

Impact Assessment of Supervisory statement on differential pricing practices in non-life insurance

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eiopa

European Insurance and
Occupational Pensions Authority

1. PROCEDURAL ISSUES AND CONSULTATION OF INTERESTED PARTIES

According to Article 29(2) of the EIOPA Regulation,¹ the Authority conducts, where appropriate, an analysis of costs and benefits in the process of issuing opinions or tools and instruments promoting supervisory convergence. The analysis of costs and benefits is undertaken according to an Impact Assessment methodology.

EIOPA delivers this draft Supervisory statement on differential pricing practices (Supervisory statement) on its own initiative on the basis of Articles 17, 20 and 25 of Directive (EU) 2016/97² (the IDD) and Commission Delegated Regulation (EU) 2017/2358³ (POG Delegated Regulation), in particular Articles 4, 5, 6, and 7 thereof.

This Supervisory statement is addressed to the competent authorities⁴, as defined in Article 4(2) of Regulation (EU) No 1094/2010.

The Supervisory statement builds on previous work developed by EIOPA, including the 2018 European Supervisory Authorities (ESAs) report (preceded by a public consultation) on the use of Big Data by financial institutions⁵ and EIOPA's 2019 thematic review on the use of Big Data Analytics (BDA) in motor and health insurance.⁶

The Supervisory statement also leverages on the AI governance principle report⁷ developed by EIOPA's stakeholder expert group on digital ethics in insurance, as well as on the monitoring of these practices conducted by EIOPA via its annual Consumer Trends reports,⁸ which includes a consumer research assessment as well as feedback provided from National Competent Authorities (NCAs) about the use and issues arising from differential pricing practices in their jurisdictions.

¹ Regulation (EU) No 1094/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/79/EC (OJ L 331, 15.12.2010, p. 48).

² Directive (EU) 2016/97 of the European Parliament and of the Council of 20 January 2016 on insurance distribution (OJ L 26, 2.2.2016, p. 19).

³ Commission Delegated Regulation (EU) 2017/2358 of 21 September 2017 supplementing Directive (EU) 2016/97 of the European Parliament and of the Council with regard to product oversight and governance requirements for insurance undertakings and insurance distributors (OJ L 341, 20.12.2017, p. 1).

⁴ Notwithstanding the fact that specific points of this Supervisory Statement describe supervisory expectations for insurance and reinsurance undertakings, they are required to comply with the regulatory and supervisory framework applied by their competent authority based on Union or national law.

⁵ <https://esas-joint-committee.europa.eu/Publications/Reports/Final%20Report%20on%20Big%20Data.pdf>

⁶ https://www.eiopa.europa.eu/document-library/fact-sheet/big-data-analytics-motor-and-health-insurance_en

⁷ <https://www.eiopa.europa.eu/sites/default/files/publications/reports/eiopa-ai-governance-principles-june-2021.pdf>

⁸ https://www.eiopa.europa.eu/document-library/consumer-trends-report/consumer-trends-report-2021_en

The draft Supervisory Statement and its Impact Assessment are envisaged to be subject to a public consultation. Stakeholders' responses to public consultation will serve as a valuable input in order to revise the policy proposals.

2. PROBLEM DEFINITION

Differential pricing practices, where consumers with a similar risk and cost of service are charged different premiums for reasons other than risk and cost of service, are not new for the insurance sector. However, advances in new technologies and the availability of new datasets enable insurance firms to increasingly tailor the premium paid by the customer to their personal behaviour and characteristics, such as their low propensity to shop around or their price elasticity. The competitive pressure in the markets can also lead to an increasing use of these practices, and therefore impacting a larger number of consumers.

Consumers who are more prone to search for a better deal and switch at point of renewal are likely to benefit from differential pricing practices (or at least less likely to suffer any disadvantages) in comparison to consumers with similar risk and cost to serve characteristics, but a lower propensity to switch. Differential pricing practices can also encourage price competition and innovation in the market, and therefore facilitate access to insurance products for some consumers unable or unwilling to pay a higher premiums.

