Annex 2

Value of pure protection

January 2026

Contents

Chapter 1

Introduction

1.1 In this annex, we consider the value of protection products in more detail. We also discuss how firms assess the fair value of pure protection at different points in the distribution chain.

1.2 We begin with a more detailed look at the claims ratios, margins and consumer understanding of income protection. We then look in more detail at guaranteed acceptance over 50s.

1.3 The final chapter briefly summarises firms' fair value requirements (under the Product Intervention and Product Governance Sourcebook rules), and how these apply to the pure protection market. We then describe the evidence we saw on firms' approach to fair value assessments.

1.4 We have used several data sources including firm financial information, firms' data on premiums and commissions and qualitative information provided by firms in response to our Request for Information.

Chapter 2

Income protection

2.1 As noted in *MS24/1.3 Structure of the UK pure protection market for retail customers*, income protection typically covers a percentage of the policyholder's monthly income and continues to pay out based on a specified maximum term or until the policyholder reaches their selected retirement age, recovers, or passes away (whichever comes first). These policies typically include an initial waiting period (also known as a 'deferred period') which is the time between when the policyholder becomes unable to work and when the income protection payments begin.

2.2 The interim report highlights income protection as having the lowest claims ratio and second highest net cashflow margin of pure protection products – see Figure 4.3 in the Interim Report. We look into the reasons for these findings in more detail in this chapter.

Product complexity contributes to differences in claims ratios between income protection and other pure protection products

2.3 Insurers have highlighted a number of factors that contribute to differences in value between income protection and other pure protection products. These include:

- Income protection, like critical illness, has a more complex underwriting criteria relative to some other protection products, reflecting the additional risk of assessing morbidity risk compared to mortality risk.[1] Specific to income protection, firms must assess both the likelihood of a claim and the likelihood of recovery, reflecting higher volatility of claims compared to other products. Firms also noted that the relative immaturity of certain income protection product offerings meant they had relatively less experience and data to model expected claims.
- Income protection involves additional complexity in underwriting due to rating factors (eg occupation class) and product options (eg varying deferred and payment periods) which do not apply for other pure protection products.
- Claims handling costs are higher for income protection as payouts are ongoing compared to the lump sum payout for other pure protection products, meaning there are additional costs associated with managing (including periodic reassessments) and paying claims for an extended period.
- Income protection typically includes the provision of rehabilitation services to assist customers in their recovery and return to work. Use of these services may therefore result in some customers returning within the deferred period, or relatively quickly while claims are being paid. Similarly, health and wellbeing services are offered to support the prevention of a customer needing to claim.

1 While the underwriting of critical illness products are also reliant on morbidity assumptions, the associated risk profile is lower than income protection given that mortality assumptions also underpin the product's cover.

