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EIOPA Differential Pricing Practices Public Consultation

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Introduction

1. Background and rationale

The European Insurance and Occupational Pensions Authority is launching a public consultation on a supervisory statement on differential pricing practices in non-life insurance.
This consultation is a response to concerns that some differential pricing practices can be detrimental for consumers and result in unfair treatment.
It aims to ensure that differential pricing practices do not result in unfair treatment of consumers, as well to promote greater supervisory convergence amongst National Competent Authorities.
The supervisory statement sets out the supervisory expectations on this matter following a risk-based approach. Insurance manufacturers would still be able continue to use some differential pricing practices, but other practices are considered to not be compliant with the applicable legislative framework.
Insurance manufacturers wishing to make use of differential pricing practices must demonstrate that they have adequate POG measures in place to ensure the fair treatment of consumers and the mitigation of consumer risks.

2. Responding to the Consultation Paper

EIOPA welcomes comments on the Consultation paper on Supervisory statement on differential pricing practices in non-life insurance lines of business.

Comments are most helpful if they:
respond to the question stated,
where applicable; contain a clear rationale;
and describe any alternatives EIOPA should consider.

Please send your comments to EIOPA via this EU Survey, by 7 October 2022.
Contributions not provided via the EU Survey or after the deadline will not be processed.
In case you have any questions please contact differentialpricing@eiopa.europa.eu

Publication of responses

Your responses will be published on the EIOPA website unless: you request to treat them confidential, or they are unlawful, or they would infringe the rights of any third party. Please, indicate clearly and prominently in your submission any part you do not wish to be publicly disclosed. EIOPA may also publish a summary of the survey input received on its website.
Please note that EIOPA is subject to Regulation (EC) No 1049/2001 regarding public access to documents and EIOPA's rules on public access to documents.

Declaration by the contributor

By sending your contribution to EIOPA you consent to publication of all information in your contribution in whole/in part – as indicated in your responses, including to the publication of your name/the name of your organisation, and you thereby declare that nothing within your response is unlawful or would infringe the rights of any third party in a manner that would prevent the publication.
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Context and objective

Introduction

2.1. A trustful and well-functioning insurance market improves consumers' financial health and it is beneficial for society as a whole.

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2.2. On top of risk-based actuarial tariffs (expected cost of claims) and premium adjustments to take into account costs of service (e.g. commissions paid to distribution channels and other overheads like taxes, salaries, etc.), some insurance product manufacturers further adjust the premium using a number of different techniques which are unrelated to the risk profile of the consumer and the cost of service. For example, consumers may be charged a different premium based on personal behavioral characteristics such as their price elasticity, propensity to shop around at the renewal stage or the customer's life-time value estimation "score" during the tenure with the manufacturer. It is also a common practice to adjust the premium to the market price offered by competitors.

> In a free and deregulated market, insurers must be able to choose the offered premiums freely. Restrictions to this premise can lead to detrimental effects to costumers as it limits competition.

2.3. Such pricing techniques, here referred to as differential pricing practices, are not new for the insurance sector. However, advances in technologies such as Artificial Intelligence (AI) and the greater availability of new datasets (Big Data), enable insurance firms to increasingly tailor the premium paid by consumers to their personal behaviours and characteristics. Technological advances also make it possible to increasingly automate and implement at scale differential pricing practices, therefore increasingly affecting a larger number of consumers and raising important concerns of possible detrimental outcomes for consumers.

> Differential pricing practices (DPP) can also be applied without new technologies like e.g., AI methods or the use of Big Data. However, we agree that AI methods do place some additional requirements on the user in terms of transparency and controllability. If additional regulation is required, the regulatory requirements regarding DPP should be formulated in a precise manner to avoid detrimental outcomes for customers – esp. also irrespective of the methods used.

2.4. Market competition is an important driver of differential pricing practices: over the past years the European non-life insurance sector has experienced an increasingly competitive environment, in which insurance firms not only compete on services and cover offered, but also increasingly on price. This is the result of a wide range of factors such as the entry of new competitors or consumers becoming more price sensitive (e.g., use of comparison websites). And, while price competition is welcomed, as it delivers better outcomes for consumers, some types of differential pricing practices can lead to unfair treatment of some consumers.

> We agree on the point, that price competition leads to better outcomes for consumers in a free market. If required, regulation with respect to DPP should therefore take into account that restrictions on competition can lead to detrimental outcomes for costumers.
> Note: in Germany non-life insurance is usually understood as P&C and does not refer to health insurance. We will stick to this point of view for our answer.

2.5. Consumers who are more prone to search for a better deal and switch at point of renewal are more likely to benefit from lower insurance premiums. On the other hand, consumers who are less price sensitive, who are unaware of these practices, or who are 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 consumers more and target them with premium increases at the renewal stage during their tenure with the company, leading to unfair consumer outcomes.

