GIBRALTAR FINANCIAL SERVICES COMMISSION

Underwriting and Pricing

Supervisory Statement - July 2018

GIBRALTAR FINANCIAL SERVICES COMMISSION

Introduction

1.1 This supervisory statement is addressed to all firms that are regulated by the Gibraltar Financial Services Commission (GFSC), and fall within the scope of the Solvency II Directive. It sets out the GFSC's expectations of firms with respect to general issues regarding underwriting and pricing. This Supervisory Statement should be read in conjunction with the Approach to Insurance Regulation document published by the GFSC on 12th February 2018.

General considerations

2.1 For the purposes of this document, the term 'underwriting' refers to the process of risk selection, including product coverage, endorsements and the decisions around whether to provide a quote for any given risk.

2.2 In this document, the term 'pricing' refers to the process of determining the price to charge for any given policy, including any discounts or loadings. It covers both the calculation of the technical risk price, and any subsequent amendments used to produce a final 'street' price.

2.3 The GFSC considers effective underwriting and pricing to be a key component of effective risk management. Firms are expected to:

- Carry out sufficient and appropriate due diligence before taking on new books of business.
- Have clear and well documented underwriting and pricing policies.
- Consider the customer experience and ensure that sufficient thought is given to conduct of business requirements.
- Monitor underwriting and pricing performance on an ongoing basis, and at an appropriate level of granularity.
- Have the ability to make changes within an appropriate timeframe when underwriting or pricing issues are identified.

2.4 This document will focus on the four broad areas of due diligence, conduct of business, monitoring underwriting performance and ability to make changes.

Conduct of business requirements

3.1 It is essential that firms have a clear understanding of the conduct obligations that accompany any proposals to underwrite a particular class of business in any geography. Firms should consider the interests and appropriate treatment of customers and how they will oversee this aspect of any delegated underwriting or claims management arrangements.

3.2 Firms should therefore ensure that appropriate consideration is given to and that arrangements are put in place to cover the following:

i. How conduct requirements for the particular class of business and geography will be met;

ii. Clear allocation of responsibilities between the various parties involved;
iii. Oversight over product design and ensuring that customer needs are, and continue to be, met;
iv. Management information needs, reporting timelines and KPI analysis;
v. Complaints processes, handling, outcomes and the monitoring of this; and
vi. The parameters and process for escalating matters identified to the Board or Underwriting Committee either for, or between meetings.

3.3 Firms should be aware that the potential for consumer detriment increases the more complex the distribution chain becomes as do the monitoring challenges for the firm.

Due diligence

4.1 The GFSC expects firms to obtain a detailed understanding and develop a clear underwriting plan for any new business that it intends to write or acquire, prior to finalising the decision to proceed.

4.2 Although the exact requirements for due diligence will vary depending on the type and nature of the business, firms are expected to carry out thorough and effective due diligence, proportionate to the scale and complexity of the business.

4.3 This due diligence should be sufficient to understand the complexities and risks associated with the business. Firms should have a clear view of how they will manage the business, and how it will impact their existing business.

Case Study

Firm A was approached by a key broker partner about taking on a new line of business, previously written by a competitor. Firm A had no previous experience of this line of business, but their broker assured Firm A that this was good and profitable business. Firm A requested management information relating to the new business. The broker provided a summary of gross written premium, projected loss ratio and number of policy sales for the most recent year of business.

The broker also informed Firm A that the business was available because the competitor who previously wrote the business had lost a key member of staff and felt that they no longer had the resource or level of expertise required to manage the business. Firm A discussed at a board meeting, and agreed to take the new business on, with the board agreeing to review performance at the end of the first year.

Review

Although the GFSC is open to firms expanding into areas where they do not have significant previous experience, firms are expected to carry out extensive due diligence, and seek expert opinions from external sources if necessary. In this case, Firm A carried out minimal due diligence, and did not seek external advice.

Firm A should have obtained data from multiple sources if possible when carrying out the due diligence, preferably including audited figures. In addition, they should have obtained data over multiple years to allow them to understand any trends and identify any changes in performance.

Although the broker informed Firm A that the previous underwriter had decided to stop writing the business due to changes in personnel, Firm A should have verified the reasons for the previous provider no longer writing the business. They could have attempted to contact the previous insurer, or investigated whether there were any stories in the market indicating any other reasons why they may have decided to exit that book of business.

In addition, Firm A should have made more effort to understand market conditions. The historic data may have failed to highlight any recent changes, for example claims trends, or changes in the regulatory or legal environment. Firm A should have carried out detailed analysis to understand the resource needed to successfully run the new book of business, including an assessment of how it may impact on existing resources currently utilised in other lines of business.

Given the lack of knowledge about this business, Firm A should have put in place detailed and comprehensive performance monitoring in the early stages of writing the business. The end of the first year is unlikely to be early enough to pick up any major issues with the business before they cause significant detriment to the firm.

Monitoring underwriting performance

5.1 It is essential that firms have a clear and detailed understanding of the performance of their business at all times. Firms should monitor underwriting performance with sufficient frequency and at an appropriate level of granularity.

5.2 The level and granularity of performance monitoring should be proportionate to the scale, nature and complexity of the business. However, all lines of business should be subject to regular monitoring at an appropriate level.

5.3 Monitoring should allow firms to assess all measurable indicators that are likely to impact underwriting performance. These indicators should be monitored over an appropriate time period, in order to allow firms to track changes in performance and market environment.

5.4 Firms should have resource with sufficient expertise and knowledge to properly interpret the data, and to communicate this to the board and other stakeholders. Monitoring should be communicated to all stakeholders who are likely to be impacted by changes in underwriting performance.