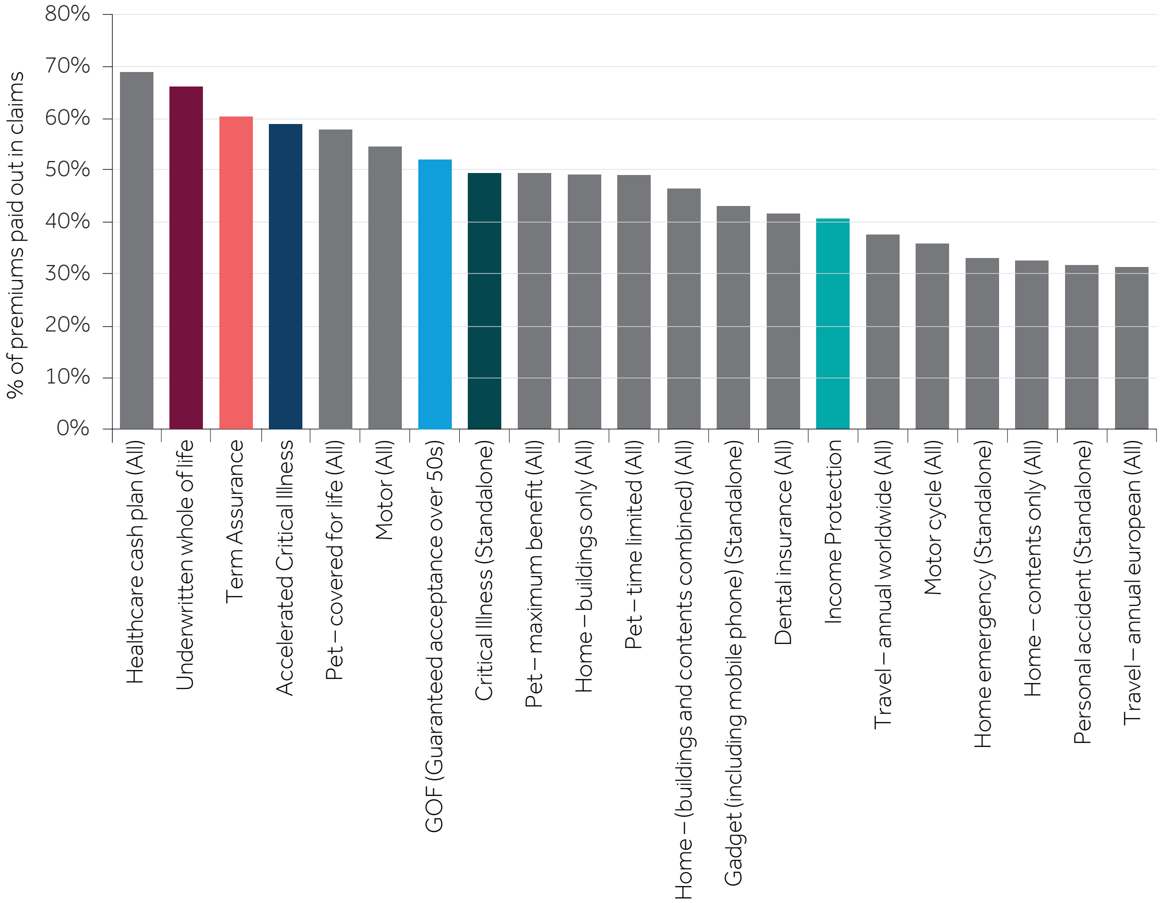
These contribute to a reduction in the incidence and duration of claims, reducing the proportion of premiums paid out as claims but benefitting customers by limiting the time in which they are unable to work.

- The associated risk profile of income protection can impact capital requirements. Under the PRA's Solvency II, the capital held for different risks is calculated individually and then adjusted for diversification across the portfolio. While all risks contribute to the overall requirement, morbidity risk typically requires around twice the capital of mortality risk. This higher capital charge acts as a proxy for greater underlying risk and means that income protection, as a morbidity-based product, needs a larger margin within premiums to cover the cost of additional capital, as corroborated by guidance from the Institute and Faculty of Actuaries.

Comparison of pure protection and general insurance claims

2.4 For additional context, we benchmarked pure protection claims ratios against general insurance value measurements – the equivalent measure of value to consumers in terms of premiums paid in as a percentage of claims paid out. While there are obvious limitations in the comparability of pure protection and general insurance products – for example differences in policy terms and capital requirements – it provides context that the claims ratio for income protection products does not appear to be an outlier when compared to many general insurance products with regards to claims ratios. Figure 1 shows the comparison between the pure protection and general insurance markets.

Figure 1: Pure Protection average claim ratios 2021-2024 vs General Insurance value measurement for 2024



Source: FCA analysis of firm data and select products from the FCA's general insurance value measures data 2024.

2.5 Due to the heterogeneity of general insurance products, we see a wide range of values. For example, products like travel, and home have lower value measurements than income protection.

Claims ratios provide an indicator of value to customers, but a holistic assessment of value is essential

2.6 Value needs to be considered in the round: while we expect firms to think about price when assessing fair value, this should not be considered without also assessing the benefits and relevant product features that make up the overall value offered. While claims ratios are a commonly used metric across insurance products and provide an indicator of value to customers, they are not an all-encompassing measure; the value of a product may also reflect non-monetary and intangible benefits to customers.

