FINANCIAL CONDUCT AUTHORITY

Annex 2

Pure protection market study: fair value assessments – positive examples and areas for improvement

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Chapter 1

Introduction

1.1 We reviewed a sample of insurers' and intermediaries' fair value assessments submitted as part of the pure protection market study to understand how firms are meeting their obligations. In particular, we examined remuneration arrangements as part of firms' fair value assessments, and the assessment of target market value for guaranteed acceptance over 50s products.

1.2 To help firms learn from what we have observed, in this Annex we describe positive examples of firms' practices to illustrate ways for firms to meet their obligations and support good consumer outcomes. We also include areas for improvement, that highlight where firms may be able to strengthen their approach.

1.3 The examples are not intended to be prescriptive, they are provided to help firms learn from each other and create improvements across the market. They do not create new regulatory guidance or requirements.

1.4 However, firms should carefully consider the examples set out in this publication, assess how their current practices align with the intended consumer outcomes under PROD 4, and identify any scope for improvements. We may also consider targeted supervisory engagement if we're concerned about specific firms' performance.

Chapter 2

Pricing and commissions

2.1 Pricing and remuneration arrangements are central to whether pure protection products provide fair value for customers. In this Chapter, we set out positive examples of how firms assessed the relationship between price, commission, distribution costs and product value. We also identify areas where firms could do more to show that remuneration structures are justified by the services provided and do not undermine customer outcomes.

How manufacturers assess the relationship between the total price paid by customers and the value provided

Positive examples of firms' practices

2.2 Some firms demonstrated a clear understanding of the relationship between total price paid by customers and the quality of the product and services provided. These firms used a combination of qualitative and quantitative information to assess fair value, including analysis across customer cohorts, distribution channels and pricing variations. They assessed whether commissions, premium loading and other fees within the distribution chain were consistent with providing fair value and did not adversely affect the product's intended value.

2.3 For example, some firms analysed the total price, individual price components (including metrics related to distribution) and/or other measures of value for different customer cohorts, such as those based on product, personal characteristics and distribution channels. We saw examples of firms analysing outcomes by distribution arrangement, individual distributor or comparing different remuneration structures to determine whether they were associated with differences in customer outcomes or service. Where value metrics appeared weaker, firms undertook further investigation to understand the drivers of those outcomes.

Areas where we've identified opportunities for improvement

2.4 We identified instances where firms could provide greater clarity on how they assessed whether the expected total price paid by the customer, including remuneration and other distribution costs, was reasonable relative to the quality of the product and services provided, and therefore consistent with the product delivering fair value. For example, some firms could strengthen the rationale provided for any thresholds or tolerance limits applied to customer value metrics.

How manufacturers assess the impact of distribution on product value

Positive examples of firms' practices

2.5 Some manufacturers assessed whether distribution arrangements supported the intended value of the product by evaluating remuneration across different distributors and channels, and identifying where particular arrangements or distributors had weaker value metrics and what caused these.

2.6 In some cases, firms had governance processes in place to evaluate the impact of changes to remuneration on value, with additional approval requirements for non-standard arrangements. For example, they considered cancellation and lapse rates alongside information about distributors' business models, sales processes, business quality and customer outcomes to assess whether additional remuneration was justified by better service. Some firms also monitored the level and number of non-standard arrangements in their distribution mix.

2.7 We also saw examples of firms taking action where distribution arrangements adversely affected the value provided to customers, such as adjusting premiums, reviewing remuneration structures or terminating relationships with distributors where the value delivered did not justify remuneration.

Areas where we've identified opportunities for improvement

2.8 There are opportunities for firms to strengthen how they evidence the impact of remuneration and other distribution costs in their fair value assessments. In some cases, although firms considered the reasons for non-standard arrangements, they could give more clarity on how they considered commissions, premium loading and additional distributor fees in relation to the total price paid by customers and the product's intended value.

