

# Summary of feedback received

November 2019

<b>Consultation title</b>	<b>The GI distribution chain: Proposed guidance for insurance product manufacturers and distributors GC19/2</b>
<b>Date of consultation</b>	10 April 2019
<b>Summary of feedback received</b>	<p>This document summarises the feedback we received and our response.</p> <p>We received 21 responses to GC19/2 from regulated firms, trade bodies and others. Most respondents broadly supported our proposed guidance but raised concerns and questions about specific expectations in the guidance.</p>
<b>Response to feedback received</b>	<p>In general, we plan to implement the consultation proposals as consulted on, but have made some amendments and additions based on the feedback.</p> <p>Below is our response to the feedback from firms.</p> <p>We asked specific questions in GC19/2, but the responses addressed issues more generally, so we have addressed these thematically.</p> <p>Some of the issues respondents raised related to the underlying rules rather than the guidance. We have not addressed any of these issues.</p> <p><b>Value</b></p> <p>Our proposed guidance set out our expectation that firms should consider the value of the insurance products they manufacture. This includes when they design products, determine distribution strategies and set their remuneration structures.</p> <p>All respondents agreed that the product value for the end customer was an important consideration. However, a few respondents raised concerns about our guidance on the meaning/focus of value.</p>

1. A few respondents argued that the expectation in the guidance does not come from the rules. They pointed out that there is no express reference to 'value' in PROD 4, the Insurance Distribution Directive (IDD) or our consultation papers and policy statements on implementing IDD.

**Our response:** The current rules, including those in ICOBS, PROD and SYSC, require firms to consider a range of matters in the manufacture and distribution of insurance products. For example, manufacturers will need to consider a range of issues for insurance products they manufacture. These include what the product is meant to deliver and whether the product's costs and charges are compatible with the target market's needs, objectives and characteristics. Firms throughout the distribution chain are also required to act honestly, fairly and professionally in the best interests of their customers and to ensure their remuneration does not conflict with this requirement.

We believe that when firms do not meet the obligations under our various rules, it is likely that customers are being provided with a poor value product. Therefore, the guidance does not go beyond our existing rules. It clarifies that the effect of the existing obligations, when taken together, require firms to consider the product's value to the customer. We have amended the guidance to clarify this further.

2. Some respondents also said the description of value in the guidance is too narrowly focused on price and remuneration and does not consider other important consumer outcomes (for example, product quality or additional services). Some respondents also asked us to clarify what aspects of value can be considered.

**Our response:** In GC19/2, we sought to clarify that a number of our rules together create a requirement for firms to consider value. This was the reason we specifically referenced the need for firms to consider whether the product is compatible with the objectives, interests and characteristics of the target market, as well as the product's costs and charges.

We recognise that price is not the only important indicator of value. Value being provided to the customer also involves consideration of the product's overall price and quality. Quality might include non-price benefits for the customer, such as the level of cover or services – including claims experience – they receive. We do not intend to provide a list of value factors that firms should consider, as these will vary widely across firms and products. We have clarified this in the finalised guidance.

3. A few respondents also said that, by issuing guidance for firms to consider value, the FCA is moving towards indirect price regulation.

**Our response:** We have clarified above that the guidance is not intended to focus narrowly on what price firms should be charging. The guidance is clarifying our expectations for firms about how they meet their respective obligations under our existing rules. As such, we regard this guidance as compatible with our standard regulatory approach.

### Complex distribution chains

Our proposed guidance set out an expectation for manufacturers to get information about cost and remuneration from all distributors in the chain so that they can consider the product value to the end customer.

4. Several respondents said that this guidance:

- creates expectations that go significantly beyond the current rules
- presents significant practical challenges to manufacturers
- could give rise to potential conflicts with competition law requirements, because of the risk of sensitive information being passed to competitors in the distribution chain which could lead to firms leaving the market

**Our response:** Our current rules require that manufacturers select distribution channels that are appropriate for the target market and monitor whether the distribution strategy remains appropriate. The current requirements on the review of insurance products include (PROD 4.2.38EU) that manufacturers' monitoring of the distribution chain should be reasonable, taking into consideration the characteristics and the legal framework of the respective distribution channels.