> For the insurance companies it must be clear to what extent the use of DPP is acceptable and what measure would be used to determine this extent. For this purpose, a concept of materiality could be used. In addition, the scopes and boundaries of DPP must be defined precisely. It must be clearly recognizable for insurance companies, which DPP is compliant to avoid inefficiencies and legal risk on the one hand and unfair treatment of consumers on the other hand.
> Regarding the German market we would like to point out that renewal is different and stronger regulated than in other EU-markets. Contracts are usually renewed automatically with strict boundaries on the change of prices.

2.6. This would be particularly concerning when the groups of consumers that suffer most are more vulnerable consumers (e.g., older consumers or consumers with limited access to digital channels which makes it difficult to shop around). There may be other factors affecting consumers' ability to switch, for instance if they do not have time or knowledge to search and switch to a cheaper provider due to a particular life circumstance.

> It must be clearly defined for insurance companies which DPP is compliant to potential upcoming further regulation. For this purpose, it must be clearly determined, especially from a regulatory perspective, which customer group is considered a vulnerable group. Since target segments in the sense of DPP are usually defined multidimensionally and dynamically this definition has to be as clear as possible. The given explanations are too vague to define a good regulation.
> We would also like to point out, that it may be impossible to distinguish consumers, that don't want to shop around and are willing to pay a higher price, from those whose who are simply not able to. A regulation, that does not take this into account can result in prices favoring wealthier consumers (note, that for example younger consumers tend to have less money at their disposal than older consumers).

2.7. The increasing use of different types of behavioral data not related to risk or cost of service for differential pricing practices also 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 could be amplified when data is processed with complex AI systems, which can find multivariable non-linear combinations between the variables of the model and, therefore, potentially reconstruct protected information.

> DPP can also be applied without AI methods or the use of Big Data. However, we agree that AI methods do place some additional requirements on the user in terms of transparency and controllability. DPP regulations should however be formulated irrespective of the methods or data used.

2.8. A recent study from the Central Bank of Ireland on differential pricing practices in private car and home insurance markets found empirical evidence that younger policyholders tend to have shorter tenures, whereas older policyholders tend to have longer tenures. As older customers tend to have a longer tenure, there is a concern that older, and potentially vulnerable, customers are disproportionately impacted by differential pricing practices. Following the assessment of these practices, the Central Bank of Ireland concluded that price walking practices could result in unfair outcomes for some consumers and introduced a number of measures to strengthen the consumer protection framework, including a ban on price walking practices on policyholders' second or subsequent renewal.

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2.9. Another study from the Dutch Authority for the Financial Markets acknowledged the use of differential pricing practices in their jurisdiction, and, noted that, in line with the findings of the Financial Conduct Authority of the UK in a related report, the competitive pressure could override the moral compass: insurers who were morally opposed to the loyalty penalty implemented it, nevertheless, to maintain or bolster their competitive position. The Dutch Authority also noted that in addition to the margin component of the premium covered by differential pricing practices, price differentiation practices also take place on the actuarial component of the premium and, could potentially also be done on the basis of the terms and conditions of an insurance product.

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2.10. In Sweden, in February 2022 Finansinspektionen launched a market study to assess the impact on retail consumers of differential pricing practices in motor and home insurance in their jurisdiction. The findings of this study are expected to be published in Q2-Q3 2022. Italy's Istituto per la vigilanza sulle assicurazioni is also expected to publish a report on this matter in Q3-Q4 2022.

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2.11. Outside of the European Union, in the United Kingdom the Financial Conduct Authority introduced new rules on general insurance pricing practices, including a ban on price walking practices. In the United States of America (USA) the National Association of Insurance Commissioners (NAIC) published a White Paper on price optimisation in November 2015, concluding that some price optimisation practices could be considered as unfairly discriminatory. Several States from the USA subsequently prohibited or restricted the use of such pricing practices in insurance.

We would like to emphasize that in the UK the prices for new business increased after regulation where taking effect. This can be interpreted as a sign of decreasing of competition due to increased pricing regulation.

2.12. In 2018, the European Supervisory Authorities (ESAs) published a report on the use of Big Data by financial institutions. The report, which was preceded by a public consultation, identified the benefits and risks of Big Data in the securities, banking and insurance sectors. Among other things, the report highlighted the use of differential pricing practices which could result in the unfair treatment of consumers.

The report pointed to the use of DPP that could lead to unfair treatment of consumers. However, DPP can also occur completely without the use of Big Data. Regarding DPP, if there is additional regulation required, this regulatory requirements should be formulated in a general manner, irrespective of the methods used, in particular irrespective of Big Data.

2.13. In 2019, EIOPA published a thematic review on the use of Big Data Analytics (BDA) in motor and health insurance, which showed that 59 out of the 222 firms that participated in the survey (i.e. 26%) already used or planned to use in the next 3 years BDA tools in pricing and underwriting. However, only 19 of them made explicit reference to the use of BDA for differential pricing and/or churn models.

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2.14. EIOPA's Big Data Analytics thematic review also provided evidence on some of the rating factors used in pricing and underwriting in insurance. While the majority of rating factors used were perceived as having a direct causal link to risk (e.g. type of cars, years of driving experience, age of the driver), other types of rating factors (e.g. distribution channel, tenure with the company, or income) were perceived as having a more indirect causal link, likely more relevant for differential pricing purposes.

