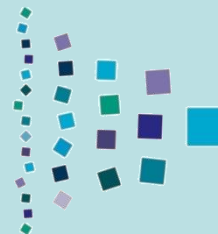


# PROTECT

Legal and Regulatory Review

MARCH 2019

Malcolm  
Padgett  
LEGAL  
REGULATORY  
COMPLIANCE  
TRAINING



# December to March

- A regulatory overview – but some key themes:-
  - Product “value”
  - Pricing and value in the distribution chain
  - Customer best interests and a duty of care
  - Individual responsibility
- They all add up to a major shift in what “compliance” is all about

# There was a time . . . .



Product



Route to  
Market



Market

# The “value”



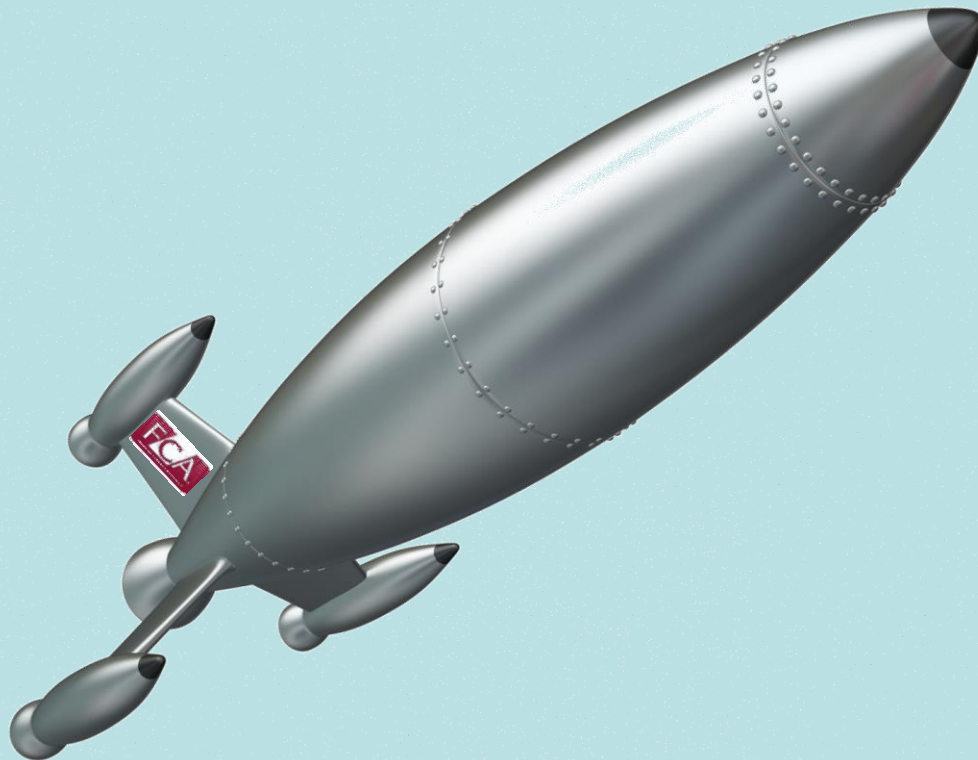
And “compliance” was all about . . .



We are now . . . . .



Let's go on the last 4 months of the journey  
to where we are going



# In November





# Pricing

- The FCA:-
  - published a Discussion Paper (DP18/09) on Fair Pricing in Financial Services
  - launched a Market Study into how general insurance firms charge their customers for home and motor insurance
  - published a Thematic Review report (TR18/4) setting out the findings of its thematic review into pricing practices in the retail general insurance sector
  - published a “Dear CEO letter” setting out its expectations of general insurance firms undertaking “pricing activities”

It looks as if FCA just might  
be interested in . . .

