

The Institute and Faculty of Actuaries – Written Evidence (CIM0027)

IFoA response to House of Lords Financial Services Regulation Committee call for evidence – Regulation of the consumer insurance market

The Institute and Faculty of Actuaries (IFoA) is a royal chartered, not-for-profit, professional body. We represent and regulate over 34,000 actuaries worldwide, and oversee their education at all stages of qualification and development throughout their careers. Actuaries are big-picture thinkers who use mathematical and risk analysis, behavioural insight and business acumen to draw insight from complexity. Our rigorous approach and expertise help the organisations, communities and governments we work with to make better-informed decisions. In an increasingly uncertain world, it allows them to act in a way that makes sense of the present and plans for the future.

Key points

The Institute and Faculty of Actuaries (IFoA) welcomes the opportunity to contribute to this call for evidence (drawing on input from our General Insurance Pricing Research group).

Our comments focus on areas where actuarial research and practice can provide evidence and insight, namely pricing, risk assessment, fairness, access to insurance, and the use of data and analytical methods. We do not seek to comment in detail on claims handling practices, regulatory enforcement, or dispute resolution processes, except where these interact directly with pricing and consumer outcomes.

A recurring theme throughout this response is that advances in predictive modelling increasingly shift the policy debate away from whether insurers can accurately assess risk, towards which predictive factors society considers appropriate to use in determining insurance premiums.

Specifically, we would like to flag Q4 where, as part of the government's Financial Inclusion Strategy, the IFoA is partnering with the financial inclusion charity Fair4All Finance to facilitate a pilot to support the insurance market to develop and deliver one or more home contents insurance propositions for social tenants.

Insurance pricing has become increasingly sophisticated and will continue to do so. This brings significant benefits in terms of pricing accuracy and

market efficiency, but also raises increasingly difficult questions regarding affordability, accessibility and societal concepts of fairness. These are ultimately matters of public policy rather than actuarial science.

The role of actuarial practice is to explain the likely consequences of different policy choices and to support the development of governance frameworks that ensure increasingly sophisticated pricing techniques continue to operate in a transparent, accountable and fair manner.

IFoA Response

Q1. What are the key areas of concern for consumers in the regulation of home and travel insurance?

Our principal observation is that many of the challenges facing the home and travel insurance markets arise from the interaction and tension between three important objectives:

- Risk-reflective pricing;
- Consumer affordability and access; and
- Public perceptions of fairness.

Advances in data, modelling and analytics have enabled insurers to assess risk with increasing precision. This can improve pricing accuracy, reduce inappropriate cross-subsidies and support efficient insurance markets. But it may also create tensions with affordability, accessibility and consumer perceptions of fairness.

We would assess the key consumer concerns as:

- The affordability of insurance;
- Significant premium increases over time, including at renewal;
- Limited understanding of the factors that influence premiums;
- Perceptions of unfairness in pricing outcomes;
- Availability of insurance for consumers facing elevated risks.

Technical Perspective on Fairness

Historically, actuarial pricing has sought to align premiums with expected cost as closely as possible. This represents the traditional actuarial concept of fairness. Clearly, there is always a fortuitous element to risk

that cannot be predicted, and it is this uncertainty that insurance is intended to protect against.

This approach has a number of theoretical benefits.

First, it encourages decisions and behaviours that reduce risk, as these are rewarded through lower premiums.

Secondly, it aligns with a relatively free-market approach to insurance pricing. Where insurers are free to set prices and competition is effective, premiums should tend towards reflecting underlying risk as accurately as possible. Insurers whose pricing materially departs from expected risk are likely to experience adverse selection, attracting business that has been underpriced while losing business that has been overpriced, with a corresponding deterioration in profitability. Competitive pressure therefore provides a strong commercial incentive for insurers to price risk as accurately as possible, and to focus on product quality, service and efficiency to attract customers.

However, this traditional actuarial perspective is not necessarily consistent with broader societal concepts of fairness, and the theoretical benefits described above depend upon assumptions that do not always hold in practice.

