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**ENHANCING PRODUCT OVERSIGHT AND
GOVERNANCE**

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ENHANCING PRODUCT OVERSIGHT AND GOVERNANCE – GENERAL INSURANCE AND PURE PROTECTION: KEY TAKEAWAYS FROM THE FCA'S THEMATIC REVIEW 24/2

1) Introduction

The Financial Conduct Authority (the "FCA") has called on insurers and insurance distributors to ensure they demonstrate fair value and good customer outcomes in respect of general insurance ("GI") products and pure protection products, following its recent Thematic Review 24/2 (the "TR").

In August 2024, the FCA published the TR, examining information provided by 28 manufacturers (firms that create, develop, or design insurance products) and 39 distributors (firms involved in insurance distribution activities). This focused on 10 different GI products (excluding contracts of large risks and reinsurance) and pure protection products (such as life, medical, and income protection cover) to assess whether firms were ensuring that customers receive fair value and positive outcomes from the products and services they manufacture and distribute, as required under the FCA's Product Governance Sourcebook (PROD 4). The review revealed a lack of readiness among firms and outlined necessary actions to improve governance, product approval, management information ("MI"), and information sharing.

This briefing note sets out the TR's key findings and next steps for firms to ensure compliance with the FCA's expectations.

2) Background

The FCA strengthened PROD 4 in 2021, introducing a specific requirement for firms to ensure that insurance products provide fair value to customers within their target markets. The subsequent introduction of the Consumer Duty in 2023 further elevated the standard of conduct expected for products and services offered to retail customers. The FCA has expressed its disappointment with the lack of progress made by firms in meeting these requirements. The response indicates that Boards, senior managers, and compliance teams need to quickly understand and meet the FCA's expectations for the insurance sector.

The FCA has also announced that it will, in the coming year, launch a full "market study" into how pure protection insurance products are sold.¹ This follows concerns that competition is not functioning well in the market. After inviting firms to submit comments on its terms of reference by 11 October 2024, the FCA has now asked that firms urgently assess their product governance arrangements and take immediate corrective action where necessary. This includes providing redress to customers who have suffered harm.

3) Key findings

Manufacturers

The FCA's assessment of Product Oversight & Governance ("POG") arrangements revealed that, although most firms had updated their frameworks to meet PROD 4 requirements, many still fell short in practice. Despite having a broadly consistent POG framework, firms often lacked a comprehensive approach to product oversight. This was evident in their inability to provide sufficient evidence of how they assessed products for fair value and the rationale behind key decisions, including product approvals. For instance, the FCA said that some firms could not demonstrate how their governing bodies and senior managers had approved products, leading to poorly designed products that do not offer fair value, ultimately causing customer harm.

Fair value assessments ("FVAs") and ongoing monitoring were also areas of concern. Many firms conducted FVAs that did not adequately consider the total price paid by customers, including intermediary remuneration. This lack of oversight undermines the assessment of product value and hinders the identification of potential issues. Additionally, the FCA found that the quality of MI was often insufficient, preventing effective monitoring of distributors' remuneration and the overall assessment of fair value. For example, some firms failed to include all forms of remuneration in their FVAs, such as profit commission, which the FCA deems important in understanding the product's value. This lack of detailed and granular MI is particularly problematic when evaluating value across different customer groups, including vulnerable customers.

¹ <https://www.fca.org.uk/news/press-releases/fca-announces-work-pure-protection-market>

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According to the FCA, target market statements were frequently too high-level and lacked the necessary granularity, increasing the risk of products being mis-sold to customers. Some target market statements were found to be overly broad, such as describing a motor insurance product as suitable for "anyone who owns a car," without considering specific exclusions or restrictions. Another example involved a private medical insurance product that did not adequately consider key underwriting criteria or customers' characteristics and risk appetite. The FCA claims that this lack of detailed target market identification can lead to products being sold to customers for whom they are not suitable, resulting in poor customer outcomes.

The underlying insurer is always a manufacturer and insurance intermediaries are also considered manufacturers. In cases of co-manufacturing, the FCA maintained that many firms did not fully understand or meet their responsibilities under PROD 4, due to ambiguity around key activities, such as identifying the target market and assessing fair value. For example, some firms were said to have relied entirely on intermediaries for product approval and design, without having their own product governance arrangements. This lack of clarity and accountability can result in gaps in governance and oversight, increasing the risk of customer harm. Furthermore, in the FCA's view, many manufacturers had not adequately considered their distribution arrangements or the choice of distributors in relation to their product and target market. There was also a failure to provide appropriate and timely information to distributors, which is crucial for ensuring that products are sold in a manner that delivers fair value and good customer outcomes.

Distributors

The FCA's assessment of product distribution arrangements revealed significant gaps in governance and oversight. While some firms had strengthened their frameworks and could demonstrate how their activities and remuneration impacted product value, many arrangements lacked detail on critical areas such as distribution strategy and remuneration. This high-level approach was shown to often result in unclear governance structures and processes, making it difficult to determine who was responsible for decision-making and escalation. Defining clear roles for manufacturers and distributors under distribution agreements is also relevant to demonstrating compliance with competition and antitrust laws.

