

Guidance consultation

The GI distribution chain: Proposed guidance for insurance product manufacturers and distributors

GC19/2

April 2019

1	Introduction	3
	Background to this guidance	3
	About this guidance	4
	Who does this guidance affect	5
	Equality and diversity considerations	5
	Compatibility statement	5
	How to respond to this consultation	6
2	Application of the guidance	7
3	Guidance on the responsibilities of insurance product manufacturers	8
	Our expectations	8
	Relevant considerations for insurance product manufacturers	9
4	Guidance on the responsibilities of insurance product distributors	12
	Our expectations	12
	Relevant considerations for insurance distributors	13
5	Assessment of harms, impacts on firms and benefits to customers	16
	Impacts on firms	17
	Benefits to customers	17
	Annex I – Mapping of this guidance to the applicable Handbook provisions	19
	Annex II – List of questions	23

1 Introduction

Background to this guidance

- 1.1 Product value in general insurance (GI) is an increasing area of concern for the FCA. Customers should expect value from the products they buy, and in [our business plan](#) we said that one of our key activities would be diagnostic work on value in the distribution chain. Our focus has been to explore to what extent the value customers receive from their insurance products is reduced by the way distribution chains operate.
- 1.2 Alongside our work on overall product value, we are conducting a separate market study into how GI firms charge their customers for home and motor insurance. This market study focuses on the fairness, impact and customer outcomes from firms' pricing practices. We aim to publish the interim market study report, where appropriate with discussion of potential remedies, in the summer.
- 1.3 Our diagnostic work on GI distribution chains was conducted during 2017 and 2018. The report setting out the findings of that work TR19/2 has been published alongside this guidance consultation. In summary, the findings are:
 - There is a potential for harm to customers arising from the product development and distribution approaches used in some sectors of the GI market.
 - Many customers paid prices which appeared significantly higher than the production and delivery costs of the products. This was due to very high levels of commission within the distribution chain.
 - Many firms did not adequately consider risks of harm to customers when developing products and their related distribution arrangements.
 - Some product manufacturers were giving control of the product design (including pricing) to other parties in the distribution chain without proper oversight and without considering the impact on the value of the product and outcomes for customers.
 - Some firms had a lack of appropriate due diligence and oversight of distribution partners. This meant they were failing to consider the suitability and ability of parties to whom authority, control or responsibility is being delegated or passed.
- 1.4 Our Principles for Businesses require firms to put in place appropriate measures to manage the risks in their business, and to treat customers fairly. In the [Responsibilities of Providers and Distributors for the Fair Treatment of Customers](#) (RPPD) Regulatory Guide we set out how these requirements applied to firms who manufacture and distribute products.

- 1.5 While we were conducting our thematic work, the Insurance Distribution Directive (IDD) was implemented in the UK through legislation and FCA rules that came into force on 1 October 2018. This included new rules:
- On product design, oversight, governance and distribution.
 - Requiring firms to act honestly, fairly and professionally in line with the best interests of the customer.
 - Prohibiting remuneration for insurance distributors and their employees that conflicts with their duty to comply with the customer's best interest rule.
- 1.6 The RPPD guidance still applies to firms in the insurance sector.
- 1.7 Because of the findings of our thematic work, and the requirements introduced by the IDD, we are consulting on non-Handbook guidance alongside the publication of our thematic report.
- 1.8 We have to consult on the proposed guidance as it forms 'general guidance', as defined in section 139B(5) of the Financial Services and Markets Act 2000 (FSMA). FSMA does not require a cost benefit analysis on guidance. However, Chapter 5 sets out a high-level assessment of the harms this guidance is intended to address and the costs to firms.

About this guidance

- 1.9 This guidance gives further clarity on our expectations of firms in the GI sector. In particular, how firms should consider the value that the product and distribution arrangements present to the customer.
- 1.10 The IDD requirements concerning product oversight and governance were implemented through the Product Intervention and Product Governance Sourcebook (PROD) Chapter 4. In addition, some requirements are directly applicable under the [IDD EU Regulation](#) on product oversight and governance and so do not require implementation (though are reproduced in PROD 4 for convenience). We have chosen to apply these requirements, as if they were FCA rules, to all authorised firms who are not subject to the directly applicable provisions but who manufacture or distribute insurance products. This guidance applies to both the requirements in the IDD EU Regulation and where we apply these requirements as if they were rules in the FCA Handbook.
- 1.11 The requirements concerning the customer's best interests and remuneration of insurance distributors are implemented through Chapter 2 of the Insurance: Conduct of Business Sourcebook (ICOBS) and Chapter 19F of the Senior Management Arrangements, Systems and Controls Sourcebook (SYSC). In Policy Statement [PS17/21](#), in response to feedback to the consultation (CP17/7), we said that we would consider issuing guidance on our expectations about certain aspects of these new requirements.

