PROTECT

GI Value Measures and a Whole Lot More

November 2020

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Today's Agenda

PS 20/09

FCA's decisions on the extension of **value measures reporting** requirements to (nearly) all general insurance products

CP 20/19

A Consultation arising from the FCA General Insurance **Pricing Practices** Market Study. The study was specific to home and motor products but much of CP 20/19 applies to all GI

We cannot look at these two issues in isolation – they are part of a very complex. . . . .

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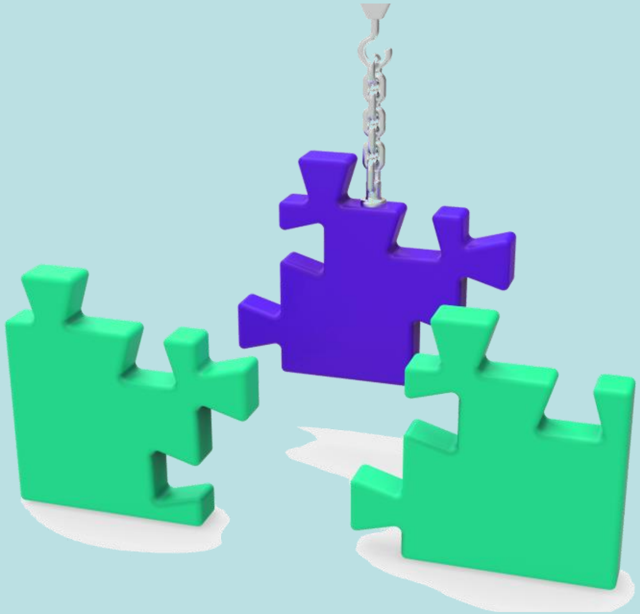
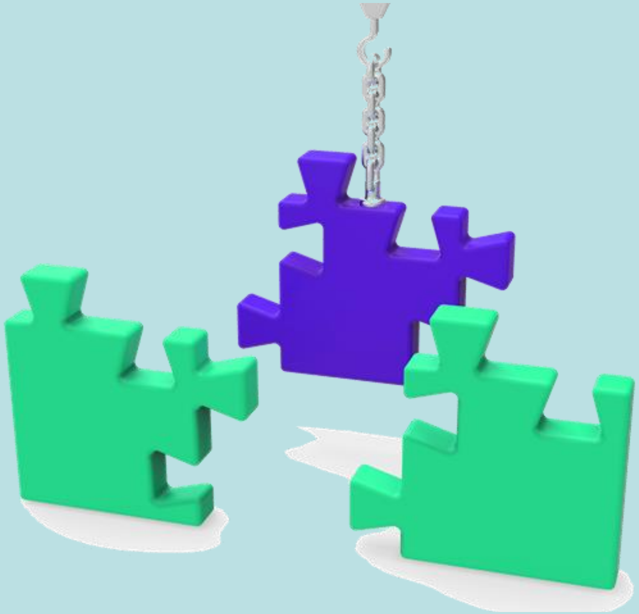
Jigsaw Puzzle



- The other pieces are:-
  - The FCA expectations for **value in GI distribution chains**
  - Existing requirements for **product governance and oversight**
  - Proposed significant <u>extensions</u> to requirements for product governance and oversight

In order to understand any one piece

- You <u>have</u> to know about all the other pieces . . .
- <u>and</u> how they fit together



Let's look at each of the pieces

Value Measures

Purpose - to require (usually) insurers to provide the FCA with specified data ("value measures data") which the FCA can publish on its website and then use to assist it in:-

- Monitoring firms
- Promoting competition
- Protecting consumers

In Effect – 1 July 2021; so that the first submission of data (a "value measures report") for the period 1 July 2021 to 31 December 2021 - i.e. a **six** month period) can been made to the FCA by the deadline of 28 February 2022.

Firms will <u>thereafter</u> be required to submit their report **annually**, on or before 28 February, in respect of the immediately preceding period - beginning on 1 January and ending on 31 December

Who does the reporting?