In view of this, we consider that the guidance could clarify our expectations of firms more clearly. Firms should consider what information it is necessary and reasonable to get. This does not require that firms share sensitive information where this could conflict with their legal obligations.

We have amended the guidance to clarify that:

- Firms will need to consider how the distribution strategy affects overall value based on information the manufacturers should already have or can reasonably obtain. This could include the difference between risk price and end premium or final selling price.
- Where manufacturers detect potential poor value, it is for them to consider whether and what action to take to reduce customer harm.

- It is for manufacturers to decide what information they will need to get. This may include more detailed information from other parties in the chain to decide on product value.
- When getting information, manufacturers will need to consider PROD monitoring requirements and firms' wider obligations including those under competition law.

5. A few respondents asked whether the guidance implies that the manufacturer is responsible for the distributor's actions.

**Our response:** The current rules place obligations on both manufacturers and distributors. This includes specific obligations for distributors, who remain responsible under our rules for their insurance distribution activities. Manufacturers must meet certain oversight obligations for the insurance products, including considering whether using selected insurance distribution channels continues to be appropriate based on the information they get. The proposed guidance does not change this position but clarifies our expectations based on the roles of different parties in the distribution chain.

### Competition

A number of respondents highlighted concerns about the impact of our guidance on competition in the market. We have addressed these points below.

6. Some respondents said that the expectations could lead to manufacturers setting fees for distributors or controlling the premium price. This could lead to breaches of competition law.

**Our response:** We confirm that the guidance does not require manufacturers to set the distributors fees or control premiums (for example, by putting pressure on distributors to set minimum prices). We do not expect this to be a side effect of the guidance.

7. A number of respondents said that misinterpreting or misapplying the guidance and terms such as 'value' could lead to potentially good value products being removed from the market, reducing competition.

**Our response:** Properly applied, the guidance should only lead to the removal of products where they do not offer value to the customer. This is the intended impact of the rules and this new guidance, and is unlikely to reduce competition.

### Scope

In GC19/2, we said the guidance is specifically for GI business and that it also applies to firms conducting insurance business for pure protection products.

8. Several respondents asked questions about the scope of the guidance, including:

- Whether the guidance should apply to pure protection products, Private Medical Insurance (PMI) and Legal Expenses Insurance (LEI). They argued that these products operate differently from other general insurance (GI) products and the benefits to consumers can be long term.
- Why the guidance applies to products that were not considered in the thematic review, TR19/2, which led to the guidance
- Whether the guidance only applies to products launched after 1 October 2018 (when the IDD was implemented).
- Whether the guidance should apply to large commercial customers and to non-UK business.
- Whether the guidance should allow for a 24-month transition period for firms.

**Our response:** We believe that the guidance will be relevant where the harms in TR19/2 have the potential to occur, in the sale of all GI or pure protection products. We recognise that GI products, such as PMI and LEI cover, might operate differently to the products reviewed in TR19/2, which were travel, tradesman, and GAP/motor ancillary insurance. But this difference does not make product value any less important (see section on value above). Nor does it prevent firms from considering value for these other products. The high-level nature of the guidance allows firms to apply the guidance flexibly to different products.

The proposed guidance clarifies firms' obligations under our current rules including in ICOBS (which applies to both GI and pure protection insurance products). The guidance has the same scope and application date as the underlying rules (as mapped in Annex I of the finalised guidance). The underlying rules set out their scope. This will inform where the guidance applies, which will include all GI products (including PMI and LEI) and pure protection products in scope of the underlying rules. We have amended the finalised guidance to make this clear.

The guidance stems from obligations under PROD 4. These obligations apply to all insurance products including pure protection products launched (or which have been

significantly adapted) on or after 1 October 2018. The rules also apply to products manufactured for commercial customers, except for contracts of large risks and reinsurance contracts. It also applies to activities carried on from an establishment in the UK regardless of where the product is to be distributed. The guidance relating to PROD 4 has the same application.

