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29 July 2022

Dear Sir/Madam,

Product Governance and Fair Value – General Insurance and Pure Protection

Background

In May 2021, we published [Policy Statement 21/5](#) (updated in [PS 21/11](#)) setting out our final rules on insurance pricing and the enhanced product governance. These were designed to improve competition and ensure firms offer fair value products to consumers.

The enhanced product governance rules came into force on 1 October 2021, and apply to manufacturers and distributors of all general insurance and pure protection products (except [contracts of large risks](#) or reinsurance contracts).

In August 2021, we conducted a market survey which assessed firms' readiness to comply with the final rules. Following this work, we sent a letter to all insurance intermediary firms with general insurance permissions setting out that we expected those firms to:

- establish whether it was a manufacturer or distributor of general insurance or pure protection products (excluding contracts of large risks or reinsurance contracts);
- assess the impact of the enhanced product governance rules on the firm; and
- take the necessary steps to ensure compliance with the enhanced rules that came into effect 1 October 2021.

Following on from the August 2021 survey, we conducted a multi-firm-review (MFR), commencing with a survey of firms in February 2022, the purpose of which was to assess whether firms that manufacture insurance products were:

- undertaking the necessary work to comply with rules and guidance in relation to product governance and oversight under PROD 4.2; and
- putting in place product approval processes that identified whether their products provide fair value to consumers and will continue to do so for a reasonably foreseeable period in line with PROD 4.2, PROD 4.3 taking into consideration distributors' obligations (which came into effect on 1 October 2021) and PROD 4.5 (which came into effect on 1 January 2021).

Firms were given a one-year transitional period from the date the enhanced PROD 4.2, PROD 4.3 and PROD 4.6 rules came into effect to: (a) apply product approval processes under PROD 4.2 (including fair value assessments) for legacy non-investment insurance products manufactured before 1 October 2021 (and had not been put through a PROD 4 approval process); and (b) ensure

existing non-investment insurance products, which had already been approved under PROD 4, meet the fair value requirements in PROD 4.2. This transitional period ends on 30 September 2022.

For new products or significant adaptations to existing products from 1 October 2021, the enhanced rules took effect immediately. Firms are also required to have the appropriate systems and controls for product governance in place with effect from 1 October 2021.

Summary of our key findings

1. A third of manufacturers have scheduled a significant proportion of their product reviews including the fair value assessments in Q3 2022. This means that many manufacturers may be leaving it too late and therefore would not have adequate time to make any required changes to their products and their distribution to ensure fair value in order to prevent the risk of harm to consumers. This also means many manufacturers plan to share their value assessments with their distributors in September 2022, leaving distributors very little time to understand the outcome of the manufacturer's value assessment.
2. Some manufacturers intend to share the outcome of their value assessments via a generic web-based outcome statement. Such an approach may not provide enough information to distributors to enable them to understand the outcome of the value assessment and so lead to further delay in the completion of the required fair value reviews.
3. Over a third of the manufacturers in the survey told us they had not undertaken the value assessment as required under PROD 4.5 and so were unable to indicate they were in compliance with those rules. The majority we spoke to said while they had undertaken some type of value assessment, they are unlikely to be able to evidence that they had fully complied with PROD 4.5.
4. Some manufacturers identified challenges in obtaining information from the entire distribution chain to undertake their value assessment. This was particularly so where the distributor was an overseas entity. Some manufacturers are adopting a "best endeavours" approach to obtaining the information to undertake the value assessments.

We are disappointed with the progress made by many manufacturers which falls short of our expectations on timely implementation. The outcome that we expect these rules to provide is that consumers are assured that the products that they are sold offer fair value to them. Taking a "one size fits all" approach or leaving implementation until the very end of the transitional window is unlikely to result in a compliant process and/or would not ensure that customers are getting the fair value that they deserve.

Further, this approach by manufacturers will put increased pressure and strain on distributors to understand the manufacturer's value assessment, to identify the value the product is intended to provide and to understand the impact of the distribution arrangements on the overall value of the product to the customer. To ensure that there is no material impact on consumers, we have set out how we will approach our supervision of distributors' implementation of these rules. Please see separate correspondence on this.