The FCA also found that many distributors did not have robust processes for obtaining necessary information from manufacturers. This hindered their ability to meet obligations under PROD 4.3, such as understanding the product, its target market, and the outcome of value assessments. For instance, some distributors received only limited information from manufacturers, such as a simple statement confirming the product offered fair value, without any supporting evidence. This inadequate information flow created significant risks, as distributors could not fully understand nor assess the product's intended value or its impact on customers. Moreover, many distributors lacked comprehensive policies to manage conflicts of interest, further exacerbating the risk of customer harm. While distributors need to ensure that they have the necessary information, they must also be mindful of establishing appropriate controls on the flow of competitive sensitive information, particularly in situations where conflicts of interest might arise.

With respect to target market understanding, most distributors' target market statements aligned with those of manufacturers, but there were notable exceptions. In some cases, distributors' statements were either more or less detailed than the manufacturer's, leading to inconsistencies. Additionally, some distributors did not adequately consider customers' objectives, interests, and characteristics, raising concerns about whether their distribution strategies were aligned with the manufacturer's target market. To ensure alignment, manufacturers may wish to impose constraints on distributors targeting customers outside their target market but will need to ensure that any such restrictions do not fall foul of the competition laws.

The FCA's findings also highlighted alleged shortcomings in distributors' specific distribution strategies. The FCA stated that many firms failed to amend their strategies when issues were identified, such as products not providing the intended value. For example, some distributors did not consider the potential harmful effects of distributing insurance products as part of a package, such as duplication of cover or inappropriate product bundling. Additionally, where retail premium finance was involved, many distributors did not account for the costs of this finance, potentially leading to poor value. The lack of adequate information from manufacturers further complicated the issue, but distributors also failed to proactively seek the necessary information under PROD 4.3.

4) Next steps

The FCA states that all manufacturers and distributors of GI and pure protection products should analyse the TR and assess whether, and to what extent, these issues apply to their firm's activities. If shortcomings are identified, firms should resolve them and, if customers have been harmed, firms are expected to offer redress.

We set out below some examples of good practice and advise firms to act sooner rather than later in reviewing their product governance arrangements in relation to all steps of the customer life cycle.

Manufacturers

To meet FCA compliance requirements, manufacturers must show they have enhanced their POG arrangements, conducted thorough fair value assessments, and ensured that their distribution strategies align with the identified target markets. Robust documentation, clear accountability, and proactive collaboration with co-manufacturers will be essential to mitigate risks and show that FCA standards have been upheld. The following actions should be considered:

a) Strengthen POG arrangements

Specific senior managers should have responsibility for product governance, with clearly defined roles and duties. This includes regular training and updates on regulatory changes and industry best practices. By appointing dedicated senior-level personnel, there is a clear chain of accountability, and product governance is demonstrated to be a priority at the organisation's highest levels.

It is important to establish dedicated committees or forums responsible for product approval and ongoing monitoring. These committees should have the authority to challenge and make decisions. Additionally, a clear escalation process should be implemented for issues requiring higher-level intervention. This structure will enable rigorous oversight and ensure that any potential problems are swiftly addressed.

All product approval processes should be clearly documented, including any changes and the rationale behind key decisions. This documentation should be readily accessible for audits and regulatory reviews. Not only will this transparency aid in compliance, but it will also showcase the firm's dedication to robust governance practices.

b) Conduct robust FVAs

Ensure that FVAs take into account the total amount paid by customers, including intermediary compensation, operational expenses, and risk premium. Detailed criteria should be used to evaluate each product component. Customer input and market comparisons should be incorporated to validate the assessments but should not be relied upon in isolation. This will help identify any areas where the product may not be providing fair customer value.

Detailed MI should be leveraged to support FVAs, providing evidence of product value. This includes claims data, customer feedback, and market comparisons. Dashboards and reports that highlight key metrics and trends should also be developed.

Formal performance evaluation processes, such as quarterly or biannual reviews, should be implemented to regularly assess product performance and customer outcomes. These review cycles should be used to identify trends and areas of improvement. The review findings should be thoroughly documented and acted upon in a timely manner.

c) Improve target market Identification

Develop detailed target market statements that consider specific customer needs, exclusions, and risk profiles., with demographic data, customer surveys, and market research to inform these statements. Regularly update the target market statements to reflect changes in market conditions and customer behaviour. This will help ensure that the product is well-suited for the intended customer base.

Ensure the distribution strategy is consistent with the identified target market. The strategy should be regularly reviewed and adjusted based on market changes and customer feedback. Controls should be implemented to monitor the effectiveness of the distribution strategy. Ensuring alignment with the distribution strategy will help prevent mis-selling.

d) Enhance co-manufacturing arrangements

Establish clear co-manufacturing agreements that outline each party's responsibilities, including target market identification, product design, and value assessments. All parties should understand their roles and responsibilities. Clear agreements will help in avoiding misunderstandings and ensuring that all parties are aligned in their objectives.