2.7 Our consumer research found that 84% of consumers who had bought an income protection policy in the last 12 months said the policy represents good value for money. Similarly, 86% of consumers felt positive about their decision to purchase income protection, which is in line with whole of life insurance (86%) and critical illness (83%). Although consumer sentiment provides helpful context, it is not relied upon in the assessment of whether a product is offering fair value.

Some evidence points to potential issues with customers' understanding of income protection products

2.8 A product that consumers understand is more likely to offer them value. Clear, understandable products help consumers make informed choices. When consumers understand a product, they are better equipped to select products that meet their needs.

2.9 Research carried out for the Financial Services Consumer Panel in 2018[2] highlighted that, while intermediaries believed it to be the right product for most people, income protection products were complex and difficult for consumers to understand. Evidence from a 2024 Mintel report indicates that this sentiment continues – their research indicates that there are gaps in knowledge and understanding of some aspects of income protection, for example, some customers think they could claim income protection payments straightaway if they fall ill when, in reality, they would have to wait a minimum of four weeks (ie the deferred period).

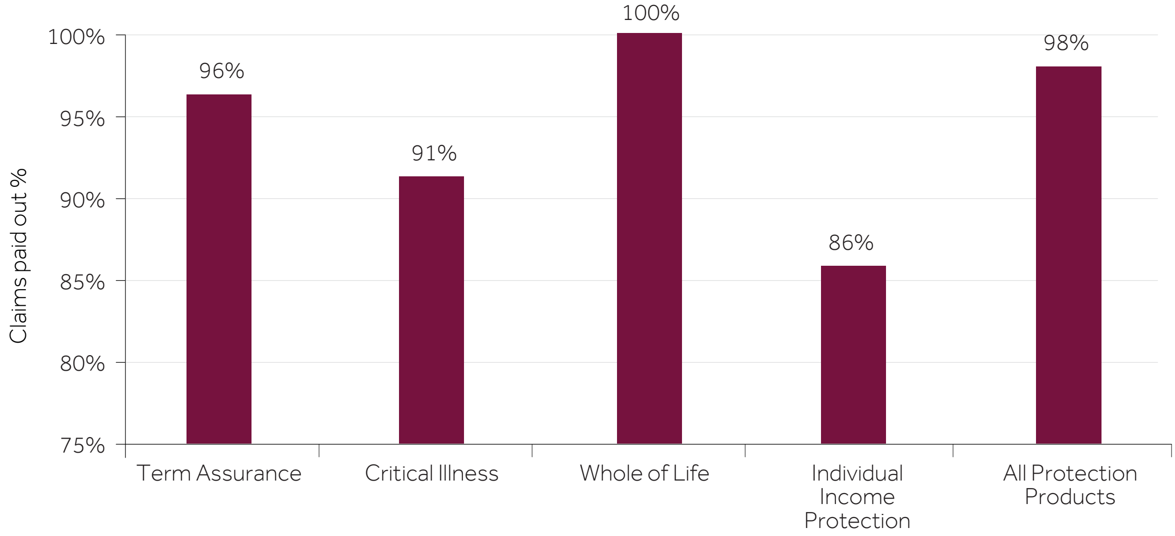
2.10 Similarly, research submitted by one firm found that consumers' claimed understanding of income protection was high but was in fact fraught with misconceptions, particularly around the circumstances in which income protection could be claimed. Many wrongly believe they could use income protection for unemployment, redundancy and short-term leave. Income protection's uptake also remains more limited than other pure protection products, with income protection accounting for only 10% of all new protection policy sales in 2024.

2.11 Although sold predominantly on an advised basis (97% of sales in 2024 were made on an advised basis), evidence suggests there are potential issues with consumers' understanding of income protection. With the product's diverse features, benefits, and limitations, it can be challenging for consumers to fully understand.

2.12 We also found that income protection has the lower rate of claims accepted across the in-scope pure protection products at 86%, as shown in Figure 2.

