FINANCIAL CONDUCT AUTHORITY

General insurance distribution chain

Thematic Review

TR19/2

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1 Executive summary

Background

1.1 General insurance ('GI') products serve an important social need and are key financial products underpinning a well-functioning economy. They give UK consumers and businesses the security and stability to go about their daily activities with confidence. So, it is essential that consumers and businesses can access high quality, good value insurance products which meet their needs and perform in line with their reasonable expectations.

1.2 There are currently over 300 insurers and 5,000 intermediaries operating in the UK GI marketplace, seeking to meet these insurance needs. These firms have a wide range of business models, allowing UK customers to access GI products via a variety of different distribution channels and purchase methods.

1.3 The competitive marketplace and the diverse and evolving insurance needs of UK customers means that GI firms often develop new products, or find new ways to distribute existing products or access new markets and groups of customers. As business models have evolved some distribution chains have become long and complex, with multiple parties involved in the manufacture, distribution and delivery of insurance products and services. Additionally, some distribution chains are potentially subject to significant influence from parties that are not FCA regulated, such as retailing groups whose main business is unregulated.

1.4 The length and complexity of some distribution chains and the potential influence of parties that are not regulated by the FCA has given rise to 2 key risks. These are:

- The number (or nature) of parties in some distribution chains increases the price of GI products and adversely affects the value of the products (and associated services).
- The complexity of chains and number of parties involved negatively affects the delivery of services and customer experience or outcomes. This may be either during the sales process (e.g. via mis-selling) or while fulfilling obligations to customers (such as claims and complaints handling).

1.5 We are concerned about these risks because of their potential to cause harm to customers, particularly personal lines and SME customers. These harms to customers include the following:

- Customers purchasing products which deliver little benefit. Firms may develop and market these products due to failings in their product design and approval processes.
- Customers may purchase products that are less appropriate for them, where firms sell a product not offering value. For example, where the value of the product for a particular cohort of customers is not established or where the firm selects a distribution strategy which may lead to the product being offered to customers who do not need it.

- 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 occur when a firm distributes the product to customers outside the target market or due to conflicts of interest in a firm's remuneration structure incentivising it to sell a particular product.
- Remuneration structures may lead to customers paying increased prices as a result of remuneration that is paid to firms in the distribution chain who incur little cost or deliver little benefit to customers.
- Firms may fail to identify products not providing value to customers or to take appropriate remedial action, due to shortcomings in oversight, management information ('MI') or monitoring.

1.6 These potential harms are not unique to longer or more complex GI distribution chains, but our concern is that where multiple parties are involved the risks of these harms occurring is significantly greater. Our overarching expectation is that 'a customer's experience should not be affected by whether a product or service was provided and distributed by a single institution or two or more institutions' (RPPD1.2). This expectation relates to all elements of the insurance product and related services which could affect the customer's experience. So, it encompasses the design and manufacture of the product, its distribution and sale, claims handling, complaints handling and the delivery of any other related services.

1.7 Our concerns about these potential harms led us to scope and carry out 2 pieces of work. These were a diagnostic thematic review of Value in the GI Distribution Chain[1] ('VITDC') and a multi-firm supervisory review of delegated authority ('DA') arrangements.[2]

1.8 These reviews considering the GI distribution chain were performed in parallel to our diagnostic work on GI pricing practices (which we reported on in October 2018) and are complementary to it. They each looked at a different range of GI products considering how they are distributed, the range of parties involved and how that impacts on value – but had the same focus on identifying the risks of potential harm to customers and their causes. These complementary pieces of work are aligned because they both emphasize the economics of the products and services being provided to customers, and the distribution chains and methods by which they are delivered. Consequently, there are similarities to the findings of our GI pricing practices work, not least in terms of the risk of customers paying excessive prices and suffering poor outcomes. Also, that these harms appear to emanate from issues around firms' culture and business models, and how these are driven by their purpose and values, and their governance and controls.

1.9 We have now launched a market study on pricing practices in home and motor insurance. The findings and actions resulting from this work on the GI distribution chain, as set out in this report and accompanying documents, provide part of the regulatory context for the market study, but do not in any way preclude or prejudge the outcomes of that work.

1 A priority A project announced in our 2017/18 business plan, with the intention of gaining a better understanding of a variety of GI distribution chains and their impact on the value provided to consumers.

2 A follow up piece of multi-firm work performed due to the serious extent and nature of the shortcomings identified in our 2015 and 2016 thematic reviews on DA and appointed representatives ('ARs') (TR15/7 Delegated authority: Outsourcing in the general insurance market and TR16/6 Principals and their appointed representatives in the general insurance sector). This multi-firm review focused on delegated authority arrangements and considered the extent to which firms have responded to our findings and expectations as set out in our 2015 report.

What we found – potential harms and our responses

1.10 Our work identified significant potential for harm to customers arising from the product development and distribution approaches currently employed in some sectors of the GI market and by some GI firms. The risks of harm we identified included examples relating to both features of the distribution chain and of the particular product involved. We saw many cases where it was not clear that firms (both insurers and intermediaries, acting as manufacturers or distributors) had considered the impact of their actions (and inactions) on the value of the products provided and customer outcomes.

1.11 However, it is important to note that while we saw many examples of such issues, there were also many other GI distribution chains and products we considered in our work which appeared to be delivering good value insurance products and appropriate outcomes, with no evidence of these harms manifesting.

1.12 Specific examples of the potential harms we identified in our work include the following:

- Customers buying GI products paying high prices, which appear significantly higher than the production and delivery costs of the products due to high levels of commission within the distribution chain. One example where we saw potential harm occurring was for Guaranteed Asset Protection ('GAP') insurance (and other motor ancillary insurance products) purchased alongside a motor vehicle, where the average level of commission taken by some distributors was over 60%. These distributors were often directly regulated intermediaries or appointed representatives ('ARs') forming part of an otherwise unregulated group, like a motor manufacturer or dealership network, and they appeared to be able to extract these levels of commission due to the control they could exert over both the distribution chains and the customers.
- Firms failing to fulfil obligations to customers, including where the services provided to customers are not delivered appropriately. We saw examples of this where there were shortcomings in the processes and practices surrounding claims handling, including in cases where the responsibility for handling claims had been delegated, creating the risk that legitimate claims could be rejected.

The work we performed found that these and other potential harms stemmed from 2 key causes.