We like to stress, that in general it is impossible to determine, if DPP was used in creating a final price by observing the prices ex post. On the one hand the connection between risk and/or costs and the used rating factors may not be obvious. Cost allocation could even defer between target groups or different distribution channels. On the other hand observed price differences may appear solely due to deviances in the portfolio structure used for price evaluation.
The usual actuarial process of developing risk and tariff models includes a detailed analysis of the impact of each rating factor on the claims experience. Hence the latter kind of rating factors most likely will have a significant impact on claims experience, if it is in the tariff model.

2.15. EIOPA encouraged a stakeholder dialogue about ethical practices in insurance; EIOPA's stakeholder group on digital ethics in insurance produced a report on AI governance principles in 2021, which, among other things, encouraged insurance firms to avoid the use of certain types of price optimisation practices such as those aiming to maximise consumers' "willingness to pay".

This statement from EIOPA's stakeholder group contradicts the principle of setting prices freely and independently. Any kind of restriction to price setting leads to restrictions in market competition. This will likely result in adverse developments for customers in general, for example an increasing price level due to reduced competition. This does however not mean that prices need necessarily to increase for all customers, as there might be specific customer groups that still experience a price decrease.

2.16. In EIOPA's 2021 Consumer Trends Report, 13, out of 24 competent authorities which responded to the questionnaire, reported having observed (in some case it was based on anecdotal evidence) differential pricing practices in their market, especially in motor liability insurance (59% of the cases) and household insurance (29% of the cases). The Consumer Trends Report also incorporated the findings of a consumer research study sponsored by EIOPA, which showed that over 76% of the consumers interviewed experienced a premium increase for at least one of their insurance products after one year, where only 18% of the consumers linked such increases to a change in their personal situation (e.g. change of coverage or having an accident).

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2.17. While the present Supervisory Statement focuses on non-risk differential pricing practices, several of the above-mentioned reports and publications also assessed the topic of risk-based pricing practices and data bias. EIOPA is aware that risk-based pricing techniques, when relying on inaccurate data and/or when leading to too granular pricing, can also be a source of consumer detriment and financial exclusion if not accompanied by adequate governance measures; EIOPA will further assess the topic of biased datasets and their impact on financial inclusion and issue supervisory guidance and measures if needed.

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2.18. For the purpose of the present Supervisory Statement, differential pricing practices are understood as those pricing techniques where consumers with a similar risk and cost of service are charged for the same insurance product (with the same terms and conditions) different premiums for reasons other than risk or cost of service.

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2.19. Due to their high risk of consumer detriment, particular emphasis is put on the so-called “price walking practices”, i.e. when the premium paid by the consumer is increased at the renewal stage based on the analysis of characteristics specific to a particular consumer to predict behaviours not related to risk or cost of services, such as how much of a premium increase an individual consumer will tolerate before shopping for coverage with other product manufacturers.

As outlined in our response to 2.14 it might well be that this kind of price differentiation is actually due to actuarial analyses. For instance, there might be a direct relationship between tenure (i.e., how long a customer stays with the insurer) and actual claims experience (e.g., having a reduced claims frequency). Therefore, we find it difficult how the line should be drawn between compliant and non-compliant “price walking practices”. Hence, it must be clearly defined by the regulatory authority to which extend which DPP is compliant with the intended supervisory statement and how to measure this.
From an actuarial perspective it must be clearly defined which DPP is compliant with the intended supervisory statement. For this purpose, it must, among others, be clear to which extent a differentiation is acceptable and which measures would be used to determine whether a pricing (approach) is compliant or not. Therefore, a materiality concept might be used. In addition, clearly defined scopes and boundaries of DPP should be described (for example which consumers are considered vulnerable).
Moreover, note that it is usually not possible to use the actual price for risks to evaluate whether any pricing differentiation is based on differences in the risk and/or cost structure. In general, it might be even possible that a certain differentiation is solely due to deviances in the portfolio structure used for price evaluation.
Finally, any kind of restriction with regards to price setting leads to restrictions in market competition. This will likely result in adverse developments for customers in general, for example an increasing price level due to reduced competition.

From an actuarial perspective, it is necessary to implement suitable measures to avoid the described detrimental effects within the overarching pricing process. These measures need to be documented and monitored adequately by insurers.

2.20. The Supervisory Statement covers the activities of insurance undertakings and intermediaries (including managing general agents) that manufacture insurance products that are offered for sale to customers (jointly referred as 'manufacturers'), which are competent for determining the premium paid by a consumer of an insurance product. It also covers the activities of insurance intermediaries that do not have any influence in determining the premium paid by the consumer, but only to the extent they are made aware of such differential pricing practices, since they need to take this information into account when providing information to consumers.

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2.21. The focus is placed on the outcomes of differential pricing practices as well as on the process followed by the insurance product manufacturer to determine the price and/or price increase rather than on the price and/or the price increase itself, this is with the aim of ensuring fair treatment without interfering in the pricing of products.

The notion of "fair" is hard to assess from an actuarial perspective and needs to be clearly defined. Without clear definition it also remains unclear, how to measure the fairness of pricing or pricing techniques.