2 Financial Services Consumer Panel, Consumer Panel Discussion Paper – Understanding the protection gap, 2018.

Figure 2: Claims accepted percentage based on 2024 Association of British Insurers (ABI) claims data



Source: ABI 2024 claims data. Note that this data combines guaranteed acceptance over 50s and underwritten whole of life policies.

2.13 Insurers noted that rates of declined claims have prompted reviews and further action to address the risk that customers do not have an adequate understanding of their policy, and that distributor behaviour is contributing to instances of misrepresentation at the point of sale. Firms reported that declined claims were due to claims not meeting the policy criteria, such as attempts to claim based on symptoms, without being able to evidence a condition – one firm stated that 80% of their declined claims were in respect of not meeting policy criteria and that lower customer understanding of income protection was a contributing factor. Firms also commonly identified misrepresentation[3] and non-disclosure as the reason for claims being declined for income protection products – some firms indicated that misrepresentation and non-disclosure accounted for around 20-85% of claim declines in 2024.

2.14 We note that while complaints to Financial Ombudsman Service (Ombudsman) remain relatively low compared to the total income protection policies in force, complaints relating to declined claims are the most common complaint issue (60%), the highest across all pure protection policies in scope.

Insurers have highlighted pricing reductions in 2025

2.15 The provision of income protection is highly concentrated, with two insurers accounting for the majority of new income protection sales in 2024. However, we understand that some insurers have repriced their income protection products in 2025 as part of efforts to ensure products remain competitively priced. If the value of benefits have remained stable, then the price reductions noted by insurers can be expected to increase value for consumers.

3 Whether either the customer or the broker fails to accurately disclose individual circumstances at the point of sale.

Chapter 3

Guaranteed acceptance over 50s

3.1 In the Terms of Reference for this market study, we stated that for guaranteed acceptance over 50s products, some customers appear to receive low average payouts compared to overall premiums paid and that other products, such as underwritten whole of life insurance, may offer better value.

3.2 In this chapter, we set out our review of guaranteed acceptance over 50s products. We consider the factors that impact the overall value of guaranteed acceptance over 50s products, the evidence from insurers on the extent of customers receiving average payouts lower than the overall premiums paid, and the measures taken by insurers to limit the extent to which customer pay premiums above their sum assured.

Guaranteed acceptance over 50s provides access to a pure protection product where an alternative may not be available

3.3 Firms have emphasised that guaranteed acceptance over 50s is designed to provide access for consumers who may be unable to access a fully medically underwritten protection product, for example due to the consumer being uninsurable through a full medical underwriting process or where this product may be cost prohibitive. Similarly, consumers may choose a guaranteed acceptance over 50s product where they are seeking a lower sum assured value compared to that of underwritten whole of life policies, which have a higher level of minimum cover. Insurers noted that policies are designed to be affordable and are generally purchased by mid/low socio-economic groups with lower disposable income, and the target market includes customers with pre-existing conditions. Our consumer research shows that customers consider the affordability of guaranteed acceptance over 50s policies when taking out a policy, with 23% new customers in the last 12 months choosing this over alternative products due to it being more affordable.

3.4 The relatively older target market of guaranteed acceptance over 50s reflects that this product caters to consumers that might otherwise struggle to obtain coverage due to age – one insurer noted that new fully medically underwritten policies are restricted at age 77, therefore guaranteed acceptance over 50s offers cover to customers who wouldn't be able to get cover from other products.

3.5 Similarly, insurers emphasise that one of the principal benefits to customers is the simplicity, certainty of acceptance and known payout for this product. Evidence shows that claims acceptance rates are consistently higher for guaranteed acceptance over 50s products compared to other pure protection products. One firm noted that zero claim rejections supports the overall intended value for a customer, which is to provide the value of the policy to their beneficiaries easily when it is needed to support their intended wishes to provide financial support for end-of-life costs. Our consumer research also found that 35% of guaranteed acceptance over 50s customers chose the product after considering alternatives due to the fixed monthly premiums and payout.

