Bankhall

PS21/05: General insurance pricing practices market study

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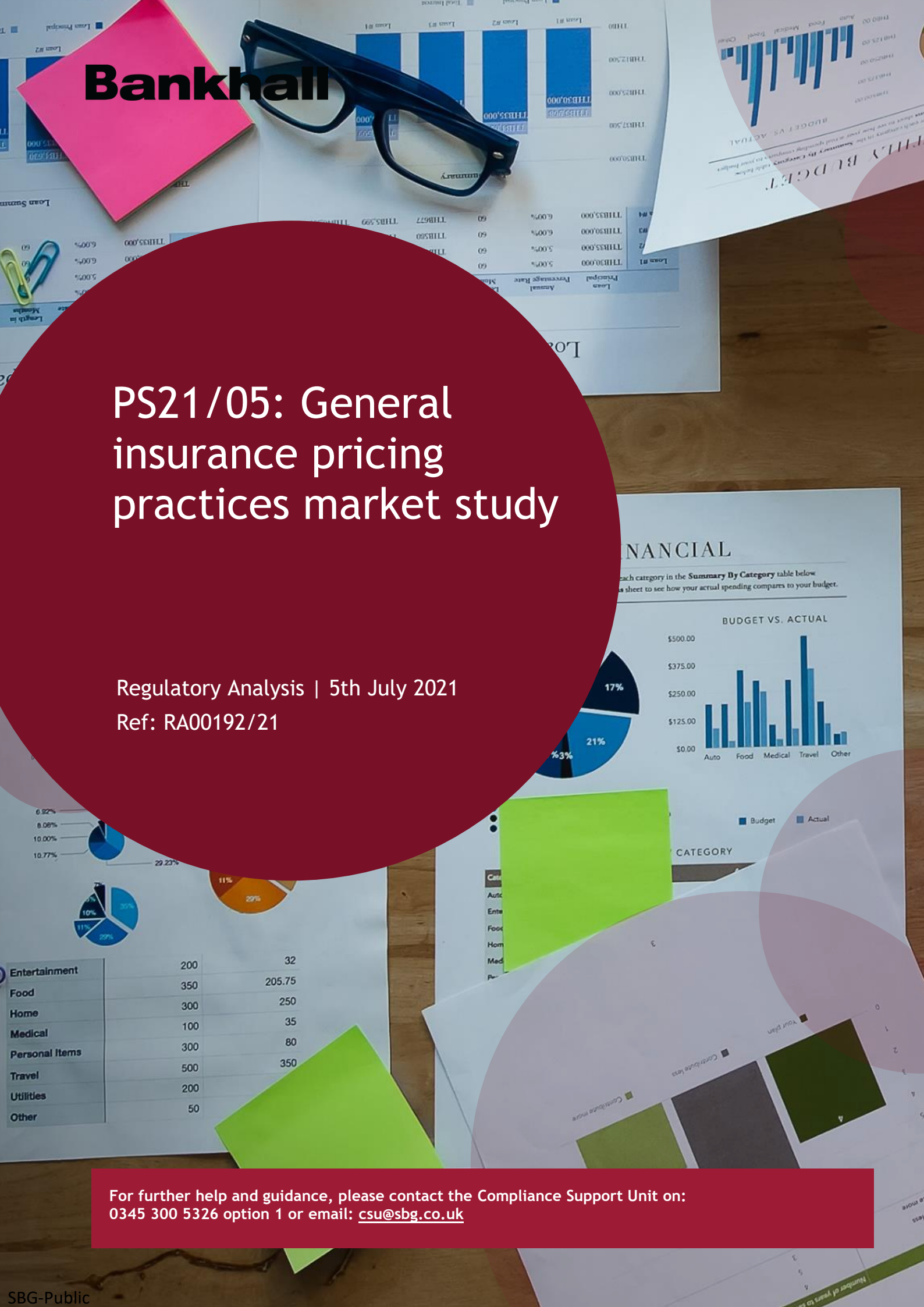

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Impact Rating		
	Red	Significant importance / Immediate action required
	Amber	Important / Future action likely to be required
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28/05/2021	PS21/5	General insurance pricing practices market study	Policy Statement / FCA	**Red**	Non-Investment Insurance Firms

August 2021 update:- This analysis has been updated to reflect the changes to the original policy statement as covered in the FCAs policy statement amendments paper (PS21/11) issued on the 18th August 2021. Bankhall Weekly dated 24th August 2021 provides a summary of the amendments.

Introduction and background

In 2018, the FCA published their findings from a thematic review 'TR18/4: Pricing practices in the retail general insurance sector: Household insurance'. This identified issues relating to firms' pricing practices and in particular the 'loyalty penalty' for existing customers renewing their policies. Following this review the FCA conducted the general insurance pricing practices market study to investigate these concerns in more detail.

In September 2020 the FCA set out their final findings to their two-year market study in MS18/1.3. This follows on from an interim report (MS18/1.2) issued in October 2019.

The final rules and guidance now published in PS21/5 followed a consultation paper on proposed market remedies (CP20/19) issued back in September 2020.

Key points

The headline change introduced by the new rules is that when an insurance provider (or any other price setting firm) offers a renewal price to a customer, this should be no greater than the equivalent new business price (ENBP) for a new customer for home and motor insurance and any additional products sold alongside these products including retail premium finance.

This will stop what is commonly referred to in the industry as "price walking" which is year on year renewal price increases for existing customers. The FCA's September 2020 market study found that millions of home and motor insurance customers lose out if they renew repeatedly with their current providers. The study found that in 2018, 6 million loyal policy holders would have saved £1.2 billion had they paid the average price for their actual risk.

These new rules will apply to all insurers and intermediaries involved in price-setting at each stage in the price setting chain. In response to feedback the FCA have provided greater clarity on which intermediaries fall within scope of the price setting rules. The rules apply to intermediaries involved in the setting of any portion of the renewal price, including those that take the net price quoted by an insurer and make any adjustment to it to determine the gross price (the final premium the customer pays). Importantly, this will include within scope any intermediary that rebates commission to lower the premiums of products.

The new rules also introduce other requirements including:-

- Additional product governance rules that will require insurance and intermediary firms to have processes in place to deliver products that offer fair value to customers. These new processes **will apply to all non-investment insurance products** rather than just home and motor general insurance products.
- Rules to enable firms to offer accessible and easy options for customers wishing to cancel auto-renewal. These measures **will also apply to all general insurance contracts**.
- Reporting requirements to support the ongoing supervision of the home and motor insurance markets. Whilst the more onerous reporting requirements will apply to insurers there will also be some reporting for intermediaries.

