

Hot TopICS

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Rules around premium finance – old and new

Up to half of all motor and household insurance customers in the UK choose to pay their annual premiums by monthly instalments and, in doing so, they are likely to enter into a regulated credit agreement with a third-party finance provider. This article looks at the legal and regulatory requirements as they affect insurance intermediaries.

The FCA regulates the consumer credit sector with a focus on fairness, creditworthiness and affordability, based largely on the Consumer Credit Rules (CONC) and for insurance related credit, the Insurance Conduct of Business Sourcebook (ICOBS). The rules and guidance have their roots in the Consumer Credit Act which legislates to protect ‘individuals’* seeking credit in the UK.

Firms offering credit are expected to abide by strict rules and guidance.

The rules and guidance continue to evolve. The FCA has recently issued a [Policy Statement](#) confirming a ban on discretionary commission models for motor finance with effect from 28 January 2021. This should remove any incentive for motor dealers and motor finance brokers to profit unduly from high interest rates charged to customers using credit to finance the acquisition of a motor vehicle. Other types of consumer credit are not directly targeted by the ban but new rules and guidance around the transparency of commission arrangements affect the wider consumer credit market, including insurance intermediaries offering premium finance.

Brokers will need to give more information to customers (under the consumer credit rules that includes natural persons, sole traders, small partnerships and some unincorporated bodies) about the nature of their earnings in respect of consumer credit and how that affects the overall cost of buying an insurance policy.

Another development which will have a significant impact on premium finance has arisen through the FCA’s [General Insurance Pricing Practices Market Study](#). Based on the findings of the study, the FCA is consulting on a package of remedies intended to ensure that GI firms focus on providing fair value to customers. The headline measures are to prevent systematic increases in prices for home and motor insurance customers; but the proposed enhancement of product governance rules is set to apply across all insurance products and associated sales – including premium finance.

As if all that wasn’t enough, the pandemic seems to have nudged the regulator into overdrive, producing extensive [guidance](#) for firms around supporting disadvantaged customers with possible payment deferrals and other measures.

Consumer credit rules and legislation – an outline

The Consumer Credit Act has been revised and updated since it came onto the statute books in 1974. Major changes came about through the EU Consumer Credit Directive and the resultant UK Consumer Credit

* For the purposes of regulated consumer credit, ‘individuals’ are defined as a natural *person*; or a *partnership* consisting of two or three *persons* not all of whom are bodies corporate; or an unincorporated body of *persons* which does not consist entirely of bodies corporate and is not a *partnership*.

Regulations 2010. As outlined, broadly speaking, the legislation governs any credit arrangement between a lender and a natural person or a partnership of two or three persons and covers:

- the information consumers should receive before they enter into a credit agreement – this includes the Standards European Consumer Credit Information Form (SECCI)
- the content and form of credit agreements, including the amount and timing of repayments, the APR, and the protection and remedies available to the customer
- the method of calculating annual percentage rates of interest (APR)
- procedures relating to events of default, termination and early settlement
- credit advertising

From April 2014, the FCA took over the regulation of consumer credit from the Office of Fair Trading. Insurance intermediaries must be authorised by the FCA for credit broking, allowing them to introduce consumers and other 'individuals' to lenders, thus enabling their customers to pay for insurance policies by instalments. Some intermediaries undertake other regulated consumer credit activities such as lending on their own account, debt administration and debt collecting for which additional permissions are needed. The FCA Handbook (CONC) contains [specific rules and guidance](#) for credit brokers and others engaged in consumer credit activities.

In addition to the CONC requirements, the rules in ICOBS are relevant to premium finance. Premium finance is regarded as an optional additional product (add-on), so a customer must actively opt-in and the cost of the credit arrangement should be disclosed separately from the premium. There are also cross-selling rules which require firms to inform the customer whether it is possible to buy the different components (i.e. the policy and the premium finance) separately and, if so, to provide further details including a breakdown of costs.

As always, the specific rules and guidance are underpinned by the High Level FCA regulatory requirements including the overarching 'Principles for Businesses'. Other laws and regulations such as the Equality Act 2010, Data protection Act 2018, Proceeds of Crime Act 2002 and the Sanctions and Money Laundering Act 2018 may also be relevant to consumer credit transactions.

Disclosure of commission arrangements for premium finance

Under the current rules in CONC, credit brokers must disclose to a customer in good time before a credit agreement is entered into, the existence of any commission or fee or other remuneration payable to the credit broker by the lender where knowledge of the existence or amount of the commission could actually or potentially:

- affect the impartiality of the credit broker in recommending a particular product; or
- have a material impact on the customer's transactional decision.

Also, at the request of the customer, a credit broker must disclose to the customer, the amount (or if the precise amount is not known, the likely amount) of any commission or fee or other remuneration payable to the credit broker by the lender.

Insurance intermediaries have a certain amount of discretion to make a judgement as to whether the remuneration received affects their impartiality or the customer's decision. In practice, many firms tell customers about their premium finance remuneration arrangements as part of their terms of business. On a customer's request, they then would also need to disclose the actual or likely amount of their earnings.

