

CP11/20**

Financial Services Authority

Packaged bank accounts:

New ICOBS rules for the sale of
non-investment insurance contracts

Contents

	Abbreviations used in this paper	3
1	Overview	5
2	Proposed changes	9
3	Price transparency	14
	Annex 1: High-level market failure analysis and cost-benefit analysis	
	Annex 2: Compatibility statement	
	Annex 3: List of questions	
	Appendix 1: Draft Handbook text	

The Financial Services Authority invites comments on this Consultation Paper. Comments should reach us by Friday 27 January 2012.

Comments may be sent by electronic submission using the form on the FSA's website at: www.fsa.gov.uk/Pages/Library/Policy/CP/2011/cp11_20_response.shtml.

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A confidential response may be requested from us under the Freedom of Information Act 2000. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the Information Commissioner and the Information Tribunal.

Copies of this Consultation Paper are available to download from our website – www.fsa.gov.uk. Alternatively, paper copies can be obtained by calling the FSA order line: 0845 608 2372.

Abbreviations used in this paper

CP	Consultation Paper
FSMA	Financial Services and Markets Act 2000
ICOBS	Insurance Conduct of Business Sourcebook
CBA	Cost-benefit analysis

1

Overview

Background

- 1.1 A packaged bank account is typically a current account bundled with a range of insurance policies, access to preferential terms for other financial services (e.g. overdraft, personal loan or mortgage), and sometimes non-financial products and services, for which the customer often pays a monthly account fee.
- 1.2 The number of consumers with a packaged bank account has increased significantly in the last few years. Mintel¹ estimated 8.5m packaged bank accounts in 2009 and more recent information from firms indicates that in January 2010 there were approximately 10 million, i.e. around one in five of the UK adult population. The range of different packages available nearly doubled in the four years to 2010², creating more choice for consumers. But this also potentially increases the risk of consumer detriment if consumers find it difficult to make informed decisions about the complex range of choices available.
- 1.3 When we implemented the Banking Conduct Regime on 1 November 2009 we stated our intention to carry out a review of packaged bank accounts to get a better understanding of the product and the market.³ This was consistent with our Consumer Protection Strategy, launched in March 2010⁴, and our goals to make the retail market work better for consumers and avoid the crystallisation of conduct risks that exceed our risk tolerance.
- 1.4 We concluded the following:
- There is a place in the market for these accounts. Some consumers can get value from the way they are packaged, depending on the features they use.
 - But, the bundling of many different products together can make it difficult for consumers to focus on the important information when it comes to making informed decisions.

1 Mintel Current, Packaged and Premium Accounts, Finance Intelligence, June 2010

2 Mintel Current, Packaged and Premium Accounts, Finance Intelligence, June 2010

3 www.fsa.gov.uk/Pages/Doing/Regulated/banking/bcobs/q_a/index.shtml

4 www.fsa.gov.uk/pages/Library/Communication/PR/2010/044.shtml

- This complexity may also further limit already low switching rates between accounts and providers of packaged bank accounts.

1.5 Our priority is to address the information needs of consumers at the point of sale and annually thereafter.

Outline of proposals

1.6 The aims of our proposals are: to ensure that consumers are in a position to make an informed decision about the insurance policies⁵ sold as part of a packaged bank account; and limit the potential risk that they rely on one or more of the policies, only to find out later that they are unexpectedly unable to claim because they are ineligible, or the policy was not suitable for their needs.

1.7 For example, travel insurance policies may exclude pre-existing medical conditions, have age limits and not necessarily offer cover for winter sports or world-wide. So it is important that consumers think about the cover they need.

CONSUMERS

For example, consumers should ask themselves:

'Does the policy cover the type of trip I am likely to make (Europe or world-wide)?'

'I have a medical condition. Would I be eligible to claim?'

'I am over a certain age. Will I be covered?'

1.8 Our current requirements for the sale of insurance policies were not written with packaged bank accounts in mind. While these rules give firms flexibility to comply in different ways, we think it is necessary for us to make specific requirements for eligibility and suitability. This will provide adequate consumer protection and clarity about the steps we will expect firms to take in future sales.