Next Steps/Actions for firms

Whilst the new rules will have the most impact on intermediary firms who are involved in price-setting there are new requirements that all intermediaries will need to follow.

The pricing remedy

The pricing remedy will have the most impact on intermediary firm's that are routinely involved in setting the price of contracts i.e. those that have the discretion to adjust the final gross premium paid by customers. It will require such firms to:-

- Maintain processes and procedures ensuring compliance with the price setting rules
- keep records of their decision-making processes regarding how they set prices
- annually attest to the FCA that the pricing model complies with the pricing remedy requirements.

As the definition of a price setter will also include insurance intermediaries that offer commission rebates to lower the premium of insurance contracts, consideration will need to be given to the additional compliance requirements this introduces and whether the costs outweigh the benefits of continuing with this practice.

Whilst outside the definition of price setting, any intermediaries that charge fees for advising and arranging activities will need to ensure that they do not charge higher fees to renewing customers. This is an anti-avoidance measure to prevent a similar outcome to "price walking" through increased fees.

Intermediaries will need to ensure that they address the pre-sale contract disclosure requirements for retail premium finance, which may require particular attention if they sell this as a stand-alone product to any retail premium finance offered by an insurer.

Product Governance

Whilst many of the new requirements that are being introduced are heavily focused on insurers in ensuring that they consider the "fair value" of products through regular reviews of those products, there are some clear focal points for intermediaries to consider, including:-

- With all non-investment insurance products (including legacy products) now subject to minimum annual requirements for reviews there is an onus on intermediaries to gather and make use of this information when determining distribution strategies, including the construction of panels.
- There is a particular onus on intermediaries to consider the overall costs of any distribution arrangements and how this might impact on the value to the end customer. This may often be outside the control of the insurer where third parties such as introducers are used, hence the focus from the FCA on intermediaries giving particular focus to this aspect of the product governance requirements.
- Where intermediaries are distributing products provided by different providers as a package, the onus will be to ensure that these offer value as a package and that there is no duplication of cover for risks.
- Intermediaries arranging retail premium finance will need to ensure that remuneration arrangements are not leading to them selecting poor value products and consider alternatives where necessary.

Reporting requirements

The new reporting requirements are designed to ensure that the FCA has detailed data available that will enable them to monitor whether firms are continuing to "price walk" or not. This means that the FCA will require detailed information from insurers and price setting intermediaries to be annually reported. However, in August 2021 the FCA confirmed that firms that only price set through rebating commissions to lower premiums, will not be required to report detailed data on prices. Instead they will be required to notify the FCA where over 25% of either their home or motor sales include commission-rebating through the annual attestation requirements.

Whilst the more onerous reporting requirements apply to insurers and price setting intermediaries, all firms will be required to report on any fees that they have charged over the reporting period.

All intermediaries will be required to report data on retail premium finance that they have advised and/or arranged if the price of that is being set by a retail premium finance provider, rather than the insurer of the motor or home insurance (or additional product) policy that the retail premium finance is paying for.

Cancelling auto renewals

The new requirements to make it easier for existing customers to cancel policies that auto renew rest almost entirely with insurers. However, intermediaries should make clear when arranging the purchase of a product the process

customers are expected to follow to cancel that product. Namely, if they should approach the intermediary firm or go direct to the provider. If they are directed to go to the product provider directly, then the intermediary should draw attention to the provider information on how to carry out the cancellation request.

Further considerations regarding the impact on intermediaries are contained in the detailed analysis section of this regulatory analysis.

Next steps

The new rules will come into effect:-

- On **1 October 2021** for the rules relating to systems and controls, product governance (including premium finance requirements set out in ICOBS 6A.5).
- On **1 January 2022** for the rules on pricing, auto-renewal and reporting.

Following implementation, the FCA plan to assess firms' compliance, including thorough analysis of the new reporting data requirements and attestations, as well as consumer and market intelligence.

A longer-term evaluation to understand the effect on the market is planned to begin in the first half of 2024, as by that time the FCA will be able to assess the impact of the pricing remedies on customers after at least two renewals, and three renewals for some customers.

Detailed analysis

In this section we look at the new requirements in more detail including any practical requirements for intermediaries.

The pricing remedy

In their consultation the FCA proposed to introduce a pricing remedy, so that a firm must offer a renewal price to an existing customer that is no greater than the equivalent new business price (ENBP) that it would offer a new customer. Whilst these rules will primarily impact insurance providers it will also include general insurance intermediaries that are able to set the price of a general insurance product. Further coverage of intermediaries considered to be price setters is given in the sub-section 'Distribution channels and intermediary requirements' below.

The FCA are taking forward the pricing remedy in their final rules but are making some changes to the details of the rules to address issues raised in the feedback to their consultation. The following are the main finalised requirements that firms need to be aware of.

Scope of the new rules

The new pricing remedy will apply to all home (buildings and/or contents) and motor insurance products. The one notable exception is where the contracts are for commercial customers. This means that landlords' insurance for business buy to let customers will fall outside the scope of the pricing rules.

The rules will apply equally to single or multi-product policies. E.g. buildings and contents or where home and motor insurance are offered together.

Additional products

The pricing rules will also apply to additional products and cover extensions. For example, legal expenses cover may be sold as an additional product or a cover extension of the core contract for home and motor insurance. Whether the product is sold as an additional product or a cover extension, the rules require that the total price at renewal is no more than the ENBP. The pricing rules will also apply to premium finance.

However, when an additional product is instead sold as a stand-alone product, then the pricing rules don't apply.

Timing of the pricing assessment

The pricing rules apply at the point when a firm prepares a customer's renewal notice, not at the point the customer's contract is renewed. This is the point at which a firm should calculate the ENBP.

The reason why the FCA have made the pricing rule apply at the date of the preparation of the renewal is because of how frequently insurers change their prices due to underwriting. This enables insurers to lower their actual prices to the one quoted to the customer in the renewal notice and therefore removes the possibility that a customer will be penalised by the insurer having to charge at the price quoted in the renewal notice.

The pricing rules will apply to renewal notices prepared after the rules take effect, rather than to policies renewing after the rules take effect.

Additional risk information

Many insurers said the final rules should be amended to clarify that, when calculating the ENBP, they can take account of additional risk information obtained during the contract term. Firms could, for example, have data from telematics devices showing if the customer represents a greater or lesser level of risk.

The FCA confirm that the renewal quotation may differ from last year's premium due to changes in the consumer's risk since they became a customer or since the last renewal.

