars may not sum to 100 due to rounding. New Business equal to FL 'Less than 1 year'. Renewal equal to FL 'NET: 1 year or more'.

Vulnerability and tenure

5.15 The FCA defines a vulnerable consumer as somebody who, due to their personal circumstances, is especially susceptible to harm, particularly when a firm is not acting with appropriate levels of care. There are many reasons a person may be vulnerable. These may be related to health, capability, resilience, or the impact of a life event. Financial Lives suggests 35% of motor insurance and 36% of home buildings and contents consumers display one or more of these characteristics of vulnerability.[10] For contents only insurance, the proportion of consumers displaying characteristics of vulnerability is higher at 60%.

5.16 Financial Lives also suggests long tenure consumers could be more likely to display characteristics of vulnerability, although differences are often not large, linear or consistent across markets. In motor (Figure 8), 38% (39% in home buildings and contents) of consumers who have been with their insurer for less than one year display characteristics of vulnerability, while 45% of consumers with 10 years or more tenure display characteristics of vulnerability (47% in home buildings and contents - Figure 9). However, in both home and motor fewer than 100 respondents to the survey are recorded with 10 years or more tenure.

5.17 The proportion of consumers displaying characteristics of vulnerability also does not appear to progressively increase with tenure. For both motor and home buildings and contents, consumers who have been with their provider for 3 to less than 5 years have the lowest proportion of consumers displaying characteristics of vulnerability (21% in motor and 20% in home buildings and contents combined).

5.18 The proportion of consumers displaying characteristics of vulnerability is also sensitive to tenure groupings. When consumers with less than three, and three or more, years of tenure are grouped, longer tenure consumers are not more likely to display characteristics of vulnerability. For home buildings and contents, 39% of consumers with less than three years tenure display characteristics of vulnerability, while 29% of consumers with three or more years tenure display characteristics of vulnerability. In motor, the proportion of consumers displaying characteristics of vulnerability is similar for consumers with less than or more than three years tenure (35% & 34%).[11]

5.19 Within the joint dataset, in home insurance markets we observe limited evidence of differences in vulnerability across new business and long tenure consumers. In motor, the proportion of vulnerable consumers can be different between high tenure consumers and new business consumers. Although differences are generally small and vary across different vulnerability and tenure definitions.

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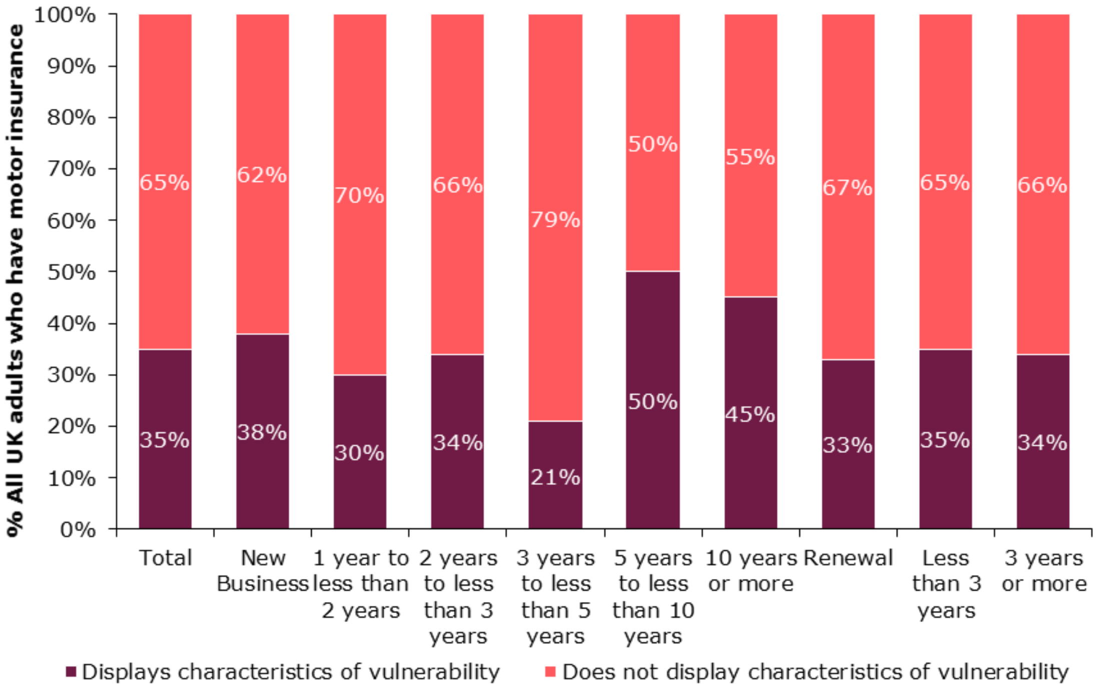
[10] Much of the surveying for Financial Lives 2020 was completed before March 2020 and therefore vulnerability outcomes will not reflect the impact of Covid-19.

