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Differential Pricing in Practice

November 2022

CBI differential pricing regulation

Effective 1st July 2022

The Central Bank of Ireland (CBI) has introduced new regulation* regarding differential pricing for home insurance and motor insurance policies, effective 1st July 2022.

In this brochure, Deloitte is setting out some of the background considerations for pricing actuaries and underwriting teams, including critical steps over the next six months and how we can help.

CBI differential pricing regulation for insurers and intermediaries – key elements

Treating customers fairly

- **Ensure no systematic discrimination** takes place against consumers with longer tenure for **motor** and home insurance products from **July 2022**
- Subsequent renewal prices to be set **no higher** than **the equivalent first renewal price.**
- Assumption that consumer's previous **sales channel** and **payment method** are used.
- Above principles applicable on **add-on products, service** and **closed books.**

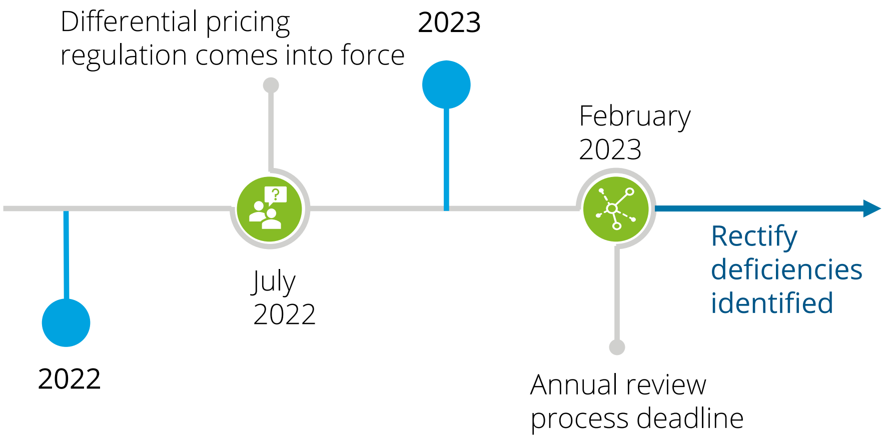
Annual review process

- To hold the annual review process within **two months** of each year end, starting **February 2023**.
- **Written records** to evidence **no systematic discrimination** against consumers with longer tenure and **adequate controls** in place.
- **Rectification for any deficiency** identified during the review process.

Renewal documentation

- **Cancellation rights documented** for consumers (any time during the policy and free of charge).
- **Notification to the consumer** regarding **automatic renewal** and details on opting out.

2022/2023 timeline



** Central Bank (Supervision and Enforcement) Act 2013 (Section 48(1)) (Insurance Requirements) Regulations 2022*

Annual review and record-keeping

Our view of market best practices for pricing governance, controls and monitoring

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A holistic approach to pricing

Pricing policy

- A clear description of the aims and objectives of pricing
- Statements on the treatment of special classes of consumer, e.g., vulnerable consumers.

Pricing methodologies register

To create transparency in the pricing practices in use and to record approvals

Pricing governance

- Holding a regular pricing forum with minutes and terms of reference
- Roles and responsibilities for pricing and pricing sign off
- Documented rate change process
- Annual reviews as required by the proposed regulations

Clear management information

- Relevant KPI's defined with tolerances
- Appropriate tracking and forums

The non-prescriptive nature of the regulation

The implementation of this regulation should be consistent with the "spirit" of the regulation. The regulation is intended to be interpreted to suit an individual company's circumstances and not put undue regulatory burden on firms. However, we note that:

- There is no description or guidance as to how to actually implement the duration-neutral pricing required;
- There is no mention of how renewal prices will be ensured to be set no greater than the equivalent first renewal price;
- The idea of "systematic discrimination", while easy to understand in spirit, may not translate to the quantitative nature of pricing insurance policies as smoothly as anticipated.

Thus, we feel that it is important to adopt a holistic approach to pricing so that all elements of the pricing ecosystem are well documented, understood across the organisation and clearly call out the aims of pricing along with detailing how the company's approach meets the regulations. We recommend considering the list of exhibits here as key elements of a holistic pricing approach.

This regulation is particularly important for the protection of vulnerable consumers, who may be less likely to shop around at renewal. Management information and key performance indicators (KPIs) could be used on an aggregate level to check if consumers are being treated fairly. The type of fairness actually being measured would then need to be communicated to stakeholders. For example, if metrics are based on groupings of vulnerable consumers, this should be communicated, alongside how accurate and complete these groupings are.