- In most cases the insurer (where different insurers underwrite different elements of cover, then the insurer underwriting the main part of the cover must report value measures data for all elements of the cover)

- An insurance intermediary which distributes a contract of insurance may be responsible where the insurer is neither UK based, nor is an overseas insurer with authorisation to carry on business in the UK

- Managing Agents are responsible for reporting data in connection with any contract of insurance written at Lloyds

- Note: these requirements may be affected by final Brexit arrangements

Which products are in scope?

- Motor
- Motorcycle
- Home - Home (buildings and contents)
- Home (contents only)
- Home (buildings only)
- Travel – annual multi-trip (European travel)
- Travel - annual multi-trip (Worldwide travel)
- Travel - single-trip
- Event/Wedding/Party
- Pet – accident only
- Pet – time limited
- Pet – maximum benefit
- Pet – lifetime
- GAP
- Home emergency
- Identity theft
- Healthcare cash plan
- Dental cover
- Personal accident
- Gadget (including mobile phone)
- Mortgage all other Payment Protection
- Motor legal expenses
- Home legal expenses
- Legal expenses
- Key cover
- Breakdown cover (for motor)
- Parts and garage cover
- Excess cover (for motor insurance)
- Tyre cover (for motor)
- Alloy Wheel/Vehicle Cosmetic
- Pot-Hole
- Mis-fuelling
- Extended warranty – electrical goods
- Extended warranty – furniture
- Extended warranty – motor

It's easier to see which products are excluded from scope!!

- Private Medical
- Insurance provided with packaged bank accounts
- No claims bonus protection
- Commercial products
- Group policies

What data must be reported?

- the number of policy sales
- total gross retail premiums (written)
- the number of claims registered
- average number of policies in force
- claims frequency
- the number of claims accepted
- the number of claims rejected
- claims acceptance rate
- total claims pay-out cost
- average claims pay-out
- the amount that the top 2% of claim pay-outs are above
- The names of the five largest distribution arrangements
- the number of claims walkaways
- the number of claims complaints
- claims complaints as a percentage of claims

How is data reported?

- Firms which are responsible for reporting (see earlier) will have to collect all the required data in respect of each of their in scope products
- The data (subject to thresholds – see later) must then be reported to the FCA via a standard format for the reporting as is set out in SUP 16 Annex 48AR - the "Value Measures Report Form (REP019)"
- The report will be submitted online "through the appropriate systems accessible from the FCA website"

Reporting thresholds

Reporting thresholds (SUP 16.27.10R (2))

- Reporting thresholds are set so that value measures data need only be included in relation to each product (within scope) where both of the following criteria have been met in respect of that product in the relevant reporting period:-

  - where total retail premiums (written) are above £400,000; and

  - where more than 3,000 policies (with which the firm is involved with a "nature of business") are in force

- The "nature of business" requirement would mean that a UK based insurer must apply the threshold by reference to each contract of insurance for each product (in scope) which it effects, whilst an insurance intermediary (if distributing products for e.g. an overseas insurer) would apply the threshold only to the contracts which it distributes

How will the data be published?

- The FCA had proposed that value measures data for the largest five distribution arrangements should be separated out
- This has been replaced with a requirement that the names (but not separate data) of the firms and or brands which represent the largest five distribution arrangement be reported
- A "distribution arrangement" is defined to be, in relation to the relevant product, each distribution arrangement through which the product is sold, as identified by the **consumer facing** firm <u>or</u> brand
- This offers some flexibility as to the way the insurer can "slice" its distribution arrangements for reporting purposes (by firm or brand) – but in either case the reporting of the product in that way **must be recognisable by a consumer**