2.22. Following a technology-neutral approach, all differential pricing practices are covered by the Supervisory Statement regardless of whether they are based on AI systems or other technologies. However, when they are based on AI systems, insurance product manufacturers should have in place additional governance and risk management measures to address the specific challenges arising from the use of this technology. In this regard, several of the high-level AI governance principles developed by EIOPA's stakeholder group on digital ethics (e.g. human oversight, record keeping, transparency, fairness, proportionality etc.) are embedded, to a certain extent, in the governance processes of product manufacturers foreseen in the IDD and POG Delegated Regulation.

We support the above outlined technology-neutral approach. From our point of view, it is equally important that the approach is methodology-neutral. Of course, AI methods impose additional requirements on the user with regards to transparency and controllability. Nevertheless, DPP can also result from other methods not linked to AI. Therefore, if additional regulation would be deployed, the regulatory requirements on DPP should be independent of the specific methods used.
The Actuarial Function is experienced with both price differentiation as well as regulatory governance. Therefore, the actuarial experts are well suited to play a vital role in any kind of DPP regulation and should play a central role in the linked process.

2.23. The Supervisory Statement focuses only on differential pricing practices applied to retail customers, since, due to their personal and behavioural characteristics, retail customers are more likely to experience differential pricing practices than corporate clients. It also covers only non-life insurance lines of business, where the contracts typically need to be renewed on a regular basis, and where there is greater evidence of differential pricing practices taking place. The aim is to address those practices that have a higher possibility of having a detrimental impact on consumers.

> It must be clearly defined which DPP is compliant with the intended Supervisory statement. For this purpose, it must, among others, be clear to which extent a differentiation is acceptable and which measures would be used to determine whether a pricing (approach) is compliant or not. In addition, clearly defined scopes and boundaries of DPP should be described.

2.24. With the Supervisory Statement EIOPA aims to promote a convergent approach amongst competent authorities in the supervision of product oversight and governance (POG), fair treatment of consumers and disclosure requirements covered in the IDD and the POG Delegated Regulation, with the view of ensuring that consumer detriment and unfair practices are prevented. This Supervisory Statement does not aim to interfere with pricing, which manufacturers are free to set, but rather it aims to ensure that the process followed ensures that the differential practices used does not unfairly affect certain categories of consumers – e.g., more loyal customers.

> If DPP would not be allowed, this limits the opportunity of manufacturers to set prices freely. This seems to contradict the goals outlined above.
> However, if DPP would be regulated, it must be clearly defined which DPP are compliant with the intended Supervisory statement. Moreover, it is necessary to implement suitable measures to avoid detrimental effects within the overarching pricing process. Furthermore, these measures need to be documented and monitored by insurers adequately.
> The Actuarial Function is experienced with both price differentiation as well as regulatory governance. Therefore, the actuarial experts are well suited to play a vital role in any kind of DPP regulation and should play a central role in this process.

2.25. In particular, the Supervisory Statement highlights key aspects which competent authorities should look at when supervising said requirements in the context of differential pricing practices. The aspects highlighted and included in this Supervisory Statement do not constitute new requirements, and is designed to assist competent authorities in supervising manufacturers and distributors in the implementation of said requirements.

Additional to the previous comments on 2.24, for all regulatory actions which could be taken, the principle of proportionality should be applied. This means to have an adequate and reasonable relationship between such regulatory actions including their expected outcome and the related effort to implement them.
The supervisory authority should also take into account to align additional regulatory requirements with existing governance structures of the manufacturers as well as to avoid any conflicts of interest. The already existing Actuarial Function seems to be well equipped to address any DPP requirements if entrusted with it.

2.26. The Supervisory Statement is also aimed at ensuring the fair treatment of consumers by – in line with Article 6.2 of the POG Delegated Regulation – preventing insurance manufacturers from bringing to the market products for which, as a result of the product testing, there is evidence that, because of differential pricing practices, they result in consumer detriment. Therefore the clarifications provided in the Supervisory Statement do not aim to interfere with business decisions and/or pricing, they are rather intended to assess whether the process followed by insurance product manufacturers in the product design and pricing are sufficiently customer-centric, balancing the interests of the target market with the interests of the manufacturer.

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3.1. Article 17(1) of the IDD sets out that insurance distributors shall always act honestly, fairly and professionally in accordance with the best interests of their customers.

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3.2 Article 20(1) of the IDD states that insurance distributors shall provide customers with objective information about the product in a comprehensible format allowing them to make informed decisions.

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3.3. Article 25 of the IDD and the POG Delegated Regulation set out that the product approval process has to ensure that products are aligned with the needs, objectives and characteristics of the target market and that products do not adversely affect customers, in order to prevent customer detriment.

The regulatory requirements for companies with regard to the product approval process should be defined in a risk-oriented approach in order to avoid undesired effects.
Especially in smaller companies, extensive regulatory requirements would quickly lead to cost-related problems that could adversely affect customers of these companies overall. As a result, there may ultimately be a reduction in competitive activity.