1.13 The first of these was the **purpose and values of firms**, and associated issues with their **business model and strategy**. This was characterised by firms lacking focus on customer outcomes, with it not being clear that these firms' purpose and culture paid sufficient regard to customer outcomes. In these examples, which manifested in both reviews, customers were not being placed at the heart of GI firms' business models and this was leading to potential harm for customers. There were several manifestations of this core issue, including:

- Failure to adequately consider risks of harm to customers in the development of products and the related distribution arrangements.
- Manufacturers ceding complete control over all elements of the product sale (including allowing absolute discretion over the end price charged to customers) to distributors without due regard for the impact on the value of the product and

customer outcomes. This included cases where the distributors were directly regulated intermediaries or ARs contained within retail groups which are not otherwise regulated for insurance distribution.
- Failure to consider or assess through appropriate diligence the suitability and ability of parties to whom authority, control or responsibility is being delegated or passed.

1.14 The second cause of potential harm to customers related to poor **governance and oversight** and the failure to have adequate systems and controls over the end to end product and service development, manufacture and delivery chain. This meant that in some cases, even where the purpose and intent of the firm was to produce GI products which met genuine customer needs and resulted in good customer outcomes, the firm had not taken appropriate actions to make sure these were delivered. This manifested in a few different ways:

- Lack of appropriate governance and risk structures. This included in relation to performing due diligence of partners/delegated parties within a distribution chain.
- Failings in approaches to risk management, oversight and/or compliance, including in relation to delegated parties within distribution chains. These resulted in the arrangements in place not being adequate or sufficient to achieve intended objectives.
- Lack of clarity regarding roles and expectations, including in relation to pricing decisions and practical delivery to customers.
- Lack of MI or failure to adequately use or consider MI focused on customer outcomes.

1.15 Our work on the GI distribution chain has revealed the extent to which many firms have failed to respond sufficiently to our previous work and interventions, most notably our 2015 report on DA arrangements and the expectations we set out there. While we have seen some progress in the governance and controls around GI distribution chains since 2015, we often encountered a lack of customer focus or consideration of value. This was both in deciding what activities to undertake, who to partner with and what products to sell/distribute; as well as in the systems, controls frameworks, monitoring and MI. The findings and expectations described in that report remain applicable to many firms within the GI sector, when read alongside those set out here. The widespread extent of these issues within the GI sector is extremely disappointing given the focus and emphasis placed on these areas by the FCA in recent years.

1.16 The above issues have already led to FCA interventions. We fined Liberty Mutual Insurance Europe SE ('Liberty') over £5m (post reduction for early settlement) in October 2018. This followed an Enforcement action looking at harms resulting from failings in claims handling in a GI distribution chain. We entered into an agreement in February 2017 with Express Gifts Limited for it to provide £12.5m redress to approximately 330,000 customers who were sold insurance that offered little or no value. We commissioned 2 s166 skilled person reviews further to our recent follow-up multi-firm work on delegated authority.

1.17 In March 2019, we fined The Carphone Warehouse over £29m (post reduction for early settlement) for mis-selling mobile phone insurance and failing to properly investigate and fairly consider complaints arising from the mis-selling. The Carphone Warehouse was the retail distributor in this case. We note that, following our implementation of the Insurance Distribution Directive ('IDD'), regulated firms selling directly to customers need to make sure the sale complies with certain standards. These include making sure the product meets the customer's needs. Where a regulated firm is selling insurance products through a retailer which is not regulated due to the connected contracts exemption then the regulated firm will need to make sure that the sale complies with these standards. Further details of actions we have taken can be found in Section 4.

1.18 The new more detailed rules arising from our implementation of the IDD are directly relevant to the manufacture and distribution of GI products, the concerns we have identified and the harms and potential harms they may cause. They include the obligation for all firms involved in the GI distribution chain, both insurers and intermediaries, to 'act fairly, honestly and professionally in accordance with the best interests of the customer'.[3]

1.19 Additionally, the Senior Managers and Certification Regime ('SM&CR') will clarify and enhance the level of firm and individual accountability for these issues.

1.20 We have also been working to develop suitable value measures for GI products. These measures will provide consumer groups, firms and market commentators with additional indicators of value for a range of insurance products.

1.21 The new rules, the SM&CR and other initiatives will help us to take a more interventionist approach if we see failings in future. We will seek to use the full range of regulatory tools for both existing and any future issues.

Our expectations

1.22 We expect all GI firms to put customers at the heart of their business models and have appropriate regard for the value customers receive from the GI products and services they manufacture and distribute. This expectation applies to firms in all parts of GI distribution chains and is underpinned by our rules and the Principles for Businesses, which firms must comply with. Alongside this report we are consulting on proposed non-handbook guidance setting out our expectations under our rules. We have set out the more detailed expectations in full in Section 5 of this report. These detailed expectations are intended to provide firms with clarity about their obligations as manufacturers and distributors of GI products.[4]

1.23 The themes that our key expectations fall into are set out below. However, firms need to carefully consider Section 5 of this report and our non-Handbook guidance in their entirety when seeking to assess whether they are meeting their obligations. If, further to this, firms identify shortcomings in their policies, procedures or practices, they should take appropriate action to address these shortcomings immediately.

1.24 Our key expectations are as follows:

- All GI firms must act fairly, honestly and professionally in accordance with the best interests of their customers.

3 ICOBS 2.5.-1R
4 Where we refer to expectations in this report which are in the guidance consultation, firms should take account of the finalised guidance published after consultation.

- All GI firms should consider the value their customers ultimately receive from their products and services.
- All GI firms should maintain appropriate systems and controls over the remuneration they receive.
- All GI manufacturers should have sufficient knowledge of the roles and remuneration of all entities in the distribution chains they use to be able to assess the impact they have on the value customers receive.
- All GI firms must maintain appropriate systems and controls (including the production and use of appropriate management information) over their GI products and services. This includes when delegating authority to another business.
- All GI distributors should consider the impact of their distribution strategy (including the distribution method and the level of remuneration they receive) on the overall value of the product for their customers.

Next steps

1.25 We intend that this report, the findings and harms set out in it and the accompanying suite of documents (including a Dear CEO letter) should serve as an immediate call to action to all GI firms. They must urgently address the issues of culture and governance, and the accompanying failure to consistently focus on customer outcomes which remain widespread within the sector. To achieve the step change we expect of GI firms, we have also published proposed non-Handbook guidance to make clear our expectations and remove any remaining ambiguities. This clarity will facilitate decisive future interventions (using the full range of our regulatory tools) where we identify firms who are not meeting their obligations to their customers.