- 1.12 The guidance is intended to set out our view of how firms should consider value when complying with the requirements on the manufacture and distribution of insurance products. The key points are:
- a. All firms in the distribution chain have an obligation to act fairly, honestly and professionally in accordance with the best interests of the customer (the customer's best interests rule).
 - b. Value is an important consideration for firms when designing products, determining distribution strategies and setting their remuneration structures.
 - c. Manufacturers have an obligation to design, monitor and review products to ensure they meet the needs of the target market and prevent/mitigate customer harm. This includes considering the cost of the product to the customer, and overseeing the impact on value from the distribution chain.
 - d. With the introduction of the Senior Managers & Certification Regime, we also expect there to be clear lines of individual accountability within all firms for each of the expectations and related activities detailed in the guidance.

Who does this guidance affect

- 1.13 This guidance is relevant to all firms who manufacture or distribute GI or pure protection products.
- 1.14 Detailed comments on the application of different parts of this guidance to different types of firms in the insurance sector are set out in Chapter 2.

Equality and diversity considerations

- 1.15 We have considered the equality and diversity issues that may arise from this guidance. We do not believe that this guidance will adversely affect any of the groups with protected characteristics.
- 1.16 We will continue to consider the equality and diversity implications of this guidance during the consultation period, and will revisit them when publishing the final guidance. In the interim, we welcome any feedback to this guidance consultation on these matters.

Compatibility statement

- 1.17 Section 1B of FSMA requires the FCA to carry out its general functions, as far as is reasonably possible, in a way that is compatible with its strategic objective and advances one or more of its operational objectives. The FCA also needs to, so as far as is compatible with acting in a way that advances the consumer protection objective or the integrity objective, discharge its general functions in a way that promotes effective competition in the interests of consumers.

- 1.18 The guidance is intended to address the harm to customers resulting from not receiving value from their insurance products. This harm arises from:
- failures in product design
 - a lack of robust oversight of the distribution chain
 - poorly designed product distribution strategies
 - conflicts of interest caused by remuneration structures
- 1.19 We are satisfied that the proposed guidance is compatible with our general duties under section 1B of FSMA, in particular having regard to the matters set out in section 1C(2) FSMA and the regulatory principles in section 3B. We think that:
- it will help us to use our resources in an efficient and economic way
 - the expectations contained within it are proportionate to the benefits
 - it supports the principle of the responsibility of senior management
 - it recognises differences in the nature of, and objectives of, businesses carried on by regulated firms
 - it supports the principle that the regulators should exercise their functions as transparently as possible
- 1.20 We are satisfied that the guidance is compatible with our objectives. It advances our consumer protection objective by seeking to prevent the harm described above. It may also enhance our competition objective by reducing inappropriate incentives in remuneration structures, and by encouraging firms to compete based on the value that products offer rather than the remuneration it will pay to other firms.

How to respond to this consultation

- 1.21 The proposed guidance on which we are consulting is set out in Chapters 4 and 5. We welcome views on the questions we ask about the proposed guidance. You can find them in Annex II. Please send us your comments by **9 July 2019**.
- 1.22 Use the online response form on our website or write to us at the following address:

Joe Thompson
Strategy & Competition Division
Financial Conduct Authority
12 Endeavour Square
London
E20 1JN
Email address: gc19-02@fca.org.uk

2 Application of the guidance

2.1 This guidance will be applicable to all firms who conduct the following regulated activities:

- insurance distribution activities
- effecting or carrying out contracts of insurance
- managing the underwriting capacity of a Lloyd's syndicate as a managing agent at Lloyd's

2.2 The application of each chapter of this guidance is set out below:

- **Chapter 3 applies to firms manufacturing insurance products ('manufacturers')**¹. This will include all firms who are effecting insurance products (including Lloyd's market participants) and other firms who are involved with creating, designing or developing insurance products. This may include some intermediaries².
- **Chapter 4 applies to firms who are conducting insurance distribution activities.** This includes authorised firms and the activities of appointed representatives. The guidance will also be relevant to insurers and intermediaries' arrangements when distributing products through firms who rely on the connected contracts exclusion³.

2.3 In Annex I, we have set out a table which maps the rules relevant to each piece of this guidance.

2.4 This guidance is specifically for GI business. It is also applicable to firms conducting insurance business for pure protection products; in particular, where the firm has not elected to comply with the Conduct of Business sourcebook (COBS)⁴.

¹ Defined in relation to PROD 1.4 and 4 as creating, developing, designing and/or underwriting a contract of insurance

² For example, in the circumstances set out in PROD 1.4.4EU

³ ICOBS 2.6.1R

⁴ In accordance with ICOBS 1 Annex 1 Part 2 3.1

3 Guidance on the responsibilities of insurance product manufacturers

3.1 This chapter sets out our expectations of how manufacturers should consider the value⁵ provided by their products through their product approval and review processes, and how they should oversee their distribution arrangements.