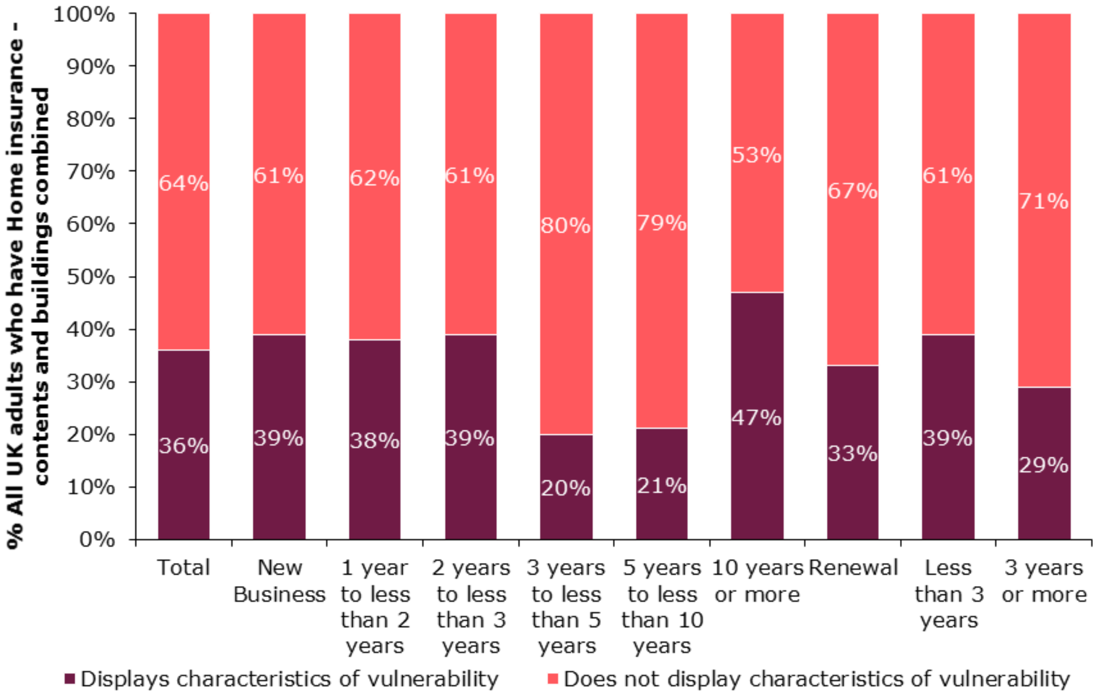
[11] For home contents only the proportion of consumers displaying characteristics of vulnerability is also similar for consumers with less than three (61%) and three or more (60%) years of tenure.

Figure 8: Vulnerability of motor insurance consumers by tenure



Source: FCA Financial Lives 2020. Note bars may not sum to 100 due to rounding. New Business equal to FL 'Less than 1 year'. Renewal equal to FL 'NET: 1 year or more'. 5 years to less than 10 years and 10 years or more groupings based on low sample size.

Figure 9: Vulnerability of home buildings and contents combined insurance consumers by tenure