1.26 To drive and embed meaningful change in the sector, we will also:

- Undertake a programme of further communications and engagement with the sector about our findings and our expectations.
- Consider the need for additional interventions further to our review of the information we received in the course of this thematic work, as well as that obtained from relevant supervisory work.
- Plan a programme of future supervisory work in this area, both through regular supervisory activities and further thematic or multi-firm work.

Further details of our next steps can be found in Section 6.

1.27 We have already intervened in the Liberty, Express Gifts and The Carphone Warehouse cases. We will not hesitate to intervene in future where we see firms who do not meet their obligations under our rules and exhibit similar issues. Our future engagement with firms will reflect our focus on these issues, the clarity with which we have set out our expectations and the extent and duration of our communications on this subject. In this context, we will use the full range of our regulatory tools if we encounter issues and potential failings at firms causing harm or potential harm to customers.

2 Approach, scope and methodology

2.1 As set out above, the length and complexity of some GI distribution chains and the range and nature of parties involved gave us concerns that this could be causing harm to customers by:

- Adversely affecting the value of products from a customer's perspective.
- Negatively affecting the services received by customers, and the outcomes they experience.

2.2 We set out in our 2017/18 Business Plan our intention to undertake discovery work focusing on 'Value in The Distribution Chain' ('VITDC'). We aimed to gain a better understanding of a range of GI distribution chains and their impact on customers.

2.3 We were also concerned about the serious extent and nature of the shortcomings identified in our 2015 thematic review of DA arrangements. So, we performed a follow up piece of multi-firm work to assess the extent to which firms had responded to the issues and expectations set out in our 2015 report.[5]

2.4 Both of these pieces of work considered (through different lenses) the potential for harm to customers (and other conduct risks) arising from the GI distribution chains and arrangements we reviewed. They also sought to assess whether customers are being treated fairly and truly being placed at the heart of firms' business models. The VITDC work focused on 3 specific GI products; travel, tradesman and GAP/motor ancillary insurance. The DA multi-firm work considered the delegated arrangements of 7 insurers with a variety of different business models and insurance products.

Theories of harm

2.5 The theories of harm we considered in our work relate to 2 primary areas of harm.

Pricing and quality

We considered whether there was evidence indicating that customers may be:

- Paying excessive prices, fees or charges.
- Being sold sub-standard or 'hollowed out' products providing limited or no utility or lacking key elements of cover.

Sales and customer service/treatment

We also considered whether there was evidence that:

- Customers were purchasing unsuitable products.
- Firms were failing to fulfil their obligations or provide services to customers.

5 TR15/7 Delegated authority: Outsourcing in the general insurance market

- Customers were unaware of the risks that they were insured against or misunderstood the policy benefits due to shortcomings in the sales process.

2.6 We sought to assess the extent to which the distribution chains could adversely affect the products (and services) being received or customer outcomes. So, we considered whether firms have established effective risk frameworks and controls to identify and mitigate the risks arising from these distribution chains (particularly where they delegate authority to other parties). We also considered how widespread any issues identified are within the GI sector, or whether they are confined to specific sub-sectors, firms or products.

2.7 We designed the VITDC information request to better understand:

- Who was involved in the distribution chains for a selection of GI products.
- The roles these parties fulfil and the remuneration they receive.
- The strategy and approach firms followed in selecting the parties in the various distribution chains.
- The extent to which firms understand and monitor the remuneration taken by different parties in the chain and consider the impact of the chain on the value of the GI products and services provided to customers.

2.8 We reviewed 3 GI products; travel, tradesman and GAP/motor ancillary insurance. We selected these products to provide us with insight into a range of GI distribution chains, given their different characteristics. Tradesman insurance is a mass market SME product that is required and bought by small businesses (given the liability component). It gave us insight into the commercial value chain. Travel insurance is a mass market consumer product which is arguably essential for overseas travel but not compulsory. It is sold through a very wide range of distribution routes, giving us the opportunity to understand how these different distribution chains contrasted and affected the value of the product the customer received. GAP insurance and motor ancillary insurance are widely sold, niche consumer products. This gave us an insight into the dynamics and economics of a GI distribution chain where ownership of the customer relationship often resides with the seller of the primary product. These sellers are therefore often able to exert a significant degree of influence over the GI product and the price it is sold to customers for.

2.9 We requested information from 40 firms involved in providing these 3 GI products. This included insurers and intermediaries (acting as MGAs, brokers and/or administrators), and encompassed a variety of business models. We followed our review and analysis of this information with visits and meetings with 17 of these firms.

2.10 Our multi-firm supervisory work on DA was intended to assess the extent to which firms have responded to our 2015 report and acted to enhance their risk and control frameworks and embed compliant practices and processes where they delegate authority. Specifically, we wanted to test whether firms:

- Had a clear risk appetite regarding delegating authority, including for the risks this poses to customer outcomes, and were able to evidence this risk appetite.
- Understood their responsibilities for the performance of products and customer outcomes.
- Had effective, risk-based controls to facilitate oversight of their delegated arrangements.

- Received and used appropriate customer focused MI to monitor customer outcomes and identify any poor conduct by their delegated partners.

2.11 The multi-firm review focused on 7 insurers who delegated underwriting or claims handling authority for UK-based personal and SME business customers. These firms were generally reflective of the sample included in the 2015 review and one of the firms was in the original review. This work involved requesting information which we reviewed, followed by face-to-face interviews with all the insurers and a sample of 13 intermediaries to whom authority was delegated by the 7 insurers.

2.12 During our review of the information provided and our visits to firms across both reviews, there were several key indicators of potential harm:

- Instances where the purpose or value of the GI product from a consumer standpoint and/or ownership of its manufacture (including product design) and/or choice of distribution route appeared unclear.
- Examples where the prices paid by consumers for insurance products did not appear consistent with the fair treatment of customers. For example, the extent to which the price took account of the utility or quality of the product, in terms of factors such as coverage and customer service. This included products where the price for end customers is significantly increased by the levels of commission taken in the distribution chain.
- Cases where firms' (particularly manufacturers') understanding and oversight of the distribution chains they were involved in (including their knowledge of sales methods and processes) did not appear commensurate with the range of risks to customers arising from their activities in these distribution chains.
- Examples where there appeared to be significant levels of remuneration taken by parties (either in commission or through other fees and charges) where it was unclear what their role and contribution was in delivering the products and services being provided to customers.
- Instances where ownership of responsibility for the delivery of core services (such as claims handling) or the related decision-making processes was unclear, potentially resulting in poor product delivery or customer outcomes.