3.4. National insurance legislations may establish more detailed requirements directly relevant to differential pricing practices (e.g. transparency measures at renewal or limitations on premiums increases at renewals).

A precise clarification of the compliant DPP is necessary. It must be clearly recognisable for companies which DPP practice is compliant. For this purpose, it must be clearly defined from a regulatory perspective, which customer group is considered a vulnerable group, especially since target segments in the sense of price differentiation are usually defined multi-dimensionally and dynamically (e.g. depending on market conditions). In addition, it must be clear up to which degree differentiation is acceptable and which measure would be used to determine this degree.
The need for clear and unambiguous regulation arises in particular as it is not possible to determine on the basis of actual prices whether a difference has come about on the basis of the forecast risk or cost structure or due to DPP. In general, it cannot even be ruled out that structure portfolio under consideration is solely responsible for an apparent differentiation. It would therefore be necessary to take the regulatory required steps to prevent any undesirable effects already in the pricing process, to document them and to have them monitored internally.
When establishing national insurance legislation more detailed, level playing field considerations should be taken into account.

3.5. The EU legislative framework currently allows some differential pricing practices to take place. Indeed, product manufacturers have the freedom to give commercial, marketing or underwriting discounts to consumers in order to try to acquire or retain them in the course of a commercial transaction. They can also freely determine their market position vis-à-vis their competitors and adjust the tariff accordingly.

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3.6. However, insurance manufacturers using differential pricing practices must demonstrate that they have effective POG measures throughout the entire lifecycle of the product to ensure that differential pricing practices do not unfairly affect consumers within the target market of the insurance product. Indeed, price is a key feature of a product and therefore it must form part of the POG process, whereby insurance product manufacturers should assess whether the pricing technique used ensures an alignment between the target market's characteristics, needs and objectives.

Due to the challenging nature of demonstrating the existence of effective POG measures we highly recommend to involve actuaries in this process, due to the following reasons
- Actuaries are experts when it comes to price differentiation in insurance products. Actuaries are familiar with the modelling of risk differentiation but also with pricing methods. They know how to adequately measure and monitor price differentiation. Within the framework of pricing oversight, the actuarial function already carries out price monitoring activities.
- Actuaries are governance experienced. Actuaries have many years of experience with governance processes and with the implementation of supervisory requirements. This is especially true for the actuarial

function.
- Actuaries offer a high level of quality and commitment through their education and training and their code of ethics. Actuaries are obliged to undergo basic and further training. This ensures a high level of professional competence. Actuaries are committed to acting with integrity and professionalism through their everyday-work.

3.7. POG requirements are applicable to insurance products manufactured and or commercialized on or after 1 October 2018. They are also applicable to insurance products which have been significantly adapted on or after 1 October 2018.

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3.8. Notwithstanding the above, some types of differential pricing practices, and in particular the so-called “price walking” practices, where the premium paid by consumers is increased at the renewal stage based on the analysis of characteristics specific to a particular consumer to predict behaviours not related to risk or costs of service, will likely result on unfair outcomes for consumers and therefore fail to comply with the applicable legislative framework. Examples of practices that are considered to lead to unfair treatment of consumers, and therefore not compliant with Article 17(1) IDD, include the following:

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3.8.1. Increasing the price of the insurance product at renewal stage based on the customer’s low propensity to shop around (low probability of churn);
3.8.2. Increasing the price of the insurance product at renewal stage based on the customer’s low price elasticity (also known as “willingness to pay”);
3.8.3. Advising or nudging consumers to buy one insurance product vs. another one because of very low initial on-boarding price, which then result into sudden, unexpected and significant price increases for consumers at renewal for reasons unrelated to risk or cost of service;

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3.9. Differential pricing practices described in the previous subparagraphs would lead to unfair treatment of consumers, since these practices would unfairly penalise loyal customers, also taking into account that vulnerable groups (e.g. older customers, low level of education, low income) are likely to be disproportionately negatively affected by these practices; insurance manufacturers using such practices would struggle to justify that they have undertaken an adequate balancing of interests in order to develop adequate governance processes and procedures to mitigate consumer detriment in situations arising from price walking practices.

The determination of a price for business policy reasons must in principle be possible even without reference to risk and costs. Restrictions of this freedom will lead to restricted competition and thus to disadvantages for consumers. This is especially true since the principle of equal treatment no longer applies in the P&C sectors.

Examples are:
- a price reduction for a policy due to a positive development, which may be preferable from an economical point of view compared to the acquisition of a new business policy, taking into account e.g. commissions,
- or a pricing depending on an expected retention period in the portfolio, which may be taken into account by lower prices with an increasing retention period.

The latter shows that customers with a rather short length of stay could not receive lower prices in every case.
Less freedom in price determination in the aforementioned sense could also make certain product and price designs more difficult, which aim at sustainability or sustainable customer behavior in respect of ESG. Such pricing would have no or less connection to risk and costs (keyword: impact underwriting) and could be prohibited by DPP regulation.

3.10. The requirements included in the Insurance Distribution Directive to ensure that consumers are treated honestly, fairly and professionally in accordance with their best interest are aligned with other efforts of the European Union legislation to promote a fair treatment of consumers. This is notably the case of the Directive 2005/29/EC concerning unfair business-to-consumer commercial practices in the internal market...