Our expectations

3.2 Firms must put in place a product approval process, covering product design and review. As part of this process, we expect manufacturers to consider the value that the product presents for its intended customers (the target market) and how the distribution chain affects overall value. This should include consideration of:

- the benefits the product is intended to provide to the target market
- the value considerations which are relevant to the target market
- the overall cost to the end customer, including product costs and charges, and remuneration received by other parties in the distribution chain

This will enable firms to consider whether their product is compatible with the needs, objectives and characteristics of the target market and whether the distribution strategy is consistent with the identified target market. We expect firms to be able to appropriately evidence these considerations and the conclusions reached.

3.3 Where manufacturers are unable to clearly establish the value of the product to its intended customers, this is likely to indicate that:

- the product is not compatible with the objectives, interests and characteristics of customers in the intended target market; and/or
- the distribution strategy of the product is not consistent with the identified target market; and/or

⁵ By 'value' we mean the value being provided to the end customer from the product and the distribution arrangements, including as a result of remuneration structures throughout the distribution chain. Product value includes consideration of whether the product is compatible with the objectives, interests and characteristics of the target market, as well as the costs and charges of the product itself. We consider that any target market will have interests in seeing that their overall costs do not bear an unreasonable relationship to the benefits of the product and service being provided. Overall this will enable firms to identify whether what is being provided gives rise to risk of harm or adverse effect (whether actual or potential) for customers.

- the product's manufacture and/or distribution is not compliant with the customer's best interests rule

In these circumstances, we expect manufacturers to make changes to the product or the distribution strategy to prevent harm to customers.

- 3.4 Authorised firms retain full responsibility and accountability for discharging all their regulatory responsibilities. Firms cannot delegate any part of this responsibility to a third party.

Relevant considerations for insurance product manufacturers

Product design process

- 3.5 Manufacturers should use the full suite of data and information available to them to assess the value their products' offer to customers. This should include:
- Information available to the firm internally. This could include customer research, claims and complaints data.
 - Information available externally. This could include analysis of competitor products and data published as part of the FCA's work on value measures in the general insurance market.
- 3.6 When considering the value of an insurance product, manufacturers should consider the total price that the customer will pay. This includes remuneration of other parties in the distribution chain that is included in that premium, and any fees which the distributor may charge.
- 3.7 Where the manufacturer offers a 'net-rate' to another party in the chain⁶, they should ensure they receive all relevant information on the remuneration of other parties in the chain, and the final selling price⁷. This is to enable them to consider how the distribution strategy affects overall value to the customer, given the final price that the customer will pay.

⁶ By 'net rate' we mean a situation where the manufacturer offers the product to another party in the chain for a certain price, but allows others to determine the final selling price (thereby determining their own remuneration).

⁷ By 'final selling price' we mean the total price the customer pays in relation to insurance product. This includes all remuneration received by firms in the distribution chain and paid for by the customer (either directly or indirectly).

- 3.8 A difference between risk premium and the final selling price that bears no reasonable relationship to the benefits or services provided by firms in the distribution chain, can indicate that the level of value that product is offering is causing harm to customers. In this case the product or distribution strategy may need to be changed. This is regardless of whether the differential results from a single firm in the distribution chain receiving the remuneration in question, or if it is split between multiple firms in the distribution arrangement.

For example, TR19/2 highlighted an example of a travel insurance product sold by a coach tour operator where the operator's remuneration made up approximately 73% of the final selling price paid by its customers. The operator was given a net-rate by the managing general agent who managed the product on behalf of the insurer.

Product distribution strategy

- 3.9 Manufacturers should clearly understand the role of each of the parties in the distribution chain. This should include the benefits provided to the customer by the involvement of that distributor, and how much each takes in remuneration. As part of ensuring that the distribution strategy is appropriate and that conflicts of interest are managed properly, manufacturers should consider whether remuneration structures could result in the product providing a level of value that results in harm to customers. For example, this could include situations where a distributor's remuneration bears an unreasonable relationship to the benefits their services provide to the customer or the role they provide in the distribution chain.
- 3.10 If a manufacturer delegates activities to other parties within the distribution chain, including to firms who are not regulated, they must have adequate systems and controls to ensure that these activities are delivered in line with the manufacturer's obligations. This should include having appropriate ongoing management information and processes to monitor the value provided by the product, to ensure that the product performs in a way that is compatible with the needs, objectives and characteristics of the intended customers.

Product review process

- 3.11 As part of their ongoing product reviews, manufacturers should ensure that they have sufficient, good quality management information to enable them to consider the value provided by the product and the impact the distribution chain has on this.
- 3.12 Manufacturers must respond appropriately when the ongoing product review process indicates a risk of harm to customers. This includes the risk of harm where products are no longer providing the intended value. Manufacturers must have processes in place for taking corrective action where products are detrimental to customers, including appropriate mitigation and remediation of the harm. This may require changes to the product, the target market, the distribution strategy or the remuneration structures for

which it is responsible. Ultimately, in some situations it may require withdrawing the product from the market, or significantly changing the distribution method.

