

FCA Pricing Remedies – Product Governance for Product Distributors

In our [first July Hot TopICS](#) we set out an overview of the FCA's new rules in relation to product governance requirements for manufacturers, as set out in [Policy Statement \(PS21/5\)](#).

In this next Hot TopICS in the series, we look at the requirements for product governance which come into force on 1st October 2021, and the implications of those requirements for product distributors.

An insurance broker which is a 'distributor' but which is also a product manufacturer or co-manufacturer should review our Hot TopICS in relation to the new requirements for product manufacturers / co-manufacturers.

This is the third in a series of Hot TopICS to outline the details of the final rules, to consider changes to the original proposals as set out by the FCA in the Consultation, and the implications of the new rules for and the likely impact on insurance brokers and other distributors.

Hot TopICS in this series published so far

- New rules in relation to general insurance pricing (June 2021)
- FCA pricing remedies – product governance for product manufacturers (July 2021)

We will issue further Hot TopICS in the coming weeks in relation to each of the new remedies.

Remedy	Products Subject to scope	Types of firms subject to scope
Product governance designed to ensure firms focus on offering fair value products and have strong oversight and governance in place to support this	<ul style="list-style-type: none"> All general insurance policies and additional products sold alongside them, including premium finance (except contracts of large risk and reinsurance) All pure protection insurance (except reinsurance) 	Applies to firms manufacturing, co-manufacturing or distributing the products that are within scope

Background

In setting out its new product governance and systems and controls rules and guidance the FCA is looking to build on the existing [product governance rules in relation to insurance contracts](#) and has introduced the concept of assessing whether those products offer fair value for a reasonably foreseeable period. From an insurance distribution perspective, product manufacturers (to allow them to consider fair value to the end customer) will require information from distributors in relation to end pricing, commissions and remuneration etc. to enable that assessment to be made.

The [systems and controls requirements](#) that are included within the overall product governance remedy apply to remuneration from premium finance, and will be introduced alongside the new product governance rules from 1st October 2021. As they impact distributors, we will cover those systems and controls requirements in this Hot TopICS.

The premium finance disclosure requirements, again for distributors (and due to be introduced from 1st January 2022), will be the subject of a separate Hot TopICS.

Is your firm just a distributor?

We will consider the impact on insurance brokers of the [new product governance rules for product distributors](#). Remember, though, that Insurance intermediaries can be distributors *and* manufacturers or co-manufacturers.

The FCA Handbook Glossary term 'manufacture' includes 'designing, developing, creating and/or underwriting' which cover activities prior to the insurance product being approved for marketing and distribution, and on a continuing basis after such approval.

Insurance intermediaries are likely to be considered manufacturers (or, more likely, co-manufacturers) where they have a decision-making role in designing and developing an insurance product for the market. However, to realistically be considered a manufacturer or co-manufacturer, that decision-making role needs to allow the intermediary to autonomously determine the essential features and main elements of an insurance product, including its coverage, price, costs, risk, target market and compensation and guarantee rights, which are then not substantially modified by the insurance undertaking providing coverage for the insurance product. This particular analysis (the autonomous determination) is likely to be a key factor in deciding whether a distributor is also a manufacturer or co-manufacturer

Summary

The product governance requirements apply across the board – not just to motor and home insurance – and, in summary, require that product distributors must:

- understand the outcome of the value assessments carried out by the product manufacturer/s in relation to each product that they distribute;
- provide information to product manufacturers to allow them to make their value assessments (for example, details about end pricing, commissions and remuneration etc.);
- identify any customer groups that the products are unsuitable for;
- consider a wide range of issues (set out in rules and guidance in [PROD 4.3](#)) prior to the distribution of any given product and also on an ongoing basis (see ‘The new PROD 4.3 rules and guidance’ below); and
- have robust policies, procedures and records in place.

In relation to premium finance, product distributors must:

- ensure that they are not influenced by remuneration to offer premium finance at higher rates of interest than are available elsewhere;
- review regularly the premium finance they offer to ensure that it does not adversely impact the value of the product and remains in line with:
 - the existing requirement to act in the customer’s best interests; and
 - the new requirement to deliver fair value.

