Dame Harriett Baldwin MP
Chair, Treasury Committee
Committee Office
House of Commons
London SW1A OAA

Riverbank House
2 Swan Lane
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12 April 2024

Dear Dame Harriett,

**Inflation within the insurance industry and the Consumer Duty**

Thank you for your invitation, sent on behalf of the Treasury Committee, to submit written evidence on inflation within the insurance industry and the impact of the Financial Conduct Authority's Consumer Duty. I am pleased to respond on behalf of Direct Line Group ('DLG'), one of the UK's leading general insurance groups with customers holding over nine million policies with the Group.

I became Chief Executive Officer of DLG on the 1 March 2024. Since joining the business, I have been examining all aspects of our operations and performance.

Serving our customers is at the heart of DLG's business and values, and we know that insurance plays an important role in protecting individuals and businesses against unforeseen events and in driving the UK's economic growth. As such, we are fully supportive of the Consumer Duty, and we have introduced tangible improvements to help and support our customers as a result of it. These improvements underpin our commitment to putting our customers first. We are determined to uphold high standards by putting right instances where things have gone wrong in the past and by strengthening processes to ensure that historic mistakes are not repeated.

We know that our customers have been contending with the backdrop of high inflation and pressure on the cost of living. We are taking measures to support our customers through this challenging time, while ensuring that we remain efficient, competitive, and profitable.

I am grateful for the opportunity to describe our activities in more detail. Below I address each of the five questions you pose.

**Question 1: ONS inflation data shows that across the industry, car insurance inflation has at times been running at over 50 per cent in the past 12 months and is at present running at 35 per cent. What is justifying these price increases?**

A key factor in causing premium inflation at DLG through 2023 was claims inflation. A further factor was the requirement to return our Motor business to a sustainable footing given the significant cost increases we had experienced in relation to that business.

Claims inflation ran at high teens in 2022, but had not been fully priced in, and this contributed to substantial losses in our Motor portfolio. We then observed high single digit claims inflation in 2023 of which the main driver was increased motor repair costs with higher labour costs the single biggest factor, combined with the rising cost of parts, increased energy costs, and changes in vehicle technology which further exacerbated the severity of inflation. As well as materially increased repair costs, the market has felt the impact of the cost of second-hand cars increasing significantly and remaining high through 2022 and 2023. Alongside the claims inflation faced during 2023, DLG has seen and responded to developing theft trends of some high value vehicles and a strengthening of assumptions against some large bodily injury claims. Additionally, there was a return to normal driving behaviour, following the Covid-19 period, that caused an increase in the frequency of claims experienced.

We expect there to be further claims and premium inflation through 2024 however it is evident that price increases have slowed down compared with the recent inflationary environment. The outlook for claims inflation in 2024, whilst more stable, remains at high single digits. We note that although the Office for National Statistics (ONS) data shows quoted premiums have increased around 50% at times through 2023, the Association of British Insurers (ABI), who report on movements in actual sold premiums, show premiums were up 34% in Q42023 versus the same period in 2022.

DLG is aware of the impact of the rising cost of living on our customers and we have and continue to take measures to help support customers during this period. For example, we launched two new 'Essentials' Motor products; one on our Churchill brand, available via price comparison websites ('PCW'), and the other on our Direct Line brand, available direct only. Both products were designed to meet the needs of customers looking for a comprehensive product but with reduced cover levels for a reduced premium.

As a member of the ABI's Board Sub-Group on Motor Affordability and a member of the ABI Board we are engaged in their work as to how the industry can best support customers and in looking to identify measures that can help tackle insurance costs.

**Question 2: As part of its review of "insurers' valuation of vehicles", the FCA has identified several areas for improvement for car insurance providers for when dealing with stolen or written-off car valuations. What is your response to the FCA's findings?**

DLG welcomes the FCA's review of how insurers value vehicles that need to be written-off including those which have been stolen and not recovered.

Prior to the publication of the FCA's findings in March 2024, we had reviewed our processes for valuing written-off vehicles, to check that we were valuing those vehicles in a way that identified a fair estimate of their market value. Through this review, we identified that we hadn't always got things right, which had led to us undervaluing some customers' written-off vehicles. We hold ourselves to high standards and strive to put customers at the heart of our business, so we were highly disappointed to identify these cases and very much regret that this happened.

However, where things have gone wrong, we are committed to putting them right. As a result, and in response to our review, we initiated a past business review of motor total loss claims settled between 1 September 2017 and 17 August 2022, the aim of which was to identify any customers who received an undervaluation and provide them with appropriate compensation. The process is underway of contacting customers whom we have identified as having potentially not received a fair valuation for their written-off vehicles to offer both our apologies and provide compensation. We will be proactively contacting the remaining customers in the coming months. We have set aside more than £100 million to compensate affected customers.

Through the work we have done in relation to the past business review, we have also looked at how some vehicles came to be undervalued so we can ensure lessons are learned and embedded into control and process improvements. For example, following this work we have strengthened our quality control processes and the oversight of those processes to ensure consistency between valuations, re-trained our engineers on valuation methodology and made our processes simpler and more streamlined.

When the FCA published the findings of its review in March 2024, we revisited the work that we had already done to ensure that we had considered and actioned feedback identified by the FCA in its review. We believe that we have addressed the majority of areas flagged by the FCA in their feedback, but we are continuing to compare our current processes against the FCA's feedback to identify any further areas where changes or enhancements may be appropriate.

We will continue to keep our approach to valuing written-off vehicles under continual review to ensure that we continue to deliver good outcomes for customers, while remaining in close dialogue with the FCA and the Financial Ombudsman Service (FOS) on this topic.