Q1. Do you have any comments on the guidance for manufacturers?

4 Guidance on the responsibilities of insurance product distributors

- 4.1 This chapter sets out our expectations of how distributors should consider the impact their processes have on the value the customer receives from the products they offer. It sets out important considerations for firms when complying with the requirement not to be remunerated in a way that conflicts with the customer's best interests.

Our expectations

- 4.2 We expect firms to consider the impact that their distribution strategy has on the overall value of the product to the customer. Firms must ensure that the remuneration they receive for their insurance distribution activity does not conflict with their duty to comply with the customer's best interests rule.
- 4.3 We expect distributors to monitor the products they offer, and their distribution arrangements, on an ongoing basis. This enables them to act if they identify situations where the product is not providing the intended value to customers, resulting in customer harm. This includes situations where they become aware that the level of remuneration they are receiving is not in the customer's best interest, because of its impact on the value of a product.
- 4.4 We expect distributors to be well placed to identify initial signs of a product resulting in customer harm because of the value it is providing. For example, this could be:
- through their direct interactions with customers
 - through their assessments of customers' demands and needs
 - by referencing the data published as part of the FCA's work on value measures in general insurance
 - through analysis of claims or complaints
- 4.5 When distributors identify that the product is resulting in customer harm, they should inform the manufacturer and, if necessary, amend the way they distribute the product. This might include stopping the use of a particular distribution method (for example, through aggregators), reducing the amount of remuneration they receive or ceasing to distribute the product entirely.
- 4.6 Authorised firms retain full responsibility and accountability for discharging all their regulatory responsibilities. Firms cannot delegate any part of this responsibility to a third party.

Relevant considerations for insurance distributors

Remuneration

- 4.7 Distributors should be aware that the definition of 'remuneration' is very broad and includes revenue from commission, profit share agreements, fees and all other economic or non-economic benefits received as part of the distribution of an insurance product.
- 4.8 Remuneration that could conflict with the customer's best interests rule includes:
- Remuneration which incentivises the firm to offer a product which is not consistent with the customer's demands and needs.
 - Remuneration which incentivises the firm to offer a product due to the remuneration being inconsistent with or not bearing a reasonable relationship to the costs of the benefits/services that the distributor provides to the customer.
- 4.9 While the product may provide benefits to the customer, the level of distributors' remuneration may mean the product fails to provide the intended value identified in the product approval process. This would mean that distributing the product would conflict with the customer's best interests rule. This could be the case regardless of whether the remuneration is included in the total premium or is paid separately by the customer. Examples of situations where firms should be particularly vigilant are:
- **A distributor receiving a level of remuneration which bears no reasonable relationship to their costs or workload to distribute the product.** This imbalance between remuneration and cost/effort could incentivise the firm to sell a product which does not provide value to the customer.
 - **A distributor receiving significant remuneration, but where their involvement in the distribution chain provides little or no benefit beyond that which the customer would receive from the product anyway.** This imbalance could indicate that the customer is being charged for a service that provides little benefit.
 - **A distributor receiving remuneration which incentivises them to propose or recommend a product which either does not meet the customer's needs, or does not meet them as well as another product would do.**
 - **A distributor receives a net rate from the product manufacturer, and is able to set their own remuneration by determining the final selling price themselves.** Where a firm can, in effect, set their own remuneration level, this could incentivise the firm to set it at a level which means the product does not provide value to the customer. A difference between net premium and the final selling price which bears no reasonable relationship to the benefits or services provided by firms in

the distribution chain can indicate that the product value is causing harm to the customer.

For example, TR19/2 found multiple examples of products such as GAP and 'scratch and dent' insurance sold as add-ons by motor vehicle retailers who received a very substantial commission. However, the customer received no additional benefit from buying the product through the retailer rather than directly from an insurer or specialist insurance intermediary where prices were lower.

The example referenced in paragraph 3.8 above is likely to be relevant.

- 4.10 Some insurance distributors may only offer a single product, or a range of products from a single provider. The points above are also relevant to these firms, as it may be that their remuneration incentivises them to sell a product when it would be better for the customer not to buy any product (or not buy a product offered by that firm).
- 4.11 Distributors should ensure that they understand the product manufacturer's assessment of the value the product should provide.
- 4.12 If, after considering the factors set out in this guidance, a firm concludes that its remuneration arrangements conflict with their duty to act in accordance with the customer's best interests rule, then we expect the firm to amend its remuneration arrangements. Unlike other situations which give rise to potential conflicts of interest identified in relation to insurance distribution activities (such as conflicts of interest covered by SYSC 10), disclosure cannot be relied on as a satisfactory means of managing the conflict or as a measure of last resort in this area.
- 4.13 Our expectations apply to fees paid directly by the customer to the distributor. Distributors should be particularly mindful of fees which may become payable after the customer is 'tied in' to a contract (such as administration fees for mid-term adjustments). Where a distributor charges different levels of fee to different customers, the firm will need to ensure that the method for determining those fees is fair and in line with the customer's best interests rule. TR19/2 found that firms are often not able to demonstrate or evidence how the fees being charged can be explained and rationalised in the context of relevant costs.