Eligibility and suitability

1.9 Our proposals are that a firm selling insurance policies as part of a packaged bank account must do the following.

- Take reasonable steps to establish whether a customer is eligible to claim the benefits under each policy. In taking reasonable steps it must check whether the customer meets the qualifying criteria to claim each of the benefits under each policy. The firm must also tell the customer if they would be ineligible to claim and keep a record of the eligibility assessment for each sale for at least three years.

⁵ A non-investment insurance policy which is: a *contract of insurance* which is a *general insurance contract* or a *pure protection contract* but which is not a *long-term care insurance contract*.

- Throughout the term of each policy, provide customers with an annual eligibility statement, which sets out any qualifying requirements to claim the benefits under the policy and recommend that the customer reviews their circumstances and whether they meet the eligibility requirements.
- When selling on an advised basis, consider the suitability of each insurance policy. The proposed rule will set out the steps we expect a firm to take, i.e. it must establish the customer's demands and needs, take reasonable care to establish whether each policy is suitable for the customer's demands and needs, tell the customer if any of these are not met, and explain its reasons for any recommendation given. It must also keep a record, for at least three years, of the suitability assessment and of the advice given.

Premium disclosure and wider transparency issues

- 1.10** The focus of this Consultation Paper is to ensure that consumers are in a position to make an informed decision about the insurance policies in the packaged bank account. We have therefore also considered whether having a breakdown of the individual insurance premiums would be helpful to consumers.
- 1.11** In general we think that price transparency is important to help consumers compare and shop around/switch. In the case of packaged bank accounts the total price includes many elements and we think that just providing a breakdown of the individual insurance premiums is not the right answer for consumers. In fact, we think it is more likely to create confusion.
- 1.12** However, we would like to see better price transparency of the overall package and would welcome suggestions as to how to achieve this in a way that helps consumers know what they are buying and choose between different packaged or non-packaged bank accounts.
- 1.13** We agree that the lack of transparency and complexity (for consumers) created by bundling may lead to detriment. We therefore propose collecting a range of data, beginning in early 2012, from firms providing packaged bank accounts. This will enable us to monitor how the market evolves, e.g. changes in levels of switching or prices for packaged bank accounts; or further packaged bank account product developments. And it will inform our view about whether it is necessary to intervene further in the future to improve consumer outcomes.

Who should read this paper?

- 1.14** This CP will be of interest to **firms selling insurance as part of a packaged bank account**. It will also be of interest to **insurers** and, more generally, **retail intermediary firms selling general insurance products**.

CONSUMERS

Consumers and consumer representative groups will be interested in the proposed new rules as well as the future work exploring how to improve price transparency. The aims of these proposals are: to ensure that consumers have the information they need when considering buying insurance policies as part of a packaged bank account; and to reduce the possibility that a consumer may rely on a policy, only to find out later that their insurance claim is not paid, or the policies do not meet their needs.

PROTECTED GROUPS

Stakeholders representing protected groups will be interested in the proposed new rules. Some consumers in protected groups choose a packaged bank account because it provides them with reasonably priced insurance cover, e.g. travel or mobile phone. But they may also be more vulnerable to inappropriate sales and at a greater risk of buying insurance as part of a packaged bank account that they would not be able to claim under or that they do not need. The aim of our proposals is to ensure that sales processes are appropriate for all consumers without having a disproportionate effect on any group.

Timetable

- 1.15** Please send us your responses to this consultation by **Friday 27 January 2012**. Subject to the outcome of this consultation, we expect to issue a Policy Statement with final rules on eligibility and suitability and proposals in relation to price transparency in July 2012.

2

Proposed changes

- 2.1** The sale of insurance is subject to our Insurance Conduct of Business (ICOBS) rules and our Principles for Businesses. We did not write our ICOBS requirements with packaged bank accounts in mind. Although our current rules give firms flexibility to comply in different ways we think it is necessary to make detailed rules and specify the steps firms must take to establish eligibility and suitability (for future sales), in order to provide appropriate consumer protection.
- 2.2** We propose new ICOBS rules for eligibility and suitability. The proposed new eligibility rules apply to all sales of insurance policies as part of a packaged bank account. In addition, the suitability rule also applies to those sales where a firm makes a personal recommendation in relation to the bundled policies. Each rule will set out the steps that we expect firms to take either at the point of sale or annually for the duration of the packaged bank account.
- 2.3** The rules will be detailed, in contrast to the generally high-level ICOBS rules, but we think our approach is consistent with that taken in ICOBS for more complex products, for example protection products.