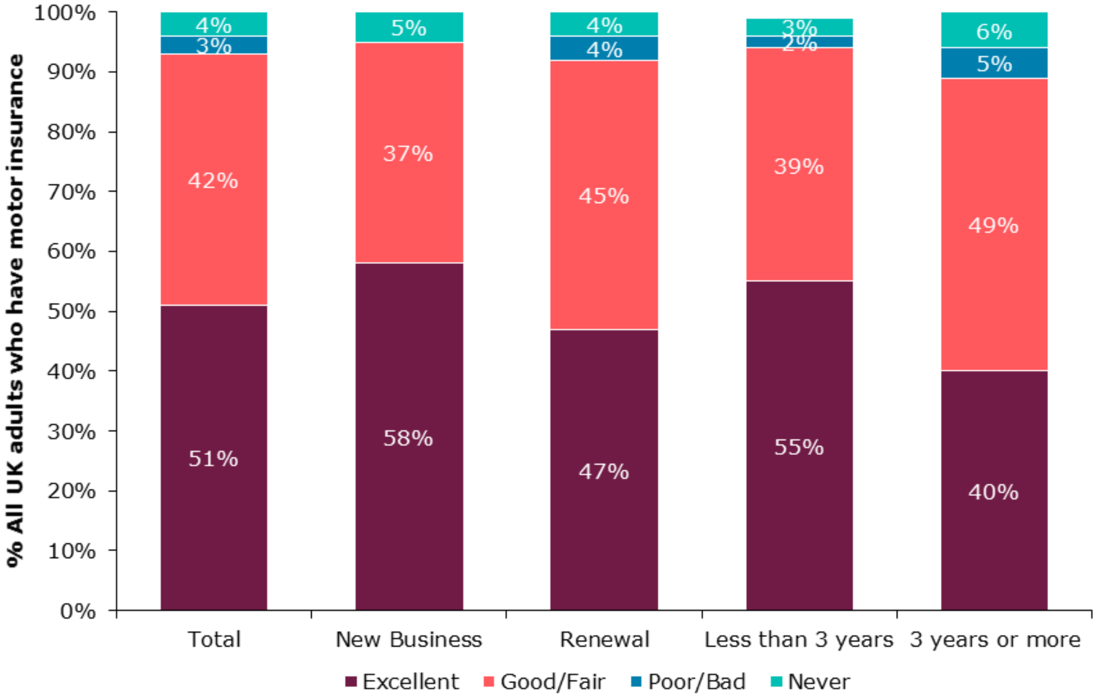


Source: FCA Financial Lives 2020. Note bars may not sum to 100 due to rounding. New Business equal to FL 'Less than 1 year'. Renewal equal to FL 'NET: 1 year or more'. 5 years to less than 10 years and 10 years or more groupings based on low sample size.

Other consumer characteristics

5.20 Financial Lives data also suggests long tenure consumers are less confident in using the internet. Around 5% of motor and home buildings and contents consumers with less than 1 year of tenure rate their ability with the internet as Poor/Bad or never use it. While around 11% of motor (8% home buildings and contents combined) consumers with 3 or more years of tenure rate their ability in the same way. Further, in motor (although less so in home buildings and contents combined) a lower proportion of consumers with 3 years or more tenure rate their internet ability as Excellent (Figure 10 and Figure 11). We observe a similar relationship amongst consumers in the joint dataset.

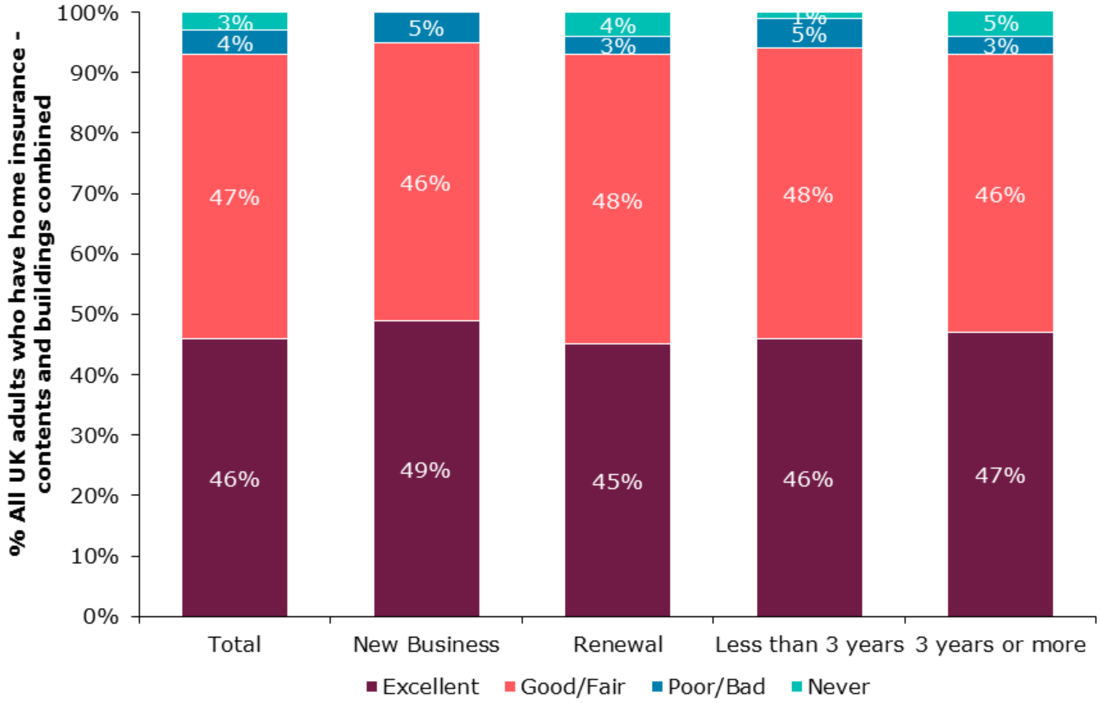
Figure 10: Internet ability of motor insurance consumers by tenure