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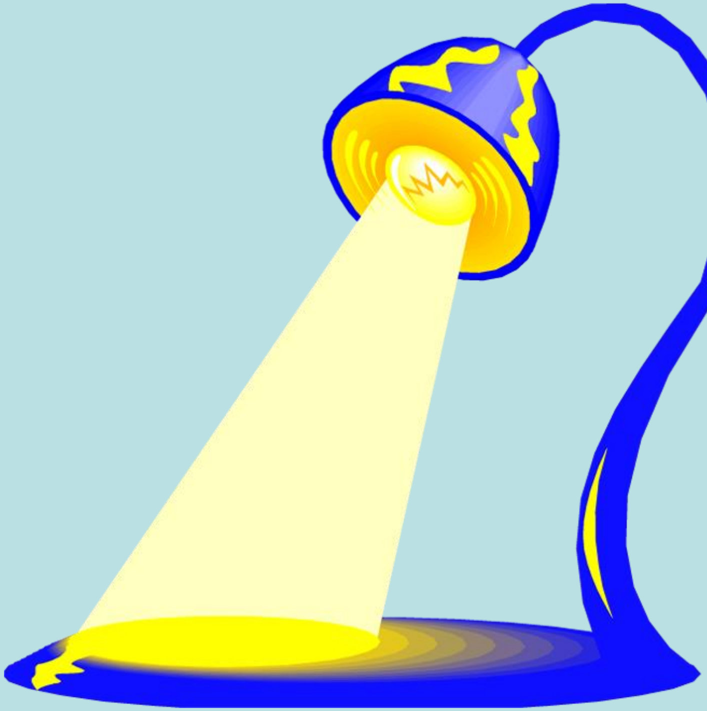
Will the publication of value measures data be a major problem?

- Alone (however tiresome and occasionally uncomfortable) - probably not
- But value measures reporting is not a lone jigsaw piece
- The major issue is another piece of the value jigsaw – into which value measures reporting will link . . . . .

Product Governance and Oversight



Product Governance and Oversight

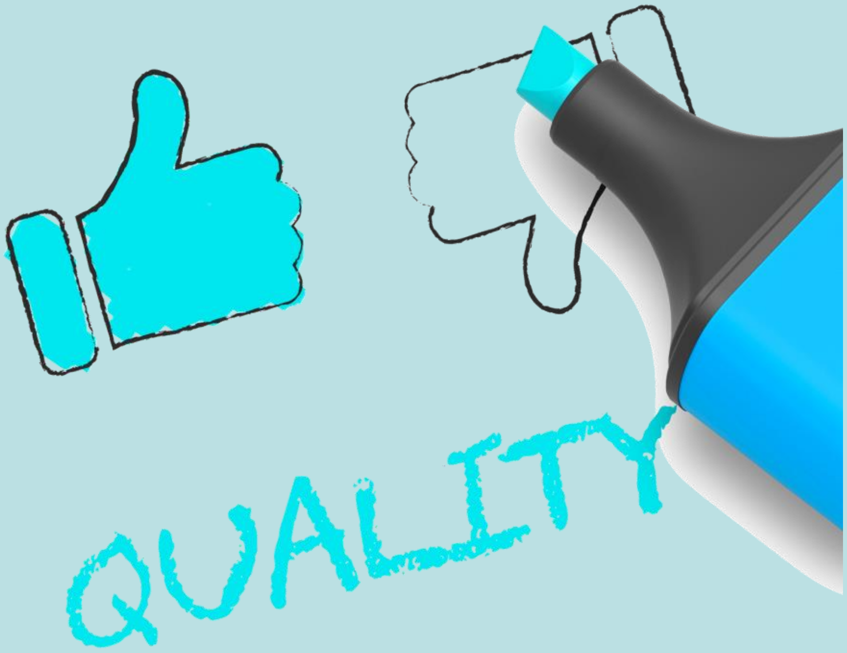
- Since October 2018 all firms are required to undertake pre-launch and thereafter regular and structured product reviews under Chapter 4 of the Product Intervention and Product Governance Sourcebook (“PROD”). This Sourcebook contains the IDD requirements that “manufacturers” of insurance must:-

  - specify a target market for each product, including identifying groups of customers for whom the product is generally not compatible;

  - design products to be compatible with the needs, characteristics and objectives of the target market; and;

