

FCA SUPERVISORY STRATEGY FOR INSURANCE INTERMEDIARIES

Steven Francis, a partner at Addleshaw Goddard LLP, recently presented a Technical Forum that focussed on the FCA's supervision strategy for insurance intermediaries. The FCA has published its views on the key risks faced by intermediaries and this Bulletin summarises the key points from the forum. The slides and a full recording of the Technical Forum are available on the Member Portal.

DRIVERS BEHIND THE CHANGE

The new Consumer Duty is an important regulatory change that was proposed by the FCA due to the lack of confidence consumers had in the UK financial services industry. The objective is to improve the standard of care firms offer to consumers by putting the consumer's needs first, as a number of harmful practices had been identified.

A non-exhaustive list of the concerns the FCA intend to address via this change, relate to insurance products, (i) where it is difficult to assess value; (ii) which contain long and complicated contracts where the consumer has a limited opportunity to examine the wording; (iii) which act on the behaviour instinct of the consumer; (iv) where policyholders are encouraged not to claim and; (v) which contain invariably long distribution chains.

The key objective is ultimately to make consumers better equipped to make effective choices about products and services that best meet their needs and promote their best interests.

THE CHANGES

The changes will apply to a firm's 'retail market business' and follows the principles set out in ICOBS (Insurance Conduct of Business Sourcebook). A new Consumer Principle will come into force, Principle 12:

"A firm must act to deliver good outcomes for retail customers".

Principle 12 will replace existing Principles 6 (customers' interests) and 7 (communications with clients) and will apply to all of the firm's activities from high level strategic planning to individual customer interactions.

Whilst the rules are set out to be interpreted in accordance with the standard that could reasonably be expected of a prudent firm, they will require firms to consider:

- the nature of the product being offered;
- the characteristics of the target market including the presence of vulnerable persons;
and
- the firm's role.

To assist in delivering the above, the FCA have provided three cross-cutting rules to clarify the FCA's expectations under Principle 12 and four outcomes which represent the key elements of the firm-consumer relationship.

CROSS - CUTTING RULES

A reasonably prudent firm is expected to deliver good outcomes for retail customers. To achieve this:

- A firm must act in good faith towards retail customers (PRIN 2A.2.1R) which requires firms to act with honesty, fairness and consistency.
- A firm must avoid causing foreseeable harm to retail customers (PRIN 2A.2.5R), this can be breached either by act or omission.
- A firm must enable and support retail customers to pursue their financial objectives (PRIN 2A.2.10R), this requires firms to take steps to understand customers' financial objectives.

FOUR OUTCOMES

The following are intended to support the Cross-Cutting Rules:

1. Products and services outcome (PRIN 2A.3) – These rules distinguish between a Manufacturer and a Distributor, who each have their own set of obligations within (PRIN 2A.3). In summary, the new Consumer Duty requires all products and services to be fit for purpose. That means they are designed to meet the needs, characteristics and objectives of customers and are targeted/distributed accordingly.
2. Retail outcome on price and value (PRIN 2A.4) – The key obligation is that the consumer receives fair value i.e. that there is a reasonable relationship between the price paid by the customer and the benefit they can reasonably expect to get.
3. Retail outcome on consumer support (PRIN 2A.6) – This includes support before, during and after any sale of a product. It also ensures that customers do not face unreasonable barriers which will prevent a consumer from realising the benefits of a product or service.
4. Retail outcome on consumer understanding (PRIN 2A.5). These rules apply to all firms irrespective of whether they have a direct relationship with the retail customer, it also ensures that firms' communications give customers the necessary information to support and enable customers to make informed decisions about financial products and services.

It is expected that insurers should carefully identify their target market for products and ensure that distribution methods are appropriate and that products reach the intended target market.

Distributors need to understand the intended value of products and ensure that their distribution arrangements are consistent with providing fair value to the customer.

Where issues are identified, a firm is expected to take appropriate action without undue delay to rectify or prevent any harm arising.

MONITORING

As well as acting to deliver good customer outcomes, firms will need to understand and evidence whether those outcomes are being met. Therefore, a firm must notify the FCA if it becomes aware that any other firm in a distribution chain is not or may not be complying with the rules.

The FCA have commented that it continues to acknowledge that '*consumers should take responsibility for their decisions*' s.3B of FSMA.

Internally, firms must ensure that the consumer duty and related rules are reflected in their strategies, governance, leadership and people policies, including incentives at all levels.

RETROSPECTION

The FCA has stated that most elements of the Consumer Duty would apply on a forward-looking basis only to existing products or services. That said, many long-term contracts of insurance, although entered into some time ago, will have impacts far into the future. The point is that 'retrospection' may be difficult to judge in certain cases.

ULTRA-TERRITORIAL IMPACTS

For insurance businesses the territorial impacts of the Consumer Duty may cause problems. The basic principle is that the duty applies to firms conducting regulated activities in the UK. However this means (for example) that a UK distributor dealing with a local broker in (say) the US in relation to risks located in the US will need to seek information from that local broker so that it can monitor prices and outcomes even though that local broker is not subject to the Consumer Duty rules. The FCA recognises the problem but doesn't offer a solution, other than to point out that the application of the Duty is subject to what is reasonable in the circumstances.

ACTION TO BE TAKEN

The rules and guidance will come into force on a phased basis:

1. By 31 October 2022, firms' boards should have agreed their implementation plan and be able to evidence that they have scrutinised and challenged the proposed plans to meet the new standards.
2. By 30 April 2023, Manufacturers (i.e. mainly insurers in the insurance context) should aim to complete their review to meet the Four Outcomes.
3. By 31 July 2023, the Consumer Duty will apply to all new products and services, and all existing products or services that remain on sale or open for renewal.
4. By 31 July 2024, the Consumer Duty will come fully into force, applying to all closed products and services.

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