**PRICE**

# The pricing issues which worry the FCA

- Firms failing to have appropriate and effective strategies, governance, control and oversight of their pricing practices and activities, “such that they are unable to reliably assess and evidence whether they are **treating their customers fairly**”
- Differential pricing, “leading to some identifiable groups of consumers paying significantly higher prices than other identifiable groups of consumers”
- The FCA says that its “overall aim” is to ensure that general insurance markets deliver competitive and fair pricing outcomes for consumers. It intends to:-

*"act as required to ensure this happens, including where appropriate, taking steps that may fundamentally change pricing practices"*

# Reinforced by a Dear CEO letter

- FCA expects firms to demonstrate how they have considered the issues raised in the Thematic Review and be able to explain, and evidence, any remedial actions they have taken. In particular, firms are reminded that they need to:-
  - assess whether their pricing practices result in their customers being treated fairly and **demonstrate how they have reached this conclusion**; and
  - make clear who, within the business, is **responsible** for pricing decisions, and therefore responsible for the customer outcomes that result from those decisions
- The letter emphasises that, when considering pricing issues, firms must note the new “PROD” (product governance and oversight) rules in effect from 1 October (on which more later . . .)
- Note also the FCA theme on pricing is directly linked to individual responsibility for it

# More on Pricing . . .

- We also had (a now confirmed) FCA proposal for a price-cap on extended warranties sold in the rent to own sector
- This will be coupled by an anti-avoidance provision – firms must not attempt to recover revenue lost, via a price cap, through increases to prices for connected goods or services
- FCA is not waiting for the price cap – it says that all firms in any sector must, in any event, be meeting the “customer best interests rule (ICOBS 2.5):-

*A firm must act honestly, fairly and professionally in accordance with the best interests of its customer*

- Do not underestimate the power of a customer best interests rule in the hands of a regulator committed to pricing controls – your desire for profit is simply not in that game
- Remember that power is linked to individual responsibility for pricing within firms

# Into December



# December . . .

- FCA published a new webpage on “delivering clear and fair outcomes for consumers under the IDD”
- Note the warning:-

*“The FCA expects firms to learn from this”*

- The FCA says that it expects (of course) firms to have “adapted their processes to meet IDD requirements” (that is “Handbook stuff”) but the FCA is a whole lot more interested in the:-

*“important areas around which we are focusing supervision”*

- So, we better look at what these are . . .

# FCA will “focus supervision” on firms doing three things . . .

- Identifying customers' insurance demands and needs, and ensuring that products offered are consistent with them
- Having in place product oversight and governance (POG) arrangements
- Complying with the customer's best interests rule



# Identifying customers' demands and needs

- The FCA says that firms can still carry out non-advised sales, and it does not always expect them to perform a detailed investigation of a customer's circumstances
- But, the FCA says, firms must not offer customers products that do not meet their demands and needs
- The demands and needs investigations (at whatever level) must happen and must be interactive
- However, the FCA says, an individual customer's demands and needs are just a small part of a much bigger picture . . . .

# Having in place product oversight and governance (POG) arrangements

- Before a product gets anywhere near a demands and needs process with an individual customer - the product must meet all the requirements of Chapter 4 of the Product Intervention and Product Governance Sourcebook (PROD)
- That involves identifying and testing the target market for the product and putting in place requirements up and down the distribution chain to ensure that all necessary information and feedback is delivered and captured to ensure that the product continues to meet . . .

# . . . the customer's best interests rule

- This is now the central plank of supervision
- This is what the FCA say:-

*“the IDD introduces a rule which requires that all firms act honestly, fairly and professionally in the customers’ best interests regardless of their position in the distribution chain, and whether or not they have direct contact with the end customer. Throughout the distribution process, including the marketing, remuneration and the sales of products, firms must always focus on and meet this requirement”*

- You must ask yourselves - are you a firm which still delivers, for distribution, bulk product to maximise profit - or are you a firm which drives its business via the customers’ best interests?
- For many firms the answer is still the former – that is a very dangerous place to be. PROD demands . . .

# Shared product oversight

- PROD requires the entire distribution chain take responsibility for liaison and co-governance to ensure that no product is launched, nor maintained, in the market unless it is, and remains, compliant with PROD
- That is coupled with equivalent requirements for liaison and governance over the business strategies and conduct of business within those distribution chains – whether related to remuneration, culture or to the knowledge and competence of those working within them
- All this must drive a complete change of behaviour, and operational requirements, within the general insurance market. The way that everybody has conducted business in the GI market (especially firm centric, and non-participatory, operation of responsibilities within the distribution chain) has got to fundamentally change
- This is what FCA say about this . . . .