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Product approval process

3.11. In line with the POG requirements, manufacturers should put in place an approval process which ensures that consumers' interests are taken account in the product design and approval process and that it is also proportional to the complexity of the product design.

Having the customers interest in mind requires both, skills and a certain degree of independence from profitability-goals. Actuaries are well suited candidates to deliver both as they fulfill the crucial requirements:
- Actuaries are experts when it comes to price differentiation in insurance products. Actuaries are familiar with the modelling of risk differentiation but also with pricing methods. They know how to adequately measure and monitor price differentiation. Within the framework of pricing oversight, the actuarial function already carries out price monitoring activities.
- Actuaries are governance experienced. Actuaries have many years of experience with governance processes and with the implementation of supervisory requirements. This is especially true for the actuarial function.

- Actuaries offer a high level of quality and commitment through their education and training and their code of ethics. Actuaries are obliged to undergo basic and further training. This ensures a high level of professional competence. Actuaries are committed to acting with integrity and professionalism through their everyday-work.

Since it is not possible to determine on the basis of the actual prices whether a difference has come about on the basis of the forecast risk or cost structure, it is therefore necessary to take suitable steps to prevent any undesirable effects already in the pricing process, to document these and also to have them monitored internally.
We propose to extend the competences and responsibilities of the actuarial function within the framework of pricing oversight to the topic of DPP. To this end, the actuarial function should be involved in the product development and pricing process earlier and in greater detail than now.
In addition, we deem it necessary that the requirements for companies should be risk-adjusted in order to avoid undesired effects. This would affect the required processes and especially the documentation requirements. Especially in smaller companies, extensive regulatory requirements can quickly lead to cost-related problems that could disadvantage the policyholders of these companies overall. As a result, there may ultimately be a reduction in competitive activity.

3.12. The final approval of product design relying on differential pricing practices should be at a hierarchical level which is sufficiently high to assume the risks and responsibilities, avoiding risks relating to unfair treatment, which could result from differential pricing practices.

We see actuaries as sufficiently qualified to support decision-makers in their insurance manufacturers with the needed basis for decision-making (see answers to question 3.11).

3.13. Adequate measures should be in place to ensure the identification, prevention and mitigation – throughout all the stages of the product lifecycle – of the main drivers of conduct risk, actual or prospective, which can emerge from differential pricing practices. Such measures should be defined by manufacturers as part of their product development and product testing process; some examples of measures include:

- defining appropriate thresholds / guardrails for differences in premium for consumers with a similar risk profile and cost of service;
- ensuring that information provided to consumers, including marketing communications, are transparent (e.g. about the existence of a premium discount only on the first year(s) or month(s) of the contract), clear, simple and not misleading so as to enable consumers to make informed decisions;
- in case of the use of AI systems, insurance manufacturers should be able to provide appropriate explanations on the impact of AI on pricing, adapted to the

needs of different stakeholders (e.g. consumers, distributors, supervisors, etc.), and set up other relevant governance measures such as adequate levels of staff oversight throughout the life cycle of an AI system;

- closely monitoring and mitigating the impact of differential pricing practices on consumers, particularly in relation to vulnerable groups as well as different consumers groups belonging to the same target market;
- making reasonable efforts to ensure that the datasets used for differential pricing practices and the outcomes of AI systems are free of bias.

> Through their training and tasks in technical pricing, we see actuaries as a good fit to perform those tasks, especially when it comes to the usage of AI. Actuaries are already used to perform calculation within a given regulatory framework in the insurance industry. In addition, we deem it necessary that the requirements for companies should be risk-adjusted in order to avoid undesired effects.

Target market

3.14. Processes and procedures should ensure the level of granularity of the target market takes into account the target market's characteristics which are relevant to all the products' features – including pricing discounts and increases not linked to the risk profile or the cost of service of the customer.

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3.15. The product design process should ensure that the objectives, interests, and characteristics of the target market, including vulnerable consumers (e.g. older customers, low level of education, low income), are taken into account when assessing whether differential pricing practices for a certain product are compatible with the target market. Importantly, this assessment should take into account that consumers might not be aware of the existence of differential pricing practices, and that the capacity of insurance manufacturers to determine their propensity to switch and price elasticity of consumers at individual level will likely confer them a disproportionate information advantage via- à-vis consumers.

> Regulatory requirements regarding the product design process should be proportionate to the related risk. Especially in smaller companies, extensive regulatory requirements can quickly create cost-related problems that could disadvantage the policyholders of these companies as a whole. As a result, there may ultimately be a reduction in competitive activity.

3.16. The staff involved in designing and manufacturing insurance products should have sufficient and adequate professional and educational skills to perform their function and to understand pricing techniques. Adequate levels of human oversight are particularly important when differential pricing practices rely on AI systems.