Case Study

Firm B writes nine different lines of business, across five different geographical areas. The Underwriting Committee (UC) is scheduled to meet each month, although only three meetings actually took place in the last year, due to cancellations. The UC consists of the Chief Underwriting Officer, CEO, Head of Pricing, Underwriting Manager and Claims Manager. In addition, heads of other departments are included when needed.

The UC reviews an underwriting pack produced by the underwriting manager, and distributed at the meeting. The pack covers gross written premiums, new business sales volumes, renewal volumes and loss ratio performance for the three most important lines of business, over the last quarter. The UC discusses performance and any planned changes to underwriting and / or pricing over the next month. In addition, daily Key Performance Indicator packs are sent out to all executive level and heads of departments.

Review

Monitoring of performance is vital to managing the business, and detailed discussions should take place at appropriate intervals. If Firm B believes that monthly meetings are appropriate, then these should happen as a matter of priority. When necessary, meetings should be rearranged for the soonest available time, rather than cancelled.

Interpretation of performance metrics should be discussed and challenged, which requires attendees to have sufficient time to assess the management information in the underwriting pack. Firm B should send the underwriting packs in advance, rather than distributing these at the meeting.

Stakeholders from all areas impacted by underwriting performance should be involved in the monitoring of performance. Although this may vary from firm to firm, it is likely to include representatives from underwriting, pricing, claims, marketing, operations and IT, as well as the executive. Firm B should consider whether they should include representatives from marketing, operations and IT in the UC.

Likewise, the appropriate breadth and granularity of performance indicators to monitor will vary from firm to firm. However, for most lines of business monitoring should include claims frequency and severity (by head of damage as appropriate), new business quote conversion, renewal retention rate, cancellation rates (split by cancelled from inception and mid-term cancellations). Firm B should expand their pack to include these measures and any other appropriate key performance indicators. All metrics should be tracked over an appropriate time period, which will usually be in excess of one year.

Planned actions should be assessed in detail, with the expected impact on key performance indicators clearly documented. Actual vs expected analysis should be carried out for any past actions that were expected to impact underwriting performance. Firm B should add both of these areas to their underwriting packs, and discuss at their UC meetings.

Underwriting and pricing agility

6.1 Given the significant uncertainty inherent in insurance business, it is essential that firms have the ability to react quickly when issues with performance are identified. Firms who are unable to effect change quickly and efficiently are at risk of amplifying the impact of errors or changes in market conditions.

6.2 The need for an ability to effect changes quickly is particularly acute in highly competitive markets, especially where price comparison websites have significant influence. In these markets, weaknesses in underwriting or pricing can be compounded by significantly increased sales volumes in the segments where weaknesses are present.

6.3 In order to react quickly to changing conditions, firms must have:

- Appropriate information to quickly identify underwriting issues or changes in conditions.
- Suitable systems, processes and controls to ensure all relevant data is captured accurately.
- Resource to effectively analyse data to confirm the cause of any issues.
- A clearly defined and efficient process for approving changes.
- A clearly defined and efficient process for implementing changes.
- Adequate testing to confirm successful changes with minimal delays.
- Sufficient documentation to ensure that all changes have adequate audit trails.

Case Study

Firm C writes 100% of its business in the UK personal lines motor market. At a monthly underwriting meeting, the underwriting team identified a sharp increase in aggregator sales for drivers aged under 30 years old. The team had a large project on at the time, so instigated an investigation into the issue two weeks after the underwriting meeting.

Following a month long investigation, the firm discovered that a previous price change had been implemented incorrectly, causing a 10% decrease in prices instead of a 10% increase for drivers aged under 30 years old.

Once the issue was identified, the team carried out analysis over a two-week period on the expected impact of backing the change out. This then had to be presented to the pricing committee for approval, which was unable to meet until the following month.

Once the change was approved, it was submitted to IT for implementation. Due to a change freeze in place because of a large IT project, there was a four week lead time before IT could begin working on the change. Finally, following a two-week period of testing, the rates were backed out, and previous rates were reinstated.

In total, there were eighteen weeks between the issue being identified, and the fix being implemented.

Review

As outlined in the previous section, adequate monitoring is essential to identifying issues quickly. Such a significant error should have been identified by Firm C in daily or weekly KPIs. Following significant changes, firms should carry out extensive testing and monitoring to ensure that changes have been implemented as expected. Had Firm C carried out this testing, then it is likely that the issue would have been identified sooner.

Firms should have adequate resource to ensure that when issues are identified, they can be investigated quickly and efficiently. In this case, Firm C was slow to begin work, and took a long time to carry out the investigation, suggesting a lack of suitable resource.

Firms should have policies in place for errors in pricing or underwriting, so that a clear sequence of events is immediately initiated when an error is confirmed, rather than having to carry out further analysis. If necessary, firms should be able to make changes outside of scheduled committee meetings, as this can significantly impact their ability to react quickly to events. Firm C were significantly delayed in implementing a fix, as they had to first carry out further analysis, and then wait for a scheduled committee to approve the fix.

Likewise, firms should have processes in place to ensure that they do not face extended periods where they are unable to make changes, for example due to projects in other areas. The underwriting / pricing team in Firm C should have coordinated with their IT team to ensure that there was some provision for essential but unplanned changes, to avoid further delays.

Finally, Firm C should have had efficient and well established pre-change testing processes, in order to avoid lengthy gaps between agreeing changes and actually implementing them. In competitive markets such as UK motor, particularly through aggregator channels, errors in pricing can be severely punished. In this case, in addition to Firm C pricing policies for drivers aged under 30 years old lower than intended, the firm also experienced significantly increased sales at these inadequate prices. Firms who compete in these markets must ensure that they can react quickly to such incidents, to minimise the risk of writing significant volumes of unprofitable business.

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