Eligibility to claim

- 2.4** Bundling many different products together creates a large amount of information for the consumer to assimilate and therefore an increased risk, at the point of sale, that consumers may not adequately understand whether each policy meets their needs. The consumer's focus might also be elsewhere, e.g. the bank account or the overdraft rate, so they do not give sufficient attention to the detail of the policies. We see similar risks in other secondary sales of insurance products.
- 2.5** Our primary concern is therefore that consumers might rely on one or more of the insurance policies and unexpectedly find that they are ineligible when they try to make a claim.

- 2.6** In ICOBS 5.1.1G we give guidance on how a firm might treat customers fairly, in line with Principle 6, by taking reasonable steps to ensure that a customer only buys a policy under which they are eligible to claim benefits. However, it is not clear how this guidance applies when multiple insurance policies are bundled as part of a fixed package. For example, the consumer may decide that the overall package is appropriate for them even if they are not eligible to claim under one or more of the insurance policies.
- 2.7** We therefore propose a new eligibility rule for policies sold as part of a packaged bank account. The rule sets out the steps we will expect firms to take to ensure that customers understand whether they will be eligible to claim.
- 2.8** The rule will not prevent a firm from selling a customer one or more policies, as part of the package, under which the customer is ineligible to claim. We think consumers should retain the freedom to choose this option as long as they clearly understand the implications of their choice.
- 2.9** We propose that the new eligibility rule will include the following steps in relation to each policy in the package.
- i) Take reasonable steps to check whether the customer is eligible to claim the benefits under each policy, including checking whether the customer meets any qualifying criteria for each of the benefits.
 - ii) Tell the customer whether or not they would be eligible to claim each of the benefits under each of the policies, so the customer can take an informed decision on whether to proceed.
 - iii) Make a record of the eligibility assessment, and keep it for at least three years if the customer proceeds with the arrangements proposed.
- 2.10** The existing requirement for a statement of demands and needs (ICOBS 5.2.2R) continues to apply, so a firm must also specify the demands and needs of the customer for each policy.
- 2.11** We are also concerned that, as these policies are monthly rolling contracts, there is no natural review point, unlike annually renewable policies. Consumers' circumstances may change and we think they should be reminded regularly to review whether the policies provided with the packaged bank account continue to meet their needs.
- 2.12** We are therefore proposing a second new eligibility rule, which will require a firm to provide a packaged bank account customer with an annual eligibility statement that sets out any qualifying requirements to claim under each of the insurance policies, and reminds customers to review whether they meet these requirements. Firms will not be required under the new rule to ask their customers to respond to the eligibility statement.

Q1: Do you agree with our proposal for a new eligibility rule for the sale of insurance policies as part of a packaged bank account?

Q2: Do you agree with our proposal for a new rule requiring an annual eligibility statement of the insurance policies provided as part of a packaged bank account?

Ensuring advice is suitable

2.13 For advised sales, our suitability rule⁶ states that a firm must take reasonable care to ensure the suitability of its advice for any customer who is entitled to rely on its judgement. Selling a number of insurance policies as part of a packaged bank account raises different questions about the suitability of advice compared to standalone insurance policy sales. The current rule refers to reasonable care and so gives flexibility to firms to comply in different ways. We think it is necessary to specify what firms should do when making a personal recommendation about insurance policies sold as part of a packaged bank account.

2.14 We are therefore proposing a new rule, in addition to ICOBS 5.3.1R, for this kind of advised sale. The rule will set out the following steps, which a firm must take for each insurance policy in the packaged bank account.

- i) Establish the customer's demands and needs.
- ii) Take reasonable care to establish whether each policy is suitable for the customer's demands and needs.
- iii) Inform the customer of any demands and needs that are not met.
- iv) Explain to the customer its recommendation and the reasons for the recommendation.
- v) Make a record of the suitability assessment and any advice given and retain it for at least three years if the customer proceeds with the recommendation.