Distribution process

- 4.14 Firms must regularly review their distribution processes to ensure that they are in line with the intended target market of the product, and that they are not adversely affecting customers. This should include considering whether their distribution processes risk customer harm. For example, where the product could reach customers outside of the identified target market or to whom it does not provide value. Firms should ensure that they have sufficient, good quality management information to enable them to understand the value provided by the distribution process.

- 4.15 If a distributor delegates activities to other parties within the distribution chain, including to firms who are not FCA authorised (such as retail brands), they must have adequate systems and controls to ensure that these activities are delivered in line with the needs and objectives of the customer. This should include ensuring they have appropriate ongoing management information and processes in place to monitor and assess customer outcomes.

Q2. Do you have any comments on the guidance for insurance product distributors?

5 Assessment of harms, impacts on firms and benefits to customers

- 5.1 As we stated in Chapter 1, we are not required to publish a cost benefit analysis when we consult on general guidance. However, to ensure firms are clear on its purpose, we have set out below a high-level assessment of the harm this guidance intends to address and the benefits customers will receive from firms following it. We do not consider it reasonably practical to quantify either the costs to firms or the benefits to customers.
- 5.2 This guidance is published alongside TR19/2, which details the harms identified in our reviews of GI distribution chains. These are summarised in paragraph 1.3 above.
- 5.3 The principle that underpins this guidance is that it is not in a customer's best interests to be offered an insurance product that does not provide value. Such products being made available in the market may lead to a number of harms to customers:
- Firms may develop and market products which deliver little benefit to customers, due to failures in their product design and approval processes.
 - Customers may purchase products that are less appropriate for them due to firms' failures to properly identify a product not offering value. For example, where the value of the product for a particular cohort of customers is not established as part of the target market identification, or where the firm selects a distribution strategy which leads to the product being offered to inappropriate customers.
 - Firms may fail to identify products not providing value to customers, and fail to take appropriate remedial action due to failures in their product review processes.
 - Customers may pay substantially more for a product which delivers no additional benefits compared to alternative, less expensive products available in the market. This could be due to a failure of the firm to distribute the product to the correct target market or due to conflicts of interest in the firms' remuneration structures incentivising it to sell products which do not offer value to customers.
 - Remuneration structures may lead to customers paying increased prices because of remuneration that is paid to firms in the distribution chain who incur little cost or deliver little benefit to customers.
- 5.4 We believe that firms which follow this guidance are less likely to manufacture or distribute products which do not provide value to customers, and are more likely to be acting in their customers' best interests.

Impacts on firms

5.5 Firms must adhere to our rules, and to directly applicable EU regulations. While this guidance is not binding on firms, we believe that firms will be more likely to be able to evidence compliance with our rules if they follow this guidance. Where firms follow the guidance, we believe there may be increased costs to them.

One-off costs

- 5.6 We believe that the one-off costs incurred by firms are likely to be in the following areas:
- Familiarisation and training costs – unless firms are already adhering to the expectations in this guidance, there are likely to be costs in familiarising themselves with the guidance and with training relevant members of staff.
 - Changes to processes – adhering to this guidance in the future may require firms to amend their existing processes for product design and review. This could include changes to documentation and to IT systems used as part of the review process (such as those that generate or analyse management information).

Ongoing costs

- 5.7 We believe that firms adhering to this guidance in the future may incur some ongoing costs resulting from changes to their product review and oversight processes. This could include:
- Costs from increased time and resource requirements where additional considerations are included within the firm's review processes.
 - Costs from increases to the management information being requested by product manufacturers and distributors. This could create additional costs for both the firm producing the information and the firm receiving it.

However, we consider that these costs are likely to be minimal once the new processes have been implemented.

- 5.8 Where firms' product review processes identify issues, there are likely to be costs incurred in mitigating the harms to customers. These could range from minimal costs (where only minor changes are required) to more significant costs (where, for example, a product has to be withdrawn or a distribution firm removed from the distribution chain).
- 5.9 We believe that following this guidance will lead firms to re-assess their remuneration structures. This could lead to a reduction in the remuneration firms receive.

Benefits to customers

- 5.10 We consider that the benefits to customers are likely to derive from many of the same changes which give rise to the ongoing costs to firms.

