



Institute
and Faculty
of Actuaries

GC 19/2 General insurance distribution chain: proposed guidance for insurance product manufacturers and distributors

IFoA response to the Financial Conduct Authority

9 July 2019

About the Institute and Faculty of Actuaries

The Institute and Faculty of Actuaries (IFoA) is a royal chartered, not-for-profit, professional body. We represent and regulate over 32,000 actuaries worldwide, and oversee their education at all stages of qualification and development throughout their careers.

We strive to act in the public interest by speaking out on issues where actuaries have the expertise to provide analysis and insight on public policy issues. To fulfil the requirements of our Charter, the IFoA maintains a Public Affairs function, which represents the views of the profession to Government, policymakers, regulators and other stakeholders, in order to shape public policy.

Actuarial science is founded on mathematical and statistical techniques used in insurance, pension fund management and investment. Actuaries provide commercial, financial and prudential advice on the management of assets and liabilities, particularly over the long term, and this long term view is reflected in our approach to analysing policy developments. A rigorous examination system, programme of continuous professional development and a professional code of conduct supports high standards and reflects the significant role of the profession in society.



Joe Thompson
Strategy & Competition Division
Financial Conduct Authority
12 Endeavour Square
London
E20 1JN

9 July 2019

Dear Joe,

IFoA response to GC19/2: The GI Distribution Chain

1. The Institute and Faculty of Actuaries (IFoA) welcomes the opportunity to respond to the FCA's Guidance Consultation (GC) on the general insurance (GI) distribution chain. Given the scope of the FCA's proposals within the GC paper, our General Insurance Standards and Consultations sub-Committee and General Insurance Board have been involved in the drafting of our response. Members of the Committee and Board work for a range of product providers and consultancies in the GI sector.
2. It is important to note that, as for any IFoA consultation response, we have considered the issues relevant to the FCA's proposals from the perspective of the public interest.

General Comments

3. The IFoA is supportive of the FCA reviewing the value customers receive from their insurance products, in particular arising from both the product development and distribution approaches used in some sectors of the GI market. Regular review of insurers' product ranges and their features, as well as distribution arrangements, is increasingly important in an era of change driven by technological advancements and changing societal expectations.
4. Our response notes some considerations regarding specific aspects of the proposals which we hope the FCA finds helpful:
 - i) Primary accountability for customer value will differ dependent on whether the distributor is FCA-regulated or not, and the role of the manufacturer in setting the end price. If the distributor sets the end price and they are FCA-regulated then we would expect accountability to reside with them. However, if the manufacturer has been complicit in setting the end price then accountability should be shared. Finally, if the distributor is not FCA-regulated then the manufacturer should ensure the price is set appropriately ahead of distribution.
 - ii) Whilst 'fair' and 'excessive' may be difficult to define, there have been cases where the end cost of insurance has been materially above what is reasonable considering the risk coverage and supply costs. In such a scenario, consumers have been paying significantly more than would be fair in a competitive, open-market situation.

- iii) The customer's best interests rule (ICOBS 2.5) requires firms to act honestly, fairly and professionally in accordance with the best interests of its customers. Our understanding is that this requires firms not to act in a way that is detrimental to the consumer, including by selling inappropriate products which the consumer does not need.
- iv) The FCA's proposals on remuneration may not be straightforward for insurers or distributors to implement, as excessive remuneration is a matter of opinion, and may vary.
- v) If these guidelines stifle innovation in regards to either product design and manufacturing or distribution, not only would this be a negative consequence in and of itself, but it could also deter new entrants to the market, such as insurtech companies.
- vi) Last, but not least, in developing this guidance we ask that the FCA is mindful as to whether its approach is more stringent than that which may be required of European insurers, as this could hamper competitiveness.