Summary of our expectations and actions for firms

Expectations for manufacturers

We expect manufacturers to:

1. Complete their fair value assessment(s) in good time so that they meet the necessary deadlines including to make any required changes to their products/distribution arrangements where they have identified there is not fair value and to ensure they are

providing the necessary information to distributors, to prevent the risk of harm to consumers.

2. Share the required information with distributors under the rules including relevant information on the value assessment in good time as both manufacturers and distributors must be compliant with PROD 4 by 30 September 2022. Where a product does not offer fair value, it must be withdrawn from the market or the necessary changes made to ensure it does provide fair value.
3. Ensure that the information that is provided to distributors is sufficient (and detailed enough) to enable them to understand the outcome of the value assessment as required under PROD 4.3.
4. Have taken all necessary steps to have appropriate product governance frameworks in place and be able to demonstrate compliance with PROD 4. This must include demonstrating their products provide fair value to customers in the target market, and whether it will continue to do so for a reasonably foreseeable period.
5. Include in the governance framework in 4 above, the appropriate policies and procedures in place to ensure compliance with PROD 4.5 and be able to demonstrate all relevant products offer fair value to consumers on a continuing basis.
6. Ensure that they have identified all their products covered by the value measures rules and that they offered fair value to customers from 1 January 2021 in line with PROD 4.5.4R. Should they find that any of the products did not offer fair value on a continuing basis from 1 January 2021, they must take appropriate action, including appropriate remedial action where this has, or may have, caused harm to customers.
7. Take all reasonable steps to obtain the information required from their distributors to enable them to undertake their product reviews including a fair value assessment as set out in PROD 4.

We have noted manufacturers' challenges for obtaining information where the distributor and customer is located overseas. We appreciate that many firms have been using a "best endeavours" basis, utilising information already held by the firm to undertake their value assessments for those products where the distributor and customer is located overseas. We are considering further action to assist firms undertaking these reviews (see section 5b. – International Distribution and Action for the FCA for further information).

Expectations for distributors

We expect distributors to:

1. Ensure they have taken the necessary steps to complete their assessment of how any distribution strategy set up or applied by the distributor is consistent with the aim of providing fair value to the customer. This must include, where the distributor is responsible for packaging the product with other products (including offering premium finance), consideration of whether these arrangements are consistent with the aim of providing fair value to a customer and any package does not have a detrimental effect on the intended value of any non-investment insurance product. For distribution arrangements for non-investment insurance products in scope of the transitional provision, this must be completed by 30 September 2022.
2. Engage with the manufacturers of the products they distribute, to obtain the manufacturer's value assessments at the earliest opportunity to ensure that they comply with their obligations under PROD 4.3. This should ensure that they are getting the level of information that will enable them to identify the value the product is intended to provide and the impact of the distribution arrangements on the overall value of the product to the customer.
3. In line with PROD 4.3.10, distributors shall upon request provide manufacturers with relevant information to support the product reviews (including the value assessment) carried out by the manufacturers.

What we did

We requested information (via the Product Governance and Fair Value information request survey) from a sample of 96 firms (including insurers, managing agents and intermediaries) of varying sizes and business models from different sectors of the general insurance and protection market, all with responsibility for manufacturing products.

We reviewed and analysed this information and followed up with 'virtual meetings' with Senior Managers and other relevant staff in 17 of these firms.

We then evaluated our findings against relevant Handbook rules and guidance, applicable at the time of the review. For the purposes of this letter, we would draw your attention to the Handbook definitions of manufacture and distribute in relation to insurance:

- **Manufacture:** (in relation to [PROD 1.4](#) and [PROD 4](#)) creating, developing, designing and/or underwriting a contract of insurance.
- **Distribute:** (in relation to [ICOBS 1](#), [ICOBS 6B](#), [PROD 1.4](#) and [PROD 4](#)) advising on or proposing a contract of insurance to a customer.

What we found

1. Manufacturers' product reviews and value assessments – PROD 4.2 and PROD 4.6

A product manufacturer has until **30 September 2022** to review each product in scope of the transitional period for PROD 4 and ensure that it meets the fair value requirements in PROD 4.2. Firms' responses to our survey showed that:

- a third of manufacturers had a product review schedule which extended into September 2022; and
- some of these firms planned to undertake a significant proportion of product reviews in Q3 2022. Our meetings with firms confirmed this remains the current position for many of these firms. A small number of these firms had brought forward their target end date to an earlier date in September or into August 2022.

