

Pro Global

Decoding the General insurance distribution chain review

Summer 2019



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References. FCA thematic review papers TR19/2 and GC19/2.

Introduction

Receiving value from the general insurance (GI) products that customers purchase, has been the subject of a recent review conducted by the FCA.

The FCA found that:

- There is a potential for harm to customers arising from the product development and distribution approaches used in some sectors of the GI market.
- Many customers paid prices which appeared significantly higher than the production and delivery costs of the products.
- Many firms did not adequately consider risks of harm to customers when developing products.
- Some product manufacturers delegate control of the product design (including pricing) to other parties in the distribution chain without proper oversight and without considering the impact on the value of the product.

- Some firms had a lack of appropriate due diligence and oversight of distribution partners.

The Insurance Distribution Directive (IDD) was intended to address many of the same problems

IDD was implemented in the UK on 1 October 2018 and defined new rules for:

- Product design, oversight, governance and distribution;
- Requiring firms to act honestly, fairly and professionally in line with the best interests of the customer; and
- Prohibiting remuneration for insurance distributors and their employees that conflicts with their duty to comply with the customer's best interest rule.

Applicable Sourcebooks SYSC / PROD / ICOBS

General insurance distribution chain review

Key findings

Summary

- All firms in the distribution chain have an obligation to act fairly, honestly and professionally in accordance with the best interests of the customer
- Value is an important consideration for firms when designing products, determining distribution strategies and setting their remuneration structures.
- Manufacturers have an obligation to design, monitor and review products to ensure they meet the needs of the target market, and mitigate the potential for customer harm. This includes considering the cost of the product to the customer and overseeing the impact on value from the distribution chain.

Recurring themes

The FCA found that Customers are suffering harm by not receiving value from their insurance products, the key causes of harm were:

- Failures in product design;
- A lack of robust oversight of the distribution chain;
- Poorly designed product distribution strategies; and
- Conflicts of interest caused by remuneration structures

Pro comment

It's clear that the IDD has not been fully embraced by all product manufacturers and distributors of GI products, and in our opinion this latest review increases the likelihood of the FCA conducting more frequent enforcement activities.

GI product manufacturer

Product basics

Product approval

Firms must have a product approval process, that formalises product design, and be able to evidence:

- 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
- The remuneration received by other parties in the distribution chain

Product design demands special attention

Manufacturers should assess the value their products' offer to customers, by considering:

- Information available to the firm internally;
- Information available externally; and
- The value of an insurance product, by considering the total price that the customer will pay. This includes remuneration of other parties

Pro comment

Where the manufacturer offers a 'net-rate' to another party they should ensure they receive all relevant information on the remuneration of other parties in the chain, including the final selling price. The requirement to fully understand how all parties in the distribution chain are rewarded (and to what extent) will require manufacturers to implement new processes and reporting cycles.

GI product manufacturer

Product basics

Product distribution

Manufacturers must understand the role every party in the distribution chain plays. This should include the value-added to the customer by the involvement of that distributor, and how much each is rewarded.

If a manufacturer delegates activity 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.

Pro comment

Understanding the value-added by every party in the distribution chain is likely to be challenging, especially for remote relationships, such as sub-Brokers.

Product review

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

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.

Pro comment

Measuring value will be a new concept for most manufacturers. Developing new key performance indicators that capture 'value' metrics could be time consuming and expensive. Identifying how customers can be harmed by a GI product is a concept that some manufacturers will struggle to rationalise. Meaningful measurement and robust processes to manage the risk of potential for harm will require creation in many instances.

GI product distributor

Product basics

Monitoring

Distributors must 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.

Distribution

Firms must regularly review their distribution processes to ensure that they are appropriate for the intended market. If a distributor delegates these activities to a third party, they must have adequate systems and controls to ensure that the third party delivers services that meet the needs and objectives of the ultimate customer.

Remuneration

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.

Considering the risk of customer harm

Distributors are expected to identify the initial signs of a product causing customer harm, by:

- Direct interactions with customers;
- Assessments of customers' demands and needs;
- Referencing the data published as part of the FCA's work on value measures in general insurance; and
- By analysis of claims or complaints.

Pro comment

Formalising Product monitoring and quantifying the risk of customer harm will require investment and new reporting and control mechanisms.

GI product distributor

Product basics

When a Product is causing harm

When distributors identify that the product is causing customer harm, they should inform the manufacturer and, if necessary, amend the way they distribute the product.

Firms should be particularly vigilant when:

- A distributor is receiving a level of remuneration which bears no reasonable relationship to their costs or workload to distribute the product.
- A distributor is 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.
- A distributor is 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.

Assessing harm to customers - what to look out for:

- Products which deliver little benefit to customers;
- The lack of an operational capability to identify a product that does not offer value;
- Lack of leadership intent to remedy short comings in the product review process;
- Customers paying substantially more for a product which delivers no additional benefits; and
- Remuneration structures that lead to customers paying increased prices due to multiple parties being in the distribution chain

Pro comment

Distributors should ensure that they understand the product manufacturer's assessment of the value the product should provide. If a firm concludes that its remuneration arrangements conflict with their duty to act in accordance with the customer's best interests' rule, its remuneration arrangements must be changed.

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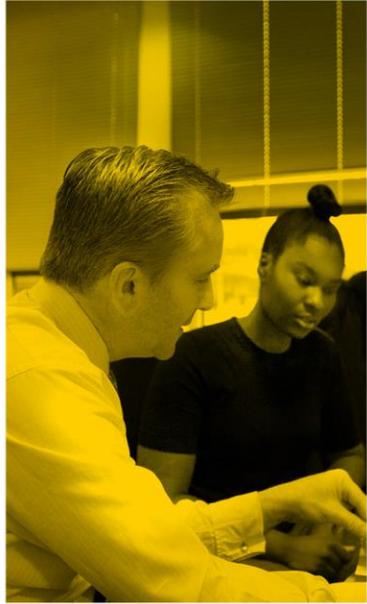
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