Ensure all parties collaborate effectively to meet PROD 4 requirements. Regular meetings should be held to discuss product performance, customer feedback, and regulatory compliance. Joint action plans should be developed to address any identified issues. Effective collaboration will help in ensuring that the product remains compliant and provides fair value to customers.

e) Strengthen distribution arrangements

Distributors with the necessary knowledge, expertise, and competence to understand the product and target market should be chosen. Due diligence should be conducted, and comprehensive training should be provided. Performance monitoring should be implemented to ensure distributors meet the required standards.

Distributors should receive all necessary information about the product, including its value, target market, and any potential risks. Detailed product guides, training sessions, and regular updates should be used. A feedback loop should be developed to capture distributor insights and experiences. Providing comprehensive information will help in ensuring that distributors are well-informed and can effectively communicate the product's value to customers.

Distributors

To comply with FCA requirements, distributors must thoroughly understand the distribution strategy and target market identified by manufacturers. They must implement robust controls to monitor their activities and remuneration, promptly address any distribution or value problems, and maintain effective communication with manufacturers to ensure alignment and transparency.

a) Understand and implement distribution strategy

Senior managers and other relevant individuals should thoroughly understand the distribution strategy and target market identified by the manufacturer, with regular training and updates on any changes. Detailed guidelines and checklists should be developed to ensure compliance. Thorough comprehension will help ensure that the distribution strategy is effectively implemented, and the product reaches its intended target market.

Controls should be implemented to ensure the product is only distributed to customers within the identified target market. Detailed checklists and monitoring tools should be used to ensure compliance. Regular audits should be conducted to verify adherence to the distribution strategy. Consistent implementation will help in preventing mis-selling and ensuring that customers receive fair value.

b) Assess impact of activities and remuneration

Regular assessments of how remuneration structures affect product value should be conducted. Commissions, fees, and other forms of remuneration should not erode customer value. Detailed financial analysis and benchmarking should be used and policies to cap or adjust remuneration as necessary should be developed. Evaluating remuneration structures will help ensure the product remains affordable and provides fair value to customers.

Detailed MI should be utilised to monitor the impact of distribution activities on product value. This includes tracking sales data, customer feedback, and claims ratios. Dashboards and reports should be developed to provide insights into the effectiveness of distribution activities. Effective use of MI will enable distributors to make informed decisions and demonstrate compliance with regulatory requirements.

c) Identify and address distribution or value problems

Proactive mechanisms to detect issues with distribution or value early should be implemented, such as automated monitoring tools and regular audits. A risk management framework should be developed to

assess and prioritise potential problems. Proactive detection will help in identifying issues before they escalate, therefore minimising customer harm.

Prompt corrective action should be taken to address any identified issues. This could include adjusting the distribution strategy, retraining staff, or modifying the product features. All actions taken should be documented and their effectiveness monitored.

d) *Obtain necessary information from manufacturers*

All necessary information should be obtained from manufacturers to understand the product, its target market, and value assessment outcomes. Detailed data requests and regular communication should be used and a standardised template for information requests developed. Comprehensive data collection will help ensure distributors have all the information required to effectively sell the product.

Ongoing dialogue with manufacturers should be maintained and regular meetings scheduled, particularly to encourage feedback on product performance. Joint action plans should be developed to address any identified issues.

e) *Manage conflicts of interest*

Comprehensive policies to identify and manage conflicts of interest should be established and regularly reviewed and updated. Training should be provided to staff on recognising and managing conflicts of interest. Developing policies will help in ensuring that conflicts of interest are effectively managed and customer interests are prioritised.

Effective mechanisms should be implemented to ensure conflicts of interest do not adversely impact customer outcomes. Detailed reporting and monitoring tools should be used, and a whistleblowing policy developed to encourage reporting of potential conflicts.

f) *Review and update distribution arrangements*

Regular reviews of distribution arrangements should be conducted to ensure they remain effective and aligned with regulatory requirements. This should be supplemented by review schedules and checklists. Review findings should be documented, and corrective action taken as necessary. Regular reviews will help in ensuring that distribution arrangements remain effective and compliant.

Distribution strategies should be amended as necessary to address any identified issues and detailed action plans and follow-up reviews should be formulated to ensure customer value remains fair. The effectiveness of any changes made should be monitored. Adjusting strategies will help ensure the product continues to provide fair value and meets customer needs.

The FCA is also considering the most appropriate supervisory and regulatory actions to address the issues found as soon as possible. Where failings cause significant harm to customers, the FCA will ensure that firms and senior managers are held accountable and responsible for actions to remediate the harm.

Another upcoming action is the FCA's proposed market study into pure protection insurance products, mentioned above; the FCA is inviting comments on its draft terms of reference by 11 October.

If you need assistance carrying out the above exercises, addressing any gaps you have found, or in preparing your business for the forthcoming market study into pure protection insurance products, please do not hesitate to get in contact with us.

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