Actuaries are well-suited to bring the necessary background and skills – esp. also when using AI. Actuaries are experts when it comes to price differentiation in insurance products.
In particular, Actuaries are familiar with the modelling of risk differentiation, but also with pricing methods and know how to adequately measure and monitor price differentiation.
Actuaries offer a high level of quality and commitment through their education and training and their professional code of conduct.
Actuaries are obliged to apply for a permanent training to maintain and improve their technical skills and their actuarial knowledge. This ensures a high level of professional competence. With their code of conduct, actuaries have committed themselves to acting with integrity and in a professional manner.
In addition to the aforementioned educational and professional skills, within the framework of pricing oversight, the actuarial function already carries out price monitoring activities.

Note: DPP-regulation should be method-independent. DPP can also occur completely without the use of AI methods. However, AI methods do indeed impose some additional requirements on the respective user in terms of transparency and controllability. Regarding DPP, however, the regulatory requirements should be formulated in a generally valid manner, independent of the methods used.

3.17. The product testing process should ensure that pricing processes and procedures are sufficiently customer centric and entails a balancing of interests between consumers within the same target market and also between the interests of the target market and of the insurance product manufacturer.

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3.18. For non-life insurance products, which are likely to be renewed on a yearly basis and/or for which the manufacturer bases the pricing process on the fact that a certain portion of the target market would likely renew, processes and procedures should ensure the product testing methods fully consider how they are aligned with the needs, objectives and characteristics of the target market not only for the first year/term but also at renewal.

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3.19. In particular, processes and procedures should ensure that manufacturers test whether such products are aligned with the characteristics, objectives and needs of the target market – i.e., offer value – for a reasonable time, whereby reasonableness should take into account for how long the target market is likely to hold such product and the specific characteristic of the product.

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3.20. If, based on the product testing, it becomes evident that certain features may adversely impact some consumers' belonging to the target market because of their characteristics, processes and procedures should ensure the product should either not be brought to the market, in line with Article 6.2 of the POG Delegated Regulation or the target market should be sufficiently reviewed to exclude those consumers' categories within the target market which could be adversely impacted.

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Product monitoring and review

3.21. Insurance product manufacturers' processes and procedures should ensure that products relying on differential pricing techniques continue to be monitored, including with the use of relevant metrics, to identify any adverse impact they may have on consumers.

As experts for product monitoring and statistics, we recommend to involve actuaries in monitoring differential pricing techniques and for defining metrics to identify adverse impacts that may be detrimental for the customers.
Due to the knowledge of actuaries in modelling risk differentiation and in the methods of pricing, as well as due to the high level of professional expertise, which is ensured by the obligation of continuous training, actuaries are very well suited for a comprehensive monitoring of the differential pricing techniques and of measuring a potential adverse impact.

3.22. In particular, they should identify and monitor whether some consumers within the target market, including vulnerable groups, are adversely impacted by these pricing techniques over the years and take appropriate remedial measures to cease the detriment.

The regulatory requirements for the process of identifying client groups that are potentially disadvantaged by DPPs should be proportionate to the risk of undesired effects. In addition, it is essential in our view that a clear definition is given, which consumers are seen as vulnerable. A focus solely on age, for example, will not suffice as pointed out before.

With regard to the already described roles and responsibilities and skills we highly recommend to involve actuaries in the identification and monitoring process (e.g. see answer to question 3.11).

Documentation

3.23. Processes and procedures put in place by insurance product manufacturers to ensure that the products do not adversely affect consumers should be clearly structured and documented through adequate records.

> The regulatory requirements for companies should be in proportion to the related risk. This in particular affects the documentation requirements. Especially in smaller companies, extensive regulatory requirements can quickly lead to cost-related problems that could disadvantage the policyholders of these companies overall. As a result, there may ultimately be a reduction in competitive activity.

3.24. Documentation and records, including when differential pricing practices rely on AI systems, should be sufficiently detailed so as to ensure accountability of insurance manufacturers with regards to differential pricing practices.

> We think that due to the complex nature of insurance pricing and the statistic behind it, actuaries are best suited to assure a comprehensive documentation

Distribution channels

3.25. As part of the POG documentation, manufacturers should provide to insurance distributors with sufficient information about the product, including, in general terms, on how the pricing of a product may work at renewal and the existence of differential pricing practices. This information would allow distributors to act in the best interest of consumers when assessing their demands and needs and to provide consumers with all relevant information to make informed decisions.

> See 3.23

3.26. When providing advice and/or selling products which rely on differential pricing practices, insurance distributors should provide fair and transparent information on renewals and price increases. Explanations should be meaningful and easy to understand in order to help consumers make informed decisions.

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3.27. Following a risk-based approach, competent authorities are expected to supervise that differential pricing practices do not lead to consumers' unfair treatment. For this, competent authorities should carry out market monitoring activities to identify those products for which differential pricing practices are used and for which they believe the highest risks for consumers exist.

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3.28. Competent authorities should engage with relevant insurance product manufacturers and review the POG processes as well as the sales process and marketing material of those products for which differential pricing practices techniques are used and that were detected as part of their risk-based supervision. For this purpose they may use different tools, including:

- off-site supervision;
- on-site inspections;
- thematic reviews.