  - market test products <u>before</u> launch and <u>regularly</u> thereafter against the above criteria

Basically – an existing obligation for internal "quality control" processes for every firm



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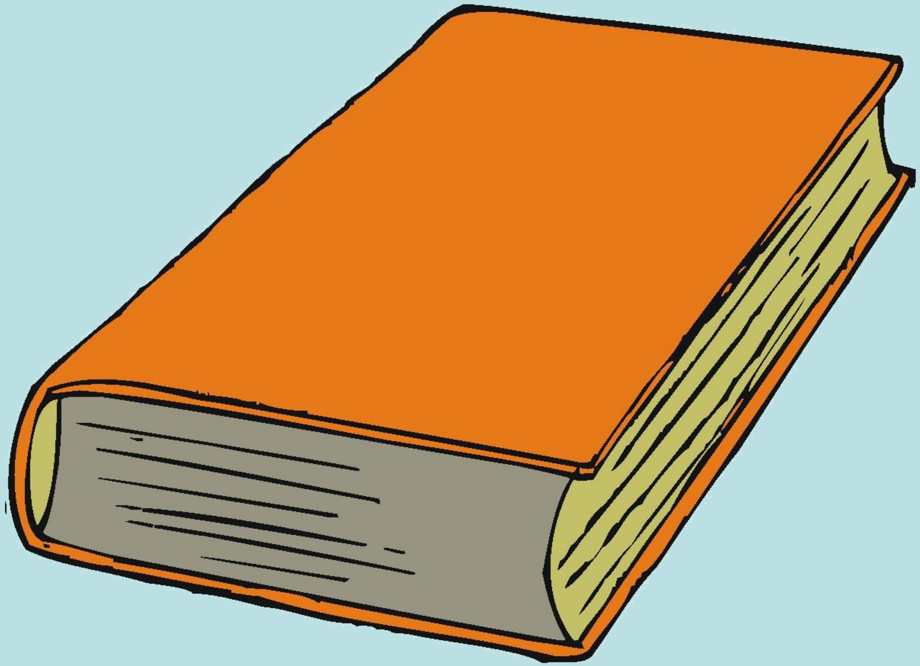
But <u>now</u> there is a <u>new</u> piece of the jigsaw

From 1 January 2021
a whole <u>new</u> chapter for PROD



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PROD 4.5 “Additional expectations for manufacturers and distributors in relation to value measures data”

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Product Governance will no longer be just internal quality control . .

- From 1 January 2021 firms must have in place effective procedures to ensure that, on a continuing basis, their products offer “fair value” (changed from “sufficiently good value” in consultation; more on this soon) to customers in the target market, taking into account, among other things:-

  - the **needs** of the target market
  - the firm’s reasonable assessment of the **value expectations** of customers in the target market
  - the **value measures information**, within a reasonable period
  - any particular features of the product or the terms and conditions that may give rise to concerns about poor value
  - appropriate product testing including scenario analysis and testing on consumers; and
  - the charging structure of the product including examination of whether the costs and charges are compatible with how useful the product is to consumers and the transparency of costs and charges

So internal quality control is ramped up

- It must now include "value control" – and
- Value control must be informed by reference to the published value measures data for other firms
- By that simple interlocking of two jigsaw pieces the FCA have ensured that "value" will be determined by reference to the best value available in the market place

And if a manufacturer finds its product does <u>not</u> offer fair value . .

- It must:-
  - take appropriate action to mitigate the situation and/or prevent further occurrences of any possible detriment to customers
  - inform any relevant distributors promptly about remedial action being taken; and
  - where relevant, not bring new products to market or make any proposed changes
- There is more . . .
  - manufacturers must regularly review the products they offer or market to ensure they continue to offer fair value taking into account any event that could materially affect whether this remains the case

How does this impact on value measures publication?