2.13 We began these 2 pieces of work in Q4 2017 and concluded our fieldwork in Q3 2018. Our analysis of the evidence and the issues identified revealed a significant degree of alignment and commonality in the findings of the 2 pieces of work. So, we decided to combine these findings, and our conclusions, actions and expectations into this single report.

2.14 We performed both reviews in the context of the applicable regulatory framework, rules and guidance at the time of our review. This predated the FCA's implementation of the IDD (effective 1 October 2018) and SM&CR being applied to insurers (effective 10 December 2018). We have presented the findings from our work in this context, and the actions we have already taken were based on the historic regulatory framework. However, the new rules emanating from our implementation of the IDD and the enhanced obligations arising from the SM&CR are very relevant to the concerns and potential harms identified. They are also relevant to our expectations of firms to work to address these issues. So, we have set out our expectations, which are taken from the proposed guidance accompanying this report (on which we are consulting), in the context of the updated regulatory framework now applicable.

2.15 While we did not engage directly with consumers when performing these 2 reviews, we used existing FCA information and analysis relevant to consumer behaviour, the sector and the products being considered. This included the research and analysis performed in the context of the following FCA reviews and publications:

- MS14/1: General insurance add-ons market study (July 2014)
- PS15/13: Guaranteed Asset Protection insurance: competition remedy (June 2015)
- OP 12: 'Encouraging Consumers to Act at Renewal' (December 2015)
- PS16/21: Increasing transparency and engagement at renewal in GI markets (August 2016)
- FS16/5: following a 'Call for inputs on Big Data' (September 2016)
- The financial lives of consumers across the UK: Key findings from the FCA's Financial Lives Survey 2017 (June 2018)
- TR18/4: Pricing practices in the retail general insurance sector: Household insurance (October 2018)

2.16 These pieces of consumer-focused research and analysis tell us the following relevant information:

- The Financial Lives Survey 2017 expressed concern that consumers' lack of knowledge and lack of engagement with products and providers could lead to harm occurring more readily (pg. 25). It also stated that this creates conditions for harm to occur more readily due to customers who are not engaged with products not fully understanding what they are buying (pg. 68).
- The Financial Lives Survey 2017 found that just over 12 million UK adults don't think they have enough information to decide, on quality, between different insurance policies (pg. 15).
- Consumers do not always know what cover they need. They are open to considering a wide range of covers even if they were previously unaware that a product existed or they had not planned to buy it. This is particularly true if consumers place trust in the firm who distributes the product. Or if insurance is not the primary sale and insurance is only introduced towards the end of a sales process for another product by a distributor whose main role is not insurance related (General insurance add-ons market study).
- Consumers may have a poor understanding of the cover available. During our VITDC review, firms told us that consumers were regularly unaware of the risks that they were insured against or misunderstood the policy benefits. When considering whether to buy a product, such misunderstandings may affect a consumer's assessment of what they will receive for their money and, therefore, the value of the product.
- Consumers are often unaware they can buy products from another provider or feel the time and effort involved in shopping around to be significant, or believe that savings to be gained from shopping around would be small (General insurance add-ons: qualitative research analysis pg. 39).
- When consumers do shop around, their research tends to be superficial and they sometimes measure cost by comparing the price of the insurance relative to other items, such as the price of the vehicle they wish to buy (General insurance add-ons: qualitative research analysis pg. 50). These behavioral biases can add to the consumer's sense that savings which may be gained from shopping around seem insignificant.

- Distributors' sales tactics may add to this feeling. For example, by making time-restricted offers, grouping the cost of the sale with another product to make the items' individual prices unclear, or passing the consumer to a 'financial services expert', which some consumers may find intimidating (General insurance add-ons: qualitative research analysis pg. 57).
- If consumers are unable to effectively compare the price and coverage of products, they can't properly assess the relative value of products and make informed decisions.

2.17 We have considered this evidence about customer behaviours in carrying out these reviews, forming our conclusions and setting our expectations of the firms which operate in this sector.

3 Findings

3.1 Our 2 thematic reviews relating to the GI distribution chain took different approaches. The VITDC work focused primarily on the impact of the distribution chain on the value of customers' GI products and services. The DA work looked at the systems and controls surrounding distribution chains involving delegated authority.

3.2 However, while the specific approach for these 2 reviews was different, there was significant commonality in the findings, and a consistency to the issues we found across both reviews. It was also clear from both reviews that the concerns we were seeing in some cases, were not narrow compliance issues with limited consequences, but issues with the potential to cause harm to customers on an ongoing basis.

3.3 A key theme underlying many of the issues we identified was the apparent failure of some firms to focus sufficiently on customer outcomes, particularly where multiple parties were involved in delivering GI products and services. In these cases, it appeared that customers were not being consistently placed at the heart of firms' business models and that a customer focus had not been fully embedded within the culture of these firms. Where firms lacked a clear customer focus this often manifested across the full range of the activities undertaken by the firm. This included in the processes of selecting partners, product development and manufacture, and product and service delivery, as well as the oversight and monitoring of these activities. This created the potential for customers of the firm to suffer harm.

3.4 Having found evidence of similar concerns and potential harms in both reviews there was a clear alignment in the key messages and expectations we wanted to communicate to the sector. Additionally, the relevant rules and guidance we wanted to refer firms to in order to address these potential harms were the same. These include the new rules introduced further to our implementation of the IDD and the enhanced levels of individual accountability arising from the SM&CR. So, we chose to consolidate our findings and expectations into a single report.

3.5 As detailed above the theories of harm we considered through these pieces of work related to 2 main areas of potential harm:

- price and quality
- sales and service

3.6 We have grouped our detailed findings (including examples of the issues and potential harms we saw) under these 2 headings. As set out above in the approach, scope and methodology section, these reviews were not intended to involve detailed work to identify and quantify harm, but instead to identify issues which gave rise to significant risk of harm to customers. These themes and issues were by no means universal across the sample of firms and products we considered in our work. However, they were common, with many of these findings and examples of potential harm observed in several firms included within the 2 reviews and across a range of different products.

3.7 We found that the potential harms we saw came from 2 key causes. The first of these was the **purpose and values of firms**. This related to firm's **business model and strategy** and was characterised by firms lacking focus on customer outcomes, with it not being apparent that their purpose and culture paid sufficient regard to customer outcomes. The second cause of potential harm to customers related to poor **governance and oversight** and the failure to have adequate systems and controls over the end to end product and service development, manufacture and delivery chain. This meant that in some cases, even where the purpose and intent of the firm was to produce GI products which met genuine customer needs and resulted in good customer outcomes, the firm had not taken appropriate actions to make sure these were being delivered. In setting out our findings and the examples of potential harm identified, we have also referenced the cause of harm where our work allowed us to identify this.