Insurers' analysis of customers' 'tipping point'

3.6 Guaranteed acceptance over 50s is a specific type of whole of life insurance plan that does not require medical or health information for individuals over the age of 50 to qualify for cover[4], paying a lump sum to beneficiaries on the policyholder's death. These products require customers to pay a monthly premium until their death or until they reach a specific age. When the product is sold, firms know that some customers will pay more in premiums than the sum assured, and they are likely to know when a customer will reach that point. This possibility is also communicated to customers. Under the Consumer Duty (the Duty), firms are required to ensure communications meet the information needs of customers to ensure customers can make an informed choice when purchasing a product.

3.7 Although some customers may pay more in premiums than the sum assured, a guaranteed acceptance over 50s plan provides the benefit of a guaranteed payout whenever they die, as long as premiums are paid. This means their beneficiaries will receive money even if the customer dies relatively soon after buying the policy, which could be more than the total premiums paid. This level of certainty cannot be achieved through a savings product, where the amount available depends only on how much the person has managed to save.

3.8 Aggregate measures of value, such as the projected claims ratio, help evidence the value of a product to cohorts of customers – as noted in the interim report, the guaranteed acceptance over 50s claims ratio is not an outlier when compared to other pure protection products in aggregate. However, with the point noted in our Terms of Reference, we have considered the distribution of value amongst guaranteed acceptance over 50s customers to understand whether certain cohorts of guaranteed acceptance over 50s customers pay more in contributions than they receive and by how much.

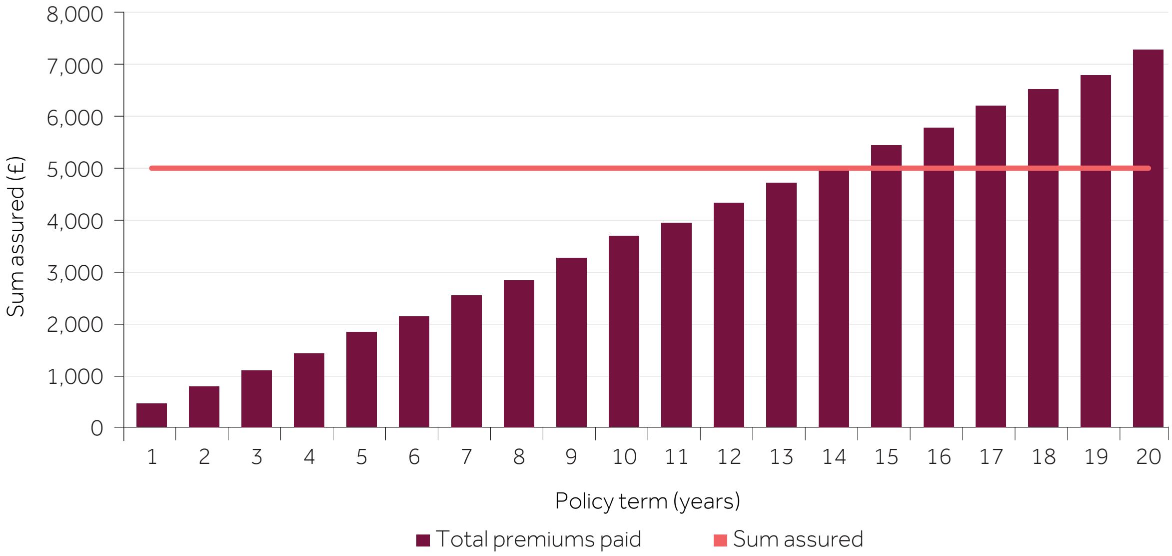
3.9 Insurers must consider their product's target market at a sufficiently granular level to support their monitoring and assessment of differential outcomes to evidence that the product is providing fair value for different consumer groups. For some products, such as guaranteed acceptance over 50s policies, individual customers who keep paying beyond a point may pay more than is ultimately paid out. Their contributions help sustain the pool for others. Without this dynamic, insurers would need to rely on lapses to remain profitable, which may not deliver good consumer outcomes, particularly where there is no surrender value for the product, as is the case with guaranteed acceptance over 50s.