This tension is already recognised in the regulatory framework, which prohibits discrimination on the basis of certain protected characteristics such as sex and race. However, other characteristics are not protected, even where differential pricing based upon them may be regarded by society as unfair. A relatively free-market approach therefore not only permits insurers to make use of any predictive rating factors – even potentially unfair ones – that improve pricing accuracy, but creates strong commercial incentives to do so.

Discrimination by Proxy

An individual's true level of risk cannot be observed directly. Insurance pricing is therefore necessarily based upon statistical inference, using characteristics that are predictive of future claims experience. Many rating factors are therefore proxies for risk, rather than the underlying causes of risk themselves.

Where these proxy variables are correlated with protected characteristics, or with other characteristics that society may regard as inappropriate grounds for differential pricing, discriminatory outcomes may arise even

though the protected characteristic itself is never used within the pricing model.

For example, insurers do not collect or use information on race for pricing purposes. Two individuals who differ only by race would therefore receive the same premium. However, postcode is widely used as a legitimate predictor of risk and may correlate with ethnic composition. As a consequence, different ethnic groups may pay different premiums on average, despite race itself playing no role within the pricing model.

Avoiding such indirect effects is technically challenging. It would require insurers first to collect information on protected characteristics, analyse the relationship between those characteristics and other rating factors, and then adjust the resulting premiums to remove any indirect discriminatory effect. Such an approach would itself raise significant practical, legal and ethical questions.

Socio-economic Factors and Monthly Payment

Socio-economic deprivation is one example of an unprotected characteristic where differential pricing may be regarded as socially undesirable, despite having predictive value. It also correlates with a number of legitimate rating factors, including postcode.

One specific area where targeted regulatory intervention may merit consideration is the treatment of monthly premium payments. Customers paying by monthly instalments often pay substantially more than those paying annually, with the difference commonly presented as reflecting the cost of providing credit. However, insurance differs fundamentally from a conventional loan. Cover is generally provided only while premiums continue to be paid, and policies are typically cancelled following non-payment. The insurer's credit exposure is therefore limited. While financing, administration and payment default costs may justify some additional charge, they may not fully explain the observed premium differentials.

It is therefore likely that part of the premium differential reflects differences in observed claims experience between customers choosing different payment frequencies. This improves predictive accuracy, but payment frequency is unlikely to be causal in itself. Rather, it is acting as a proxy for wider socio-economic circumstances. Customers with the financial means to pay annually are more likely to do so, meaning those paying monthly are more likely to have limited financial resources. As a

consequence, pricing based on payment frequency may disproportionately increase the cost of insurance for those least able to afford it.

This illustrates a broader policy question: should variables that primarily act as proxies for socio-economic circumstances be treated in the same way as variables that directly reflect the underlying insurance risk? We believe this is one area where further regulatory consideration may be justified.

Choice and Circumstance

A further distinction that may be relevant when considering fairness is the extent to which a rating factor reflects choices made by the consumer, rather than characteristics or circumstances over which they have limited practical control. Consumers are generally more likely to regard pricing as fair where it reflects voluntary decisions that influence risk, such as purchasing a higher-value property, choosing to smoke, or installing security measures. By contrast, concerns are more likely to arise where premiums are influenced by factors that primarily reflect wider socio-economic circumstances, such as the need to pay monthly, working patterns or other characteristics that consumers may have little realistic ability to change.

This does not imply that such variables lack predictive value; indeed, they may improve the accuracy of risk assessment. Rather, it raises a broader policy question as to whether all statistically predictive variables should be regarded as equally acceptable for pricing purposes. As insurers gain access to increasingly rich data and more sophisticated analytical techniques, the question is increasingly no longer whether insurers can predict risk accurately, but which predictive variables society considers acceptable for pricing purposes. We believe this is likely to become one of the defining regulatory questions for insurance over the coming decade.

A. Are there any other types of insurance where consumers are facing similar challenges

Similar issues arise in motor, pet, health and income protection insurance. Common themes include affordability, access for higher-risk consumers, and perceptions of fairness in increasingly risk-based pricing systems.

Q3. Does the current regulation of insurance distribution and sales ensure that consumers purchase appropriate home and travel insurance? Are there any changes that should be made to the regulatory requirements?

While the Group does not comment on insurance distribution practices themselves, there are important interactions between pricing, product design and consumer decision-making.