How distributors assess the value of their remuneration

Positive examples of firms' practices

2.9 Some distributors used a combination of quantitative metrics and qualitative information to evidence that the commissions received were aligned with the cost of distribution and level of service. This included demonstrating how remuneration reflected the nature, extent and value of their services. For example, one distributor analysed remuneration and distribution costs by marketing channel and insurer, explaining how different channel costs supported differences in commission.

2.10 We also saw distributors seeking to show that enhanced commissions were justified by additional services or improved customer outcomes. In these cases, firms were able to show how higher remuneration related to measurable differences in service quality or customer experience. For example, one firm used measures including cancellations shortly after sale and the proportion of policies placed in trust to support its assessment of service quality.

Areas where we've identified opportunities for improvement

2.11 We identified instances where distributors could be clearer about the relationship between remuneration and the services they provide. Some gave high-level descriptions of their distribution services, with limited evidence of how remuneration related to the costs incurred or the nature, extent and benefits of the services they provided.

2.12 Some distributors could better assess and evidence the appropriateness of commission levels in the context of the services provided. In some cases, firms could provide greater clarity on how they considered specific remuneration structures or distribution arrangements as part of their assessment of customer outcomes and fair value.

Chapter 3

Guaranteed acceptance over 50s

3.1 Guaranteed acceptance over 50s products can meet specific customer needs, but firms need to be clear about the customers these products are designed for and how the product delivers value for them. In this Chapter, we highlight positive examples and areas for improvement across target market definition, information sharing with distributors and monitoring of distribution arrangements.

Benefits of the product for the target market

Positive examples of firms' practices

3.2 Some firms defined their product's target market in detail, explaining how the characteristics and needs of specific customer segments aligned with the product's design and the value it offered. We saw examples using consumer classifications based on a range of factors, including financial behaviour, financial product purchases and holdings, and channel preferences to define its target market.

3.3 Some firms linked characteristics of vulnerability within their target market to the product's design to explain how it delivers value for these customers. We saw examples of firms using management information to review the characteristics of vulnerability expected in the target market against actual identification rates. This informed changes that would ensure the product's design meets the needs of these customers.

Areas where we've identified opportunities for improvement

3.4 We identified opportunities for firms to strengthen the evidence supporting their target market assessments. In some cases, they could link target markets more directly to consumers' needs and financial objectives. For example, some firms used research relating to all financial services customers rather than evidence specific to their target market.

Sharing of information with distributors

Positive examples of firms' practices

3.5 Some firms set out in detail the information they shared with distributors and its relevance for understanding the product and its target market. For example, communicating which customers the product would and would not suit or provide fair value for. We also saw insurers maintaining regular dialogue with distributors, with agreed schedules for engagement and information sharing.

Areas where we've identified opportunities for improvement

3.6 We identified opportunities for firms to provide more detail on the information shared with distributors and how it helps distributors understand the product and its target market. For example, although some firms explained how information is shared between insurers and distributors, they could do more by clarifying exactly what information was shared and its relevance for the distributor's understanding of the product's target market.

Monitoring of distribution arrangements

Positive examples of firms' practices

3.7 Some firms detailed their arrangements for overseeing product distribution to the target market, such as product-specific management information, the frequency of their monitoring, and why this helped identify sales outside the defined target market. Some firms highlighted lapse rates and root cause analysis of customer complaints as key components of their monitoring.

3.8 We also saw examples of firms taking action in response to their ongoing monitoring to address distribution to customers outside of the stated target market, working with distributors to amend marketing or sales processes in response to trends in consumer outcomes.

Areas where we've identified opportunities for improvement

3.9 We identified opportunities for firms to provide greater detail on their monitoring arrangements and how they oversee distributors' adherence to the target market. For example, some could enhance their assessment by explaining the metrics used to monitor sales outside the target market, their methodology for setting criteria, and thresholds for identifying and escalating potential concerns.

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