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8 September 2020

**Re: Central Bank of Ireland review of differential pricing in the private car and home insurance markets – Phase 1: Market Analysis - Observations**

Dear CEO

On 21 November 2019, the Central Bank of Ireland (the “Central Bank”) wrote to the insurance sector outlining the potential risk to consumers arising from the practice of differential pricing and informing relevant firms of its intention to conduct a multi-phase review of differential pricing in the private car and home insurance markets (the “Review”).

The objective of Phase 1 - Market Analysis, was to establish the extent to which differential pricing is in use within these markets and where it does exist, to determine how firms are utilising the practice. The purpose of this letter is to present our initial observations from the conclusion of Phase 1, outline our next steps and make clear our expectations of firms.

The market analysis conducted to date has identified weaknesses of varying degrees in firms, raising concerns that some firms may not be adequately considering the effect of their pricing practices on their consumers, potentially leading to poor customer outcomes.

The key issues observed include:

- **Differential Pricing Practices:** Failure to recognise and/or failure to acknowledge the utilisation of price differentiation in firms.

While a number of firms maintain that they do not utilise differential pricing in their pricing practices, the Central Bank observed that the majority of firms utilise differential pricing through techniques such as price elasticity modelling, retention/lapse modelling, conversion rate modelling and the use of models that facilitate the flexing of sales remuneration.

Firms have a responsibility to understand fully the impacts of such pricing practices on their customers. Failure to recognise and/or acknowledge the practice of price differentiation raises significant concerns about a firm’s ability to assess these impacts.



- **Governance and Controls:** Inadequate governance and controls arrangements, including insufficient evidence that firms have the level of ownership and oversight expected when they apply differential pricing practices.

There were varying degrees of awareness of pricing practices at Board of Directors<sup>1</sup> (“Board”) level and, in many cases, it was not evident that Boards had appropriately considered or discussed the impacts of their firms’ differential pricing practices on their consumers.

Firms failed to have clearly documented controls in place to quantify or monitor the impacts of differential pricing on consumer groupings in advance of pricing model implementation.

Failure to be specific about the firm’s differential pricing practices, and failure to have the requisite frameworks and controls in place prior to the implementation of these practices, will result in firms being unable to effectively monitor the impact of their pricing activities and unable to evaluate how their pricing decisions affect customer outcomes.

- **Culture and Conduct:** Insufficient evidence of a consumer focused culture in respect of pricing decisions and practices.

While firms have developed pricing policies, which clearly impact customers, they have not sufficiently considered customer interests. Failure to ensure that customers are at the centre of pricing decisions raises questions regarding how customers’ interests are considered as part of the pricing process and creates significant concerns in respect of a firm’s culture.

## Action Required

The Central Bank expects that the best interests of customers are protected and that markets operate in a fair and transparent manner. As such, we require the Board and senior management teams within all firms to consider the observations set out above in the context of their own firms and their pricing practices and respond accordingly.

Where gaps/weaknesses are identified, firms should develop and implement actions to address these and to mitigate any risk to customers immediately.

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<sup>1</sup> References to the Board includes Boards of Directors and/or senior management as applicable.



The Central Bank requires firms to:

- Assess their own pricing methodologies against the Central Bank's definition of Differential Pricing<sup>2</sup>. If a firm does not consider its pricing practices to fall under the definition of differential pricing, the rationale for this should be clearly documented and agreed by the Board.
- Take responsibility at Board level for the impact of differential pricing on customers. Put a robust governance framework in place, where Board and management structures are designed to ensure a firm's pricing practices are well-governed, controls operate effectively and appropriate oversight is in place, with roles and responsibilities for pricing activities clearly defined. The Board should take ownership of the firm's differential pricing practices and be fully informed of the impact of those practices on their customers.
- Ensure that a fully embedded consumer protection risk framework is in place to manage conduct risk and drive positive behaviours. This framework should form an integral part of the pricing process, and will assist firms in determining if their pricing processes, including the deployment of new pricing models and monitoring of existing models, is ensuring fair treatment of customers in line with the Consumer Protection Code 2012 (the "Code").