This allows a firm to take account of any additional risk information acquired during the term of the customer's current policy where this information is:

- information the customer would be asked to disclose if they were a new business customer; or
- information about new business customers that would be available to the firm from other external sources of information e.g. this could be the data from a telematics device

The new rules do not prevent a provider quoting a different premium at renewal to last year's premium, just that it should not be greater than the ENBP for a new customer. This is because the ENBP should consider any change in relevant risk factors. In some cases this could lead to lower premiums for renewing customers over new customers. For example, there is typically a lower risk of fraud with renewing customers than with new customers.

Missing risk information

Insurers also asked how they should treat long-standing customers where they lack some relevant information required to calculate the ENBP. It may be, for example, that a firm now asks new business customers for information that they did not gather in the past.

The FCA acknowledge that there could be situations where firms have information on new business customers that is not available for renewal customers. However, they have left it up to insurers as to how they address this gap, if in doing so they do not discriminate against renewing customers.

Payment methods and distribution channels

Under the draft rules, firms would have been required to assume that customers had selected the same payment method (annually or monthly premiums) as they originally used to pay for their policy when determining the ENBP.

However, as some customers may switch from annual premiums at outset to monthly premiums at renewal this rule would not work as intended. The FCA has therefore scrapped this requirement in the final rules and insurers should present the ENBP on the payment method used at last renewal.

Where firms do not have a record of the original distribution channel, the FCA have introduced a rule requiring firms to use the channel most commonly used by new business customers, when calculating the ENBP. Examples of a distribution channel are covered in the next section.

Flexibility to define distribution channels

The rules require firms to determine the ENBP based on the original distribution channel used by the customer. The FCA allows insurers and intermediaries to determine what represents a distribution channel but this could include advised and non-advised sales, sales through a website, sales through different brands or derived from different types of marketing.

Discounts and incentives

The FCA has introduced specific rules for discounts and incentives which are aimed at preventing firms getting around the rules on price walking. E.g. offering discounts at policy inception but removing or gradually reducing the discounts at subsequent renewals.

Where firms are offering cash or cash-equivalent discounts and incentives this must be reflected in the ENBP for any subsequent renewals.

The FCA defines a non-cash incentive as one that is not capable of being readily expressed as having a definite monetary value. The FCA gives the following examples to help firms although the list is not intended to be exhaustive.

Type of incentive	Category	Must be reflected in ENBP?
Toys	Non-cash incentive	No
Carbon off-setting	Non-cash incentive	No
A percentage chance to win back the premium	Non-cash incentive	No
Points in a retail loyalty scheme	Cash equivalent	Yes
Retail vouchers	Cash equivalent	Yes
Cashback	Cash	Yes
A free add on	Cash equivalent	Yes
One month free	Cash equivalent	Yes
A monetary discount on the premium	Cash	Yes
A percentage discount on the premium	Cash equivalent	Yes

The FCAs rules apply both to:-

- insurers who set renewal prices;
- and intermediaries who set prices at renewal by:-
    - adding their commission to a net price set by an insurer
    - offering a cash discount on a gross price set by an insurer.

Some firms have sought clarity on how these rules apply to intermediaries as this was not clear. The FCA have confirmed that intermediaries are equally in scope and provide the following two scenarios:-

1. Intermediaries that set prices at renewal by offering a cash-equivalent incentive on a gross price set by an insurer. For example, an insurer sets the final customer price for a product sold via an intermediary. The intermediary offers retail vouchers alongside the price set by the insurer, both at new business and renewal. The intermediary could reduce the value of the vouchers over time at subsequent renewals which would effectively be "price walking" the customer.
2. Intermediaries that offer cash or cash-equivalent incentives at new business and are involved in arranging the renewal, but do not set prices at renewal. In this case, the insurer sets the final customer price. The intermediary then offers either cash or retail vouchers to new business customers alongside the price set by the insurer. The intermediary could decide not to offer the same incentive at renewal. The FCA consider this to be price walking as the incentive offered at new business is withdrawn at renewal.

Most typically, intermediaries may offer to rebate commission to reduce the premiums a customer may pay. If they do this, then they would be required to offer the same rebate to that customer at all future renewals.

Under the rules, firms can offer discounts depending on the distribution channel used to particular groups such as staff discounts, or for consumers who use different channels. However, from a treating customers' fairly perspective we would advise intermediary firms to consider how they offer discounts to different groups. Is it necessarily fair to discount in the form of a commission rebate to certain customers and not others?

Renewal transparency rules

The FCA have clarified in response to consultation feedback that the pricing remedy does not clash with their existing renewal requirements to encourage customers to shop around; which will remain unchanged.

The existing renewal transparency rules require firms to disclose the renewal price and the previous year's price as part of the renewal notice. Firms are also required to remind the customer, from the fourth renewal onwards, that they can compare prices and levels of cover from other providers, with a prescribed message required to be given.

The FCA explain that the new pricing rules are not intended to prevent the renewal price from being higher than the previous year or even the best price on offer in the marketplace. The new pricing rules merely prevent the renewal price being higher than the ENBP for new customers. So it will still be in the interests of customers to shop around as previously.

Parties to a transaction

The FCA explain that where one of the parties to a renewal transaction is new, the business should be regarded as new business for them.

So, if an intermediary re-brokes to a new insurer, that insurer is not bound by the pricing remedy until the subsequent renewal. Similarly, if a price-setting intermediary acquires a book of business from another firm, but keeps the business with the same insurer, the intermediary would regard the customers as new business customers and the insurer would treat them as renewing customers.

Premium finance

The FCA rules require that any premium finance for new customers must be offered at the same terms for renewing customers.

In determining whether the price of the premium finance at renewal is no higher than ENBP, the relevant price is the Annual Percentage Rate (APR) of interest if the premium finance is a regulated credit agreement or, if it is not a regulated credit agreement, the total price paid by the consumer. This means that the cost of the finance for a renewal should be no higher than it would be if the customer was a new customer.

Pre-contract disclosures

As the FCA has particular concerns that customers have been unaware of the difference between the costs of policies with or without premium finance, they have set out new rules in ICOBS 6A which will apply from 1 January 2022, which covers pre contract disclosures.

In good time before the conclusion of a policy including on any renewal, a firm offering retail premium finance in relation to that policy must give the customer:
(1) price information about:
(a) the total cost of the policy if purchased without retail premium finance;
(b) the total cost of the policy with retail premium finance including costs of, or associated with, the retail premium finance; and
(c) any difference in the costs in (a) and (b), alongside each other;
(2) a description that the use of retail premium finance arrangements will be more expensive for the customer compared to paying for the policy upfront;
(3) details of any difference between the duration of the policy and that of the retail premium finance; and
(4) where the price information is presented on any basis other than annually, an explanation alongside that information of any difference between the total price to be paid by the customer when buying with or without retail premium finance.