Consideration of the regulation during pricing exercises

There will need to be consideration of the new regulation during pricing exercises going forward. If changes to the product suite offered by a company are to be made, or a POG (product, oversight and governance) review is being carried out, for example, a link needs to be made with the differential pricing regulation.

There is a possibility that the way that insurance is packaged will change quite dramatically in the future – if this is the case, pricing actuaries will need to incorporate it into future product development.

For example, the emergence of "insurtech" companies may result in new models that outcompete the existing "traditional" models used by insurers reaching the market over the next decade. In order to remain competitive, insurers will potentially need to overhaul their existing products and pricing models, which will need to be compliant with the CBI's differential pricing regulation.

The bigger picture

Things you need to consider in practice

Looking forward

Knock-on effects of implementing a new pricing methodology will also need to be considered by insurers and intermediaries. If different groups of consumers are affected in different ways by the regulation, business mix could change. Certain groups may be more attracted by lower premium rates than before, some may decide to shop around when they see competitors offering reduced rates. This change in business mix and policyholder behavior may result in assumptions for future business volumes, retention rates and assumed profitability needing to be adjusted, which could affect the entire business planning processes such as reserving.

There could also be effects on resource allocation within insurance companies and intermediaries – responsible parties for ensuring that pricing models comply with the regulation and for performing the annual review process will need to be identified.

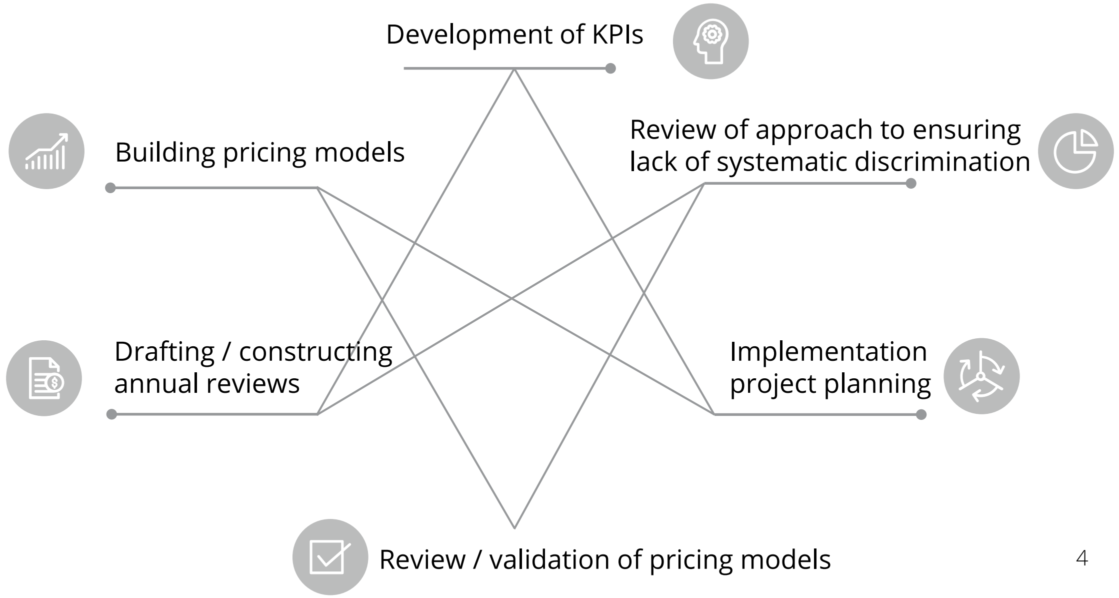
It is particularly important to consider these effects prior to the first annual review process completed by February 2023, where unexpected pitfalls may arise.

How can Deloitte help?

If you are thinking about differential pricing or considering how your pricing approach may be affected under the new regulation, Deloitte's actuarial team has a wealth of experience that can assist in meeting your needs and navigating the new regulatory environment.

Although insurers and intermediaries are already implementing duration-neutral pricing as of the 1st July, Deloitte is prepared to review the pricing models used to ensure that they are compliant with the CBI's regulation. Interactions and cross-dependencies between the new differential pricing regulation and previous pieces of legislation and regulation are likely to be a concern, which Deloitte's extensive network of actuaries and insurance professionals can help to navigate.

We would be happy to discuss any aspect, shown in the diagram across, of the implementation of the CBI differential pricing regulation.



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