Whilst most manufacturers we met were confident of meeting the 30 September 2022 deadline, there remains a real risk that some firms might not be fully compliant by the deadline.

Our expectations and actions for firms

We expect product manufacturers to:

- be compliant with PROD 4.2 (including as applied by PROD 4.6) by 30 September 2022 for non-investment insurance products to which the one-year transitional period since the rules were introduced on 1 October 2021 applies;
- aim to complete their fair value assessment in good time and well ahead of the 30 September 2022 deadline so that they can also make any required changes to their products and their distribution to prevent ongoing harm to consumers in time for the 30 September 2022 deadline. There is clear benefit for manufacturers in doing so as it will better enable distributors to meet their obligations and so permit ongoing distribution of the relevant products;
- share sufficient information on the value assessment with their distributors in good time so that distributors are able to meet their own obligations under PROD 4 by 30 September 2022 for products to which the transitional period applies, including to enable them to identify/ understand the value the product is intended to provide, and the impact of the distribution arrangements on the overall value of the product to the customer;

- continually assess whether there is a risk of not meeting the regulatory deadline to complete the product reviews and fair value assessments, and to take appropriate action where required to ensure compliance; and
- have contingency plans, which should include setting out their approach and the actions they will take where the regulatory deadline may not be met. This should include consideration of those products where the firm might not be able to form a view on whether the product provides fair value and/or whether there is or may be a breach of a rule that requires reporting to the FCA under SUP 15.3.11R.

2. Product distributors' - fair value assessments – PROD 4.3

A product distributor, in relation to products it does not manufacture, has until 30 September 2022 for products in scope of the transitional provisions, to put in place adequate arrangements to meet the rules in PROD 4.3 (including as applied by PROD 4.6). This includes being able to understand the outcome of the manufacturer's value assessment for each product they distribute and any identified group of customers for whom the product is not expected to provide fair value. These distribution arrangements must enable the distributor to identify the value the product is intended to provide and the impact of the distribution arrangements on the overall value of the product to the customer.

In addition, product distributors must assess the impact of their own activities on the fair value of the product. This must include considering things like the distribution arrangements and where they package the product with other products including when offering premium finance as distributors have responsibility for the overall package.

Distributors need to obtain the necessary information from manufacturers, and we found that some distributors are actively requesting information from manufacturers, in particular, the value assessment. However, many manufacturers in our review commented that it was only a very small number of their distributors who had done so.

Based on the survey, a third of manufacturers are unlikely to be able to share one or more of their fair value assessments with distributors until September 2022 at the earliest, as their planned product review schedule extends, in some cases, to the end of September 2022. This may be too late to enable distributors to comply with their obligations under PROD 4.3, where they also have a deadline of 30 September 2022.

Our expectations and actions for firms

We expect manufacturers to:

- take into account the need for distributors to also implement the rules by 30 September 2022 when completing their product reviews and to aim to complete their product reviews in good time ahead of the regulatory deadline of 30 September 2022. There is clear benefit for manufacturers in doing so as it will better enable distributors to meet their obligations and so permit ongoing distribution of the relevant products; and
- share completed value assessments with their distributors in good time as both manufacturers and distributors must be compliant with PROD 4 by 30 September 2022, for products in scope of the transitional provisions.

We also expect distributors to:

- assess the impact of their own activities on the fair value of the product. This must include considering things like the distribution arrangements and where they package the product with other products including when offering premium finance as distributors have

responsibility for the overall package. The rules provide that this should be completed by 30 September 2022 for those products in scope of the transitional provisions; and

- engage with the manufacturers of the products they distribute, to obtain the manufacturer's value assessments at the earliest opportunity to ensure that they comply with their obligations under PROD 4. This must include sufficient information to allow for identifying the value the product is intended to provide and the impact of the distribution arrangements on the overall value of the product to the customer.