Whilst we would expect the insurer to support these disclosures where they are providing the retail premium finance, any intermediaries offering stand-alone retail premium finance are likely to need to address these requirements themselves.

Mid-term adjustments

Where the customer has made a change to their policy during the term (i.e. a mid-term adjustment), firms should calculate the ENBP at renewal based on that new information.

Closed books

Under the FCA rules products for which there are no, or relatively few, new business customers would be classified as 'closed books' and subject to specific rules. This approach is designed to prevent renewal prices being based on ENBPs set at levels that are uncompetitive with open book products.

FCA Definition of a closed book product -
A closed book product is one where:-
1. its policies may be renewed by existing customers, and
2. either:
(i) its policies are not available for purchase by other customers; or
(ii) (where the product has been on sale for 5 or more years) the firm has not sold, or does not expect to sell, on an annualised basis, more than 7.5% of active policies under the product to new business customers; or
(iii) (where the product has been on sale for less than 5 years) the firm has not sold, or does not expect to sell, on an annualised basis, more than 15% of active policies under the product to new business customers.

A home insurance or motor insurance product is not in a closed book if the firm sells or expects to sell at least 10,000 policies on an annualised basis to new business customers.

Firms with closed books would be required to benchmark their renewal prices against a 'close matched' open book policy, where they have one. Where firms do not have any close matched products, they must ensure that renewal prices do not systematically discriminate against customers based on their tenure.

The rules for closed book products are most likely to impact insurers, although they will be in scope of the price remedy requirements for price-setting intermediaries. Therefore, we have only covered the most high-level requirements here given the limited impact for most intermediaries.

Treatment of fees

Most intermediaries receive commission for distributing retail motor and home policies. However, some also charge the customer a separate arrangement fee.

Whilst the FCA has not seen significant numbers of firms systematically increasing fees at renewal in the same way that premiums are being price walked they will be subject to the same rules. This means that firms must not charge a higher fee at renewal than they would for a new business customer.

Bankhall does not anticipate that this will have much impact for most intermediaries as it would seem to be an unusual situation that would lead to fees being charged at renewal. However, where this is the case intermediaries need to ensure that they do not charge more than they have done previously.

Firm attestation requirements

Under the new rules, firms will be required to provide regular confirmation from a senior manager function within that its pricing model complies with the pricing remedy. This attestation will be requested through the RegData platform, although the first attestation due in 2021 this will be requested by a third party firm (Qualtrics) on behalf of the FCA.

The FCA has confirmed that the attestation requirement will only be relevant to firms that have a price-setting role and not other intermediaries, although all firms may receive the attestation request as the FCA will not know who is a price-setter or not. The FCA has confirmed that firms who do not price set but receive the attestation request should complete a nil return. The FCA confirmed in their August 2021 amendments paper that the attestation form will enable firms that set price through commission rebates to report to the FCA on this matter, including whether 25% or more of their home or motor sales includes commission-rebating. It will also enable any intermediaries who offer cash or cash equivalent incentives to report on the level of such incentives.

The attestations will be requested annually with the deadline being 3 months after the reporting year ends i.e. 31 March each year. The FCA are requesting the first report by 31 March 2022 to provide insight into firm's compliance with the new rules.

To help firms prepare ahead of their first attestation, the FCA has provided examples of the forms firms will need to use, as well as the cover letter from Qualtrics:

- cover letter for Qualtrics survey for GI pricing attestation
- first annual attestation form for the GI pricing rules
- second and subsequent attestation form and notification under SUP 16.28.9

Record-keeping

The FCA expect firms involved in price setting to keep records of how they determined the price set for policies and how it addressed the pricing remedy requirements. The FCA are not mandating the content of the records but they have added guidance to demonstrate the types of records they'd expect to see. For example, this includes records of minutes of any pricing committee and any analysis showing whether similar customers face different pricing outcomes.

The record-keeping requirements relate to the price-setting process, so will not be relevant to intermediaries that do not have a price-setting role.

Distribution channels and intermediary requirements

The pricing rules apply to all firms in the distribution chain involve in price-setting.

The rules apply to intermediaries involved in the setting of any portion of the renewal price, including those that take the net price quoted by an insurer and make any adjustment to it to determine the gross price, including where the intermediary rebates commission.

The mere receipt of commission, where this is determined by another firm, is not sufficient for an intermediary to be regarded as price-setting. An intermediary would also not be price-setting where their remuneration is determined by a delegated underwriting authority that requires them to set renewal rates using a formula determined by the insurer. In this instance, they have no discretion to change the premium paid by the customer.

The pricing rules apply to intermediaries based on their role in setting the price of each contract. That means that an intermediary can be 'price-setting' for some contracts it sells and not for others. The rules apply separately to the core product and any optional additional products. As such, an intermediary can be price-setting for one and not the other.

The FCA do not expect each firm in the distribution chain to ensure that other firms comply with the rules (e.g. the insurer). Firms are only responsible for the portion of the premium that they set. Consideration of the overall "value" of the product where firms are involved in long distribution chains is something that firms need to consider under the Product Governance requirements (as covered n the next section).

The FCA are however making it a requirement that where a firm is aware that another firm is not abiding by the price setting rules then they expect firms to inform the FCA. This could be relevant to all intermediaries whether they are price setting or not. i.e. where they encounter an insurance provider that has set renewal prices above the EBNP.

Impact on intermediaries

The pricing remedy will have the most impact on intermediary firm's that are routinely involved in setting the price of contracts i.e. those that have the discretion to adjust the final gross premium paid by customers. Effectively, they will be subject to many of the same requirements as insurers in ensuring that renewal premiums are no higher the Equivalent New Business Price (ENBP). This will create onerous obligations as covered in the section above.

Whilst we do not anticipate that many Bankhall firms will be actively involved in price-setting, firms whose only activity is to offer discounts to premiums in the form of commission rebates, will also be considered as price-setters. The repercussions of continuing with this practice once the new rules come into force in January 2022 are significant in terms of processes and record keeping. As stated in the section above, this would require the firm to:-

- keep records of any commission rebates offered to any customers and continue to offer those rebates to those customers at all subsequent renewals of that policy
- keep records of their decision-making processes regarding any rebates to be offered
- annually attest to the FCA that the pricing model complies with the pricing remedy requirements.