Source: FCA Financial Lives 2020. Note bars may not sum to 100 due to rounding. New Business equal to FL 'Less than 1 year'. Renewal equal to FL 'NET: 1 year or more'.

5.21 The Financial Lives data also indicates that long tenure consumers may be more likely to have a household income below £30k, in comparison to shorter tenure consumers. 31% of motor and home buildings and contents combined consumers with less than three years tenure have a household income less than £30k, while 47% (36% home buildings and contents) of motor consumers with three or more years of tenure have a household income less than £30k. Although we do not observe the same consistent trend amongst motor and home consumers in the joint dataset.

Figure 11: Internet ability of home buildings and contents combined insurance consumers by tenure



Source: FCA Financial Lives 2020. Note bars may not sum to 100 due to rounding. New Business equal to FL 'Less than 1 year'. Renewal equal to FL 'NET: 1 year or more'.

5.22 Our joint analysis has also been used to assess differences in new business (less than 1 year of tenure) and high tenure (more than 5 years of tenure) consumers' market understanding, preferences and attitudes. It suggests:[12]

- High tenure consumers prefer brands they know and trust: 63% of home high tenure consumers (67% motor) prefer the comfort of being with a brand they know and trust, rather than changing regularly to get the best deal. For home and motor new business consumers it is 29%.
- Low tenure consumers are more likely to believe they are getting a good deal, believe it is worth shopping around and recently checked how good their current deal is: 40% of home new business consumers (47% motor) believe their current deal is amongst the lowest priced on the market. Only 18% (22% motor) of high tenure consumers believe the same. 17% of high tenure home consumers (18% motor) believe they could get a better deal, but the savings are not worth the hassle of shopping around, while only 7% (6% motor) of new business consumers believe the same. Only 6% of home new business consumers (4% motor) don't know how good their existing deal is because they have not checked for some time. 17% (12% motor) of high tenure consumers have not checked.
- High tenure consumers are more likely to believe price rises are linked to cost increases and believe their current price will remain competitive over time, even if they don't search: 39% of home high tenure consumers (42% motor) believe price rises are linked to increases in costs, while only 26% (25% motor) of new business consumers believe the same. 81% (75% motor) of high tenure home consumers believe the price they currently pay will become less competitive over time if they don't search, 87% (81% motor) of new business consumers believe the same.

[12] FCA analysis of joint dataset. All values unweighted proportions using filtered dataset.