However, consumers that are less price sensitive, less inclined to switch and more likely to renew their insurance products without searching for an alternative are more likely to lose out due to differential pricing. Insurance firms may identify that they are able to charge these customers more than they would charge similar consumers in terms of risk and cost to service, and increase prices accordingly at point of renewal.

This could be particularly concerning where the groups of consumers that suffer most are more vulnerable consumers (e.g. old age, low income), or are suffering because of potentially unfair discriminatory practices. It may also be that consumers' vulnerability is what is causing them to suffer, for instance if they do not have time to search and switch to a cheaper provider due to a particular life circumstance they are in.

The increasing use of different types of behavioural data increases the risks that some of these datasets can be biased (i.e. correlated with protected characteristics) and therefore increases the risks of indirect discrimination. These risks are amplified when processed with complex AI systems, which can find non-linear combinations between the variables and therefore somehow reconstruct protected information. Furthermore, some of these practices may be dangerous from a financial stability point of view, since the premium then is not risk adequate any more.

3. OBJECTIVE PURSUED

In the preparation of the supervisory statement on differential pricing practices (the Supervisory statement), EIOPA took into consideration the general objectives of the Insurance Distribution Directive (IDD), particularly: the enhanced consumer protection, promoting supervisory convergence and deepening the integration of the EU insurance market.

The provisions of the Supervisory statement were also guided by EIOPA's objectives to contribute to, as reflected in the EIOPA Regulation, in particular:

- improving the functioning of the internal market, including in particular a sound, effective and consistent level of regulation and supervision,
- ensuring the integrity, transparency, efficiency and orderly functioning of financial markets,
- preventing regulatory arbitrage and promoting equal conditions of competition,
- ensuring the taking of risks related to insurance, reinsurance and occupational pensions activities is appropriately regulated and supervised
- enhancing customer protection, and
- enhancing supervisory convergence across the internal market.

More particularly, the Supervisory statement has the following objectives:

- Objective 1: to ensure differential pricing practices do not result on unfair treatment of consumers;
- Objective 2: to promote good supervisory practices and supervisory convergence

4. POLICY OPTIONS

With the intention to meet the objectives set out in the previous section, EIOPA has analysed different policy options throughout the policy development process.

The following table provides an overview of the most relevant policy issues that have been discussed in the policy development process and the main options considered where the following:

- Policy option 1 - No action (maintain status quo)
- Policy option 2 - Develop a thematic review of a differential pricing practices
- Policy option 3 - Develop a Supervisory statement on differential pricing practices
- Policy option 4 – Develop a warning on differential pricing practices
- Policy option 5 - Ban on differential pricing practices

5. ANALYSIS OF IMPACT OF DIFFERENT POLICY OPTIONS

1.1. The following tables summarise the costs and benefits for the main options considered for stakeholders:

Policy option 1: No action (maintain status quo)		
Stakeholder groups	Benefits	Costs
Consumers	Consumers more prone to shop around at the renewal stage will be able to still benefit from lower prices during the first year(s) of the contract and then switch to a different provider once their premium increases. Some consumers would therefore be able to access more affordable insurance products, benefiting the financial inclusion of some consumers	Loyal customers, potentially including vulnerable groups, will continue to be penalised by paying higher premiums due to their personal characteristics such as their low propensity to shop around. Some vulnerable groups (e.g. old age) can be more impacted by differential pricing practices, hence negatively affecting their financial inclusion. Consumers unaware of the existence of differential pricing practices can face difficulties to adopt informed decisions. In view of market dynamics including market competitive pressures and advances in technology, differential pricing practices will increasingly affect greater number of consumers over time.
Industry	Insurers would have no restrictions to offer price discounts and other rebates to attract and retain customers.	No additional compliance costs, although costs might arise from unclear supervisory expectations and different approaches in different EU Member States. Potential level playing field issues between entities not using differential pricing practices vs. entities using them.