We require documented evidence that the above has been fully considered by firms and that firms have a clear understanding of their differential pricing practices and their impact on customers. Firms should also be able to demonstrate how their pricing practices adhere to the requirements in the Code specifically to:

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

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<sup>2</sup> The Central Bank defines differential pricing in insurance services as a circumstance or practice whereby customers with a similar risk and cost of service are charged different premiums, for reasons other than risk and cost of service. This includes the use of any modelling technique or the application of a non-risk adjustment during the pricing process which leads to customers with a similar risk profile and cost of service being charged differing premiums



## Next Steps of the Review

Following the conclusion of Phase 1, we have reviewed the original Terms of Reference and an updated version is appended to this letter.

Phase 2 – Quantitative Analysis and Consumer Insight of the Review has commenced. The Quantitative Analysis will assess the degree of differential pricing among private car and home insurance policy types. In parallel, a consumer insights exercise will be undertaken to further develop our understanding of how consumers engage with insurance providers.

If you have any queries on the contents of this letter, please contact [differentialpricingreview@centralbank.ie](mailto:differentialpricingreview@centralbank.ie).

Yours sincerely

A handwritten signature in blue ink, appearing to read "Derville Rowland".

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**Derville Rowland**  
**Director General Financial Conduct**



## Appendix 1

### The Central Bank of Ireland (the “Central Bank”) review of differential pricing in the Irish private car and home insurance markets (the “Review”)

#### Terms of Reference

##### Purpose of the Review

The purpose of the Review is to examine the extent to which the practice of differential pricing (whereby customers with similar risk and cost of service are charged different premiums, for reasons other than risk and cost of service) is consistent with the Consumer Protection Code 2012 (the “Code”).

The Review will seek to:

- I. Establish the impact of differential pricing on consumers;
- II. Identify the drivers of consumer behaviours including how consumers engage with the insurance industry;
- III. Assess the extent to which these pricing practices lead to outcomes consistent with the Code; and
- IV. Assess the governance and oversight of differential pricing.

##### The scope of the Review

The Review will focus on the private car and home insurance markets as these products are the most commonly held insurance products in Ireland.

The Review will examine the pricing practices of a sample of the non-life companies and intermediaries operating in the Irish market.

##### Specific issues that the Central Bank will examine

###### *Industry assessment*

- The extent to which such pricing practices exist in the private car and home insurance markets in Ireland.
- The pricing strategies, models employed, and data used by firms that give rise to price differences for similar risk and cost of service, for reasons other than risk and cost of service.

###### *Consumer outcomes*

- The extent to which these pricing practices are in compliance with the Code and other relevant regulatory requirements.
- The groups of consumers that may be impacted, and their characteristics.



#### *Governance and culture*

- How firms take account of the Code when implementing pricing strategies.
- The extent to which Boards<sup>3</sup> have oversight of such practices including oversight of delegated authority given to third parties.
- The extent to which firms consider consumer outcomes when designing pricing models.

#### *Consumer insight*

- The extent of differential pricing in different consumer cohorts (i.e. which consumer groups are affected most and by how much);
- The relationship between differential pricing and characteristics of consumer vulnerability (e.g. income, wealth, financial experience and knowledge, behavioural characteristics, etc.).

#### **How will the Review be conducted?**

The Review is split into three phases as follows:

##### ***Phase 1 – Market Analysis***

The purpose of this phase is to establish the extent to which differential pricing is in operation in the Irish private car and home insurance markets and if it does exist, to establish how it is being carried out by each firm in the scope of the Review. Observations from the Phase 1 Market Analysis will inform the breadth and depth of the data specifications required for the Phase 2 Quantitative Analysis.

##### ***Phase 2 – Quantitative Analysis and Consumer Insight***

The consumer insight phase will involve combining qualitative focus groups and a quantitative review. The quantitative review will involve an analysis of a policy level dataset provided by all insurance firms and intermediaries in scope for this Review. This will be used to examine the degree of differential pricing among private car and home insurance policy types. A representative sample of consumers will be drawn from the policy-level dataset thereby allowing for extrapolation of insights to the wider population. Data from the consumer insights survey will be linked to the policy level information.

Findings and observations from the first two phases of the review will be communicated via an interim report.

##### ***Phase 3 – Conclusions and Recommendations***

The third phase will be informed by the findings in Phases 1 and 2 of the Review. The outputs of Phase 3 will be a report or consultation on proposals for reform, as appropriate.

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<sup>3</sup> References to the Board includes Boards of Directors and/or senior management as applicable.