5.11 We believe that firms following our guidance will have significantly improved product design, approval and review processes. This is likely to lead to the following benefits for customers:

- Better targeting of products to only the cohort of customers who may benefit from them, through firms considering product value as part of their assessment of the target market. This should reduce the risk of customers being offered inappropriate products.
- The removal from the market of products that do not offer value to the customer.
- Better oversight of the distribution chain will lead to firms taking swifter and more substantial action to rectify issues leading to customer harm. In particular, we believe that greater oversight and monitoring by product manufacturers offering net rates to firms in the distribution chain will lead to a reduced incentive for firms to receive remuneration that is disproportionate to the benefits they add or the costs they incur. This should lead to reduced prices for customers.

5.12 Following our thematic work, we anticipate that some products may require significant changes to remuneration structures and pricing models. In these cases, customers are likely to receive a benefit from:

- Reduced prices due to a reduction in the remuneration paid to firms in the distribution chain.
- An increased likelihood that the products offered to customers will align to their demands and needs and represent good value to them, due to the reduced incentive on firms to offer inappropriate products.
- An increase in the quality of the products due to the reduced incentive for firms to compete based on the remuneration they pay to the distributor rather than the quality of product.

Q3. Do you have any comments on our assessment of the impacts on firms and benefits for customers arising from this guidance? In particular, are there any costs to firms which you believe we have not identified? Although not required, it would be useful if you could provide an estimate of these costs in your response.

Annex I – Mapping of this guidance to the applicable Handbook provisions

Guidance	Applicable provisions
For insurance product manufacturers	
<p>Firms must put in place a product approval process, covering product design and review. As part of this process, we expect manufacturers to consider the value that the product presents for its intended customers (the target market) and how the distribution chain affects overall value. This should include consideration of:</p> <ul style="list-style-type: none"> the benefits the product is intended to provide to the target market the value considerations which are relevant to the target market, and the overall cost to the end customer, including product costs and charges, and remuneration received by other parties in the distribution chain. <p>This will enable firms to consider whether their product is compatible with the needs, objectives and characteristics of the target market and whether the distribution strategy is consistent with the identified target market. We expect firms to be able to appropriately evidence these considerations and the conclusions reached.</p>	<p>ICOB5 2.5.-1R PROD 4.2.5EU PROD 4.2.7EU PROD 4.2.8EU PROD 4.2.15R PROD 4.2.18EU PROD 4.2.22EU PROD 4.2.24EU PROD 4.2.25R</p>
<p>Where manufacturers are unable to clearly establish the value of the product to its intended customers, this is likely to indicate that:</p> <ul style="list-style-type: none"> the product is not compatible with the objectives, interests and characteristics of customers in the intended target market; and/or the distribution strategy of the product is not consistent with the identified target market; and/or the product’s manufacture and/or distribution is not compliant with the customer’s best interests rule. <p>In these circumstances, we expect manufacturers to make changes to the product or the distribution strategy to prevent harm to customers.</p>	<p>ICOB5 2.5.-1R PROD 4.2.8EU PROD 4.2.15R PROD 4.2.18EU PROD 4.2.22EU PROD 4.2.24EU PROD 4.2.25R PROD 4.2.26G</p>
<p>Manufacturers should use the full suite of data and information available to them to assess the value their products’ offer to customers. This should include:</p> <ul style="list-style-type: none"> Information available to the firm internally. This could include customer research, claims and complaints data. Information available externally. This could include analysis of competitor products and data published as part of the FCA’s work on value measures in the general insurance market. 	<p>SYSC 3.1.1R SYSC 3.2.6R ICOB5 2.5.-1R PROD 4.2.5EU PROD 4.2.8EU PROD 4.2.15R PROD 4.2.18EU PROD 4.2.22EU PROD 4.2.34R PROD 4.2.35EU</p>
<p>When considering the value of an insurance product, manufacturers should consider the total price that the customer will pay. This includes remuneration of other parties in the distribution chain that is included in that premium, and any fees which the distributor may charge.</p>	<p>PROD 4.2.5EU PROD 4.2.8EU PROD 4.2.15R PROD 4.2.18EU PROD 4.2.22EU PROD 4.2.24EU</p>