3.10 Within the fair value assessments (FVAs) for guaranteed acceptance over 50s products, some insurers provided ex-ante modelling of the tipping point (the point at which customer premiums exceed the value of sum assured) for specific customer cohorts as part of their assessment of value. This is intended to demonstrate the value received by different customer cohorts prior to reaching their tipping point and the period of time before they reach this.

4 We note that differential pricing for smokers and non-smokers has been implemented across the market.

3.11 The scenarios modelled by insurers consider pricing points for different customer age profiles based on assumptions regarding the level of premiums, value of sum assured and average life expectancy (based on the profile of smokers and non-smokers). Figure 3 sets out a stylised example that is representative of the tipping point modelling provided by firms to show a guaranteed acceptance over 50s customer paying £30 premium per month for a sum assured of £5,000 would be expected to pass the tipping point after 13 years and 11 months.

Figure 3: Illustrative example of ex-ante tipping point modelling



Source: Illustrative example based on the assumptions of a policyholder paying a monthly premium of £30 for a sum assured of £5,000.

3.12 In addition to the modelled analysis, some insurers showed that the scale of customer premiums exceeding the sum assured varies significantly, in part due to the period for which this data is reported.

3.13 Across both the tipping point modelling and analysis of customer outcomes, some insurers identified that customers taking out a policy at an older age, typically 79 or 80 years of age, are more likely to receive a payout less than the value of premiums paid. This may be driven by a shorter period between taking out the policy and passing the tipping point given the lower value of sum assured available to older customers. However, evidence from firms indicates that the majority of guaranteed acceptance over 50s policies pay out more than the value of premiums paid in.

3.14 We note that we have not seen evidence relating to customers' understanding of this risk. Evidence from insurers shows that the risk of this has been incorporated in their marketing and communication to customers, typically as the possibility of this risk occurring or policy-specific information on the tipping point age. Our consumer research also found that almost three-quarters of consumers who had purchased guaranteed acceptance over 50s thought it offered value for money, although this was slightly less than purchasers of other types of polices. However, customers' perceptions of value may be driven by a lack of understanding, do not always reflect the actual outcomes consumers receive and cannot be relied upon to assess value.

Premium age caps

3.15 Guaranteed acceptance over 50s products typically include an age limit on premiums meaning when policyholders reach this age they cease paying premiums, but their coverage continues until their death. This measure may also limit the extent to which customers pay premiums above their policy's sum assured.

3.16 Typically, age caps on premiums apply from age 90, although we see some insurers applying this from age 95. We have seen evidence of an insurer applying an additional measure of capping premiums after 30 years, or at age 90, to limit the scale of customers paying premiums above their sum assured amount. Based on these measures, the insurer's tipping point modelling indicates that these measures limit the extent to which relatively younger policyholders and non-smokers would pay in premiums above their sum assured amount, as the 30-year premium cap is closer to the average tipping point age for these individuals.

3.17 Based on the submissions of firms, we have not seen evidence that there are a significant proportion of guaranteed acceptance over 50s customers reaching the premium age cap.

Some customers may receive a higher payout with alternative products, but there are differences in the intended target market of alternatives

3.18 Our Terms of Reference noted that for some customers, other products such as underwritten whole of life insurance may offer better value than guaranteed acceptance over 50s.

3.19 Whole of life policies, like most pure protection products, are subject to medical underwriting with applicants required to provide details of their medical history and current health status as part of the application. While these policies typically have higher premiums, whole of life offer a significantly higher sum assured compared to guaranteed acceptance over 50s, reflecting insurers' ability to more accurately assess mortality risks. This means that guaranteed acceptance over 50s customers, on average, pay more in premiums per £1,000 assured (£71.73) compared to underwritten whole of life (£8.10). This is in part reflective of the differences in the average terms of these products; guaranteed acceptance over 50s policies are typically taken out for a shorter period, whereas whole of life policies are typically taken out at a younger age.

