

HOW DOES THE CONSUMER DUTY APPLY TO THE UK INSURANCE SECTOR?

The Financial Conduct Authority ("FCA") recently published its policy statement and final rules and guidance setting out how it intends to implement its new Consumer Duty ("the Duty") in [Policy Statement 22/9](#) and [Final Guidance 22/5](#). The Duty is described as the 'cornerstone' in the FCA's strategy of setting higher standards of consumer protection in retail financial markets. The Duty marks a return to a more outcome-focused approach by the regulator and will place the onus on firms to proactively assess and evidence the extent to how they deliver good consumer outcomes.

The framework of the Duty, which was described in [Consultation Paper CP21/36](#), published in December 2021 and which followed [Consultation Paper CP21/13](#), published in June 2021, continues to comprise the Consumer Principle, cross-cutting rules, and four outcomes. There are now significant clarifications regarding how the Duty relates to "retail consumers," as well as new guidelines for the insurance industry that cover how the Duty applies to the distribution chain. The implementation timeline is also confirmed with a deadline of 31 July 2023 for all in-scope new and existing products and services that are open to sale or renewal and 31 July 2024 for closed products and services.

The final rules and guidance are discussed in this briefing together with the implications for the UK insurance industry, including insurers and distributors. For an in-depth analysis of the final Duty requirements and commentary on the duplication of Duty against existing FCA requirements, please refer to our briefing: [Consumer Duty: FCA issues final rules and guidance – September 2022](#).

STRUCTURE

The Duty is the standard of care that applies to products and services offered to 'retail consumers'. The FCA confirmed that the retail consumer definition broadly aligns with the scope of the relevant FCA conduct requirements for each sector. For insurance, the scope will follow the position in the Insurance Conduct of Business Sourcebook (**ICOBS**) which means that the Duty will not apply to reinsurance, contracts of large risk sold to commercial consumers or other contracts of large risk where the risk is located outside the UK. Nor will it apply to activities connected to the distribution of group insurance policies or the extension of these policies to new members.

The FCA has confirmed the final rules that underpin the Duty's framework, even though the framework itself has not changed. Firms should familiarise themselves with the Duty's hierarchy of the framework and its components to understand how the layers of the FCA's new requirements interact with one another:

- The Consumer Principle – this is an overarching new Principle 12 that requires firms to deliver good outcomes for retail consumers. It is supported by new rules and guidance in PRIN 2A.
- The cross-cutting rules – the FCA's expectations under the new consumer principle are made clearer by the cross-cutting rules, which expand on the four outcomes. The cross-cutting rules require firms to act in good faith, avoid causing foreseeable harm and enable and support retail consumers to pursue their financial objectives.
- The four outcomes – this comprises rules and guidance which relate to four outcomes the FCA wants to see under the Consumer Duty, namely the governance of products and services, price and value, consumer understanding and consumer support.

The FCA expects the Duty to be dynamic and adaptable so that it can apply to new products, services, and business models as the UK financial services sector continues to grow and become more digital. The Consumer Principle, despite being challenging for firms to apply in practice, is the most adaptable due to its generic language. The cross-cutting rules and four outcomes are less flexible due to the number of specific rules and guidance, but they should provide the insurance sector with more clarity on the FCA expectations in terms of innovation, competition, and creative solutions for policyholders.

APPLICATION

To comply with the Duty, firms need to proactively assess how they can evidence favourable consumer outcomes. Firms, therefore, face a significant task over the next few months in embedding the new Consumer Duty within their organisation and identifying and

implementing the changes needed. Despite the FCA's clarification that the Duty does not apply retroactively, firms should nonetheless consider how the Duty would affect products created and sold before the Duty's implementation, including closed books, to ensure that the Duty is applied correctly from the dates of implementation.

The Duty's potential application is very wide-ranging, covering everything from adjustments to a policyholder's future payments related to an existing or legacy policy (since a consumer can terminate a contract without paying an exit fee if the good or service does not provide fair value) to additional considerations for firms acquiring closed books in the future. Buyers of closed books which have long-term contracts, such as mortgage lenders and life insurance companies, will therefore need to undertake additional due diligence to fulfil their obligation to the consumer after the purchase.

