

20 September 2023

**FAO: the CEO/Director**

Dear Sir/Madam,

**Concerns about the value of Guaranteed Asset Protection ('GAP') insurance**

We are writing to GAP insurers regarding our concerns about the value of GAP insurance to customers.

**Our expectations of firms regarding fair value of insurance products**

Our review ([TR19/2](#)) found that many customers may not always receive fair value because parties in general insurance ('GI') distribution chains earn high (and potentially excessive) commission. We specifically included GAP insurance in our review, and we were clear that we expected all firms to put customers at the heart of their business model and have appropriate regard for the value customers receive.

Our [product governance](#) rules for GI products came into force on 1 October 2021. These rules require firms to understand the value of their products and stipulate that firms must carry out value assessments of their products to ensure that the product provides fair value to the customers in the target market.

In November 2022, we published [our review of the General Insurance Value Measures Data](#), which found that products with the lowest percentage of premiums paid out in claims included GAP insurance (add-on at 5.2% and standalone at 7.8%). We highlighted our concern about the picture presented by the data.

Furthermore, the Consumer Duty ('the Duty') came into force on 31 July 2023 for new and existing products or services that are open to sale or renewal. We wrote a [Dear CEO letter](#) in February 2023 that set out our expectations of firms in preparation for the introduction of the Duty. We said "we expect that robust fair value assessments will deliver real change in the value of products provided to customers which in some cases will be evidenced by, for example,

reductions in commission levels for products and in others by the product being withdrawn from the market.”

**We do not consider that GAP insurance currently provides fair value to customers**

Despite our consistent communication about the necessity of firms ensuring their products offer fair value to customers, we have not yet seen compelling evidence that the GAP insurance market has responded appropriately.

When considering value, firms must look at the relationship between the overall price paid by the customer and the quality of the service or benefit provided. A particular concern in the GAP insurance market is the apparent high levels of commission, where it is not clear how these have been assessed as being consistent with fair value. The information we have seen to date does not suggest that GAP insurance products, deliver fair value.

The latest value measures data for 2022 [published today](#) shows that:

- £308mn of GAP Insurance (stand alone and add-ons) was written in the market, with an average premium paid by customers of £330;
- There is a low frequency of claims as only 1.5% of policyholders made a claim in 2022, with an average claim pay-out of £608; and
- Only 6.3% of total written premiums were paid out in claims.

When we look at claims as a percentage of written premiums for the 34 products included in our GI Value Measures data, claims costs as a proportion of premium range from 4% for GAP Insurance (Add on) to 65% for Motor (all), with the median in that range at 35%.

For GAP, we observe what appears to be high levels of commission (which can be in excess of £0.70 for every £1 of premium) being paid to parties in the distribution chain.

Based on the Value Measures data and information we have seen, the levels of commission being paid in the distribution chains do not appear to support the delivery of fair value to customers. This is contrary to PROD 4.2.14AR, 4.2.14BR, 4.2.14CR, 4.2.14ER, 4.2.14ME, 4.2.14NR, and 4.2.14RR.

We are concerned these commissions are able to be extracted due to the control motor dealerships may exert over the market and that this is impacting the effective functioning of the market and consumer protection - hence the need for regulatory intervention.

### **Value measures for your GAP insurance products**

For the full year 2022, your firm (combined stand-alone and add-on) shows the following value measures:

- £xmn written with an average premium paid by customers of £x.
- x% of policyholders made a claim, and the average claim pay-out was £x.
- x% of written premiums were paid out in claims

On the data currently available to us, we assess that your firm's GAP insurance products are not likely to be providing fair value to customers. On this basis, our expectation is that you take urgent steps to significantly improve the fair value of your GAP insurance. This includes clearly demonstrating how fair value is being delivered, including justifying your prices and, as relevant, ensuring appropriate changes are made so that fair value will be provided.

### **Next steps**

Please complete the following actions in respect of your GAP products (see Appendix 1 for further detail on the information you are to provide in response to these actions).

**The information below should be signed off by an individual at your firm who holds a Senior Management Function (SMF).**

<b>Action</b>	<b>Timescale</b>
<b>A. Provide information on commission, gross written premium and claims information</b>	<b>Within 7 days of the date of this letter</b>
<b>B. Your existing assessment that GAP products provide fair value to customers.</b>	<b>Within 7 days of the date of this letter</b>
<b>C. Proposals for improving the value of your firm's GAP products</b>	<b>Proposal sent within 30 days of the date of this letter</b>  <b>Proposal implemented as soon as possible, and at the latest by 1 January 2024</b>

Please send the above to [GAPValueMeasures@fca.org.uk](mailto:GAPValueMeasures@fca.org.uk).