# Be warned . . .

*“the effective implementation of the IDD, and of our new rules by firms, forms an important part of our focus on firms adopting a customer-centric culture. Our Supervision teams have been highlighting its significance when engaging with firms in recent months, and will continue to focus on how firms are complying with the new rules in a way that properly considers their customers”*

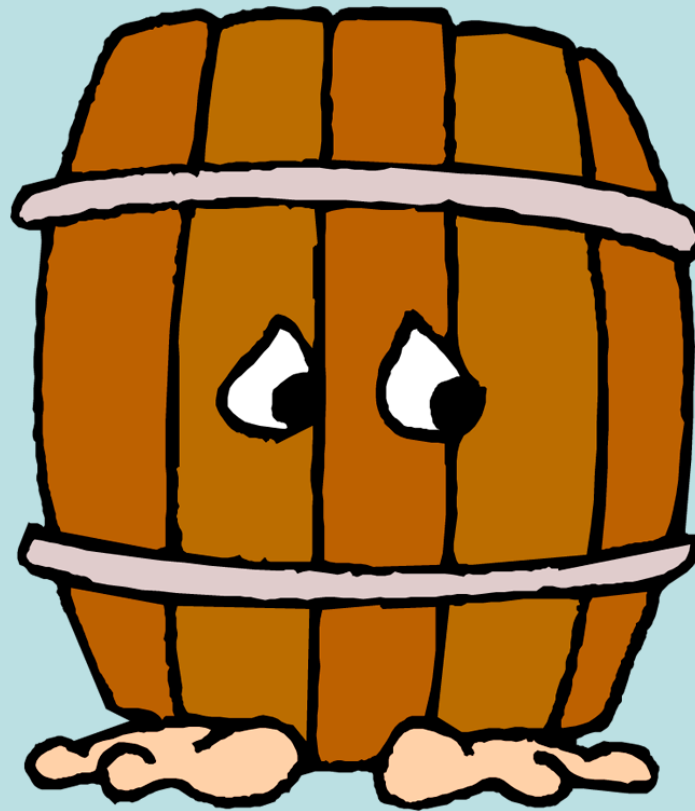
# This is easier said than done . . .

- Just before Christmas FCA issued its Finalised Guidance on the Fairness of Variation Terms in Financial Services Contracts (FG18/7)
- The main thrust is the focus on and compliance with the Consumer Rights Act if any variation of contract terms is contemplated
- Because of PROD this is going to become a much greater issue . . .

# Variation of Contract Terms

- PROD requires continuing product oversight and liaison between all members of a product distribution chain
- Where any firm in the chain identifies (whether via complaints or claims handling) that a product is “not working well” – not only must firms consider how to change the product to “work well” – but also what the impact of the “less than well working product” may have had upon all those customers who already have that product?
- A decision to change contract terms to better meet the customers’ best interests will (almost certainly) be an admission to existing customers that the product they have is (and was not when they purchased it) “clear fair and not misleading”
- That must then immediately trigger the issue of a product review to establish the impact, and potential detriment, for existing customers – and . .
- That raises the potential requirement for redress – and that may raise consideration as to whether the FCA should become involved under Principal 11 and/or SUP 15?