According to the FCA, the concept of reasonableness will be embedded at all levels of the Duty, which means that the FCA will evaluate a firm's behaviour under an objective standard. The test of reasonableness will be influenced by several additional variables. These factors include the nature of the product (where it carries a higher risk or is more complex, extra caution will be needed), the characteristics of the target market(s), including the existence of any characteristics of vulnerability, and the firm's position in the distribution chain. Firms will then need to implement governance standards to monitor how the Duty is being followed. The details of each of these factors are discussed below.

NATURE OF THE PRODUCT

The four outcomes are important in determining if an insurance policy is suitable for a consumer. A firm must make sure that insurance supplied to a consumer is designed to meet their needs, characteristics, and objectives. Policyholders are expected to pay a price for insurance coverage that is fair to them and have access to the information they need to make informed decisions in a timely manner and receive support as needed. Firms should be aware that the Duty applies to any "significant changes" they intend to make to their products or services while evaluating the nature of the product offering. This could entail changing the product or service's target market, adding, or eliminating features, and modifying any additional terms and conditions. Therefore, modifying the wording of an insurance plan to clarify the coverage might not count as a significant change. However, if the adjustment reduces the amount of coverage, this will constitute a significant change and necessitate re-evaluation through the approval procedure.

In the general insurance pricing practices work recently undertaken by the FCA, it was found that price walking (i.e., the practice of increasing prices on renewal for a loyal consumer above that for new customers) can lead to some consumers making significant overpayments which do not provide fair value. Such practices would not meet the requirements of the Duty. However, the FCA does not believe that all differential pricing between new and existing consumers necessarily causes harm. Where upfront discounts are clear and transparent, and the firm can demonstrate that both groups are receiving fair value, then this could meet the standards of the Duty.

Firms should also note that the Duty does not oblige them to go above and beyond what consumers might reasonably expect from the provision of a service. For instance, while a firm must not erect unreasonable barriers that prohibit or deter a policyholder from moving to cheaper insurance, the Duty does not place a duty on the firm to offer the policyholder a cheaper insurance contract or to educate the policyholder about cheaper possibilities elsewhere.

VULNERABLE CONSUMERS

Following calls for clarity on the characteristics on which the FCA would like firms to focus, the FCA has added guidance to state that the Duty requires firms to focus on the needs of consumers in vulnerable circumstances and those with protected characteristics under the Equality Act 2010. Other concepts such as neurodiversity and socio-economic background could be useful for firms as they consider how to meet consumers' needs, and may overlap with the concept of vulnerability as explained in [FG21/1 FCA Guidance for firms on the fair treatment of vulnerable consumers](#), but the FCA has not introduced new requirements relating to these groups of consumers. In response to feedback, the FCA eliminated language in the final Duty guidelines that described serving a hypothetical "average consumer," realising that the terms could obscure vulnerability.

The Duty does not require firms to collect new data about their policyholders' protected characteristics. Where firms hold data about policyholders' protected characteristics, the FCA expects firms to use this as part of outcomes monitoring, where possible, following data protection law. Since the Duty is underpinned by the concept of reasonableness, the frequency and nature of monitoring that the FCA will require will depend on circumstances such as the size of the firm and its relationship with the policyholder. Guidance has been included to clarify these expectations which should allay concerns of firms given the extent of MI and personal data that would need to be examined (and updated) to determine whether vulnerable consumers are correctly captured.

INSURANCE DISTRIBUTION

Since the insurance industry has already implemented the Insurance Distribution Directive ("**IDD**") including the Consumer's Best Interest rule, and IDD product oversight and governance requirements, many of the main themes and ideas supporting the new Duty will already be familiar. However, there will still be additional work involved for firms to comply with the Duty.

The Duty will apply across the distribution chain and will apply to all insurance distributors where their activities can "determine" or have a "material influence" over retail consumer outcomes, along with additional guidance on what the FCA means by these terms and circumstances in which the Duty is unlikely to apply. The FCA has confirmed that neither the distribution of group insurance plans nor the addition of new members to these policies are covered by the Duty. Although if the final consumer is an individual,

the creation of group insurance policies will still be governed by the new Consumer Duty (which is common for this kind of insurance cover).