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3.29. In their supervisory activity, competent authorities' should ensure to cover the following aspects in their assessment:

- evaluation of the POG documentation and governance aspects, including the systems and controls of differential pricing tools and techniques used and the process followed for products which rely on differential pricing practices;
- the sales process as well as relevant marketing and communication material relating to products for which differential pricing practices are used.

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3.30. If a competent authority establishes that a manufacturer's POG process is not adequate and/or that products relying on these practices have been marketed despite them not being aligned with the target market's needs, objectives and characteristics, they should action as they deem appropriate.

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3.31. If a competent authority establishes that the sales process and / or the marketing material do not ensure that fair and clear information are provided, enabling consumers to make informed decisions, they should assess the case and take actions, as appropriate.

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3.31. Competent authorities are encouraged to cooperate with market competition authorities in their respective jurisdictions given that differential pricing practices and consumer protection issues arising therein are closely connected to market competition.

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Questions to stakeholders

Q1 –Have you observed the use of differential pricing practices in the EU insurance market?

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Q2 – What types of differential pricing practices are you aware of?

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Q3 – Do you agree that the use of differential pricing practices is expected to increase as a result of competition in the markets, greater availability of data (Big Data) and/or technological advances (e.g. AI systems)?

In a competitive, free market pricing techniques get more sophisticated as competition grows and margins shrink. This is independent of the use data or technology. Restrictions of a free market can lead to detrimental effects for costumers. Therefore regulations of DPP should be clearly defined in respect to its goals and limits.

Q4 - Do you agree with the risks identified from differential pricing practices?

We believe that in a free, deregulated market, competitors should be able to choose prices freely. Restrictions should only be implemented, if there are specific detrimental effects, that cannot be mended otherwise. We see the risk, that regulation can lead to less competition and to detrimental effects on costumers.
Overall regulation of DPP has to be clearly defined. It must be obvious for insurance companies, which DPP is permitted and how this can be determined. This concerns for example the definition of the groups of vulnerable customers.
We want to point out, that it is impossible to determine if a specific pricing was subject of DPP by looking at the prices ex-post. For a working regulatory framework it would therefore be necessary to implement measures in the pricing process, that are proportionate to the risk involved. This should also be done independent of the methods and data used (e.g. BigData or AI).

Q5 - Do you agree with the scope of the Supervisory Statement?

See Q4
We like to point out, that we see actuaries as most fit to cover the technical and professional requirements needed for the implementation of DPP regulatory measures in insurance companies. Actuaries are expert in pricing methodology and governance processes and maintain a high level of professional competence through basic and further training. Actuaries are committed to acting with integrity and professionalism

through their everyday work. Therefore, Actuaries should play a major role in DPP processes. We suggest that the pricing oversight tasks of the Actuarial Function should be extended to the oversight of the use of DPP.

Q6 - Do you agree with the objectives of the Supervisory Statement?

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Q7 – Do you agree that the following practices would result on unfair treatment of consumers:
- Increasing the price of the insurance product at renewal stage based on the customer's low propensity to shop around (low probability of churn);
- Increasing the price of the insurance product at renewal stage based on the customer's low price elasticity (also known as "willingness to pay");
- Advising or nudging consumers to buy one insurance product vs. another one because of very low initial on-boarding price, which then result into sudden, unexpected and significant price increases for consumers at renewal for reasons unrelated to risk or cost of service
- Other types of differential pricing practices? Please explain.

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Q8 - Do you agree that the IDD's Product Oversight and Governance requirements are an adequate tool for addressing the use of differential pricing practices?

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Q9 - Do you agree that adequate governance measures should be put in place for the product approval process in order to ensure that differential pricing practices do not have a detrimental impact for consumers?

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Q10 - Do you agree with the governance measures described above for the product approval process?

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Q11 - Which other governance measures could be established for the approval process to ensure that differential pricing practices do not have a detrimental impact for consumers?

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Q12 - Do you agree with the governance measures described above for the target market?

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Q13 - Which other governance measures could be established for the target market to ensure that differential pricing practices do not have a detrimental impact for consumers?

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Q14 - Do you agree with the governance measures described above for product testing?

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Q15 - Which other product testing governance measures could be established to ensure that differential pricing practices do not have a detrimental impact for consumers?

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Q16 - Do you agree with the governance measures described above for product monitoring and review?

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Q17 - Which other governance measures could be established for product monitoring and review to ensure that differential pricing practices do not have a detrimental impact for consumers?

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Q18 - Do you agree with the documentation governance measures described above?

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Q19 - Which other documentation governance measures should be established to ensure that differential pricing practices do not have a detrimental impact for consumers?

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Q20 - Do you agree with the governance measures described above for the distribution channels?

-

Q21 - Which other governance measures could be established for the distribution channels to ensure that differential pricing practices do not have a detrimental impact for consumers?

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Questions from the Impact Assessment:

Q1 -Do you agree with the analysis of costs and benefits?

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Q2 - Do you agree with the policy option chosen by EIOPA?

We want to point out, that for actuaries the clarity of the regulation is more important than the policy option chosen.
See answers above.

Contact

[Contact Form]