Whilst intermediaries that charge fees for advising and arranging activities will not be considered to be price-setting, the FCA recognises that inappropriate use of fees could have the same impact as "price walking". This means that any intermediaries that charge fees must ensure that they do not charge higher fees for renewing customers.

There will be limited impact for intermediaries not involved in price setting from the pricing remedy requirements. However, the FCA does expect firms to report to them if they are aware of other firms failing to follow the rules. E.g. an insurer raising prices year on year that are not in line with the ENBP. Firms who offer a review service at renewal may become aware of such practices.

Intermediaries will need to ensure that they address the pre-sale contract disclosure requirements for retail premium finance, which may require particular attention if they sell this as a stand-alone product to any retail premium finance offered by an insurer.

Product Governance

The FCA are introducing significant additional requirements to their existing product governance rules and guidance in the PROD sourcebook of the FCA Handbook, which confirms the FCAs increased expectations regarding whether products they are manufacturing and/or distributing provide "fair value" to customers.

The new requirements will apply to all non-investment insurance products, which covers all general insurance and pure protection contracts. This is a wider scope than the pricing remedy requirements which only apply to home and motor insurance.

The new requirements come into force on 1 October 2021 and will complement the rules that have already been introduced on value measures data reporting for general insurance in PROD 4.5. At the same time the FCA is retiring their 'GI distribution chain: Guidance for insurance product manufacturers and distributors (FG19/5)' as this has now been superseded by the enhanced requirements in the PROD sourcebook.

Product Manufacturer requirements

Whilst the FCA has separate rules and guidance for manufacturers of insurance products to those for distributors (which covers advising and arranging intermediaries), understanding the requirements for manufacturers will help distributors understand their own requirements.

The FCA define a product manufacturer as one that designs, develops, creates and/or underwrites a product so we anticipate that this is unlikely to capture many Bankhall firms and is most likely to apply to insurance providers.

The existing rules require that a firm which manufactures any insurance product must maintain, operate and review a process for the approval of:-

(1) each insurance product and
(2) significant adaptations of an existing insurance product,

in each case before it is marketed or distributed to customers.

The FCA has added new rules that determine that a 'significant adaptation' may include, but is not restricted to, a proposed change to the insurance coverage, costs, exclusions, excesses, limits or conditions and any other significant change to the terms and conditions.

This has been particularly pertinent during the coronavirus pandemic with insurers changing insurance coverage to adapt to the pandemic, with renewal terms on many products being significantly different to that offered the year before. E.g. the removal or amendment of some benefits

Manufacturers will be expected to consider and actively monitor whether the distribution arrangements they have in place ensure fair value, whether they distribute products themselves or through third party intermediaries. This includes ensuring that any additional products such as retail premium offer fair value when offered as a package and that complexity in the distribution chain – e.g. where multiple parties including introducers may be involved - is not leading to additional costs for no additional value to the end customer.

When manufacturers are defining the intended target market for their products this should include consideration of the needs of:-

- different types of customers with varying characteristics including in relation to their understanding of financial matters;
- the needs of any vulnerable customers; and
- how it will affect customers of long tenure i.e. those who may hold the plan for a significant number of years

Product manufacturers will now be required to maintain a product approval process set out in a written document that contains measures and procedures focused on ensuring products (and any additional products) are and remain appropriate to customers they are targeted at.

The FCA has also introduced a requirement that product manufacturers must review their products at least every 12 months or more frequently where the risks associated with the product make it appropriate to do so.

When determining fair value for products of a long tenure, the FCA has introduced guidance to help firms when considering product value for a 'reasonably foreseeable period'.

Example of a product where the premium stays the same, but the benefits reduce over time.

Examples of this could be mobile phone or electrical goods insurance where the value of the insured asset or cost or asset reduces. Firms may need to consider whether the premium being paid remains a fair reflection of the risk. Where such products require an excess to be paid, firms should also consider the extent to which that is relevant to the quality of the product where it substantively reduces the benefit the customer would receive.

The FCA also asks firms to consider the fair value of products where the nature of the cover and the likelihood of claims changes over time.

Example of nature of cover changing over time

In the case of pet insurance it is common in this market for firms not only to increase premiums but for additional restrictions on cover (such as a co-payment for claims or limits on cover for individual illnesses) to apply as the pet gets older. Firms need to think about whether the product offers fair value to those customers who choose to renew after the premium increases.

When assessing fair value the FCA require manufacturers to use all necessary and appropriate data available to it including:-

- internally sourced information such as:-
    - customer research;
    - claims information such as handling times, frequency, severity of claims costs (including total costs and average per claim), claims ratios, rates of and reasons for claim acceptance/declinature, both expected for the product and/or any actual information from a comparable product; and
    - complaints data (including root cause analysis and handling times), both expected for the product itself and/or any actual information from a comparable product.
- public information or information obtainable by the firm from external sources including analysis of similar insurance products available from other firms and, where relevant, data published as part of the FCA's work on value measures in the general insurance market.
- information available to the firm specifically from persons in the distribution arrangements, including:
    - remuneration and its impact on the value of the product, package or component part;
    - levels or quality of service provided by any person in the distribution arrangements; and
    - any results of monitoring and oversight of the processes of any persons in the distribution arrangement (for example, call monitoring or file checks) including in relation to other products that person distributes.

The FCA will consider that a manufacturer has not complied with the "fair value" requirements where the total price paid by the customer bears no relationship to the actual cost of providing the product. This should include consideration of any distribution costs and the quality of any benefits (including additional products such as retail premium finance).

The FCA also require that manufacturers should not increase the cost for customers with vulnerable characteristics, where retail premium finance is offered or for policies subject to auto-renewal over those that are not auto-renewed.

Legacy products

Up to now the FCAs product governance requirements only applied to products manufactured or significantly adapted since 1 October 2018. The FCA are now extending the application of the PROD rules to all general insurance and pure protection products irrespective of when they were manufactured. Within one year of the rules coming into effect, firms will be required to have applied a product approval process to any existing products that did not fall within the current PROD scope and to update their approval for any in-scope products to take into account the new requirements on fair value.

The new requirements will include pure protection and insurance products that are in run off and no longer being sold to new customers. The FCA received feedback that there is little value in firms identifying a target market for pure protection products, or products that are in run-off with few customers, where this has not been done before. The FCA disagree with this feedback and state that having a defined target market allows firms to identify existing customers whose interests might not be best served by the product and take steps to mitigate this customer harm. For example, by moving these customers to a different product.