The FCA, in the Policy Statement, has also taken the opportunity to remind distributors of their existing obligation to meet all relevant insurance distribution requirements. This includes the requirement under ICOBS 5.2 to assess customer demands and needs before concluding a contract of insurance. Firms are reminded in particular that ICOBS 5.2 applies at renewal, as well as for new business. Firms need to ensure they have sufficient up-to-date information to be able to assess customer demands and needs before arranging a renewal contract for long-standing customers.

There are elements in this new regime that involve looking forward (e.g., assessing fair value for your target market for a reasonably foreseeable period), but also looking back (e.g., identifying if products have not delivered fair value, and take remedial action).

Scope of the new product governance rules

For distributors, the PROD rules apply to:

- all distributors of non-investment insurance products (that they do not manufacture), including Price Comparison Websites (PCWs) and other intermediaries;
- all non-investment insurance product types that are in-scope of PROD – so excluding contracts of large risks (as defined) or re-insurance contracts, but including any other products for distribution to customers generally (rather than each individual contract of insurance being sold or underwritten);
- all types of distribution models regardless of complexity.

Understanding and enabling manufacturers' value assessments

To understand what manufacturers will need to consider under the new product governance rules, refer to our first [July Hot Topics](#) for details of the new 'fair value for a reasonably foreseeable period' requirements and for a summary of the significantly increased rules and guidance in relation to product assessment.

The new rules included in Chapter 4 of the Product Governance Sourcebook (PROD 4) state that a firm must at least consider the benefits the product is intended to provide to the customer and the characteristics, objectives, interests and needs of the target market.

- Distributors will, in some cases, be better placed than insurers to consider the appropriateness of any given product for its own target market. That being the case, you must use the value assessment information to identify within your own customer base any customer groups that the products are unsuitable for.
- Distributors should, in addition to manufacturers, consider what the FCA has called 'fair value' (the 'interaction between the price paid by the customer and the extent and quality of any services the distributor (or any person connected to it) provides'), and whether any remuneration it receives in relation to the insurance product would result in the product ceasing to provide fair value to the customer.
- Distributors, therefore, need to understand the rationale and outcome of the manufacturer's value assessment to be able to meet their obligations under the new rules. The FCA has clarified that it does not expect the information passed between manufacturers and distributors to include commercially sensitive information, such as their costs and profit margins.
- Part of the manufacturer's responsibilities will be to assess the possible impact of the distributor's actions on the intended value (for example, where the distributor's remuneration could impact the price and lead to the product not offering fair value). Distributors should expect, perhaps, increased manufacturer oversight of the distribution of their products.
- Distributors who are responsible for putting together packages of products must ensure that these do not have a detrimental impact on the value of the products. Firms should consider the new guidance that the FCA has added at [PROD 4.3.6BG](#).
- The FCA has also added further guidance at [PROD 4.3.6CG](#) on how distributors should consider value in relation to the retail premium finance offered alongside insurance products (see also the 'SYSC requirements and premium finance' section below).

Understanding the value assessment – actions

- ✓ Establish all the manufacturers from which and products about which you need to receive value assessment information.
- ✓ Understand the nature of the assessment that the manufacturers should undertake to assist the understanding of the value assessment.
- ✓ Consider the impact that your distribution strategy and process (i.e., your sales processes, customer journeys etc.) have on the value of the products. This includes considering any remuneration you receive as part of the distribution strategy, and ensuring that it does not result in the product failing to offer fair value to the end customers. The rules set out a number of matters which distributors should consider.

