

Insights

FCA'S NEW RULES ON GENERAL INSURANCE PRICING PRACTICES - MORE THAN MEETS THE EYE

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SUMMARY

The FCA published today a collection of new 'pricing practices' rules for insurers and insurance distributors. Most headlines will be on the new price-walking prohibition for home and motor insurance, new rules on facilitating the cancellation of auto-renewing policies, and enhanced value measures reporting for home and motor insurance products. However, we think the most problematic new rules released today are the more onerous and opaque requirements upon insurers and their distributors to ensure customers – both retail and commercial - get fair value for money. These product governance rules have come in under the radar and firms need to consider carefully how to update their policies and procedures in order to comply. Time is tight – the implementation period for the new rules ends on 30 September 2021 – so now is the time to get started.

The FCA has today published its policy statement PS 21/5 containing final rules following its general insurance pricing practices market study, CP 20/19. As widely expected, the final rules include:

- A prohibition on the practice of “price-walking” for home and motor insurance, whereby firms increase their prices for existing customers each year on renewal in circumstances where the risk has not changed (resulting in existing customers paying higher prices than new customers);
- A new requirement applicable to auto-renewable insurance policies for firms to provide a range of easy and accessible methods for opting out of an auto renewal. (These rules do not apply to private health, medical or pet insurance.); and
- Enhanced reporting requirements in relation to home and motor insurance products. An extensive List of metrics concerning pricing and claims experience will be required to be reported to the FCA on an annual basis by 31 March in relation to the preceding calendar year.

Less focus to date has been given to the proposed new rules on product governance; but it is very important for insurers and their distributors to be aware of the significant new binding rules and detailed evidential provisions announced today, which require firms to carry out detailed assessments to make sure that each of their products provides fair value for money to customers, both retail and commercial. Our view is that these new requirements are among the most significant regulatory changes contained in this new rule-set.

The FCA has taken a policy decision to apply its new fair value governance rules to both retail and commercial lines, explaining in its policy statement that “we do not propose to exclude other [i.e. other than contracts of large risks] commercial non-investment insurance products from the scope of the PROD requirements, as we consider value to be equally important and relevant to these products”.

These new binding rules introduced for insurance manufacturers and distributors are framed in such a way as to be difficult to disagree with in principle, but also difficult to implement in practice. New rule PROD 4.2.14 A R requires that:

“Firms must ensure that the product approval process identifies whether the product provides fair value to customers in the target market including whether it will continue to do so for a reasonably foreseeable period”.

A further binding rule, PROD 4.2.14E R, sets out to define what the FCA means by ‘fair value to customers’ in this context, as follows:

“In PROD 4, ‘value’ means the relationship between the overall price to the customer and the quality of the product(s) and/or services provided.”

It goes on to provide a long list of the factors that “must” be considered by firms when assessing whether a product provides fair value for money to a customer, including such vague concepts as “the type and quality of services provided to customers” and a complex consideration of whether the price is appropriate, which must include:

“at least the following:

(a) the pricing model used to calculate the risk premium:

(i) for the initial policy term; and

(ii) any future renewal;

(b) the overall cost to the firm of the insurance product (including the underwriting and operating of the product) and, where relevant, any other components of a package;

(c) the individual elements of the expected total price to be paid by the customer including, but not limited to, the price paid for:

(i) the insurance product, including any additional features which are part of the same non-investment insurance contract;

(ii) any additional products, including retail premium finance, offered alongside the insurance product;

(iii) the distribution arrangements, including the remuneration of any relevant person in the distribution arrangements, and including where the final decision on setting the price is taken by another person”.

In respect of the distribution arrangements for a product, insurers are required to conduct a further value for money assessment to identify “any impact which the distribution arrangements are having on the value including whether the distribution channels remain appropriate” (PROD 4.2.35A R). This assessment will require firms to obtain such information from their distributors as they are “reasonably able to obtain” to allow them to assess the impact of the distribution arrangements upon the customer’s value for money. Detailed information about the economics of a distribution arrangement for a distributor is unlikely to be available to insurers in practice. That will raise a conundrum for firms in light of the new rule at PROD 4.2.32A R that “a firm must not use a distribution channel unless it is able to demonstrate clearly that the channel results in fair value to customers in the target market.”

We were among the respondents to CP 20/19 who suggested that further clarification was needed to enable firms to know how to conduct these value for money assessments effectively. The FCA, however, has declined to do so, responding in PS 21/5 that:

“We do not consider it necessary to provide further guidance. Providing specific illustrations on what amounts to fair value or acceptable remuneration for every product, or a standardised template of value data would be impractical and would remove the flexibility for firms to make judgements based on their business. We do not consider either would be beneficial.”

In view of the complex and somewhat abstract new rules and evidential provisions published today, and the implementation period ending on 30 September 2021, our advice to insurers is to get started as soon as possible with reviewing and updating your product governance policies and procedures for both consumer and commercial lines, to ensure you can evidence your ‘fair value’ assessments.

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MEET THE TEAM



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