3. Manufacturer's product value assessments information – PROD 4.2 AND PROD 4.3

Some manufacturers are intending to share the outcome of some of their product value assessments with distributors via a generic web-based outcome statement rather than providing a value assessment tailored to the distribution arrangements the manufacturer has for the product. A generic approach increases the risk that distributors are not given sufficient information to enable them to understand the outcome of the manufacturer's value assessment and:

- whether the distributors own activities are correctly reflected in the manufacturer's value assessment; and
- the impact the distribution arrangements have on the overall value of the insurance product to the customer.

Our expectations and actions for firms

We expect a manufacturer's value assessment which is being shared with a distributor, to be sufficiently detailed to enable the distributor to identify the impact that the distribution arrangements (including any remuneration it, or another person in the distribution chain to which it belongs, receives) has on the overall value of the insurance product to the customer.

4. Value measure products – manufacturer fair value assessments – PROD 4.5

67% of the 88 product manufacturers in the survey told us that they had not undertaken a value assessment as required under PROD 4.5 which came into effect on 1 January 2021. Of the 17 manufacturers we spoke to, 88% told us they would be unable to evidence that they had complied with the requirements under PROD 4.5.

None of these firms had undertaken a gap analysis against their existing product oversight and governance framework or processes to identify any gaps to ensure compliance with PROD 4.5. Therefore, they were unable to demonstrate that they were ensuring, on a continuous basis, each of their value measures products offered fair value to customers in the target market, in line with PROD 4.5. However, all firms that we engaged with confirmed that:

- they were continually assessing the value of their products including the value measures products; and
- their existing product oversight and governance processes would have included consideration of the value provided by the individual products and would have encompassed one or more of the requirements under PROD 4.5.4R.

We further noted that all firms that we engaged with:

- were compliant with FCA value measure product reporting requirements under SUP 16.27; and

- confirmed they were now either fully compliant with the requirements under PROD 4.5 to ensure their value measure products provided fair value, or that they would be by 30 September 2022.

Nevertheless, these findings regarding firms' non-compliance with PROD 4.5 are extremely concerning to us and we expect firms to take appropriate action to remediate any shortcomings.

Our expectations and actions for firms

- Manufacturers should ensure they have in place effective procedures and processes as part of their product oversight and governance framework, to ensure compliance with PROD 4.5, including ensuring each of their value measures products offer fair value to consumers on a continuing basis.
- We expect firms to take the necessary steps to identify that all their value measures products were providing fair value from 1 January 2021 as required under PROD 4.5.4R, where they have not already done so. Should they find that any of their value measures products do not offer fair value on a continuing basis from 1 January 2021, they must take appropriate action, including appropriate remedial action in particular where this has, or may have, caused harm to customers due to the lack of fair value.

5. Product manufacturers – market collaboration and obtaining information – PROD 4.2

a. Domestic distribution

Product manufacturers are generally engaging with their distributors (using a market or other template-based approach) to obtain the necessary information to undertake their fair value assessments. However, many firms commented that obtaining this information is proving challenging and they are having varying levels of success. Some manufacturers may, therefore, not receive the information required from all distributors to enable them to complete all their fair value assessments by the regulatory deadline of 30 September 2022. Many firms told us that they already hold information on commissions but not for fees and charges.

A small number of manufacturers told us they are not seeking to obtain details of the remuneration of all firms in the distribution chain, or the levels or quality of service provided by those firms, in respect of some of their standard mass market products e.g., home/private motor.

These firms are instead adopting a 'best endeavours' approach to value assessments and ultimately documenting whether, in their view, the product provides fair value to customers in the target market. This included, in some cases, the manufacturer incorporating a maximum fee or charge into their product value assessment along with the commission which is known to the manufacturer. These firms were then intending to produce a generic product value assessment and told us they would make clear to the distributors the maximum fees and charges taken into consideration in the value assessment. And that if an amount above the maximum fee is charged, it could impair the value of the product. Many of these firms had large distribution networks.

These firms said they would be able to 'form a view' on the value of the product based on information they already hold should they not receive all the information required from the distributor as set out in Prod 4.2.

In these circumstances, the product manufacturer may not be able to establish:

- the expected total price paid by the customer when buying or renewing the insurance product, and the elements that make up the total price; and
- the relationship between the overall price to the customer and the quality of the product(s) and/or services provided.