- As I have said, publication of value measures alone would probably not be the end of the world (certainly as the FCA originally envisaged) - but the FCA has changed its tune

- It used to maintain that publication of the measures was simply a remedy for poor competition and was a tool by which firms could educate themselves on how other products performed

- Now (as we have seen) that education has become directly linked to a prescribed product governance obligation

- Also the FCA used to be clear that value measures data was not suitable for interpretation otherwise than by other firms - now the FCA is saying that it expects **consumer groups** and **the media** to access the information for the purpose of encouraging consumers to "shop around" . . . .

Which is highly <u>ironic</u> . .

- When we move to look at the <u>third</u> piece of the "value" jigsaw
- Recent proposals arising from the FCA General Insurance Pricing Practices Market Study – a study aimed at correcting **distortion** in the GI market place, caused by firms favouring customers who . . . . .

Shop around!!!!!

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The GI Pricing Market Study

- In 2018 the FCA commenced a study into pricing practices in the motor and home insurance markets
- It concluded that pricing for new customers was effectively subsidised by higher prices for existing customers ("the loyalty penalty")
- In September the FCA consulted (CP20/19) on requirements that, when a customer renews their home or motor insurance, they pay no more than they would if they were new to their provider through the same sales channel
- This (directly at least) has little or nothing to do with most Protect members – but . . . . .

There's more!

- Whilst consulting on the motor/home renewal provisions the FCA has taken the chance to <u>also</u> consult on two sets of new provisions **which will apply to <u>all</u> GI**

- One consultation relates to making a change to ICOBS specific to auto-renewals which I am not covering today

- But the <u>other</u> proposals are to introduce a further concept into the regulatory lexicon . . .

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“Fair Value”

What is the FCA proposing?

- That, beyond:-
  - the existing PROD rules/guidance (in force since 2018) and;
  - the new PROD 4.5 coming into force in January 2021,
- There should be over **20 pages** of further rules and guidance within PROD which all firms which manufacture insurance would have to follow as part of their product oversight and governance
- We have not the time today to go through all these in detail (but you must either do so yourselves or get professional guidance on their implications)
- However we will look at the central plank of these proposed provisions - the new concept of "fair value" . . . . .

“Fair Value”

- CP19/20 and the proposed new PROD rules/guidance, together, contain the phrase “fair value” on no less than **102** occasions

- The phrase is central to the FCA’s proposed new rules and guidance to be inserted into PROD - and marks a further step change in the FCA’s march towards product regulation

- The phrase is never defined

- In essence the FCA wants only products offering “fair value” to be in the market and it expects firms to police (and demonstrate) this via rigorous product governance and oversight – directed by the proposed extended PROD rules

- How does the FCA expect you to undertake this “fair value” oversight?

- We find the starting point in . . .

Proposed PROD Rule (4.2.14R A)

“For a non-investment insurance product, a firm must ensure that the product approval process identifies whether the product provides fair value to customers in the target market including whether it will continue to do so for a reasonably foreseeable period (including following renewal)”

But <u>how</u> do you "identify" fair value?

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Proposed PROD 4.2.14E R

- Via a new provision (buried four pages into the 20 + pages of new provisions) which is titled:-

"Identifying fair value for non-investment insurance products: meaning of value"

This is what it says . . .

- "In PROD 4 'value' means the relationship between the overall price to the customer and the quality of the product(s) and/or services provided. The assessment of value must include consideration of at least the following:-
  - the nature of the product including the benefits that will be provided, their quality, and any limitations (for example in the scope of cover, exclusions, excesses or other features);
  - the type and quality of services provided to customers;
  - how the intended distribution arrangements support, and will not adversely affect, the intended value of the product
  - the expected total price to be paid by the customer when buying or renewing the insurance product, and the elements that make up the total price . . . ."

Value in pricing

- The rule goes on to say that fair value in <u>pricing</u> will include consideration of at <u>least</u> the following:-
  - the pricing model used to calculate the risk premium for the initial policy term and any future renewal;
  - the overall cost to the firm of the insurance product (including the underwriting and operating of the product) and, where relevant, any other components of a package;
  - the individual elements of the expected total price to be paid by the customer including, but not limited to, the price paid for:-
    - the insurance product including any additional features which are part of the same non-investment insurance contract - for example add-ons or optional cover;
    - any additional products, including retail premium finance, offered alongside the insurance product; and also . . .