There is no hiding place

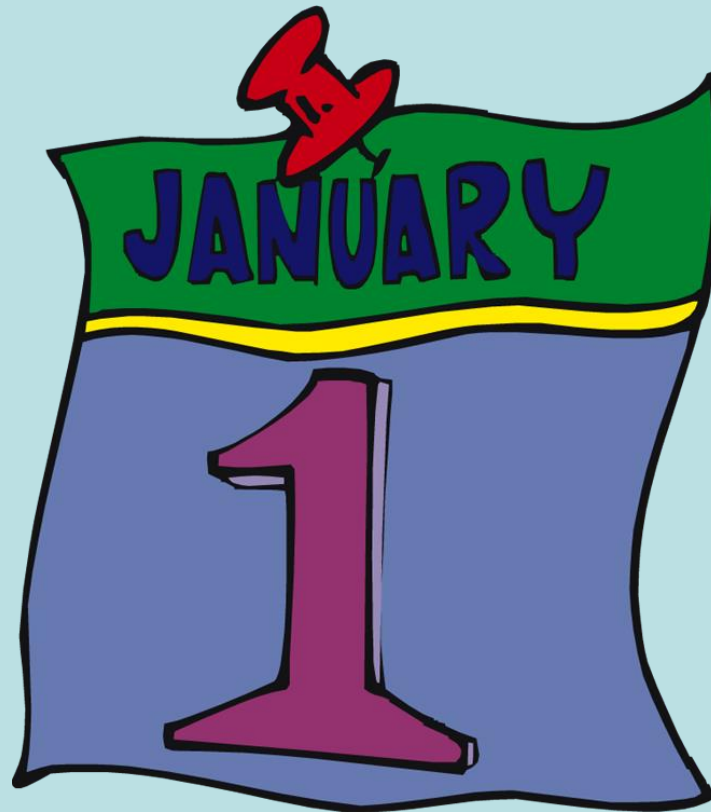




# Speaking of Principle 11 (and no hiding place)

- The FCA has fined Santander Plc £32.8 million
- The fine reflected, not only the regulatory shortcomings which Santander had with handling deceased customer accounts, but the fact that Santander knew about these problems, and tried to sort them out over a two year period **without involving the FCA**
- Worse still, it was “selective” with the information which it then did share with the FCA
- From many dealings with clients it is clear just how reluctant they are to deal with the FCA - citing lack of trust in the FCA’s fairness and proportion in response
- That is as may be, but £32.8 million is a sharp reminder that “taking matters on the chin” and dealing with any issues which may adversely affect customers, promptly and openly, and with the involvement of the FCA, when required, has to be the course you choose

# Into January . . .



# Another Dear CEO letter

- On 9 January, the FCA published a Dear CEO letter about any financial promotions by firms that suggest, or imply, that all of their activities are regulated by the FCA and/or PRA, when this is not the case
- Be very careful – this has already highlighted for many firms that their standard “GEN 4” regulatory disclosure on notepaper and other materials is unlawful
- This is because the notepaper/materials are common to both regulated and unregulated activity (e.g. arranging insurance and outsourced claims handling)

# An Amendment to the PPI Order

- The Competition and Markets Authority published the Payment Protection Insurance Market Investigation Order 2011 Variation Order 2018
- This replaces any reference, in the 2011 Order, to a Policy Summary Document with a reference to the Insurance Product Information Document (IPID)
- This has the effect, e.g., of requiring Annual Statements to be accompanied by an IPID – notwithstanding that the policy may have been sold before IPIDs existed!

# Into February



. . . And the big boy



# GI Value Measures reporting

- A special meeting on this?
- I will:-
  - set the scene
  - make a couple of quick observations; and
  - draw your attention to the really big issue

# Setting the scene (1)

- From small acorns, great oaks grow
- We started with a FCA Market Study into the Add-on Insurance market (an investigation undertaken under FCA's competition objective)
- That recommended a pilot project to assess whether the publication, on the FCA website, of various “value measures” applied to a limited range of add-on products might assist in delivering a more competitive market for add-on products more generally?
- FCA was very clear that its objective was to have a resource for firms to access - so that they could review the performance of their products (as assessed by the various measures) against the performance of other providers' products
- FCA was just as clear that it would not see this resource as suitable for consumer use, as many of the factors affecting the data would not be sufficiently understood by consumers