As the finalised guidance does not create new obligations on firms, we do not consider that a transitional period is needed.

### **Assessment of harms, impacts on firms and benefits to customers**

A number of firms raised concerns about our assessment of potential impact to firms and customers in Chapter 5 of the guidance consultation. We have addressed these below.

9. A number of respondents said that we have underestimated the costs to firms.

**Our response:** The guidance does not create new obligations for firms. It clarifies what firms should already be doing to meet their obligations under our current rules. Where firms need to amend their process to ensure compliance with our rules, they are likely to incur costs. However, we do not consider these costs are likely to be significant. The amendments to the finalised guidance are also likely to reduce costs to firms (for example, firms will only need to obtain additional information where potential poor value is detected).

10. Some respondents said the guidance could create customer harm as customers will ultimately bear the extra compliance costs for firms. Customers could also be denied access to products they need if firms decide to remove products or a particular distributor following their product review.

**Our response:** The guidance, properly applied, may lead to poor value products being adapted or removed from the market, and/or changes to distribution strategies and channels. If this happens, we do not consider customer harm is likely. We do not consider that any additional cost to customers will be significant. We believe the potential customer benefits of firms following the expectations set out in the guidance, will outweigh any potential cost-related customer harm.

### **Other feedback**

Several respondents also raised some broader issues. We have addressed these below.

11. Paragraph 4.12 of the guidance states that, unlike in other situations which create potential conflicts of interest, firms

cannot rely on disclosure as a satisfactory means of managing the conflict where a firm decides that its remuneration arrangements conflict with the customer's best interests rule. A few respondents said that, in line with the rules in SYSC 10, the guidance should permit disclosure as a potential remedy where firms identify a conflict.

**Our response:** The underlying rules to this guidance (SYSC 19F.2.2R, ICOBS 2.5.-1R and PROD 4.3.10EU as mapped in Annex I of the finalised guidance) do not allow firms to use disclosure as a means of managing conflicts in the circumstances covered by the guidance. SYSC 19F.2.2R states that insurance distributors must not be remunerated, or remunerate their employees, in a way that conflicts with their duty to comply with the customer's best interests rule. So, disclosing the conflict will not be enough to meet the relevant rules and cannot be used to mitigate the harm. Instead, we expect firms to amend their remuneration arrangements in these circumstances. The guidance merely clarifies distributors' obligations under these rules.

12. A few respondents asked for further guidance to clarify how far manufacturers are expected to go when getting remuneration information from distributors. They also wanted clarification on distributors' obligations not to withhold this information unreasonably.

**Our response:** We consider the amendments to the finalised guidance will further clarify the manufacturers' obligations under our rules. We remind firms of their obligations under PROD 4.2 and PROD 4.3 on requesting and providing information to enable the product design and distribution process. We have amended the guidance to remind distributors of their obligation under PROD to provide manufacturers with relevant sales information.

13. One respondent requested examples of good and bad distribution strategies.

**Our response:** We have not set out examples in the guidance. We would like to refer respondents to TR19/2 which gives examples of different distributions strategies.

14. One respondent requested more information on our expectations on how firms can use available data to design appropriate systems and controls to evaluate the distribution chain.

**Our response:** The guidance provides high-level information on the data firms can use. We have not given more granular guidance on this, as this is something that will vary greatly across firms.

### Changes made to the guidance as a result of feedback received

We have outlined the changes made in the relevant sections above. In summary, we have:

- Clarified the scope of the guidance.
- Clarified how the guidance on value links to existing rules.
- Explained that value includes a range of factors, including price and quality which are the focus of this guidance.
- Amended the guidance for manufacturer firms on their oversight of distribution arrangements. This includes information they should get from all distributors in the chain which may be relevant to considering value. We have also reminded manufacturers (in paragraph 3.15 of the guidance) to consider the risk of harm to customers, where the product is distributed to customers outside of the intended target market, as part of their ongoing product review process.
- Reminded distributors of their obligation to provide manufacturers with relevant sales information on request.
- Made consequential changes to other parts of the guidance to reflect the above changes.

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See the [full text](#) of the guidance consulted on

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