The distribution arrangements

The distribution arrangements

- A fair value assessment must include a review of the distribution arrangements for the product, including:-
  - the remuneration of any relevant person in the distribution arrangements, <u>including</u> where the final decision on setting the price is taken by another person; and
  - how the intended distribution arrangements support, and will not adversely affect, the intended value of the product
- Again – there is (much) more . . .

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Fair value and distribution

- A firm must, as far as reasonably possible, ensure the distribution arrangements for a non-investment insurance product avoid or minimise the risk of negatively impacting the fair value of the insurance product or package. This includes, but is not limited to avoiding or reducing the risks arising from:-

    - any remuneration of a party or parties involved in the distribution arrangements increasing, directly or indirectly, the total price paid by the customer without adequate monitoring or oversight of the nature, level and fairness justification for their inclusion; or

    - providing discretion to another person to set the final price, for example through a net pricing arrangement, without adequate monitoring or oversight of the final price paid by the customer

- And there's even more . . .

Oversight over distribution

- A firm must:-
  - ensure that appropriate arrangements will be in place to identify if the actions of another person involved in the distribution arrangements would adversely affect the value of the insurance product or package; and
  - reduce the scope for the overall effect of any distribution arrangements to detrimentally affect the value of the products or package including where the cumulative effects of the remuneration of multiple parties unreasonably add to the overall price paid by the customer
- Oh – and there's more . . . .

Fair value in distribution

- Where the firm is considering the effects of the distribution arrangements on value it should consider whether the additional costs of any individual party in the arrangements that add to the total price paid by the customer deliver any, or a proportional, additional benefit

- If not, firms should consider how they can be satisfied that the arrangements are consistent with their obligations to be able to clearly demonstrate fair value to the customer

- But there is a <u>glimmer</u> of hope . . . .

A benefit of distribution . . . .

- The Rules say that a benefit that <u>could</u> be consistent with fair value might be where a party's inclusion in the distribution arrangements increases access to the product for customers in the target market in a way that is proportionate to the additional cost involved

- This does (for example) enable "key money" forming part of a distribution overhead to be justifiable in a fair value assessment

What happens if a firm cannot demonstrate fair value?

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PROD 4.2.32R A . . . .

In relation to a non-investment insurance product, where a firm is unable to demonstrate clearly that a distribution channel results in fair value to the customer it must not use that channel

Indeed PROD 4.2.14R C will tell you . . .

- A firm must:-
  - be able to **clearly demonstrate** how any non-investment insurance product, additional product or package provides (and will provide for a reasonably foreseeable period) fair value; and
  - it must make and retain a record of the value assessment
- Where a firm is unable to both:-
  - identify; and
  - clearly demonstrate

that the insurance product or the package will provide fair value, the firm must **not** market the product or permit the product to be distributed

You can see what picture the pieces of the value jigsaw are revealing. . .

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. . . and where the FCA is taking you

- The FCA has already issued expectations, guidance and a Dear CEO letter regarding your obligations to consider "value in the distribution chain"

- These have already led to huge pressures on distributors to reduce commissions and other remuneration from GI and, critically, insurers and Lloyds "running scared" of GI

- Those impacts fade into some insignificance when compared with the likely impact from the requirements (including rules) on "fair value" which these proposed extended PROD provisions will introduce

The Jigsaw

- Value measures reporting and publication will be just a small part of a much bigger picture

- The key role of the value measures will be to inform firms of comparative performance, and to drive price and commissions downwards

- But, to understand the full impact of how this will work, you must now anticipate a market in which every firm which contributes data on value measures will already have undertaken the most brutal internal assessment of “fair value”

- The question is – just how many products will there be to report, once firms get to grips with the implications of the extension of PROD - as set out in CP20/19?

- You have until 25 January 2021 to let the FCA know your views

For more information contact

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