- ✓ Amend your distribution processes if you identify that that fair value is not being delivered, in order to prevent harm to customers. This should include taking appropriate remedial action which, for a distributor, could mean
 - * Amending your remuneration structures;
 - * Changing your distribution arrangements;
 - * Renegotiating the terms of additional products, or selecting alternative providers;
 - * Ceasing to distribute certain insurance products / packages, or ceasing to use certain distribution channels;
 - * Providing redress to customers.
 - ✓ Ensure that any information you provide to the manufacturers in relation to your remuneration and distribution strategy appears to have been considered by the manufacturers in their assessments.
 - ✓ Decide how packages of products will be reviewed.
 - ✓ Risk-rate the product reviews (e.g., RAG rating) to help you to prioritise which products to review first. The risk rating can be informed by MI including the complexity of the products, the number of policyholders, the size of the intended target market etc.
 - ✓ Review products at least every 12 months ([PROD 4.3.10A R](#)) to determine that they continue to deliver fair value to customers. Higher risk products will require more frequent reviews.*
- *In this regard the Policy Statement has introduced a new defined term of *legacy non-investment insurance contract*. Although of more relevance to insurers, this is a non-investment insurance product that was manufactured prior to, but not significantly adapted on or after, 1 October 2018, and that is either still being marketed and distributed to customers (including a renewal of an existing policy) or is not still being marketed or distributed but there are policies under the product that remain in force.
- ✓ Ensure robust processes are in place for ensuring that ongoing reviews occur as required, at least annually, and that robust records are in place to evidence work undertaken.

Enabling value assessments – actions

- ✓ Provide to the manufacturer the details they require and request about the remuneration you receive, if it is anything other than the commission paid by the insurer (which they will be aware of). This includes information on remuneration where this has an impact on the value of the product, and would include fees received from the customer.
- ✓ In addition to remuneration information, also provide to the manufacturer
 - * any information on any ancillary product or service that you provide to the customer (including insurance add-ons, non-insurance additional products and retail premium finance), which may affect the manufacturer's intended value of the insurance product; and
 - * confirmation that the distribution arrangements are consistent with the obligations of your firm under the FCA Handbook including in particular in [SYSC 10](#) (Conflicts of interest) and [SYSC 19F.2](#) (IDD remuneration incentives).

The new PROD 4.3 rules and guidance

The main elements of the new rules and guidance for product distributors have been added at PROD 4.3.6A to 4.3.6E.

- 4.3.6A R – identifying intended value, assessing fair value, distribution arrangements and distribution strategies, consideration of the benefits of the product and understand the target market, the impact of remuneration and the additional cost of any retail premium finance (see below).
- 4.3.6B G – demonstrate continuing fair value in packages of products, having given due consideration again to the target market and the value assessments carried out by the manufacturers.
- 4.3.6B G (4) – a reminder from the FCA that the arrangements a distributor is required to have in place under PROD 4.3 are separate from the processes and arrangements the firm should have in place at the point of sale, including to comply with the customer’s best interests rule and to determine whether a product being proposed is consistent with the demands and needs of a particular customer.
- 4.3.6C G – consider the effects of any retail premium finance you offer to customers including the relationship between any additional cost it would bring to the total overall cost of the insurance arrangement and the additional benefit it brings (e.g., the ability to spread cost when a single premium would not be affordable).
- 4.3.6D G – introduces an ‘evidential provision’ (set out at PROD 4.3.6E, below) which provides examples of arrangements that the FCA considers will breach PROD 4.3.6A R
- 4.3.6E E – examples of outcomes that should not arise or occur as a result of a firm’s distribution arrangements (including any distribution strategy):
 - the firm receiving a level of remuneration which does not bear a reasonable relationship to the firm’s actual costs, particularly where the firm provides little or no benefit beyond that which the customer would receive if they obtained the insurance product through another distribution channel;
 - the firm having remuneration arrangements which give an incentive to propose or recommend an insurance product which either does not meet the customer’s needs (or not as well as another product would) or is not in accordance with the customer’s best interests rule;
 - the overall price of a package not bearing a reasonable relationship to the overall benefits provided by the package, where the insurance product is distributed as part of that package;
 - the level of any remuneration (which the firm is responsible for setting) not being reasonably reflective of the costs actually incurred.

Contravention of any of the above may be viewed by the FCA as a contravention of PROD 4.3.6AR.

The new systems and controls and premium finance arrangements

The new systems and controls requirements (involving value considerations in relation to premium finance) and the 'premium finance' elements of the new product governance / distribution rules take effect on 1st October 2021. It is appropriate, therefore, to include them in this Hot TopICS. The product governance requirements in this regard have been outlined in the sections above.