3.20 Insurers have clearly distinguished different target markets for underwritten whole of life and guaranteed acceptance over 50s. As discussed previously, we observe that the intended target markets for guaranteed acceptance over 50s products are broadly those customers who may be unable to access a full medically underwritten alternative due to pre-existing medical conditions, age, or the cost of underwritten protection or alternatives do not meet the customer's needs. Individuals in good health, often referred to as 'healthy lives', and those with sufficient income to pay higher premiums, typically have access to a broader range of insurance options, including whole of life, that are likely to offer a higher sum assured than guaranteed acceptance over 50s. Research from Mintel highlights that whole of life products tend to be taken out by wealthier individuals.

3.21 While some customers may receive better value by taking out an underwritten whole of life policy through a higher sum assured relative to the level of premiums, there are distinct differences in which customers of these products are targeted which highlights that this product is not commonly a direct substitute for the intended target market of guaranteed acceptance over 50s products.

Chapter 4

Firms' fair value assessments

4.1 In this chapter, we summarise firms' the fair value obligations under the Product Intervention and Product Governance Sourcebook 4 (PROD 4) rules and evidence found in our review of firms' FVAs.

4.2 Our review focused on understanding the approach taken by firms in their FVAs to assess the value of their pure protection products in order to identify common practices and variations. Importantly, our review did not comprise an assessment of the quality or compliance of each firm's FVAs.

Fair value in the pure protection market

4.3 Manufacturers and distributors of pure protection products (non-investment insurance products) are subject to requirements in PROD 4. Under these rules pure protection products must be designed to meet the needs of the target market, and must provide fair value over the lifetime of the product.

4.4 Under PROD 4, 'value' means the relationship between the total price (including consideration of each of the individual elements that make up that price) to the customer and the quality of the product and/or services provided.

4.5 For manufacturers of pure protection products, PROD 4 places obligations on them to assess and ensure the ongoing value of the product to customers in the target market, including having appropriate oversight of the product's distribution arrangements.

4.6 Manufacturers of pure protection products are required to undertake a FVA to demonstrate how the product provides, and will provide for a reasonably foreseeable period, fair value. A FVA must use all necessary and appropriate information to evidence value including, but not limited to, claims information, complaints data, and distributor remuneration and the levels or quality of service provided by distributors. Distributors have a responsibility to gather the relevant information from manufacturers to understand the value of the end-product as they are the point of contact to retail customers. They are required to understand and assess the impact of their distribution on the value of the product, including whether any remuneration from distribution arrangements could lead to the product providing poor value to customers. Details of the requirements on manufacturers and distributors are set out in PROD 4.2 and PROD 4.3, respectively.

4.7 The Consumer Duty, set out in Principles for Businesses (PRIN) 2A, requires firms to act to deliver good outcomes for retail customers. The Duty also sets four outcomes: products and services, price and value, consumer understanding, and consumer support. For pure protection products, the 'products and services' and 'price and value' outcomes are met through compliance with PROD 4.

Insurers' approach to fair value assessments

4.8 Many of the frameworks adopted by insurers in their FVAs had clearly set out principles for how the firm would apply the concept of fair value both generally and across product lines. Some firms have adopted a framework that maps customer outcomes against PROD 4 and the outcomes under the Duty, using this quantitative evidence to inform their fair value considerations. Most insurers have also implemented defined monitoring and governance frameworks for maintaining oversight of distributors' performance.

4.9 We found that insurers use a combination of key 'value' metrics to identify risks of not delivering fair value at the product level, by customer cohort, and distributor. We observed similar approaches using certain metrics to identify risk of inconsistency with fair value (eg claims ratio, commission to premium ratio and profit margin), adopting a RAG rating system or defined thresholds as part of their value assessment. Claims ratios – a commonly used value metric across insurance products – were generally adopted as a high-level indicator of the product's benefit for customers, with firms considering this alongside other measures of value to assess the total benefit to customers.