With effect from 28 January 2021 (the same day as the ban on motor finance discretionary commissions) these rules are enhanced to clarify that the existence and nature of commission arrangements should always be disclosed prominently:

- where the commission varies depending on the lender, product or other permissible factors; and/or
- where the way the firm is remunerated could affect a customer's willingness to transact.

The disclosure must also cover how the arrangements could affect the price payable by the customer.

The new rules will sit alongside ICOBS rule 4.3 which requires insurance intermediaries to provide customers (both consumers and commercial customers) with pre-contract information on the amount of any fees and the nature of any remuneration received in relation to the contract of insurance.

It is important that the information about remuneration be provided prominently and in a durable medium (although for telephone sales the information can be provided orally then confirmed in a durable medium afterwards). Under the new rules, firms must clearly explain the nature of commission arrangements in any financial promotions that refer to consumer credit as well as when making a recommendation. The specific costs of the credit arrangement(s) offered to the customer would usually be provided as part of the new business or renewal quote.

General Insurance Pricing Remedies – implications for premium finance

The proposed new rules on product governance based on the General Insurance Pricing Practices Market Study would apply across the range of general insurance products including any add-ons. Firms will need to ensure that all their products offer fair value.

The value assessment of a product should include consideration of the impact of the distribution arrangement on overall value and distributors will need to provide some feedback to the product manufacturers (for example, the distributors' remuneration and a breakdown of the overall cost to customers) to support regular reviews of the value provided by a product.

The FCA believes certain price optimisation practices would not offer fair value; for example, '*pricing based solely on whether the customer is using auto renewal or premium finance or if the customer has characteristics that might indicate vulnerability*'. As regards home and motor insurances, the renewal price for additional products, including premium finance, must be no greater than that offered to an equivalent new customer.

The Consultation Paper reminds firms that the remuneration or associated incentives they receive in connection with an additional product must be consistent with the firm's obligations under the customers' best interest rule. Where a premium finance agreement has a higher APR than would be available elsewhere (e.g. directly from the insurer, or from another finance provider) based on the remuneration the firm will receive, this may conflict with the firm's obligations. The implication is that firms would be expected to offer the cheapest available credit option which meets the customer's demands and needs.

Where firms offer or arrange premium finance in relation to a contract of insurance, the FCA proposes to require that firms ensure that:

- they give clear information about the cost of premium finance arrangements, and make clear to customers that the use of premium finance makes the contract more expensive
- when firms give customers a choice on whether or not to take out premium finance, they must do more than simply ask the customer to choose between paying monthly or annually
- firms are not influenced by remuneration to offer premium finance at higher rates of interest than are available elsewhere.

To meet the third requirement, firms will need to regularly review the premium finance they offer to ensure that it does not adversely impact the value of the product. Where a firm identifies that the insurance product (or, where relevant, the package) or distribution arrangement is not providing fair value for customers, the FCA will expect them to take remedial action.

Regulatory reporting

The FCA expressed concern that some firms may seek to respond to the remedy package by raising prices for premium finance, additional products or fees and charges to compensate. It is therefore proposing to require firms to submit regular reports on retail home and motor insurance sales and on additional products sold alongside home and motor insurance. The data would include the firm's total charges for premium finance, the number of policies sold with premium finance and the APR range.

Summary

The themes of this article can be summarised under these main headings:

- Understanding the relevant legislation and applicable FCA rules
- Ensuring fair value
- Acting in the customer's best interests
- Providing clear information about the costs of premium finance
- Disclosing remuneration arrangements
- Collating data for product manufacturers and for regulatory reporting purposes

The FCA has made clear the importance of transparency regarding consumer credit and the new rules will impose a greater burden on firms to ensure they are disclosing all the relevant information to customers, ensuring fair value and collating data that will be required by the product manufacturers and the regulator. Firms will need to review their policies and procedures to ensure they are complying with existing rules and in a position to meet the new proposed requirements.

What do we need to do next?

New disclosure requirements for consumer credit apply from January 2021 and the pricing review proposals have yet to be confirmed. Firms should ensure they are compliant with existing requirements and prepared for those to come. It is an opportune time for firms to:

- Liaise with finance providers to confirm current and future remuneration arrangements
- Review policies, procedures and controls to ensure any commission arrangements are not detrimental to customers' best interests
- Ensure sales processes give adequate prominence to the cost of premium finance
- Ensure customer communications include the required information and explanations, focussing on the nature of commission and the effect it has on the overall cost
- Be able to show the amount or likely amount of remuneration the firm receives for arranging credit if the customer requests it
- Update relevant documentation and scripts
- Ensure relevant MI is available to enable senior managers to monitor compliance and to highlight any emerging risks and issues in relation to premium finance
- Consider additional data and reporting requirements, liaising with software providers where necessary.

If you would like any help or information in relation to this update or any FCA-related compliance issues or ICS Services, please contact your usual ICS representative or Head Office on 01892 539600 or admin@insurancecompliance.co.uk and we will be happy to discuss further.

The above information is a summary of certain matters which will affect the majority of firms conducting Insurance Mediation and reflects ICS's views at the date of publication. Each firm's requirements are individual, and rules are regularly changing; it is therefore important that you always seek specific advice from ICS before acting on anything contained in this publication.
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