Distributor Requirements

The current product governance rules for intermediaries require that where a firm distributes a product it does not manufacture it must have in place arrangements to understand:-

- the characteristics of each insurance product; and
- the identified target market of each insurance product as defined by the product manufacturer.

With product manufacturers subject to more onerous requirements as covered in the section above, this should mean that there is more detailed and focused information available on both the fair value and target market information for products that intermediaries should be gathering when determining their own distribution strategies, including determining any panels.

The FCA expect manufacturers to make readily available product information that will enable the intermediary to understand:-

(1) the value of the product including information on the main features and characteristics of the insurance products
(2) any type of customer for whom the product is unlikely to provide fair value e.g. products that contain exclusions including those that may exclude certain vulnerable customer or long tenure factors (see examples in previous section)
(3) any impact on the value that the distributor may have on the value that the manufacturer cannot take into account

Whilst the onus is on insurance firms as manufacturers to provide this information, if this is not made available then we would suggest intermediaries need to consider whether they should use that insurance provider. It should also be noted that this information should now be available for legacy non-investment insurance products manufactured prior to 1 October 2018, so there should be no products for which this information should not be available for.

With respect to bullet point 3 above, there will be certain situations where the onus will be on intermediaries to determine the fair value of a product. A common example of this will be where the intermediary is distributing products as a package of products from different insurers. This could lead to a situation where the package of products leads to duplicate cover being provided. This would clearly be something the intermediary is responsible for.

Intermediaries that arrange retail premium finance be expected to ensure that this does not lead to additional costs that makes the package uncompetitive in value. When considering the value of retail premium finance the intermediary would be expected to consider the charges whether in the APR or otherwise and any fees applicable.

The FCA is also introducing special measures in ICOBS 6A.5 that will require intermediaries to consider the value of retail premium finance whether this is sold as a stand-alone product or as part of a package. The FCA state, a firm's remuneration arrangements should not provide an incentive to offer retail premium finance having greater costs to the customer (including a higher APR) where another retail premium finance arrangement, better aligned with the customer's interests, is available to the firm in the market. This would require intermediaries to consider alternative retail premium finance providers to that being offered through the insurer and vice versa when selling stand-alone retail premium finance.

More generally, the new requirements for distributors includes a particular focus on costs and ensuring that any distribution arrangements do not lead to increased costs and therefore negative outcomes for customers. This has been a regular theme for the FCA in recent years with concerns that long distribution chains (perhaps involving unregulated introducers) drive up costs for the end customer with no added value for the end customer.

With an eye on the risks of increased costs that these distribution chains present, the FCA has introduced a specific requirement that distributors must on request provide product manufacturers with information on how they are remunerated for distributing their products including confirmation that any financial incentives schemes in operation at the firm are not leading to any negative outcomes for the end customers.

The FCA has also introduced an explicit requirement that where distributors become aware that an insurance product is not in line with the interests, objectives and characteristics of its identified target market including where it has concerns over value they shall:-

- promptly inform the manufacturer; and
- promptly amend their distribution strategy for that insurance product.

The FCA state that the steps that the distributor may need to take when amending their distribution strategy could include but are not limited to:-

(1) amending its remuneration structures;
(2) amending the distribution arrangements;
(3) improving the quality of, or ceasing, any service or benefits it provides;
(4) where the failure to provide fair value is due to the costs or quality of additional products, renegotiating the terms of the current arrangements relating to the additional products, or selecting alternative providers or distributors of them, in order to provide for a fair outcome;
(5) ceasing to distribute certain insurance products (or where relevant, packages), or ceasing to use certain distribution channels;
(6) contacting existing customers to inform them of the issues and of the measures being taken to rectify them; and
(7) providing redress to customers.

As with product manufacturers, intermediaries will now be required to review their distribution strategy for non-investment insurance products at least every 12 months.

Considering the "fair value" of pure protection products

The FCA require manufacturers and distributors to consider the fair value of all non-investment insurance products so this would include all types of pure protection. E.g. critical illness, PHI and term assurance.

The FCA state that reviewing 'fair value' could result in lower prices, better service and/or greater coverage which could equally apply to pure protection contracts as for GI products. This applies both at outset and throughout the term of the contract.

For critical illness, it could be that over time the scope of illnesses and available treatments covered increases over time, providing fairer value for both new customers and customers with existing policies. It could also be the case that the premiums reduce. Regular reviews of the target market information made available from insurers should enable intermediaries to establish the fairest value critical illness products currently available for their customers based on scope of cover and price. Information on claims from the insurer should also be considered. E.g. claims acceptance rates

For term assurance products there could be more focus on price given that there could less variations in cover between products.

For new business customers product governance and the suitability process will be straightforward. The firm will be regularly determining and renewing the panel of products from which advisers can select, following the product governance exercises carried out.

The FCA also expects intermediaries to consider the value of existing products as the FCA has said that existing customers may be best served by moving to a different product over time. Therefore, we would suggest that when advisers are conducting any ongoing reviews they need to consider re-broking. This could be to a product with a better scope of coverage and/or lower premiums. It should be noted that insurers may have improved the terms of any existing products held so any suitability review assessment would need to bear that in mind.

Whether your firm's business model is to offer ongoing reviews to existing customers is a relevant factor. If you are offering purely transactional services then this may remove the obligation to conduct such a review, although firms may still choose to do so where this is in the customer's best interests. E.g. Where much improved cover becomes available for critical illness.

Impact on intermediaries

Whilst many of the new requirements that are being introduced are heavily focused on insurers in ensuring that they consider the fair value of products through regular reviews of those products, there are some clear focal points for intermediaries to consider, as follows:-

- With all non-investment insurance products (including legacy products) now subject to minimum annual requirements for reviews there is an onus on intermediaries to gather and making use of this information when determining distribution strategies, including the construction of panels.
- There is a particular onus on intermediaries to consider the costs of any distribution arrangements and how this might impact on the value to the end customer. This may often be outside the control of the insurer, hence the focus from the FCA.
- Intermediaries arranging retail premium finance will need to ensure that remuneration arrangements are not leading to them selecting poor value products and consider alternatives where necessary.
- Where intermediaries are distributing products provided by different providers as a package, the onus will be to ensure that these offer value as a package and that there is no duplication of cover for risks.
- For firms that advise on GI renewals, there will be an emphasis on ensuring that products continue to offer fair value (including legacy products) at renewal given that all non-investment insurance products will now be subject to reviews.
- For firms that advise on pure protection contracts, you will need to ensure that you consider the value of these policies over the duration of the policy.
- Whilst not a new consideration, there is an even greater expectation on feeding back to insurers when the insurance product is not in line with the interests, objectives and characteristics of its identified target market.
- Apart from the new product governance measures that come into force on 1 October 2021 as outlined in this section, intermediaries also need to consider the value measures data that product providers will be required to report to the FCA and which will be published by the FCA. This requirement came into force on 1 January 2021, although the first value measures data will not be published until as late as 28th February 2022. The data that will be published for comparison will include claims frequencies, claims acceptance rates, average claim pay-outs and claims complaints as a % of claims. Please see Bankhall Weekly dated 15th December 2020 for further coverage of this requirement. ** Update August 2022 ** - The FCA has not yet published the value

measures it has been gathering from insurers on the FCA website. However, firms should still consider requesting this information directly from insurers as it will be useful in determining the value of a product.