	<p>PROD 4.2.25R PROD 4.2.27EU</p>
<p>Where the manufacturer offers a 'net-rate' to another party in the chain, they should ensure they receive all relevant information on the remuneration of other parties in the chain, and the final selling price. This is to enable them to consider how the distribution strategy affects overall value to the customer, given the final price that the customer will pay.</p>	<p>PROD 4.2.5EU PROD 4.2.8EU PROD 4.2.25R PROD 4.2.34R PROD 4.2.35EU</p>
<p>A difference between risk premium and the final selling price that bears no reasonable relationship to the benefits or services provided by firms in the distribution chain, can indicate that the level of value that product is offering is causing harm to customers. In this case the product or distribution strategy may need to be changed. This is regardless of whether the differential results from a single firm in the distribution chain receiving the remuneration in question, or if it is split between multiple firms in the distribution arrangement.</p>	<p>ICOB5 2.5.-1R PROD 4.2.5EU PROD 4.2.8EU PROD 4.2.18EU PROD 4.2.25R</p>
<p>Manufacturers should clearly understand the role of each of the parties in the distribution chain. This should include the benefits provided to the customer by the involvement of that distributor, and how much each takes in remuneration. As part of ensuring that the distribution strategy is appropriate and that conflicts of interest are managed properly, manufacturers should consider whether remuneration structures could result in the product providing a level of value that results in harm to customers. For example, this could include situations where a distributor's remuneration bears an unreasonable relationship to the benefits their services provide to the customer or the role they provide in the distribution chain.</p>	<p>SYSC 3.1.1R SYSC 19F.2.2R ICOB5 2.5.-1R PROD 4.2.8EU PROD 4.2.27EU</p>
<p>If a manufacturer delegates activities to other parties within the distribution chain, including to firms who are not regulated, they must have adequate systems and controls to ensure that these activities are delivered in line with the manufacturer's obligations. This should include having appropriate ongoing management information and processes to monitor the value provided by the product, to ensure that the product performs in a way that is compatible with the needs, objectives and characteristics of the intended customers.</p>	<p>SYSC 3.1.1R SYSC 4.1.1R PROD 4.2.11EU PROD 4.2.27EU PROD 4.2.38EU</p>
<p>As part of their ongoing product reviews, manufacturers should ensure that they have sufficient, good quality management information to enable them to consider the value provided by the product and the impact the distribution chain has on this.</p>	<p>SYSC 3.1.1R SYSC 4.1.1R PROD 4.2.33R PROD 4.2.34EU PROD 4.2.35EU PROD 4.2.36EU PROD 4.2.37EU PROD 4.2.38EU</p>
<p>Manufacturers must respond appropriately when the ongoing product review process indicates a risk of harm to customers. This includes the risk of harm where products are no longer providing the intended value. Manufacturers must have processes in place for taking corrective action where products are detrimental to customers, including appropriate mitigation and remediation of the harm. This may require changes to the product, the target market, the distribution strategy or the remuneration structures for which it is responsible. Ultimately, in some situations it may require withdrawing the product from the market, or significantly changing the distribution method.</p>	<p>SYSC 3.1.1R SYSC 4.1.1R ICOB5 2.5.-1R PROD 4.2.5EU, PROD 4.2.37EU, PROD 4.2.38EU, PROD 4.2.39EU, PROD 4.3.11EU, PROD 4.3.12G</p>
<p>For insurance product distributors</p>	
<p>We expect firms to consider the impact that their distribution strategy has on the overall value of the product to the customer. Firms must ensure that the remuneration they receive for their insurance distribution activity does not conflict with their duty to comply with the customer's best interests rule.</p>	<p>SYSC 10.1.3R SYSC 10.1.7R SYSC 19F.2.2R ICOB5 2.5.-1R PROD 4.3.6EU PROD 4.3.8EU PROD 4.3.10EU</p>

	<p>PROD 4.3.11EU PROD 4.3.12G</p>
<p>We expect distributors to monitor the products they offer, and their distribution arrangements, on an ongoing basis. This enables them to act if they identify situations where the product is not providing the intended value to customers, resulting in customer harm. This includes situations where they become aware that the level of remuneration they are receiving is not in the customer’s best interest, because of its impact on the value of a product.</p> <p>We expect distributors to be well placed to identify initial signs of a product resulting in customer harm because of the value it is providing. For example, this could be:</p> <ul style="list-style-type: none"> • through their direct interactions with customers • through their assessments of customers’ demands and needs • by referencing the data published as part of the FCA’s work on value measures in general insurance • through analysis of claims or complaints. 	<p>SYSC 19F.2.2R ICOB 2.5.-1R PROD 4.3.10EU PROD 4.3.11EU PROD 4.3.12G PROD 4.3.13EU</p>
<p>When distributors identify that the product is resulting in customer harm, they should inform the manufacturer and, if necessary, amend the way they distribute the product. This might include stopping the use of a particular distribution method (for example, through aggregators), reducing the amount of remuneration they receive or ceasing to distribute the product entirely.</p>	<p>SYSC 4.1.1R ICOB 2.5.-1R PROD 4.3.10EU PROD 4.3.11EU PROD 4.3.12G PROD 4.3.13EU</p>
<p>Distributors should be aware that the definition of ‘remuneration’ is very broad and includes revenue from commission, profit share agreements, fees and all other economic or non-economic benefits received as part of the distribution of an insurance product.</p>	<p>Handbook Glossary</p>
<p>Remuneration that could conflict with the customer’s best interests rule includes:</p> <ul style="list-style-type: none"> • Remuneration which incentivises the firm to offer a product which is not consistent with the customer’s demands and needs. • Remuneration which incentivises the firm to offer a product due to the remuneration being inconsistent with or not bearing a reasonable relationship to the costs of the benefits/services that the distributor provides to the customer. 	<p>SYSC 19F.2.2R ICOB 2.5.-1R</p>
<p>While the product may provide benefits to the customer, the level of distributors’ remuneration may mean the product fails to provide the intended value identified in the product approval process. This would mean that distributing the product would conflict with the customer’s best interests rule. This could be the case regardless of whether the remuneration is included in the total premium or is paid separately by the customer. Examples of situations where firms should be particularly vigilant are:</p> <ul style="list-style-type: none"> • A distributor receiving a level of remuneration which bears no reasonable relationship to their costs or workload to distribute the product. This imbalance between remuneration and cost/effort could incentivise the firm to sell a product which does not provide value to the customer. • A distributor receiving significant remuneration, but where their involvement in the distribution chain provides little or no benefit beyond that which the customer would receive from the product anyway. This imbalance could indicate that the customer is being charged for a service that provides little benefit. • A distributor receiving remuneration which incentivises them to propose or recommend a product which either does not meet the customer’s needs, or does not meet them as well as another product would do. 	<p>SYSC 10.1.3R SYSC 10.1.4R SYSC 10.1.4BR SYSC 10.1.4CR SYSC 19F.2.2R ICOB 2.5.-1R PROD 4.3.6EU</p>