Transparency Beyond Price

Markets work most effectively when consumers are able to compare the aspects of a product that determine its overall value. For insurance, these are principally:

- Price;
- The scope of cover provided; and
- The quality of claims service.

Price is readily observable and can be compared quickly and easily, particularly through price comparison websites. By contrast, differences in policy coverage are often complex, while claims service generally cannot be assessed until a claim is made. As a result, consumers have far greater visibility of price than of the other factors that determine the overall value of an insurance policy.

Competition may therefore become concentrated on headline price, and the product and service quality factors may receive less weight in consumers' purchasing decisions than their importance would warrant.

There may be merit in considering whether consumers could be provided with more standardised information regarding both policy coverage and claims performance at the point of purchase.

For policy coverage, the objective need not be to standardise insurance products themselves, as differences in cover allow insurers to innovate and consumers to select products that best meet their individual needs. However, a more standardised presentation of key features, exclusions and optional benefits could make meaningful comparisons significantly easier while preserving product innovation and consumer choice.

Similarly, there may be merit in exploring whether more standardised and accessible information on claims service could be made available. This might include measures such as claims acceptance rates, settlement

times, complaints data or other indicators of customer outcomes, recognising that no single metric is likely to capture claims quality in its entirety and that any published measures would need to be carefully designed to avoid creating unintended incentives.

Improving transparency in these areas would enable consumers to make more informed purchasing decisions and could encourage greater competition on the overall value of insurance products, rather than predominantly on headline price.

Q4. Are there any groups of consumers that face challenges in accessing suitable insurance?

As part of the government's Financial Inclusion Strategy, the IFoA is partnering with the financial inclusion charity Fair4All Finance to conduct a pilot to support the insurance market to develop and deliver one or more home contents insurance propositions for social tenants.

Working with Fair4All Finance, we plan to facilitate, fund and support the insurance and housing sectors to deliver a cross-sector pilot that tests how contents insurance can be provided to social housing tenants through reduced friction pathways at the point of tenancy.

Fair4All Finance's own research shows that 24% of people in financially vulnerable circumstances do not hold a single insurance or protection product, compared to a national average of 16%. The most recent data also finds that only 28% of people in financially vulnerable circumstances have the same levels of protection as they did 12 months ago, and only 30% of people in financially vulnerable circumstances have contents insurance, compared with 46% of all UK adults.¹

As insurers continue to improve their ability to differentiate risk, premiums will increasingly reflect the underlying level of risk faced by individual consumers. This improves pricing accuracy and market efficiency by reducing cross-subsidies. However, it also makes differences in underlying risk more visible through the premiums charged. Consumers facing the highest levels of risk are therefore likely to experience higher premiums, even though the underlying risk itself has not changed.

For some categories of risk, particularly those exposed to natural catastrophes or other severe systemic risks, there may be circumstances in which fully risk-reflective pricing results in insurance becoming

¹ Fair4All Finance. 'Home contents insurance pilot: Expression of interest'. Available at: <https://fair4allfinance.org.uk/home-contents-insurance-pilot-expression-of-interest/> (March 2026).

unaffordable or, in some cases, commercially unavailable. This does not necessarily represent a failure of the insurance market. Rather, it reflects the underlying economics of transferring particularly high or concentrated risks.

Where society considers that insurance should remain widely accessible regardless of risk, we believe it is generally preferable to address this through targeted interventions rather than by imposing broad constraints on risk-based pricing across the market. Schemes such as Flood Re demonstrate how carefully designed, mutualised or publicly supported arrangements can improve affordability and availability for specific groups while preserving the benefits of competition and risk-reflective pricing elsewhere in the market.

In our view, this targeted approach is generally preferable to wider restrictions on insurers' ability to reflect risk in pricing. It allows policymakers to identify those areas where social objectives justify intervention, while maintaining the efficiency and innovation that arise from competition in the wider insurance market.

Q8. Are there any gaps in the current legislation or regulatory framework for the consumer insurance market?

The Group does not consider there to be any fundamental gaps in the legislative framework governing insurance pricing. Existing regulation provides a comprehensive framework for areas such as governance, conduct, discrimination, consumer protection and model oversight. However, developments in data availability and predictive modelling have brought increasing focus to a number of policy questions that extend beyond traditional actuarial practice.