Supervisors	No impact.	Additional costs may arise from the need to enforce supervisory actions to ensure compliance with legislative framework.
Other	N/A	N/A

Policy option 2: Development of a thematic review on differential pricing practices

Stakeholder groups	Benefits	Costs
Consumers	No material impact	A thematic review to gather further empirical evidence would delay the introduction of any potential policy measures at least 1-2 years.
Industry	No material impact	Ad-hoc data collection requirements can be onerous for the industry, also bearing in mind that differential pricing practices can involve commercially sensitive data.
Supervisors	While there is already some empirical evidence available, a thematic review will provide more empirical evidence on the use and implications of differential pricing practices for consumers and potential vulnerable groups (e.g. old age).	Resources would be needed for collecting and analysing the data, and then subsequently to potentially develop any policy measure in case any issues were identified. It is arguable to what extent a thematic review would provide substantially different evidence to the one already available.
Other	N/A	N/A

Policy option 3: Development of a Supervisory Statement on differential pricing practices		
Stakeholder groups	Benefits	Costs
Consumers	<p>Loyal customers will not be significantly penalised based on behavioural characteristics such as their low propensity to shop around or “willingness to pay”, which could be particularly relevant for some groups of vulnerable consumers.</p> <p>Consumers will also be able to adopt more informed decisions when purchasing insurance products since they will not be subject to unexpected, sudden, significant price increases at the renewal stage.</p>	<p>Consumers who are more prone to shop around may have less opportunities to search for a better deal at point of renewal. Less price competition as a result of less price differentiation practices could potentially lead to higher prices in the market and reducing access to more affordable products.</p>
Industry	<p>Greater clarity regarding the supervisor expectations on differential pricing practices will help the industry improve their compliance with regards to their legal obligations. A common supervisory approach will also promote a level playing field in the market. New insurance products could be introduced in the market targeted to</p>	<p>Depending on whether they were already using differential pricing practices or not, less price differentiation practices could impact their ability to attract and retain customers. Product manufacturers willing to continue engaging on differential pricing practices may need to incur in compliance costs to upgrade their product governance and oversight framework.</p>

	more specific target markets, hence improving competition in the market and promoting financial inclusion.	
Supervisors	Successful application of the Supervisory statement will reduce the number of situations where supervisory intervention is required to ensure the correct application of the legislative framework.	Some potential costs are envisaged to adequately train staff on differential pricing practices and develop new supervisory activities related to differential pricing practices.
Other	N/A	N/A

Policy option 4: Warning on differential pricing practices

Stakeholder groups	Benefits	Costs
Consumers	Loyal customers would be less penalised by differential pricing practices, and consumers willing to shop around for better deals would still be able to do it, albeit potentially to a lesser extent.	Increased lack of trust in the sector given the nature of warnings that may cause alarm. Potentially less opportunities to shop around and less price competition.
Industry	Greater clarity regarding the supervisory expectations will help comply with legal obligations and promote a level playing field. New tailored insurance products could be introduced in the market targeted to more specific target markets, hence	Potential reputational risks as a result of alarm caused by a warning. Entities already using differential pricing practices may need to adapt their practices and/or their governance framework around them.

	improving competition in the market and promoting financial inclusion.	
Supervisors	Successful application of the warning may reduce the number of situations where supervisory intervention is required to ensure the correct application of the legislative framework.	Some potential costs are envisaged to adequately train staff on differential pricing practices and develop new supervisory activities related to differential pricing practices. A warning may require more immediate actions than a Supervisory statement.
Other	N/A	N/A