Detailed findings – price and quality

3.8 We identified examples of 3 key types of potential harm relating to pricing and quality occurring within the firms, and these were:

- sub-standard quality/low product value
- excessive prices
- excessive fees and charges

3.9 We set out below how each of these issues can result in harm to customers. We also provide specific examples we identified in our reviews and comment on the probable causes of these issues.

Sub-standard quality/Low product value

3.10 Sub-standard quality products or poor quality service can cause harm to customers. We have seen cases of potentially sub-standard quality products during our reactive supervisory work. In the Express Gifts Limited example, the product sold to customers appeared sub-standard because it had little or no value.

3.11 We had identified products of marginal or questionable value in our thematic reviews on DA and ARs and saw further examples during our VITDC work which had potential to cause customers harm. The likelihood of these issues arising appears greater where multiple parties are involved in the distribution chain. An example is set out below:

Example 1 - Tour operator travel insurance products for coach trips
In our VITDC review we found several examples of tour operators providing travel insurance for coach trips, including short trips made entirely within the UK. These products were bought by (often elderly and potentially vulnerable) consumers as a secondary purchase to the coach trip. The prices charged (some examples were over £20 per person) to insure short UK trips of not more than 5 days appeared very high relative to the risks being covered. Our concerns about the value offered by this insurance product remained following the examination of a monthly bordereaux (report). This showed that only £24,426 of the £92,167 (net of Insurance Premium Tax) paid by 4,320 customers was passed on to the MGA and insurer. The remaining £67,741 was retained by the tour operator as commission.

3.12 **Example 1** has some similarities to the Express Gifts Limited example. It involves a relatively low-value insurance product being sold as a secondary product alongside the primary purchase, in this case a coach tour. This product was net rated. Our review found that neither the insurer underwriting the product nor the MGA manufacturing it were actively considering the price, utility or value of the product to the end customer. This provides an example of a distribution chain where the lack of oversight or understanding of product utility or value, can expose customers to the risk of harm.

3.13 Our findings in this case align with the findings of our 2015 DA review. This found that firms (insurers or intermediaries acting as product manufacturers) had not always carried out sufficient work around the value or performance of products for customers, or how this was affected by the selected distribution approach. Not considering these conduct risks creates a potential for harm. In the cases we looked at, this was often caused by shortcomings in firms' purpose and values. There was a failure to adequately consider risks of harm to customers in the development of products (including considering the intrinsic value or utility of the product) and the related distribution arrangements.

3.14 During our 2018 DA review we found the same issues around product due diligence and the consideration of customer outcomes previously identified in our 2015 review. This indicates that in some firms an environment where customers are exposed to the risks of purchasing sub-standard quality products is being allowed to persist.

Example 2 - Claims services being provided under delegated authority

In our DA review, we saw 1 insurer delegate claims authority to a coverholder and then allow this third party to construct the claims processes and service standards with limited oversight or scrutiny. This included a lack of regular conduct related MI. The insurer was unable to evidence that the service standards were to the standard the insurer applied to equivalent claims they handled themselves. The insurer acknowledged that they could not provide assurance that claims were being handled appropriately. This exposed customers to the risk of harm through poor quality services.

Another insurer continued to rely on the longevity of a relationship with a particular third party. They acknowledged that due to this they had not followed their standard due diligence procedures to ensure that third party claims processes aligned with its own claims philosophy and delivered appropriate customer outcomes. Again, this exposed customers to the risk of harm through poor quality services or poor outcomes.

3.15 It is disappointing that we continue to see examples of issues in the application of core risk and control frameworks which should serve to mitigate the risk of sub-standard products and services being provided to customers.

Excessive prices

3.16 Excessive prices, where prices are disproportionate to the production and delivery costs of products and services customers receive, can harm customers. This includes cases of differential pricing where some customers are charged potentially excessive prices for the product (accepting that others may be paying prices which are below the cost of producing the product).

3.17 We have seen examples of potentially excessive prices coming under public and media scrutiny in recent years. In particular the renewal prices charged to longstanding customers purchasing core insurance products like home insurance. Pricing practices in the home and motor insurance markets are currently being considered in our market study, launched in October 2018. So, we did not consider these products in the course of the VITDC review.

3.18 We did however find several cases of potentially excessive prices relating to 2 motor ancillary products; GAP insurance and 'Scratch and dent' cover, as set out below:

Example 3 - GAP insurance
We saw numerous examples of parties involved in the distribution chains for GAP insurance receiving high (and potentially excessive) levels of commission. The split of the average net premium (after Insurance Premium Tax) between each of the parties in 1 distribution chain we reviewed is detailed below:

Average proportion of net premium to the insurer: 27%
Average proportion of net premium to the wholesale distributor (a GI intermediary): 2%
Average proportion of net premium to the distributor (a car dealership): 71%

Example: For a customer buying a GAP policy for £360 via this particular distribution route this amount would break down as follows:

Commission to the distributor (car dealership): £213
Commission to the wholesale distributor: £6
Net premium to the insurer: £81
Insurance Premium Tax: £60

Example 4 - 'Scratch and dent' insurance
One of the monthly 'Scratch and dent' bordereaux we reviewed listed almost 40,000 policies with total net premium after Insurance Premium Tax of £13.5m. This bordereau aggregated the sales from many different dealerships, selling both new and used cars.

The various parties involved in the distribution chain on average received the following proportions of the net premium:

Average proportion of net premium to the insurer: 33%
Average proportion of net premium to the product manufacturer (a GI intermediary): 13%
Average proportion of net premium to the distributors (a range of car dealerships): 54%

This means that of the £13.5 net premium paid by customers, £7.3m was retained by the distributors, with £4.5m going to the insurer and £1.7m to the GI intermediary who manufactured and administered the product.

Example: For a customer buying a 'Scratch and dent' policy for £300 via this particular distribution route would (on average) pay the following amounts to each party in the chain:

Commission to the distributor (car dealership): £135
Commission to the product manufacturer: £32.50
Net premium to the insurer: £82.50
Insurance Premium Tax: £50

71% of all of the 'Scratch and dent' policies listed on this particular bordereau involved commission levels above 50%. This was broadly representative and consistent with the levels of commission we saw across many similar arrangements where this product was sold.

3.19 **Examples 3** and **4** above relate to motor ancillary products, but we also saw similar issues in some travel insurance products, as well as for furniture and white goods warranty products and add-on insurances like legal expenses (considered in our DA and AR thematic reviews and in our market study on add-on insurances).