Cancelling auto-renewing policies

The FCA are going ahead with their proposals to make it easier for existing customers to cancel policies that auto renew. This means that providers must not place unnecessary barriers on consumers wanting to opt out of or stop auto renewal and that customers must be allowed to opt out of auto renewal at any point during the contract term. Provider firms will need to allow consumers to opt out of auto renewal using at least the same methods by which they allow consumers to purchase a new policy. Where Provider firms offer a telephone service they must ensure that the average call waiting time to cancel auto renewal is not unreasonably longer than the waiting time to purchase a new policy.

Provider firms will also need to inform consumers of their options to stop their contract from auto-renewing at the point-of-sale and in good time before renewal.

The new rules will apply to all types of general insurance products except for private health, medical and pet insurance. This is because the FCA recognise that applying the auto renewal measures to these products could lead to greater harm. For example, if consumers unintentionally opt out of auto-renewal during a period of treatment, this could result in the treatment terminating early. There is also a risk that consumers would lose cover for pre-existing conditions if they accidentally fail to renew their policy.

Impact on intermediaries

The FCA state that intermediaries may have a role in responding to requests to cancel a product that auto-renews. Therefore, intermediaries should make clear when arranging the purchase of a product the process customers are expected to follow to cancel that product. Namely, if they should approach the intermediary firm or go direct to the provider. If they are directed to go to the product provider directly, then the intermediary should draw attention to the provider information on how to carry out the cancellation request.

Reporting requirements

The FCA is introducing new reporting requirements which it will use to help it to:-

- assess firms' compliance with the home insurance and motor insurance pricing rules in ICOBS 6B;
- identify potential harm affecting consumers; and
- monitor the effects of the pricing rules in ICOBS 6B on the market for home insurance, motor insurance and related additional products.

The reporting requirements do not apply to business with commercial customers.

The new reporting requirement rules will be contained within section SUP 16.28 of the Supervision sourcebook (SUP) of the FCA Handbook.

On an ongoing basis the reporting for all elements will cover a 12-month period beginning on 1 January and ending on 31 December each year - unless the firm elects a different reporting period - with the new rules coming into effect on 1 January 2022. This information will need to be reported before 31 March each year for reporting periods running from January to December. This information will be reported through the RegData reporting system.

In 2022, firms will also be asked to complete an interim report covering the period 1 January to 30 June 2022 which firms will need to report by 30 September 2022.

The information that firms will be required to report is contained in form REP021 which is located at SUP Annex 49AR of the FCA Handbook. The information that each firm will be required to report will depend on the role that the firm has played in the manufacture and distribution of the home insurance, motor insurance and related additional products. The FCA has provided guidance notes on how to complete the form in SUP 16 Annex 49B.

All firms will be required to complete Sections 1 and 6. In addition, insurers should complete Sections 2 and 3 and price setting intermediaries (other than those that only offer commission rebates or cash/cash equivalent incentives) should complete Sections 4 and 5.

Insurer reporting requirements

The most onerous reporting requirements will fall on insurers and managing agents. They will be required to report detailed information on product pricing that covers all aspects of pricing for the duration (aka tenure) of each product in each year, including:-

- Total gross written premium
- Total number of policies incepted/renewed
- Expected claims cost in total
- Expected claims ratio – This is the proportion of a customers' premiums that are paid out in claims. Insurers will be required to provide this information in bands for every year a product is held. So for example, the proportion of customers for that product who have up to 10% of premiums paid out in claims, greater than 10% but less than or equal to 20% and so on.

Reporting on tenure means for example each of the firm's customers with less than a 1-year relationship with the firm, customers with a 1-year relationship with the firm, customers with a 2-year relationship and for each year thereafter up to 10 years, at which point tenure would be reported in the T10+ field. A more detailed definition with examples is provided further down in this section. The reason why the FCA is gathering such detailed information on tenure is because of the issue of "price walking" and the fact that customers that renew over significant period increasingly receive reduced value from their products. The FCA believe that the reporting data will enable them to identify this issue more easily.

All of the reporting items will have to be reported for each sales channel that is operated (i.e. direct, intermediated, price comparison website, affinity/partnerships) both for gross rated and net rated premiums.

The insurer will also be required to report similar information for each "closed book" product. The definition of a closed book product is provided in the 'pricing remedy' section of this analysis above.

Price-setting intermediary reporting requirements

Price-setting intermediaries (excluding those offering commission rebates or offering cash/cash equivalent incentives) will be required to report very similar information to that reported by insurers regarding price data (including the detailed tenure data). However, as they will not be involved in dealing with claims then they will not be required to report the information on claims.

This reporting will only be required where the intermediary is "price-setting" and not for any other products it sells as a "non-price setting intermediary".

In the context of the reporting requirements a "price-setting intermediary" is defined as *"an insurance intermediary whose role includes setting the gross premium paid by the customer for the core product or setting the price of any add-on policy, or retail premium finance"*.

To avoid duplication of reporting the FCA is placing the onus of responsibility for reporting on the price-setting intermediary for certain items. In summary, this means reporting responsibilities as follows:-

- Core products (including cover options and optional extras): The insurer of the core product and price-setting intermediary (where they set the final price) are responsible for reporting the data.
- Add-on products: Only the firm setting the price of the add-on product to consumers is required to report add-on product pricing data. Where that add-on product is premium finance and the price is set by a retail premium finance provider then the insurer or insurance intermediary which has the direct relationship with the consumer must report the pricing data for that business.
- Fees: Only the firm charging the fee to the customer is responsible for reporting the fees for that business

The FCA state that this approach (outlined above) will mean that the only data that would need to be shared is for core product reporting on net rated business, where the price setting intermediary would need to provide aggregated gross price data for the core product to the insurer.

As the new reporting requirements creates onerous reporting obligations for price-setting intermediaries (excluding those offering commission rebates or offering cash/cash equivalent incentives), these firms will need to consider the costs and benefits of continuing to set price.