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

- 5. Competition, education and transparency through clear/ relevant disclosure are key to achieving the FCA's objective to ensure the insurance market meets consumers' best interests. Paragraph 3.2 of the GC paper explains that firms should consider the value that a product presents for its intended consumers, including consideration of the overall cost to the end consumer. We support this, but note that the value an individual places on a product is subjective and will depend on a variety of factors, including psychological drivers such as an individual's risk appetite, which will vary from individual to individual.
- 6. We wholeheartedly support encouraging effective competition in insurance, as offering a choice of products and providers is key to meeting different customers' needs. However, we are concerned that the FCA proposals as drafted could have an adverse impact on consumer choice as they could restrict the availability of package proposition products.
- 7. When insurance is sold as part of a wider transaction - a package proposition - the consumer is likely to consider the value of the insurance in the context of the wider package. For example, when purchasing extended warranty insurance for a new appliance the consumer may take comfort when that insurance is linked to the distributor. The consumer may also value the ease of having a single point of purchase. However, there is a risk that the consumer selects the distributor based on one component of the package (e.g. the new appliance) and then considers the insurance linked to the distributor (the extended warranty) without any competitive comparison. In this scenario, the market for the package proposition as a whole is not competitive.
- 8. In respect of such package arrangements, our view is that where this is a transparent market for package propositions, it seems misguided to view the insurance commissions in isolation. Retailers may use profits generated from the distribution of insurance products to subsidise sales of the products themselves. The overall impact may be beneficial to the consumer rather than leading to consumer detriment, but this is clearly dependent on the total cost of the insurance to the consumer not being 'excessive'. Conversely, if such margins are cross-subsidising a lower sales price of the associated product, then it may be viewed as an unfair cross-subsidy between those who buy insurance versus those who choose not to.

9. Where the market for the package proposition is not transparent (i.e. the risk scenario described in paragraph 7), there is a stronger case for increased emphasis on value for money around the sale of the linked insurance product.
10. A further example to consider is the holiday car rental market. This market can be highly competitive, where some market participants may try to achieve the lowest rental price to attract custom, and then make margin on 'add-ons', such as insurance. This could potentially lead to consumer detriment if individuals select a packaged based on the car rental rate, and then subsequently discover the (high) cost of the corresponding insurance.
11. Paragraph 4.12 of the GC paper notes that disclosure cannot be relied upon as a satisfactory means of managing conflict or as a measure of last resort in this area. This could discourage the insurance industry from being more transparent and from educating consumers on the insurance value chain.
12. Instead, the issue of distributor commissions being perceived as excessive could be addressed by using disclosure coupled with a cooling off period. For example, such a framework could include:
 - explicit disclosure of commission charges or distribution fees. This information could be supplemented with historical 'cost information' based on FCA market information, such as average commission and loss cost for comparison purpose (though it is questionable whether the consumer can use this information to shop around and purchase alternative cover);
 - a cooling off period permitting no-cost cancellation for a period to allow the consumer the opportunity to shop around; or
 - a simplified combination of these options that places a requirement on the distributor to explain that there are alternative providers, and to draw attention to the cooling off period. This could be strengthened by sign-posting to an independent website that directs interested consumers to alternative service providers.
13. If certain products which are generating higher margins for firms in the value chain are discontinued as a result of the proposed guidance, firms may seek to recoup these margins from the remaining product range.

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

14. As stated in response to Q1 above - competition, education and transparency, through clear/relevant disclosure are key to achieving the FCA's objectives.
15. The IFoA recognises that there can be significant variation in both the degree and form of insurance distributor remuneration, and this is a potential source of consumer harm, particularly for vulnerable consumers. Historically, in some cases insurers have relied on the regulation of the distributors to directly address any conduct issues arising from the distributors setting the end customer price. Putting this onus back on the insurer will in many cases require changes in the monitoring and commercial arrangements between the insurer and distributors.
16. Any potential increased costs in producing the granular management information between manufacturer/ distributor to address this could be costly, with the additional costs being ultimately met by the consumer. One alternative approach to distributor remuneration would be to require the distributor to attest to following (amended) FCA guidance on the impact of remuneration. Although this may require modification of the FCA's proposals and approach, it

may avoid any adverse impact on competition. It would also serve to making the distributor's responsibility in this regard much clearer. A further option to consider is that FCA require each manufacturer to disclose anticipated profit and commission from each distribution agreement in confidence to the FCA.

Q3. Do you have any comments on our assessment of the impact on firms and benefits for customers arising from this guidance?

17. As mentioned above, a requirement for an insurer to know the detailed individual gross price charged to consumers could incur initial set up and ongoing costs. This could have an adverse impact on competition and consumer choice. The intended benefit of the FCA's proposals could potentially be achieved via the alternative of appropriate distributor attestation.

Should you want to discuss any of the points raised please contact Steven Graham, Technical Policy Manager at Steven.Graham@actuaries.org.uk or on 020 7632 2146 in the first instance.

Yours sincerely,



John Taylor
President, Institute and Faculty of Actuaries