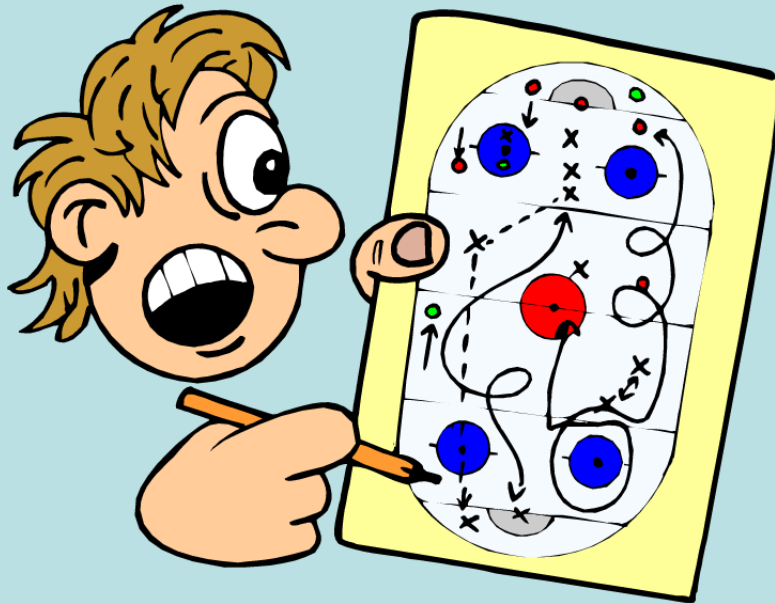


# Setting the scene (2)

- FCA has claimed that the pilot has delivered on its objectives
- Much of the evidence for this is shaky, to say the least
- However, FCA now say that, because of this “evidence”, and evidence which it says it has gathered:-
  - related to mobile phone insurance, motor insurance add-ons and isolated incidents - such as those affecting Express Gifts ; and
  - from its unpublished work on “value in the distribution chain”

it proposes to extend value measure reporting and publication to “all GI products” (STIP?)

# The implications



- Enormous (and much devil is in the detail)
- I will focus on the strategic implications today

# The strategic implications

- FCA are opening up the scope of what it is proposing, way beyond the function of reporting value data to it. FCA indicate that:-
  - quite contrary to its position on add-on insurance value measures, it sees the information which will be published as a result of reporting as valuable to both **press** and **consumers** directly (see the diagram on page 6 of CP19/8); and
  - it will create a linkage between the value measures which are published, and the actions which it will expect firms to take (in the light of the information), when meeting their obligations under Chapter 4 of the Product Intervention and Product Governance Sourcebook (PROD)

# A two pronged attack on value



- By these means FCA will create a two pronged attack on the “value” of your products:-
  - the publication for press and consumer use will apply an external pressure; whilst
  - the PROD measures will place huge internal pressures on your firm

# The External Pressures are obvious . . .



# The Internal Pressures



# The pressure from linkage to PROD

- We have already seen that PROD totally changes the game for insurance distribution away from the “pushed product” model to one focused on, and responsive to, targeting consumer needs
- The FCA’s proposals to link PROD to the reporting of value measures takes this to another level . . .

# What the FCA propose

- That a new PROD 4.5 be introduced into the Handbook
- It will be titled:-

**“Additional expectations for manufactures and distributors in relation to value measures data”**



# What will PROD 4.5 require?

- The requirement will be that firms which manufacture “value measures products” must add to their product governance and oversight:-
  - the firm’s reasonable assessment of the value expectations of customers in the target market;
  - the value measures information, within a reasonable period of its publication; and
  - any particular features of their product, or its terms and conditions, that “may give rise to concerns about poor value”

and then the firm must:-

“do whatever is necessary to correct any aspects of their product which do not offer ***sufficiently good value***” (my emphasis)

# What about distributors?

If distributors identify any aspects of a product that may mean the product does not offer “sufficiently good value” they must take “appropriate action” to mitigate the situation and report the position to the manufacturer

# We started our Review like this



Product



Route to  
Market



Market

# What a change we face!

- Consider how far we will have travelled!
- From a free market in insurance in the UK to something a great deal more potentially sinister for your business and its viability – value matching
- The outcome of these proposals will be a regulatorily driven “dive to the bottom”

# For more information on value measures

THE DESK TOP GUIDE

to

FCA's Proposals for General Insurance Value Measures  
Reporting (CP19/08)

As at February 2019



# FCA may not have finished yet . . .

- The FCA has updated its webpage on whether firms should owe customers a **general duty of care**?
- The FCA says that it is still considering the position but notes that:-

*“Although the content of the responses varied, the FCA notes that all respondents recognise the prospect of any potential new duty, in whatever form, could mean a significant change to financial services conduct and regulation”*

- The FCA intends to announce its next steps in “Spring 2019”

# Do not underestimate

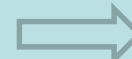
Customer best interests + customer duty of care + customer best value + pricing controls



Product



Route to  
Market



Market

# Into March





# We have already talked a lot about . .

- Pricing
- Value
- Customers' best interests and
- Duties of care
- What about commission?