- Low tenure consumers are more likely to believe shopping around can result in big savings and enjoy finding a good deal: 40% of home new business consumers (48% motor) strongly agree that there are big savings to be made by shopping around. Only 19% (21% motor) of high tenure consumers strongly agree. 26% (35% motor) of new business home consumers strongly agree that they feel good when finding a lower priced deal. Only 13% (15% motor) of high tenure consumers strongly agree.
- High tenure consumers are more likely to believe they don't have the time or energy to shop around: 44% of high tenure home consumers (46% motor) disagree or strongly disagree that they don't have the time or energy to shop around for a better deal. Almost 70% of home and motor new business consumers disagree or strongly disagree.
- Low tenure consumers are more likely to shop around due to their financial situation: 15% of home new business consumers (19% motor) strongly agree that their financial situation means they have to shop around. Only 5% (6% motor) of high tenure consumers strongly agree.
- High tenure consumers are more likely to believe there is a relationship between quality and price: 30% of high tenure home and motor consumers agree that a lower priced insurance provider is more likely to offer a lower quality product or service. 19% (14% motor) of new business consumers agree.
- High tenure consumers are less likely to be comfortable buying insurance products online: 16% of high tenure home consumers (15% motor) have on-line access, but are not particularly comfortable using it to search for or buy financial products. Only 6% (8% motor) of new business consumers are uncomfortable online.
- High tenure consumers are more likely to be unaware of the competitiveness of the product they own and have relatively low knowledge about insurance products: 59% of home high tenure consumers (65% motor) misunderstand firms' pricing practices while only 53% (52% motor) of new business consumers misunderstand. 26% of home high tenure consumers (18% motor) have relatively low self-reported knowledge about insurance products while only 17% (14% motor) of new business consumers have low knowledge.

Price walking and the sale of add-ons and premium financing

5.23 In our Interim Report, we found that many firms' pricing models consider consumers' likelihood to purchase add-ons or premium finance when setting the core price. For the Interim Report, however, we mainly investigated price walking, looking at the margin for the core policy.

5.24 As a significant proportion of policies are sold with add-ons we were concerned that pricing practices for add-ons could be contributing to the harm observed (in 2018, 44% of home policies in our sample and 21% of motor policies were sold alongside at least one add-on). Data limitations affect the conclusions we can draw when assessing how add-on margins change with customers' tenure in the transaction dataset. However, we haven't seen evidence of progressive increases in add-on margins for renewing customers. We looked at the difference in margin on the core policy for consumers who purchased add-ons, and those who did not. We found it to be around 4 percentage points lower for both home and motor consumers who buy add-ons.

5.25 We also looked at premium finance, as 25% of consumers in home and 51% in motor insurance used premium finance to purchase their insurance. In this case too we did not find evidence of a progressive increase in interest rates and fees upon renewal. Our approach to add-ons and premium finance in the pricing remedy is set out in Section 3 of the Consultation Paper.

6 Business model implications for firms

6.1 This section looks at the potential implications of the proposed pricing remedy for firm business models, which informs how competitive conditions may develop in response to the remedy.

6.2 From the Interim Report we know that there is a high level of heterogeneity across firms in terms of business models, cost structures and characteristics of their customer base. In response to our proposed remedies, firms will continue to be able to flex their business strategies to pursue their targets. For instance, some insurers could decide to pursue aggressive market expansion while others could focus on niches; some could focus on strong brand proposition while others could choose more aggressive price competition.

6.3 Due to the variety of potential responses, we have not modelled how individual firms could strategically adapt to the proposed restriction on price walking. Instead, we performed a range of analyses using historical financial information (2013-2018) gathered for the market study and business model information to:

- Understand the levers firms in the motor and home general insurance markets have at their disposal to adjust their business strategies to the proposed pricing remedy. This proved important both to understand the degree of flexibility each firm has, but also to inform the design of the proposed remedy in a way that maximises the likelihood of its effectiveness.
- Understand whether competition for new customers is likely to continue to effectively constrain overall prices. This is important insofar as the proposed remedy, to fully achieve the desired outcomes, should change competitive dynamics.
- Sense-checking that the conclusions underpinning our proposed intervention continue to hold notwithstanding the changes generated by COVID-19. This is important as we are proposing a package of measures that will lead to a shift in the home and motor insurance market at a time of significant strain.

Business model implications for insurers

Our sample

6.4 The largest players in our sample and a few medium players serve as multi-channel end to end providers. These well-known brand names are mass market insurers which utilise different channels to distribute their products. Only two insurers have a large market share in both the home and motor markets.

6.5 Our sample includes a few firms which design and develop their products for the mass market, and then distribute only through PCWs or directly. It also includes one firm that designs their own product but only distributes through intermediaries.

6.6 Our sample also includes a small group of intermediaries with their own smaller insurer in-house. These intermediaries behave like end-to-end providers (usually through delegated authority) and refer to a panel of insurers, which includes their own in-house underwriting business. These firms are also well-known brand names.