3.20 Again, these examples involve products that are net rated. Our review found that neither the insurers underwriting these products nor the MGAs manufacturing them were actively considering the price, utility or value of the product to the end customer. These products may offer genuine utility and value to customers when appropriately distributed and priced. However, the distribution chain as it currently operates creates the risk that the value of these products can be compromised by the remuneration received by some parties in the chain, potentially leading to harm to customers.

3.21 There are 2 other notable features of these particular distribution chains, which appear to be contributing factors to the level of commissions earned within these chains:

- The involvement of parties who are retailers or brands and whose business is predominantly non-regulated (in this case car dealership networks) in the relationship or arrangement. This appears to give a significant degree of influence over the regulated product and its sale (including its price) to these non-regulated parties.
- The point of sale advantage enjoyed by the distributors because these are secondary sales accompanying the sale of another (non-insurance) product. This gives the distributors ownership of the customer relationship.

3.22 These distribution chain characteristics may increase the risk of potentially excessive pricing, but even without them issues can arise. Examples identified both in the media and during our work on household insurance show that potentially excessive pricing can occur and cause harm in core as well as niche GI products.

3.23 The factors within firms allowing these potential harms to occur can include both features of firms' business models and purpose, and the governance and oversight in place around the distribution chain.

Excessive fees and charges

3.24 Excessive fees and charges can harm customers. These excessive fees and charges can take the form of administration fees or surcharges in addition to the standard commissions already paid.

3.25 Our review identified that in many cases firms involved in distributing GI products to customers charge administration fees as well as receiving commission. These fees were frequently applied to all transactions, including both new business and renewal, though the precise amount charged could vary for each transaction. Additionally, we saw cases where fees were added at multiple points within the distribution chain, for example by a wholesale distributor as well as by the retailer who makes the sale to the end customer. The level of the fees relative to the overall cost of the product, and so the impact of the fee upon the value provided to customers varied considerably, as did the level of knowledge and oversight of the fee on the part of the insurer or product manufacturer. Please see Example 5:

Example 5 - Tradesman insurance
The tradesman products we considered were often sold for gross premiums of between £100 and £300, depending on the trade involved and were generally sold on a gross rated basis, at commission levels of between 25% and 45%.

We found that distributors frequently charged customers an additional administration fee as well as the standard commission earned for selling the product. In some cases, we saw 2 administration fees charged – 1 by the wholesale distributor and 1 by the retailer.

Example: One wholesale distributor was charging a flat £20 per policy administration fee in addition to the agreed commission. The distribution arrangements also permitted the retail distributor to add their own administration fee and did not place any controls around this other than stating that any such retailer administration fee should be disclosed to the end customer. There was no oversight or monitoring of the application of fees throughout the chain by the insurer and product manufacturer, and the wholesale distributor did not oversee or monitor the application of fees or disclosure of these by the retailer. This creates the risk that customers could suffer harm through being charged large amounts in administration fees (relative to the overall cost of the insurance) which reduce the value of the product.

3.26 In addition to the examples we saw in our work, which were quite common, we have seen many examples of fees and charges being levied (above standard commission) during our normal supervision, both at the inception of policies and at other points. This shows that this feature is not confined to niche products. The extent to which firms have considered the impact of these fees on customers and the value they receive varies, but in many cases, it is apparent that this has not been formally considered. Additionally, 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. Finally, the quality of disclosure and level of transparency regarding these fees can also vary widely. It is not always apparent whether the fee is consistently communicated to and/or applied to individual customers.

3.27 If firms are adding fees and charges on top of standard commission and the reasons for the charges are unclear, they are inconsistently applied or firms haven't considered their effect on customer value, they can cause harm. This could result from issues relating to firms' purpose and values, or from weak oversight and governance. We most commonly saw issues around purpose and values in cases where distributors appeared to charge fees on an ad hoc basis and weren't being challenged regarding these by either manufacturers or customers. Issues around oversight and governance more frequently related to insurers and product manufacturers who were not aware of the additional fees and charges being levied, the basis for these or their effect on customers.

3.28 We saw examples of this potential harm in various distribution chains involving several firms and a range of different GI products. Again, this harm appeared to occur more frequently in longer and more complex chains with multiple parties involved. If there is insufficient transparency or understanding around fees and charges (both between parties within the distribution chain and for customers) this has the potential to cause reputational damage to the GI sector as well as harm to customers.

Detailed findings – Sales and service

3.29 We identified examples of 3 key types of potential harm relating to sales and service, and these were:

- purchase of unsuitable products
- failure to fulfil obligations to customers
- unavailability of customer services

3.30 We set out below how each of these issues can harm customers. We also provide examples of cases we identified in our reviews and describe some of the probable causes of these issues, as observed through our work.

Purchase of unsuitable products

3.31 The purchase of products can cause harm to customers where the product they buy is inconsistent with their needs. This can happen when firms do not meet their regulatory obligations including considering the customer's needs and, where applicable, providing suitable advice.

3.32 While we saw several examples of distribution chains which created the risk of customers experiencing this type of harm, we also saw many examples of distribution chains where some or all of the firms involved in the chain had undertaken significant work to mitigate this risk. The following 2 examples indicate some of the features that determine the presence or otherwise of this risk.

Example 6 - Travel and GAP insurance potentially sold to ineligible customers or those who do not need cover

Travel:

During our work on VITDC (as well as previously in our thematic review of Principals and their ARs) we saw a sales process for some distributors of travel insurance which exposes customers to the risk of harm, through purchasing policies they are potentially not eligible to claim under. This was particularly relevant to customers with pre-existing medical conditions where we saw cases of 2 stage sales and underwriting processes. These 2 stage processes allowed the customer to purchase and pay for a standard policy before appropriate medical screening had taken place, but then required the customer to follow up with another party for this medical screening (and relied entirely on the customer to do this). The level of clarity and explicit instruction for customers was not always sufficient to ensure that they would necessarily understand the need to undertake this process to be appropriately insured. This creates the risk of harm for customers travelling having paid for a travel insurance policy which they may then not be able to claim on, if the claim relates to pre-existing medical conditions that were not captured during the sales process.

GAP:

We also saw examples of GAP products being sold via elongated distribution chains where there had been insufficient consideration of some of the distributors and the range of customers they were potentially selling to. There was no evidence that the manufacturer had assessed whether the product was appropriate for the markets reached via some of the distributors. In these cases, particularly where some or all of the vehicles being sold were second hand, it was not clear that firms had considered whether these customers actually had any 'gap' needing insurance, or whether this was so small as to all but eliminate the value of the product.