# Commission

- Still no requirement (at a consumer level) to disclose the amount of commission – but the **nature** and **mechanics** of commission now must be disclosed (ICOBS 4.3.-7R)
- But the drivers on which commission may be lawfully offered are now hugely impacted by the overriding requirement to conduct business in the customers' best interests
- The window for appropriate commission models is ever narrowing
- Where next on this?
- A clue from the motor finance market

# The clue

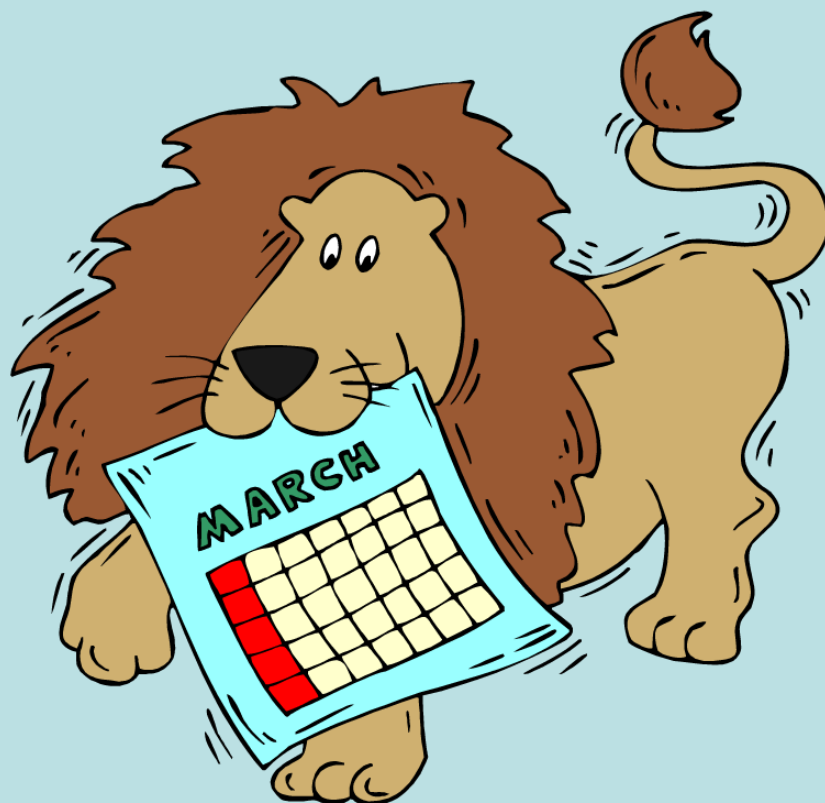
- FCA has investigated motor market commission models
- These often allow brokers discretion to set the customer interest rate
- Effectively this allows the motor dealer/broker to inflate the true (or lender's) interest rate - by building in (additional) "commission" into that rate
- The FCA says that this leads to customers paying significantly more for motor finance, and can lead to conflict of interest in the dealer's role with the customer
- The FCA says is assessing options for intervening to address this – including potentially banning or limiting the dealer's discretion to set the rate
- What has this got to do with general insurance?

# A “read over” into GI?



- GI distribution models are frequently based on a model of net and gross premium – with the intermediary left to set the gross premium
- Will the FCA, when it publishes its work on value in the GI distribution chain, repeat its concerns, as published, in respect of motor finance?

# Moving on in March



# Increased FOS awards

- On 8 March the FCA confirmed (jointly with FOS, via PS19/08) that the FOS award limits will increase on 1 April 2019 to:-
  - £350,000 for complaints about acts or omissions by firms on or after 1 April 2019;
  - £160,000 for complaints about acts or omissions by firms before 1 April 2019, but which are referred to FOS after that date
- From 1 April 2020 onwards, both award limits will be automatically adjusted annually on 1 April to keep pace with inflation as measured by the Consumer Prices Index
- The award limit remains at £150,000 for complaints referred to FOS before 1 April 2019

# Extended FOS access and awards

The range of persons eligible to complain to FOS will significantly increase from 1 April 2019 – they will then be:-

- **consumers** - basically any natural person acting for purposes outside his trade, business or profession;
- a **micro-enterprise** - basically a small family business with fewer than 10 employees and a turnover or “annual balance sheet” which does not exceed 2 million euro (or sterling equivalent);
- a **charity** – as long as it has an annual income of less than £6.5 million;
- a **trustee** – of a trust which has a net asset value of less than £5 million; and
- a **small business** – a business which is not a micro-enterprise but one which has an annual turnover of less than £6.5 million and employs fewer than 50 persons or has a “balance sheet total” of less than £5 million

# What haven't we talked about?

- We are less than a year away from the extension of the SM&CR to all financial services firms
- That comes coupled with **individual responsibility** to meet Conduct Rules
- Here are the Conduct Rules which apply to all staff (including those undertaking certified functions) . . . .