4.10 Firms use metric thresholds as an indicator that a product may not be providing fair value, or as an indicator of the product not performing as intended, prompting further investigation or corrective action if required. While any metric threshold may be expected to vary across product type (for example, reflecting inherent risk factors such as the uncertainty around claims, underwriting complexity and capital requirements) and firms (reflecting factors such as customer makeup, choice of distribution channels, cost-orientations reflecting firms' business models), many firms did not document or explain any rationale for the levels at which these are set. We have therefore seen variance in thresholds that is not explained by firms, for example, the claims ratio thresholds across term assurance products vary from 30% to 50%. This reiterates findings from the FCA's thematic review of Product Oversight and Governance in General Insurance and Pure Protection[5], which noted that it was also unclear how firms decided that the standard/tolerance limit for their customer value metrics was appropriate.

4.11 For individual products, insurers' FVAs include an assessment of outcomes across customer cohorts (eg age, product type, and vulnerability indicators) and distribution channels. We have seen that the assessment of outcomes informs remedial action where firms identify risks to fair value or existing poor outcomes. For example, some FVAs show that where key metrics were outside firms' tolerance levels, there have been pricing adjustments to ensure customers receive value from the product.

4.12 We see firms using indicators of positive consumer outcomes by customer cohort and distribution channel to support their value assessment. These indicators include claims acceptance rates, lapse rates and low complaints referrals to the Ombudsman compared to the number of policies in force to indicate their alignment with outcomes under the Duty. For example, using lapse rates as part of conclusions in relation to the 'consumer understanding' outcome.

5 FCA, TR24/2 – Product Oversight and Governance – General Insurance and Pure Protection (PROD 1.4 and PROD 4), paragraphs 4.34-4.35, 2024.

Insurers' and intermediaries' approach to assessing the fair value of distribution

4.13 In Annex 1, we examined whether certain distribution arrangements or practices, such as loaded premiums or restricted panels, could result in systematically higher prices that are not reflective of the value provided by intermediaries. We found that on average, consumers don't currently experience worse pricing outcomes from these practices.

4.14 However, the cost of intermediation can vary widely depending on the range of offerings and complexity of the consumer's requirements, meaning the value to customers from intermediation differs across individuals and products. Given the importance of intermediaries, both manufacturers and distributors have responsibilities in ensuring fair value of distribution.

4.15 Our review of FVAs found that manufacturers typically review a range of metrics on their pricing and distribution arrangements as part of a monitoring framework, with most insurers operating a distribution quality management (DQM) system which monitors the quality of business submitted and intermediary conduct. Key metrics included in DQM systems often concern sales, underwriting outcomes, persistency metrics (such as policy retention and lapse rates), and claims outcomes. Defined metric thresholds trigger investigation and/or action to address poor customer outcomes where concerns arise.

4.16 We have seen differences in how insurers consider the impact of distribution costs (and wider distribution arrangements) on value. As noted in Annex 1, we know insurers factor the impact of distribution costs into their pricing decisions, and that the same cover may be available at different pricing depending on the distribution channel and the added benefits provided by the distributor. While intermediary commissions are subject to negotiation, we have seen examples of insurers setting pricing limits amongst distributor groups for the same cover, for example, capping allowable price differences across distribution channels at 20% in order to limit variation.

4.17 We found variation in how distributors evidence the impact of their service and remuneration on customers, as required under PROD 4.3. Among the large distributors in our sample, we found that some have defined frameworks to assess the value and impact of their intermediation and advice to customers. For example, we found that some intermediaries' assessments were informed by analysis of their distribution costs against their commission levels, combined with price benchmarking across different distribution channels and other distributors to inform their assessment of the value provided to customers. We also saw evidence of firms quantifying the value of their service to customers with reference to time and cost savings.

4.18 In some cases, distributors provided only descriptive evidence on the value they brought to consumers against their own remuneration and how they assess the impact of their distribution arrangements on the product's intended value. Others simply stated the product offered fair value with no other information to back up the statement. We expect distributors to monitor the products they offer and the impacts of their distribution arrangements on an ongoing basis so they can act when they identify situations where the product is not providing the intended value to the customer. They need to ensure that they have sufficient, good quality information to enable them to understand the impact their distribution processes have on the value the customer receives.

4.19 We would restate the responsibility of manufacturers under PROD 4 to ensure the distribution arrangements support, and do not adversely affect, the intended value of the product, with consideration of the distributor remuneration and its impact on the value of the product.

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