3.33 In the above cases either the length of particular distribution chains or the number of parties involved in supplying services or selling products appear to contribute to increased risks of harm arising to customers, with responsibility for assessing the suitability of the product for the customer dispersed. The potential harms appear to stem primarily from issues of oversight and governance, with the absence of a single party assessing the targeting of the product or of a concerted effort to achieve this from all of the parties involved leading to the risk of harm.

Example 7 - Travel and GAP insurance distribution chains functioning effectively to mitigate sales risks

Travel:

We saw some examples of good practice during our review of travel insurance chains in our VITDC work. Some of these distribution chains were long and complex and covered multiple distribution channels including online and aggregator channels.

Two of the firms we reviewed had undertaken detailed work to consider the target market and customer needs when designing the product and selecting the distribution route. They had a good understanding of the market, the role each party played in the distribution chain, what their respective responsibilities were and had verified that each of the parties involved in the distribution arrangements they were putting in place had appropriate skills and knowledge, and would sell the product to an appropriate target market.

They had set out to produce a product and distribution capability that met customer needs, provided value and resulted in good customer outcomes, and could evidence this.

In addition, they had considered the need for appropriate levels of control and oversight, with suitable MI to allow them to ensure that customers were consistently being treated fairly.

GAP:

Our review of 1 of the GAP insurance product manufacturers we considered found that this firm could evidence the work they had undertaken to ensure that the product was appropriately designed and targeted. The product manufacturer also performed all associated sales training at distributors. This allowed them to mitigate the risks of customers being sold the product where it did not meet their needs.

This manufacturer only offered a single product for 1 particular distribution chain. They could demonstrate that this product was specifically designed and targeted to respond to the needs of customers using this particular distribution chain. They had implemented a clear distribution and pricing strategy for this chain which considered the value the end customer received from the product. They also had appropriate monitoring and MI which they reviewed regularly to identify any potential issues arising.

3.34 These further examples contrast with the previous examples. They show that where firms have the right purpose and values, supported by appropriate oversight and governance, this will ensure that customers are consistently treated fairly and receive good outcomes. It also shows that this can be the case even where there are long and complex distribution and service chains involving several parties.

Failure to fulfil obligations to customers

3.35 Customers can be harmed if firms fail to fulfil their commitments or obligations; at all, partially or in a timely and appropriate manner. This most commonly relates to the failure to deliver particular services or elements of services to customers, for example claims handling or other post sales services (such as providing assistance as part of a travel insurance policy).

3.36 In the case of GI products, firms failing to meet these obligations to customers is particularly critical, as these are the core of what the customer has purchased when they buy a GI product. It is only when the customer has need of the insurance that any issues (either with the upstream processes like product design or sales, or with the arrangements in place to handle their claims or provide assistance) come to light. Failings coming to light at this stage can have a potentially large impact upon consumers and cause them considerable harm. These failures also have the potential to attract significant public interest and cause reputational damage to the firm(s) involved.

3.37 We saw many examples of firms delivering products and services appropriately and appearing to fulfil their obligations to customers. However, we identified several distribution chains and DA arrangements which gave rise to concerns about whether customers were being exposed to the risk of harm. These include the following examples:

Example 8 - Failure to fulfil obligations – Travel insurance and 'Scratch and dent' insurance
Travel insurance:
In many of the GI distribution chains we reviewed key functions were outsourced to third parties to undertake, either via delegation of authority or other outsourcing arrangements. In some cases, this had been done well. There were clear lines of responsibility and expectations regarding both servicing and customer outcomes set out within the contractual arrangements and evidence that these were being adhered to. However, in some other examples there was little in the way of standards, processes and systems and controls put in place to ensure that obligations to customers were met.

One insurance intermediary responsible for the administration of a range of travel insurance arrangements allowed a 3 month backlog of complaints requiring investigation to build up, due to resourcing issues. This occurred when the firm responsible had taken on additional arrangements which affected the administrator's ability to manage the flow of complaints. Additionally, when temporary additional resource was diverted to address the backlog it became clear that some complaints weren't being recorded when received. We saw no evidence that the insurers manufacturing these products were aware of these issues, had performed appropriate due diligence surrounding the firm's ability and resource to manage these arrangements when delegating these activities or were receiving MI to enable them to promptly identify and resolve these issues. This created the risk that customers with legitimate complaints were not receiving an appropriate level of service and may have suffered harm as a result.

Scratch and dent insurance:
For 'scratch and dent' insurance much of the fulfilment of obligations to customers took the form of service provision provided by outsourced partners. In one case, we noticed that the administrator had experienced a surge of issues arising from a particular arrangement where they had taken on a new party to perform these services as volumes of business expanded. However, they had done insufficient diligence work to ensure that this new provider was appropriately resourced to deliver these services or would work to the standards they expected. This resulted in some legitimate claims/requests for services being rejected, and others not being dealt with in a timely manner or customer's vehicles not being repaired to an appropriate standard. This resulted in harm and inconvenience arising to customers. Because the firm had not put in place appropriate monitoring and MI for this arrangement it was a number of months before these issues were identified (as a result of complaint volumes).

3.38 The harms potentially arising to customers because of firms' failings to fulfil their obligations are caused by issues around firms' purpose and values and shortcomings in oversight and governance. We saw examples of both during our reviews.

3.39 In some cases (across a range of products) it was not clear that firms (including insurers and other product manufacturers) were concerned as to whether their customers received those services, or that they were delivered to an appropriate standard and in a timely manner. In these examples, this was often reflected in a lack of due diligence or agreement of standards, policies and processes before entering the relationship.

3.40 More commonly, however, issues arose where firms appeared to have done a reasonable amount of diligence when entering into the arrangements and had set out (in principle at least) their expectations of these parties, but did not have adequate governance and controls to ensure that this was delivered in practice.

3.41 As noted above, a failure to fulfil obligations can cause significant harm to consumers. These types of risks were at the core of the issues identified in our 2015 report on DA. They also underpinned our enforcement case against Liberty, which recently concluded with Liberty being fined £5m. In this context, it is very disappointing that we continue to see these issues.

Unavailability of customer services

3.42 Customers can suffer these harms when a service fails to perform or communicate as expected; for example, due to failures in systems, cyber issues or technology failures or outages. This can result in direct harm to customers, or put the customer in the position where they suffer consequential losses.