# The individual Conduct Rules

- Rule 1: You must act with integrity
- Rule 2: You must act with due skill, care and diligence
- Rule 3: You must be open and cooperative with the FCA, the PRA and other regulators
- Rule 4: You must pay due regard to the interests of customers and treat them fairly
- Rule 5: You must observe proper standards of market conduct



# If these are breached . .

- The breach must be reported (per individual) to the FCA
- That means that no individual in any financial services firm will be able, any longer, to shrug their shoulder and “just do their job”
- Everything we have covered today will be the responsibility of every individual
- That will fundamentally change the relationship between firms and their employees and between management and owners


# Updates on the SM&CR in March

- The FCA have now issued PS19/07 containing its final proposals and made rules for the Financial Services Directory
- The information which will appear publicly in the Directory is extensive as is the information which firms will have to provide for that purpose
- Insurance Intermediary firms will have one year from 9 December 2019 in which to upload the required information and the FCA expect the Directory to go live very shortly after 9 December 2020
- FCA state that firms will be able to submit the necessary data on Directory Persons by filling out “the relevant electronic forms which will be available on the FCA’s Connect system”
- Once you have uploaded the information you then have just 7 days in which to update information on joiners, leavers and changes in circumstances

# Also published in March



# Finalised Guidance on the preparation of “SoRs”

	
<b>Finalised guidance</b>	
<b>FG19/2 Senior Managers and Certification Regime: Guidance on statements of responsibilities and Responsibilities Maps for FCA firms</b>	
March 2019	
<b>Contents</b>	
<b>1 Introduction</b>	<b>2</b>
About the guidance	2
Who does this guidance affect	3
<b>2 Statement of Responsibilities</b>	<b>4</b>
Purpose	4
Handbook references	4
Key questions by SoR section for Core SM&CR firms	5
Key questions by SoR section for Enhanced SM&CR firms	5
Key questions by SoR section for Limited Scope SM&CR firms	7
Case Studies and examples of Statements of Responsibilities	8
Examples – Prescribed Responsibilities	12
Examples – Overall Responsibilities (Enhanced firms only)	19
<b>3 Responsibilities Maps</b>	<b>24</b>
Purpose	24
Handbook references	24
Key questions	24
Examples – Responsibilities Maps	26
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Financial Conduct Authority	Page 1 of 37

# Statements of Responsibility (SoR)

- Here lies the “ultimate” individual responsibility of those undertaking “senior management functions”
- Not only are “senior managers” to be responsible for further conduct rules but they are subject to prescribed responsibilities and to the requirement that all their individual responsibilities be set out in a SoR
- That is so that the FCA will know exactly who is responsible for what when firms do not comply with its expectations
- In the last 30 minutes you will have found out just how much, in just four months, FCA have added to those expectations
- It adds up to . . . .

# Compliance is no longer applying

- This



# Compliance is no longer applying

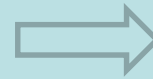
- To this



Product



Route to  
Market



Market



# Compliance is now . . .

- Every individual in every firm having a deep understanding of:-
  - what is in the customers' best interests
  - the duty of care they have towards customers
  - the products which are suitable to be marketed to their customers
  - the “value” of their products to customers (and compared to other firms)
  - their pricing responsibilities - and of any value “extracted” in the distribution chain

# SYSC 28.2 requires every relevant employee to understand how these join up

- Applicable laws governing the distribution of insurance products
- The insurance market
- Assessing customer need
- Business ethics standards
- Financial competence
- Complaints handling
- Claims handling

# This understanding is not met by “basic training”

- You must make sure that all your staff are engaged with, and deeply understand, the huge changes which are happening in the regulation of financial services – and why the FCA demands them
- These are not “compliance” or “training” issues
- These are changes which will destroy firms unless everyone understands what the issues are and what they, individually can, and must, do to deal with them
- I hope I have helped you to understand these issues a little more today!

# This will help even more

## INSURANCE DISTRIBUTION

### REQUIRED KNOWLEDGE AND COMPETENCE FOUNDATION COURSE



# For more information and details of training and engagement contact

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TRAINING



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