In particular, there is currently limited guidance on the extent to which insurers should make use of highly predictive variables that may primarily act as proxies for wider socio-economic characteristics or other factors that society may regard as inappropriate grounds for differential pricing. Existing legislation appropriately prohibits the use of certain protected characteristics, but advances in predictive modelling mean that similar outcomes may arise indirectly through correlated variables. Determining where the boundary should lie between predictive accuracy and broader societal concepts of fairness is ultimately a matter of public policy rather than actuarial science.

The Group therefore considers that the principal challenge is not a lack of regulation, but the need for greater clarity regarding the policy objectives that regulation is intended to achieve. In particular, policymakers may wish to consider the extent to which insurers should be encouraged to pursue increasingly risk-reflective pricing where this comes into tension with wider objectives relating to affordability, financial inclusion and public perceptions of fairness.

Where society concludes that departures from fully risk-reflective pricing are desirable, we believe that carefully targeted interventions are generally preferable to broad restrictions on pricing across the market. Targeted mechanisms, including mutualised or publicly supported schemes where appropriate, can address specific affordability or availability concerns while preserving the benefits of competition and efficient risk allocation across the wider insurance market.

A. Is the current regulatory regime well adapted to respond to the adoption of AI in the insurance industry?

The Group considers that it is important to distinguish between the increasing use of advanced statistical modelling techniques and the future possibility of genuinely autonomous AI-based pricing.

Over the last decade, insurance pricing has evolved from relatively simple Generalised Linear Models (GLMs) towards more sophisticated machine learning techniques such as Gradient Boosting Machines (GBMs). These models are capable of capturing more complex relationships within the data and have generally improved predictive performance. However, they also reduce model transparency and explainability, making it more difficult to understand precisely how individual pricing decisions are reached.

Despite this increase in complexity, the underlying pricing process has not (yet) fundamentally changed. At present, the use of genuinely autonomous AI for insurance pricing appears to be relatively limited. Models continue to be developed using historical datasets, independently validated, subject to governance and approval processes, and deployed as relatively stable pricing frameworks that are monitored and periodically refreshed. Traditional actuarial governance therefore remains largely applicable

For this reason, we believe that the existing principles of actuarial governance—including independent validation, model oversight, documentation, monitoring and accountability—remain appropriate,

although the increasing complexity of models places greater demands on validation, documentation and explainability.

However, AI technology is clearly evolving at a rapid pace. In our view, the governance challenge posed by AI is less about the technology itself than about the degree of autonomy it is given. A complex GBM that is trained on a static dataset, independently validated and formally approved before deployment presents a very different governance challenge from an AI system that continuously learns, adapts or generates pricing decisions without explicit redevelopment and approval. Existing actuarial governance frameworks are well suited to the former but would need to evolve significantly to accommodate the latter.

The more significant regulatory challenge would therefore arise if insurers were to adopt AI systems that continuously adapt or evolve in response to new information, rather than relying upon periodically reviewed pricing models. Such approaches could make it considerably more difficult to understand, validate and govern pricing decisions, particularly where model behaviour changes over time without explicit human oversight.

More broadly, AI does not fundamentally alter the policy questions surrounding insurance pricing; rather, it amplifies existing ones. As predictive techniques become increasingly powerful, insurers will identify ever more variables that improve pricing accuracy, many of which may act as proxies for wider socio-economic or other characteristics. The central challenge for policymakers is therefore increasingly not whether insurers can predict risk more accurately, but which predictive variables society considers appropriate to use in determining insurance premiums.

Concluding Remarks

Insurance pricing has become increasingly sophisticated and will continue to do so. This brings significant benefits in terms of pricing accuracy and market efficiency, but also raises increasingly difficult questions regarding affordability, accessibility and societal concepts of fairness. These are ultimately matters of public policy rather than actuarial science.

The role of actuarial practice is to explain the likely consequences of different policy choices and to support the development of governance frameworks that ensure increasingly sophisticated pricing techniques continue to operate in a transparent, accountable and fair manner.

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