3.43 We did not directly observe any such issues during our reviews, but note that there have been issues recently in the GI sector with computer system outages affecting sales and claims processes. Additionally, surge claims events (such as flooding) have historically led to key services being unavailable to some customers. These issues can reduce customers' ability to take appropriate steps to mitigate their exposures, or to respond to the events, resulting in harm. The issue of unavailability occurs most often at the point when the customer has most need of the GI products and services they have purchased.

4 Actions

4.1 We have taken the following actions:

- Set out within this report how some firms and individuals in GI distribution chains do not appear to be fully meeting their regulatory obligations, exposing their customers to the risk of harm.
- Highlighted the implications of new rules in this space, particularly those arising from our implementation of the IDD (including product oversight rules) and the SM&CR. These new rules and the more detailed regulations which accompany them clarify and enhance the obligations on all firms and individuals operating within GI distribution chains.
- Set out our expectations of firms clearly within our non-handbook guidance (that we are consulting on) and this report to provide certainty for firms regarding what we consider is required under our rules.
- Emphasised, in our non-handbook guidance and this report, that assessing the value of the product and services being provided to the end customer is a core component of firms' regulatory obligations.
- Intervened as appropriate using the full range of our regulatory tools where we have seen issues causing harm or potential harm to customers. These interventions include:
  - Fining Liberty over £5m (post reduction for early settlement) in October 2018 following an Enforcement action looking at harms resulting from failings in a GI distribution chain. In this case the harms related to customer service and outcomes, with the actions of a delegated party in rejecting legitimate claims meaning that Liberty failed to fulfil its obligations to customers. Due to issues around its purpose and values, business model and strategy and governance and oversight Liberty was unaware that large numbers of legitimate claims were being rejected.
  - Entering into an agreement in February 2017 with Express Gifts Limited for it to provide £12.5m redress to approximately 330,000 customers who were sold insurance that offered little or no value.
  - Fining The Carphone Warehouse over £29m (post reduction for early settlement) for mis-selling mobile phone insurance and failing to properly investigate and fairly consider complaints arising from the mis-selling. The Carphone Warehouse was the retail distributor in this case. We note that, further to our implementation of the IDD, regulated firms selling directly to customers need to make sure the sale complies with certain standards. These include making sure the product meets the customer's needs and acting honestly, fairly and professionally in accordance with the customer's best interests. Where a regulated firm is selling insurance products through a retailer which is not regulated due to the connected contracts exemption then the regulated firm will need to make sure that the sale complies with these standards.
  - Commissioning two s166 skilled person reviews further to our recent follow-up multi-firm work on DA.

- Set out our proposals to require firms to report GI Value Measures data to the FCA for publication. This information is intended to provide consumer groups, firms and market commentators with additional indicators of value for a range of insurance products. Publishing value measures information aims to address poor product value and quality and reduce the risk of unsuitable GI products being bought or sold.

4.2 We continue to consider the use of the full range of our regulatory tools to address issues identified in these 2 GI distribution chain thematic reviews.

5 Expectations

5.1 Firms must comply with the rules in the FCA Handbook and any relevant legislation. This report sets out our expectations for firms' actions to ensure that they meet their obligations to customers as manufacturers and distributors of GI products. Our expectations are reflected in guidance that we are consulting on alongside this report (GC19/2 – The GI distribution chain: Proposed guidance for insurance product manufacturers and distributors). Subject to any responses we receive to the consultation, we anticipate formalising our expectations in non-Handbook guidance. Following the consultation, we intend to publish the final guidance on our website.

5.2 Our expectations have been mapped to applicable Handbook provisions. This mapping is clearly set out in the accompanying guidance consultation paper.

5.3 Firms should assess their GI activities to consider how they are meeting their obligations under our rules taking into account the draft guidance. If firms have not taken adequate steps to meet these obligations, including assessing that their GI products or services offer utility and value for customers, they must promptly take appropriate measures to mitigate the risk of harm to customers.

Our expectations of insurance product manufacturers

5.4 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.

5.5 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
- 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.

5.6 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.

Product design process

5.7 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 GI market.

5.8 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.

5.9 Where the manufacturer offers a 'net-rate' to another party in the chain[6], they should ensure they receive all relevant information on the remuneration of other parties in the chain, and the final selling price.[7] 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.

5.10 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.

Product distribution strategy

5.11 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.

5.12 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 MI and processes to monitor the value provided by the product, to ensure that the product performs in a

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).

way that is compatible with the needs, objectives and characteristics of the intended customers.

Product review process

5.13 As part of their ongoing product reviews, manufacturers should ensure that they have sufficient, good quality MI to enable them to consider the value provided by the product and the impact the distribution chain has on this.

5.14 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.

Our expectations of insurance product distributors

5.15 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.

5.16 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.

5.17 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 GI
- through analysis of claims or complaints

5.18 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.

5.19 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.

Remuneration

5.20 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.

5.21 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.

5.22 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.

5.23 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).

5.24 Distributors should ensure that they understand the product manufacturer's assessment of the value the product should provide.

5.25 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.

5.26 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.

Distribution process

5.27 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 MI to enable them to understand the value provided by the distribution process.

5.28 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 MI and processes in place to monitor and assess customer outcomes.

6 Next steps

6.1 We are taking the following further actions:

- Sending a Dear CEO letter clearly setting out our expectations to all regulated GI firms.
- Consulting on the guidance published alongside this report which is intended to ensure firms understand their obligations and our expectations. This guidance gives further clarity on our expectations of firms in the GI sector, particularly in terms of how firms ensure that products and distribution arrangements represent value to the customer.
- Undertaking a programme of further communications and engagement with the sector about our findings and our expectations. This will be both directly with firms and via trade bodies.
- Using the information we received in the course of these thematic reviews and continue to obtain from relevant supervisory work to assess the nature and extent of further work required in this area and consider the need for any additional interventions.
- Planning a programme of future supervisory work in this area, both through regular supervisory activities and further thematic or multi-firm work. This future work will involve firms being compared to the regulatory framework applicable 1 October 2018 (with specific focus on the rules introduced further to our implementation of the IDD) and senior managers being considered in the context of the materially enhanced standards arising from SM&CR (as applicable).

6.2 Our future engagements with firms will reflect our focus on these issues, the clarity with which we have set out our expectations and the extent and duration of our previous communications on this subject. In this context, we will not hesitate to use the full range of our regulatory tools where we encounter issues and potential failings at firms causing harm or potential harm to customers.

Pub ref: 005825

12 Endeavour Square London E20 1JN
Telephone: +44 (0)20 7066 1000
Website: www.fca.org.uk