In relation to premium finance, and in summary, product distributors must:

- Ensure that they are not influenced by remuneration to offer premium finance at higher rates of interest than are available elsewhere;
- Review regularly the premium finance they offer to ensure that it does not adversely impact the value of the product and remains in line with:
 - the existing requirement to act in the customer's best interests; and
 - the new requirement to deliver fair value.

The FCA understands that many firms will have existing arrangements with premium finance providers, and will currently receive remuneration from them. Some of these may be exclusive arrangements.

Value of retail premium finance sold alongside insurance

The FCA has added further guidance at PROD 4.2.14I G and PROD 4.3.6C G that, when considering its value, firms should at least consider the relationship between the total price of the premium finance (including the applicable APR) paid by a customer and the quality and benefits. Premium finance provides the benefit of spreading the cost of the insurance premium and there are often no other benefits. In view of this, the FCA expects that the price is likely to be the most significant factor in determining whether the premium finance provides fair value.

The new systems and controls requirement

[SYSC 19F.2.2 R](#) (IDD remuneration incentives) states that insurance distributors must not be remunerated, or remunerate or assess the performance of their employees, in a way which conflicts with their duty to comply with the customer's best interests rules in relation to general insurance (ICOBS 2.5.-1R). The rule goes on to state, in relation to contracts of insurance, that an insurance distributor must not make any arrangements by way of remuneration, sales target or otherwise that could provide an incentive to itself or its employees to recommend a particular contract of insurance to a customer when the insurance distributor could offer a different insurance contract which would better meet the customer's needs.

The message here, perhaps, is that distributors must act in their customers' better interests ahead of their own.

The new SYSC rule proposed in the Policy Statement (SYSC 19F.2.3 R) effectively adds 'retail premium finance'* into the considerations in the above rule by confirming that the requirement set out in SYSC 19F.2.2 R also applies to remuneration an insurance distributor receives in relation to retail premium finance.

A new guidance item at ICOBS 19.2.4 G reminds firms that the new ICOBS 6A.5 (elements of which will come into force on 1st October 2021, with others coming into force on 1st January 2022) includes further guidance on remuneration in relation to retail premium finance.

*Retail premium finance is defined, in simple terms, as a credit agreement (whether regulated or not) to be used by a customer who is a consumer, to finance all or part of the premium for a non-investment insurance contract, except where there are no fees, charges or interest payable in relation to the credit agreement (so a 0% APR, where the total overall end price to the customer does not result in the customer paying any amount in addition to the price of the policy).

Retail premium finance considerations

Insurance distributors will need to consider which premium finance options are in the better interests of the customer. The FCA is clearly focused on the price, citing the APR as a suggested comparative measure, and this is an issue that may have systems and financial impacts on firms.

- ✓ You will need to benchmark the available APR rates (including any override that the firm may set over and above the net rate that a premium finance provider may offer to the distributor) on a like-for-like basis against other premium finance providers.
- ✓ Firms need to ensure that premium finance is not offered where it is not in customers best interests; this would reasonably include where any insurer direct debit facility results in a lower overall price to the customer when compared with any third-party premium finance arrangements that a distributor might habitually / commonly use.
- ✓ Firms need to regularly review arrangements to ensure incentives would not cause finance to be offered, costing more to the customer, where a product better aligned is available in the market.

Actions for firms – general

- ✓ Initially, review the new requirements (as indicated above, the new guidance is significant) and determine areas you fall into – particularly if you are deemed to be a co-manufacturer in addition to being a distributor (remember the note above in relation to ‘autonomous assessment’);
- ✓ Project management – engage a project team involving key stakeholders;
- ✓ Plan and record – establish a project plan to track your progress, your actions and your decisions;
- ✓ Regular Meetings – set up regular project meetings;
- ✓ Risk management and conflicts – feed any ongoing output from your project into your risk management considerations and your conflicts of interest processes;
- ✓ Schedule training time to roll out any required training ahead of implementation;
- ✓ Update and implement appropriate and proportionate processes and procedures
- ✓ Ensure robust records in place for to note and support any actions taken and decisions made.

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 Distribution and reflects ICS's views at the date of publication. Each firms' 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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