Whilst the FCA consider a firm that rebates commission to be a price-setting intermediary, the FCA has confirmed that firms whose only price setting activity is to rebate commission or offer cash/cash equivalent incentives, will not be required to report data on commission rebates in the detailed reporting fields of questions 4 and 5 of REP021. Instead, such firms will be required to annually attest whether 25% or more of either their home or motor sales include commission-rebating or cash/cash equivalent incentives, as part of the annual attestation requirements.

Reporting items that apply to all firms

The FCA are introducing certain reporting items that will apply to all firms selling home insurance, motor insurance and related additional products. This is sections 1 and 6 of the reporting form.

These items will be relevant to intermediaries that do not have a price-setting role as well as price-setting intermediaries and insurers.

Section 1 is straightforward and merely requires basic details about the firm (i.e. address, firm reference number etc) and which individual is completing the report on behalf of the firm.

Section 6 is more onerous and covers reporting items for premium finance, add-ons and any fees and charges. The following table confirms the items to be reported on.

		Tenure										
Premium finance		**T0**	**T1**	**T2**	**T3**	**T4**	**T5**	**T6**	**T7**	**T8**	**T9**	**T10+**
6.02	Total charged (£) for retail premium finance in the reporting period											
6.03	Number of core motor and home and any add-on policies incepted with retail premium finance in the reporting period											
6.04	Number of policies incepted/or renewed in the reporting period with an APR:											
	Of 0%											
	Between 0.1% to 9.9%											
	Between 10% to 19.9%											
	Between 20% to 29.9%											
	Between 30% to 39.9%											
	Between 40% to 49.9%											
	50% or more											
Add-ons												
6.05	Total gross written premiums (£) for add-ons incepted or renewed in the reporting period											
6.06	Number of add-ons incepted or renewed in the reporting period											
Fees and charges in addition to the premium												
6.07	Total pre-contractual fees/charges (£) charged to customers in the reporting period											
6.08	Average pre-contractual fees/charges (£) per customer who was charged a fee in the reporting period											
6.09	Total post-contractual fees/charges (£) charged to customers in the reporting period											

6.10	Average post-contractual fees/charges (£) per customer who was charged a fee in the reporting period											

Premium finance items

The premium finance items 6.02 to 6.04 will need to be reported by an insurer or price setting intermediary where they set the price of the retail premium finance being offered. However, where a retail premium finance firm is setting the price then these reporting items become the reporting responsibility of the customer facing firm.

This means that a non-price setting intermediary will be required to report this information where they have the relationship with the end customer, which will effectively cover all advising and arranging situations where the retail premium finance provider has set the price of their own stand-alone product. i.e. where the retail premium finance is not being offered by the insurer as part of their product offering.

Firms in scope of the reporting requirement for retail premium finance reporting will need to keep records of the total premiums charged for retail premium finance, the number of core motor and home and any add-on policies incepted with retail premium finance as well as records of the level of APR being offered.

Add-ons

Only insurers or price-setting intermediary firms will be required to report on the information for add-ons. This information is similar to that requested in the earlier sections which only covers core product details. Firms who offer commission rebates and those who offer cash/cash equivalent incentives will not need to complete this section.

An add-on product is a general insurance contract sold as a separate contract or policy in connection with, or alongside, a motor insurance or home insurance policy. E.g. legal expenses cover or GAP insurance

Fees and charges in addition to the premium

Any intermediary firms that charge fees in addition to the commission they receive for advising and/or arranging a core home and motor contract and any add-on products including retail premium finance will be required to report that information.

For pre-contractual and post-contractual fees the FCA is looking for both the total and mean average of fees. The average is the average for each reporting category, based on the number of customers who incurred these fees. Therefore, if you didn't charge a fee for certain groups of customers then this would not be part of that calculation.

For intermediaries the pre-contractual fee charged at the inception of a new policy will likely be the most common additional fee that would be charged although if charges are made at renewal these must be reported as well. The FCA do not explain how reporting of the fees should be broken down where multiple policies have been arranged as a result of one advice event, but we recommend firms keep records of how they apportioned any fees per product advised/arranged, to ensure consistency with the reporting requirements.

Post-contractual fees cover items such as administration and cancellation fees.

Tenure

All the above items to be reported will need to be broken down into periods of tenure for customers which the FCA have defined as per the text box below.

Definition of 'tenure' for reporting purposes

This is the number of years a customer has held the policy, including any renewal.

For example:

T0 = customer who has held their policy for less than 1 year;

T1 = customers who held their policy for 1 year;

T10+ = customers who have held their policy for 10 years or more.

Firms should round down to the last full year the customer has held a policy with them in cases where customers have contracts that renew on shorter than annual basis. For example, a firm should classify a customer on a six-monthly contract who has renewed the policy once as T0 (customer who has held their policy for less than 1 year) and a customer who has renewed this policy three times as T1 (customers who have held their policy for 1 year).

Firms should report data for each tenure individually from T0 to T9 inclusive. Data for any tenure that is T10 or greater should be aggregated and reported as T10+.

For retail premium finance, the tenure of the core product should first be considered and then the tenure of the retail premium finance. For example, if a customer cancels an existing policy with retail premium finance and takes out a new policy with retail premium finance, then the tenure for both the new policy and the retail premium finance would be T0. If a customer has the same policy for four years and pays by retail premium finance for the first two years, and for the third year does not use retail premium finance but for the fourth year uses retail premium finance again, the tenure in the fourth year would be T4 for the core product and T0 for the retail premium finance.

Impact on intermediaries

Given the very onerous nature of the new reporting requirements any firms that fall within scope of the definition of a "price-setting intermediary" need to think carefully about the costs and benefits of remaining so, given the extra reporting requirements this entails. Whilst firms that only rebate commissions or offer cash/cash equivalent incentives will be exempt from the more detailed onerous price reporting requirements, they will still be subject to the annual attestation requirements.

Any intermediary firm that is arranging retail premium finance separately (i.e. stand-alone retail premium finance) to the core insurance contract will be the required to make the report on those items. It is our understanding that insurers will set the price of retail premium finance offered as part of their product but even if they didn't it is our understanding that they would be fulfilling the reporting obligation.

Any intermediary firms that charge fees in addition to the commission they receive for advising and/or arranging a contract will be required to report that information.

All intermediary firms will need to ensure that they are keeping detailed records of the reporting items that are relevant to them to be able to fulfil the new reporting requirements. This will be a significant challenge for some, given the level of detail that is required for many of the reporting items.