Firms are only expected to be accountable for their operations; they are not required to monitor the operations of other firms in the chain. As the Duty applies to firms through the distribution chain, there may be situations in which firms disagree as to the best way in which to provide good consumer outcomes. In such cases, the FCA advise that a firm identifying consumer harm elsewhere in the chain must raise the concerns with other relevant parties. In compliance with Principle 11¹, a firm must also notify the FCA when it becomes aware that another firm in the distribution chain may not be complying with the Duty.

Governance

The Duty imposes new obligations on the boards of insurers and insurance intermediaries, including reviewing and approving a firm's report on the outcomes being received by retail consumers, stating whether it is satisfied with the firm's compliance with the Duty, and determining whether the firm's future business strategy is consistent with its obligations under the Duty. Additionally, the board must now show that it has approved the firm's Consumer Duty implementation plans and that it has examined and scrutinised them to make sure they are deliverable and robust. This must occur by the end of October 2022.

Firms must also ensure that the Duty is incorporated into its strategies, governance, leadership, and people policies, including incentives at all levels, and that retail consumer outcomes are the main focus of its risk and internal audit functions, according to the new requirement at PRIN 2A.8.1R. Firms should then prepare for the FCA to request implementation plans, board documents, and minutes, and to question the information included in them. The FCA also expects firms to have a Consumer Duty champion at the board or equivalent management body level, who should be a NED where possible.

Interacting with the above governance piece, the Duty also introduces a new Individual Conduct Rule 6 in the FCA's Code of Conduct sourcebook ("**COCON**"). This will require staff who are subject to the conduct rules to act to deliver good outcomes for retail consumers. The FCA has added more detailed guidance in COCON, including clarifying individual accountability responsibility where a firm does not have an end client relationship as well as more detail around seniority, expertise and experience and commensurate expectations under COCON. Although the Duty does introduce individuals and board accountability, the FCA has not provided a private right of action for breaches of any part of the Duty at this time. This is to allow firms the time to embed the Duty without the prospect of private action being brought.

NEXT STEPS

Due to the Duty's sizeable scope, preparation for implementation will require careful planning. The implementation timeline is being phased in, with a deadline of 31 July 2023 for all in-scope new and existing products and services that are open to sale or renewal and 31 July 2024 for closed products and services, even though boards (or equivalent management body) are tasked with agreeing on implementation planning by the end of this October. Firms may want to take the following into account to meet these deadlines:

- **Project management:** The FCA anticipates that the new Consumer Duty will establish more stringent guidelines for corporate culture and behaviour. Insurers and insurance distributors may wish to establish a project to evaluate the impact of the rules and to meet existing expectations relating to firm governance. Project sub-streams may be required on a product-line basis to assess impacts, depending on the scope and variety of retail products and services produced and/or provided.
- **The consumer journey:** Firms will need to consider the full product lifecycle and the interactions with policyholders at each stage if they want to ensure that their goods and services are "fit for purpose" and provide fair value. An area of focus should be on the provision of information at the early phases of marketing since policyholders learn about the insurance product via this initial contact and use it to select which cover best meets their needs. Considering the needs of vulnerable consumers, firms should think carefully about how this information is delivered, including looking at the Insurance Product Information Document ("**IPID**").

Product governance: To understand the application of the cross-cutting rules, firms will need to have assessed the potential detriment which could be suffered by retail clients, and to determine what steps could, and should be taken to mitigate these risks. Although there is much discussion surrounding the idea of "fair value," the FCA has established a direct connection between the prices of goods and services and the advantages that they are meant to offer. Firms should carefully consider how the expectations around value delivery and benefits can be accommodated within existing product governance processes, and where changes are needed. Within this context, firms will need to regularly monitor consumer behaviour and product performance to satisfy themselves that they are achieving the outcomes required by the new Duty.

HOW CAN WE HELP?

The new requirement for firms' boards to agree upon an implementation plan by the end of October 2022 creates a tight deadline within which firms must start their projects. Firms will need to begin working towards this deadline as soon as possible. We have produced a pack to assist firms with implementation planning. If you would like a copy of this, please speak to any of the Clifford Chance contacts listed below or your usual contact.

¹ A firm must deal with its regulators in an open and cooperative way and must disclose to the FCA appropriately anything relating to the firm of which that regulator would reasonably expect notice.

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