It is for firms to ensure they are meeting the requirements around fair value. We have been clear about the need for oversight by product manufacturers who are responsible for the overall distribution arrangements to ensure the distribution chain does not detrimentally affect the value being provided to customers. Manufacturers responsible for considering their distribution arrangements will need to ensure they are discharging their obligations properly without seeking to pass responsibility to others in the chain.

b. International distribution

The Lloyd's and London market firms that we met explained the difficulties and complexities they are facing regarding their international business. This related to obtaining information from overseas distributors as these overseas entities sit outside the FCA's jurisdiction and have no regulatory obligations of their own in this regard. These firms advised they would be compliant with PROD 4 by the regulatory deadline of 30 September 2022 for products where the insured risks are UK based. However, regarding their international business, these firms have said that the product reviews and fair value assessments are being undertaken on a "best endeavours" basis, utilising information already held by the firm and any information they have been able to obtain further to their requests of their overseas distributors.

Our expectations and actions for firms

We expect manufacturers to:

- have appropriate product governance frameworks in place and be able to demonstrate that their products provide fair value to customers in the target market, including whether it will continue to do so for a reasonably foreseeable period;
- take reasonable steps to obtain the information from their distributors to enable them to undertake their product reviews including a fair value assessment as required by PROD 4;
- continually assess whether there is a risk of them not receiving the information required from distributors to enable them to complete their reviews and fair value assessments by 30 September 2022 for those products in scope of the transitional provisions; and
- have contingency plans to address the above scenario and their approach to product reviews where they are not satisfied that the product offers fair value and have not received the required information from their distributors. This should include considering what actions might be appropriate to protect their customers. Where the manufacturer is not able to form a view on whether a product provides fair value, it must be withdrawn from the market until such time the firm can ascertain that the product offers fair value.

We have noted manufacturers' concerns that they have faced challenges in their ability to obtain information from overseas distributors in relation to customers with risks based overseas. We are considering what steps we can take where firms are unable to comply with these requirements despite taking all reasonable steps to obtain the required information. Our considerations include whether the collection of this specific information is

unduly burdensome and/or within the intended aim of the PROD fair value rules for business wholly relating to overseas distributors and customers. Subject to the outcome of this, we will be considering if this requirement could be modified or waived in light of the concerns raised. We expect firms to carry out a fair value assessment of all products being distributed which are not large risks, taking account of all relevant information currently available to, or reasonably obtainable by them.

Next steps

Actions for the FCA

- As well as publishing this letter we will provide individual feedback to firms included the review as deemed appropriate and will consider the need for additional interventions, using the full range of our regulatory tools as appropriate.
- We plan to undertake a second phase of MFR encompassing both product manufacturers and distributors. This would focus on the appropriateness of firms' product oversight and governance frameworks. It would include the product approval process and the product reviews (including fair value assessments) carried out in accordance with PROD 4.
- We will continue to consider firms' compliance with the PROD rules and to assess the need for further action, in line with the expectations set out in this letter. Should we find any firm to be non-compliant, we will consider our full range of regulatory tools to hold firms and their senior managers to account. As such, we reserve our position in relation to any breach of PROD 4 rules. This means the FCA could consider taking further action where appropriate, even if firms address the non-compliance we have identified.
- We are considering how [including whether a modification or waiver would be appropriate] to address the feedback from firms about the practical difficulties they have experienced in meeting the PROD 4.2 requirement to obtain information from international distributors when undertaking the fair value assessment.

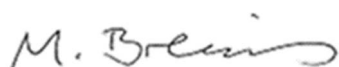
Actions for firms

We are sharing our findings with your firm, so that you can address any relevant issues which apply to your firm. You should consider these findings and how they apply to your own activities. This may help you to identify where there are gaps or weaknesses in your current approach.

Whilst we reviewed only a sample of manufacturing firms in the sector, the findings are relevant to all general insurance and pure protection firms and particularly, those that manufacture these products. All manufacturers are required to ensure that their products provide fair value and should be able to demonstrate how they have reached this conclusion. Additionally, it should be clear who within the business is responsible for product governance and therefore responsible for consumers getting fair value when they purchase an insurance product from the firm.

We expect your firm to carefully consider the content of this letter in the context of your own activities and the applicable rules and, be able to explain and evidence any actions you have taken as a result.

Yours faithfully,



Matt Brewis
Director, Insurance