6.7 In both home and in motor, 7 firms have approximately 80% of market share. In home, this is primarily end-to-end providers with a well-known brand and a large customer base. In motor, there is a more even split between these large end-to-end providers, intermediaries with their own smaller insurer, and insurers which distribute through PCWs and directly only. The value propositions and key revenue sources for these firms in both home and motor are largely similar.

How dependent firms are on back book, degree of margin-walking and variation in attrition

6.8 The effects of our remedy will depend on a number of factors, including how steeply firms price walk, the size of existing back books, and the level of current attrition rates.

6.9 In both home and motor, almost all firms in our sample price walk to some extent. In motor, we observed one insurer which offers no discount for new customers, and earns a flat margin. We see that home insurers of all sizes typically have larger back books and price walk more steeply than motor insurers.

6.10 We note that attrition rates are relatively high in both markets – although rates in home are lower than motor in general (approximately one third vs approximately half) – and that new business accounts for a substantial part of the book for most firms. Firms in general in both markets lose about a third to half of their customers every year so there is a need to stay in the new business market in order to replenish and maintain their books and market share. The pressure on firms to stay competitive in new business is higher in the motor market due to the higher level of switching and the greater use of PCWs as a distribution channel.

6.11 In motor, out of 14 (all) firms in our sample, only 5 (less than half) reported a customer base composed predominantly of customers who have only renewed their policy a limited number of times (less than 5 times). 9 (more than half) of the firms in our sample, instead, reported that a significant proportion of their customer base has renewed their policy for 5 or more years.

6.12 In response to the proposed pricing remedy, firms could attempt to increase the new business price as a means to mitigate any reductions in back book revenue. However, we expect competition in the market to limit the level of such increases. We were told by firms that consumers, especially in the motor market due to the prevalence of PCWs as a distribution channel, are sensitive to how new business prices compare between providers. Increases in prices relative to those of competitors will result in lower numbers of policies sold, and a lower base over which to spread fixed costs.

6.13 Half of the small motor firms in our sample have small back books (renewal), so the remedy may provide an opportunity for them to grow their mainstream (non-niche) consumer base (if they have one) by eroding market share from the larger players who currently tend to price walk and could therefore be tempted to materially increase their front book prices in an attempt to offset the downward pressure on back book profitability.

6.14 In home insurance, 10 out of 16 (most) firms in our sample have large or very large back books, and half of firms use steep or very steep price walking curves, which suggests that firms in this market will mostly be impacted by the constraint brought upon by the pricing remedy. This would suggest that the upward pressure on new business prices will be greater in the home market than in motor.

6.15 However, also for home, we observe a high number of players, variety of business models, distribution channels and value propositions, and importantly variation in costs. Firms in the market have invested in growing their market share and brand recognition and are unlikely to exit the market. Therefore, competition is likely to remain fierce and capable of constraining a generalised increase in prices. In this case too, we expect the proposed remedy will foster a shift in market share towards firms which are more efficient in underwriting risk and controlling operating costs.

6.16 As a result, despite the impact of the pricing remedy on the financials of firms, we do not think that firms will exit new business to concentrate only on back books.

Will COVID-19 have any impact on our assessment of firms' reactions to the pricing remedy?

6.17 We have also conducted additional analysis to explore the implication of the shocks from Covid-19 for firms and our proposed remedies.

6.18 Our analysis of the available evidence suggests that the pandemic has not had a particularly significant impact on home and motor insurance, although there has clearly been a much more material impact on other lines, such as travel and business interruption insurance.

6.19 Firms in our sample write between 1 and 7 lines of business (including home and motor), with the average being 4 lines. 47% of firms in our sample write travel insurance. Those firms who write policies across many lines may be impacted financially.

6.20 The incentives of firms and the levers they have at their disposal to react to the pricing remedy do not materially change post COVID-19, especially for home and motor lines. This is because we do not expect to see significant impacts on risks and costs. We do, however, think that competition in home and motor could increase as firms adapt to the new consumer behaviour of wanting more flexible cover.

6.21 The level of exposure to the most impacted lines - e.g. business interruption, travel, event cancellation – varies across firms. Of those firms, some extensively rely on price walking. They will therefore face additional financial pressure from the combined effect of COVID-19 and the proposed pricing remedy. This, however, will not structurally alter the competitive incentives described in the previous sections.