<ul style="list-style-type: none"> A distributor receives a net rate from the product manufacturer, and is able to set their own remuneration by determining the final selling price themselves. Where a firm can, in effect, set their own remuneration level, this could incentivise the firm to set it at a level which means the product does not provide value to the customer. A difference between net premium and the final selling price which bears no reasonable relationship to the benefits or services provided by firms in the distribution chain can indicate that the product value is causing harm to the customer. 	
Some insurance distributors may only offer a single product, or a range of products from a single provider. The points above are also relevant to these firms, as it may be that their remuneration incentivises them to sell a product when it would be better for the customer not to buy any product (or not buy a product offered by that firm).	SYSC 19F.2.2R ICOB 2.5.-1R PROD 4.3.6EU
Distributors should ensure that they understand the product manufacturer's assessment of the value the product should provide.	PROD 4.3.2R PROD 4.3.3R PROD 4.3.5EU
If, after considering the factors set out in this guidance, a firm concludes that its remuneration arrangements conflict with their duty to act in accordance with the customer's best interests rule, then we expect the firm to amend its remuneration arrangements. Unlike other situations which give rise to potential conflicts of interest identified in relation to insurance distribution activities (such as conflicts of interest covered by SYSC 10), disclosure cannot be relied on as a satisfactory means of managing the conflict or as a measure of last resort in this area.	SYSC 19F.2.2R ICOB 2.5.-1R PROD 4.3.10EU
Our expectations apply to fees paid directly by the customer to the distributor. Distributors should be particularly mindful of fees which may become payable after the customer is 'tied in' to a contract (such as administration fees for mid-term adjustments). Where a distributor charges different levels of fee to different customers, the firm will need to ensure that the method for determining those fees is fair and in line with the customer's best interests rule. TR19/2 found that firms are often not able to demonstrate or evidence how the fees being charged can be explained and rationalised in the context of relevant costs.	SYSC 19F.2.2R ICOB 2.5.-1R
Firms must regularly review their distribution processes to ensure that they are in line with the intended target market of the product, and that they are not adversely affecting customers. This should include considering whether their distribution processes risk customer harm. For example, where the product could reach customers outside of the identified target market or to whom it does not provide value. Firms should ensure that they have sufficient, good quality management information to enable them to understand the value provided by the distribution process.	SYSC 4.1.1R SYSC 19F.2.2R ICOB 2.5.-1R PROD 4.3.10EU PROD 4.3.11EU PROD 4.3.12G
If a distributor delegates activities to other parties within the distribution chain, including to firms who are not FCA authorised (such as retail brands), they must have adequate systems and controls to ensure that these activities are delivered in line with the needs and objectives of the customer. This should include ensuring they have appropriate ongoing management information and processes in place to monitor and assess customer outcomes.	SYSC 4.1.1R ICOB 2.5.3G PROD 4.3.6EU PROD 4.3.8EU PROD 4.3.10EU
For all firms	
Authorised firms retain full responsibility and accountability for discharging all their regulatory responsibilities. Firms cannot delegate any part of this responsibility to a third party.	SYSC 3.1.1R SYSC 4.1.1R SYSC 8.1.6R

Annex II – List of questions

- Q1. Do you have any comments on the guidance for insurance product manufacturers?**
- Q2. Do you have any comments on the guidance for insurance product distributors?**
- Q3. Do you have any comments on our assessment of the impacts on firms and benefits for customers arising from this guidance? In particular, are there any costs to firms which you believe we have not identified? Although not required, it would be useful if you could provide an estimate of these costs in your response.**