Please share our concerns set out in this letter with key parties in your GAP distribution chain.

If you fail to respond or are unable to demonstrate that your firm's plans under C. above will ensure your GAP insurance product(s) offer fair value to customers, then we will consider using our regulatory tools to limit customer harm.

Kind regards,



**Daniel Hurl**

Head of Department – Market Analysis & Policy  
Insurance Directorate

## **Appendix 1 – Further Information on Actions**

One of the key metrics of the FCA Value Measures reporting that indicates the value of a product is claims as a percentage of written premiums. We recognise that GAP is a multi-year product, unlike many of the other products included in the Value Measures reporting. Using gross written premium rather than earned premium to calculate this metric means that less mature books of business may show an initially lower product value, as incurred claims would not yet have flowed through. Conversely, for declining/run-off books of business, this metric may suggest that a product offers better value, as claims are being presented while premiums are declining. However, our assessment for less mature books is that the impact of this is not material enough to change our concerns, and the metric will even out over time.

For the information request below, please follow the conventions set out in SUP16.27 General Insurance Value Measures reporting.

### **A. Commission, gross written premium and claims information**

Please provide the following in respect of your GAP products:

- In respect of your Value Measures data returns for 2022, the average rate of commission (expressed both as a percentage and in £ terms of the retail price paid by the customer, excluding IPT) paid to intermediaries in each of your distribution chains. Although the Value Measures data return requests information split by stand-alone and add-on products, for the purposes of this request an aggregated figure will suffice.
- In respect of your Value Measures data returns for 2022, the average rate of commission (expressed both as a percentage and in £ terms of the retail price paid by the customer, excluding IPT) paid to end retailers (e.g. motor dealerships and including Principal firms of distributor Appointed Representative networks). Although the Value Measures data return requests information split by stand-alone and add-on products, for the purposes of this request an aggregated figure will suffice.
- For the period 01 January to 30 June 2023, the average rate of commission (expressed both as a percentage and in £ terms of the retail price paid by the customer, excluding IPT) paid to intermediaries in each of your distribution chains. Although the Value Measures data return requests information split by stand-alone and add-on products for the purposes of this request an aggregated figure will suffice.
- For the period 01 January to 30 June 2023, the average rate of commission (expressed both as a percentage and in £ terms of the retail price paid by the customer, excluding IPT) paid to end retailers (e.g.

motor dealerships and including Principal firms of distributor Appointed Representative networks). Although the Value Measures data return requests information split by stand-alone and add-on products for the purposes of this request an aggregated figure will suffice.

- For the period 01 January to 30 June 2023, the highest and lowest rate of commission paid to any distributor, as a percentage of the retail price paid by the customer (excluding IPT).
- For the period 01 January to 30 June 2023, the highest and lowest rate of commission paid to end retailers (e.g. motor dealerships and including Principal firms of distributor Appointed Representative networks), as a percentage of the retail price paid by the customer (excluding IPT).
- For the period 01 January to 30 June 2023, the gross written premium for all your GAP products.
- For the period 01 January to 30 June 2023, the total amount paid in claims for all your GAP products.

***Timescale for response: Please provide this information within 7 days of the date of this letter.***

**B. Existing assessment that GAP products provide fair value to customers.**

Please provide the following evidence you have relied on to satisfy yourself that your GAP products provide fair value:

1. The initial Fair Value Assessment you conducted for the purposes of PROD 4.2 (including those provisions as applied by PROD 4.6)
2. The most recent written record of the firm's review for PROD 4.2.34R and 4.2.35AR
3. The minutes from the key committee where (1) and (2) were agreed.

Any documents you submit as part of your evidence must be in a digital format and clearly labelled.

***Timescale for response: Please provide this information within 7 days of the date of this letter.***

**C. Proposals for improving the value of your firm's GAP products**

(i) We expect a number of firms will likely need to make appropriate changes so that their GAP products will provide fair value to customers. Please provide your proposals for ensuring that your GAP products provide fair value. Please refer to our findings on [General Insurance Value Measures Data](#).

(ii) Based on your proposed changes and using the reporting conventions in our value measures reporting, for the 2024 calendar year, please provide your projected:

- Total gross retail premiums (written)
- Total policies sold
- Average percentage of premium paid in commission to parties in the distribution chain; and
- Total amount paid in claims for 2024

Please explain any assumptions made.

(iii) Your implementation timetable.

***Timescale for response: Please provide this information within 30 days of the date of this letter.***

***In the event that your plan is acceptable to us, it will need to be implemented as soon as possible and at the latest by 1 January 2024. We have set this backstop deadline as we are conscious of the potential for first mover disadvantage and therefore see benefit in the market making changes to consistent timescales.***