Policy option 5: Ban on differential pricing practices

Stakeholder groups	Benefits	Costs
Consumers	Loyal customers, potentially including vulnerable groups, would pay the same price for an insurance product than new customers with the same risk profile and cost of service.	Consumers would see significantly reduced their capacity to shop around for better deals, which could impact the financial inclusion of some consumers that would have difficulties to access more affordable offers during the first year(s) of the insurance contract.
Industry	A level-playing would be guaranteed since all market participants would need to apply the same rules.	Undertakings already implementing differential pricing practices would incur in significant compliance costs and would need to change their pricing strategy and see limited their capacity to attract and retain customers.
Supervisors	A ban on differential pricing practices would arguably be easier to supervise compared	There is arguably not sufficient evidence at EU level about the use and impact on consumers on differential

	to a more principles-based approach requiring analysis of the governance measures put in place.	pricing practices to impose a complete ban on differential pricing practices, also bearing in mind that some differential pricing practices can be beneficial for consumers.
Other	N/A	N/A

6. COMPARISON OF THE DIFFERENT POLICY OPTIONS

The preferred policy option for this policy issue is option 3 Development on Supervisory Statement on differential pricing practices.

Without the introduction of any additional policy measure, the current status quo would fail to adequately protect consumers, including potential groups of vulnerable consumers, from the risks arising from differential pricing practices. There is already evidence available at EIOPA about the use of these practice in the EU, and market trends such as strong competitive pressure as well as advances in technologies (including AI systems) and greater availability of data (Big Data) suggest that the adoption of these practices will increase and therefore increasingly affecting larger number of consumers.

Moreover, without the issuance of supervisory expectations at EU level, the entire industry faces the risk to develop non-homogenous practices and apply them in a non-homogeneous pattern, harming the goal of achieving a level playing field in the market with the establishment of good and convergence supervisory practices with regards to differential pricing practices.

Given that there is already a legislative framework in place that covers the use of differential pricing practices, the supervisory statement, following a risk based approach, focuses on explaining which are the supervisory expectations with regards to the application of this legislative framework, namely concerning the IDD and POG Regulation requirements. In view of the use of AI systems to implement differential pricing practices, enhanced governance principles should also be embedded in the POG requirements.

By clarifying which are the supervisory expectations, differential pricing practices which have a higher probability of causing consumer detriment (e.g. price walking practices) will be discouraged. However differential pricing practices would not disappear completely; it would still be possible to implement them provided that there are adequate governance frameworks in place to mitigate the risks for consumers, including vulnerable groups. This would allow consumer that are more price sensitive to continue to shop around in search for discounts and benefit from the opportunities

offered by differential pricing practices. Insurance manufactures would also continue having the opportunity implement pricing practices aimed to attract and retain customer in a sound manner.

A thematic review on differential pricing practices would provide further quantitative evidence on the extent to which differential pricing practices are used in the EU and the issues arising from them. However it is not deemed to be the most suitable policy option given that, on the hand, EIOPA has already gathered relevant data through different sources in the past years, and on the other hand it would further delay, in case relevant, the potential adoption of policy measures to meet the objective of enhancing consumer protection.

While Policy Option 3 and 4 would lead to similar results, the most advantageous in terms of costs and benefits is Policy Option 3, issuing a Supervisory Statement to promote convergence in the approach to assessing differential pricing practices. Indeed, a warning could potentially create alarm in the sector, which could not be justified, among other things considering that some consumers can benefit from differential pricing practices.

Finally, a complete ban of differential pricing practices is considered not to be the more suitable policy option, given that consumers more prone to shop around would not be able to search for more attractive prices, which would benefit the financial inclusion of some consumers in the sense that they would be able to access more affordable prices during the first year(s) of the contract. Furthermore, insurance manufacturers should still have some flexibility to implement sound pricing strategies aimed to attract and retain consumers.

7. QUESTIONS FOR THE PUBLIC CONSULTATION

- Do you agree with the analysis of costs and benefits?
- Do you agree with the policy option chosen by EIOPA?

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