**Question 3: In its review the FCA found that "firms would sometimes provide initial settlement offers that are below the insured vehicle's estimated market value" under the expectation "that they would then increase the offer if the customer challenged the original one or complained". Can you confirm that Direct Line Group does not engage in this practice?**

DLG does not and never has had a policy of engaging in this practice.

The past business review referred to in response to Question 2 above did however identify a small number of historic instances where individual engineers have operated outside of our policy. We very much regret this occurred at all and want to be clear that it was not the result of any policy to adopt this approach. The new controls we have put in place, following the review referred to in response to Question 2 above, are built around a "right first-time" approach with the aim of offering a fair market value for the vehicle to customers at the first time of asking, every time.

To assess the retail value of a vehicle that has to be written off we use market-leading vehicle valuation guides, which use vast data sets to provide the estimated value of a vehicle at a point in time based on the specific details of the vehicle involved. Alongside the retail value, our engineers assess each vehicle individually taking into consideration the condition of the vehicle to determine whether it affects the value, and deductions are only made when there is clear evidence to support them.

If customers are unhappy with the valuation that they are offered for their written-off vehicle once their claim has been assessed and tell us this, they will be contacted by DLG to arrange a secondary valuation to check that their vehicle has been valued fairly. This secondary valuation process follows the same methodology as the first but is conducted by a different engineer who will review the valuation afresh to check for errors. The second engineer will also consider any new or additional information that a customer has provided since the original valuation of their vehicle was conducted to see if that information could impact the valuation. If a customer remains unhappy with their valuation after the secondary valuation is completed, a letter is sent to them which clearly sets out their rights to refer their case to the FOS.

**Question 4: What tangible changes have you made to the terms and conditions of your policies since the introduction of the FCA's Consumer Duty?**

DLG fully supports the Consumer Duty, and delivering for our customers is at the heart of what we do. We continually monitor and review our policies and practices to ensure that we deliver good outcomes and fair value for customers and ahead of the regulation coming into force we conducted a thorough internal review with the objective of ensuring DLG aligns with the new duty.

We have made tangible improvements to help and support our customers, including changing the wording of some terms and conditions to provide greater clarity for customers over what is and is not covered by their policy. For example, we have updated the wording of our Guaranteed Hire Car Plus wording (including the definition of Hire car) so that the type of hire car supplied is clearly stated.

Other actions we have taken as a result of the introduction of the Consumer Duty include:

- Providing Consumer Duty training to all colleagues, including those interacting with customers every day.

- Adding more clarity and examples in the online claims journey as to how to take photos and videos of damage to property, especially in relation to helping accelerate and progress with escape of water claims. We are now sending more proactive communications out to customers via email and/or text to highlight when storms and/or freeze events are forecast and sharing guidance around the steps they can take to protect their properties and belongings.

- Engaging with key suppliers, including producing a supplier-specific guidance pack, to help them understand the expectations around customer outcomes and how we will support them to achieve this.

- Launching a customer closeness programme for our Senior Leadership community to go 'back to the floor' to get closer to our customers. This includes handling complaints, listening in to sales journeys and accompanying field agents visiting customers' homes to assess claims.

- Introducing new product forums with specific accountability for reviewing customer outcomes and reporting against the four main outcomes of the Consumer Duty.

- Using a purpose-built user experience testing facility at our London office where we are meeting with customers to test new experiences to ensure their input is fed into any changes we make.

As you would expect we closely monitor our performance against the Consumer Duty outcomes to ensure we are delivering for our customers, so our terms and conditions remain under regular review.

**Question 5: What measures are you taking to make sure that customers who in good faith estimated the cost to rebuild their property when taking out buildings insurance will not be left underinsured by the rapid increases in the costs of building that have occurred since their policies were taken out?**

We appreciate it can be difficult for customers to know exactly how much it will cost to rebuild their home, and that external factors can cause this figure to fluctuate over time. To help with this, we offer the vast majority of our domestic customers buildings insurance on a "blanket cover" basis, unless their properties were built before 1760 or are listed. "Blanket cover" means, depending on the brand and policy chosen, the customer can opt for cover of at least £1 million with the option to insure their building on an "Unlimited" basis if that is more appropriate for their home.

When a customer comes to us via a PCW they are asked to put in their estimate of how much it would cost to rebuild their home. The PCW usually generates the estimate on behalf of the customer based on information given, for example the postcode, type of property, and number of bedrooms. Even when they have provided a rebuild quote, if they take out a home policy with one of our brands, the blanket cover will still apply unless their property was built before 1760 or is a listed building.

Customers who come to us direct are not asked to declare their rebuild cost in their policy application, unless they own an older property (pre-1760) or a listed building. In the pre-1760 properties and listed buildings it is not appropriate to offer blanket cover as very specific rebuild costs could apply. In these scenarios, we will use the rebuild value declared by the customer. To protect against inflation, we index link this sum insured each year using the House Rebuilding Cost Index prepared by the Royal Institution of Chartered Surveyors (RICS) to ensure the rebuild value remains suitable for their needs.

In addition, blanket cover does not apply to landlords who let their property / properties. When landlords apply for cover they are asked to state the rebuild value of their property / properties. To help our customers do this, we provide access to tools such as the Building Cost Information Service Rebuild Calculator. We also highlight to customers that they would be well advised to contact a qualified surveyor to provide a rebuild cost estimate. All customers at renewal are asked to check that they believe all the information on the policy is correct, including the rebuild cost. We are currently reviewing how we can further support our landlord customers to obtain an accurate valuation.

I hope that the information set out above addresses the questions that you raised in your letter and proves to be of assistance to your enquiries. If you have any questions about the contents of this letter, or if you think that DLG can further assist your enquiries, please do not hesitate to contact me.

Yours sincerely

**Adam Winslow**
**Chief Executive Officer**