2.15 We believe that our eligibility and suitability proposals will put consumers in a better position to make an informed decision about whether the individual insurance policies meet their needs and therefore reduce the potential for consumer detriment. We acknowledge that these proposals may increase the length of the sales process. This is particularly relevant to our equality and diversity considerations.

Q3: Do you agree with our proposal for a new suitability of advice rule for the sale of insurance policies as part of a packaged bank account?

Q4: Do you have any comments on our draft rules?

⁶ ICOBS 5.3.1R

Equality and diversity considerations

- 2.16** We identified potential equality and diversity considerations in two areas and considered whether our proposals might:
- a) significantly change the risk profile for insurers so that they either reduce the cover or increase the price for some of the insurance policies in ways which might have a negative impact on any protected groups; and
 - b) significantly increase the length of time required for sales, which might act as a barrier to buying a packaged bank account for any protected groups.
- 2.17** We know that for some older consumers the travel insurance provided in a packaged bank account is a cost-effective way of buying cover. This is also the case for some younger consumers and the mobile phone insurance if it covers the more expensive smart phones.
- 2.18** We considered in more detail the potential risk that firms may reduce the age limit for travel insurance, or remove smart phones from mobile phone insurance, or increase premiums to access this cover. We also considered whether this might mean certain groups of consumers would find it either more difficult or more costly to buy standalone insurance.
- 2.19** The Equality Act 2010 imposes a duty on firms (as service providers) to not discriminate against people with the protected characteristics that it sets out. In response to our cost-benefit analysis survey, firms told us that they do not see any equality or diversity implications from our proposals. They stated that any resulting changes to product design would be focused on customer needs and more likely to remove policy limits and exclusions, so there would be less likelihood of a customer being ineligible to claim.
- 2.20** Our conclusion is that it is unlikely our proposals would cause insurers to change either the insurance cover or premium levels, and also that alternative standalone insurance is widely available. In particular, for travel insurance for older consumers, we note that while some standalone policies have lower age limits than the policies provided with a packaged bank account, there are niche brokers and insurers making travel insurance widely available for older people at reasonable prices.
- 2.21** In terms of the length of the sales process, firms estimate this will increase, on average, by 15 minutes to give a total time of around one hour. We think that for some protected groups⁷ a longer sales process may be a barrier to them choosing a packaged bank account – if the length of the sales process becomes unmanageable for them. In contrast, if we proposed preventing the sale of packaged bank accounts in their current form, this might mean that a significant number of consumers fail to buy insurance cover that they would benefit from.

⁷ E.g. Hearing or sight impaired, older, those with learning disabilities or where English is not their first language.

2.22 On balance, we think that the benefits of a better sales process for all consumers outweigh the risks of a longer sales process and, overall, our view is that our proposals should not have a disproportionate impact on any protected group, and will be of benefit to all consumers.

Q5: Do you agree our proposals are proportionate considering any equality and diversity issues?

3

Price transparency

- 3.1 Consumer groups and the media have raised concerns that consumers are not getting good value for money from packaged bank accounts, and argue that this is partly because of the way the price for individual elements is bundled into a single monthly account fee such that consumers cannot easily compare and shop around.
- 3.2 Consumer groups have told us that they would like a breakdown of the monthly account fee to reduce the lack of transparency that the bundle creates and to help consumers to better understand what they are paying for. They argue that the increased level of information will allow consumers to shop around, increasing the level of competition.
- 3.3 Economic theory, our own experience and that of other sectoral regulators, tells us that bundling could potentially lead to consumer detriment in a market as it makes it more difficult for consumers to compare and switch products. This can then allow firms to charge excessive prices, and poor value for money can go unchallenged.
- 3.4 Where policies are sold in connection with other goods or services, ICOBS⁸ requires the separate disclosure of the insurance premium. Applying this rule to packaged bank accounts means that firms should disclose the individual insurance premiums for each policy separately from any other fees or charges. However, firms have taken the approach of providing only the monthly account fee on the basis that in their view a separate individual premium is not payable for each of the policies. We are not inclined to agree with this reasoning, albeit that any charge for the policies may be difficult to identify as a premium in the traditional sense and therefore may not be meaningful to consumers.
- 3.5 Our separate premium disclosure rule addresses concerns around secondary and add-on sales, with the aim of ensuring the consumer knows: (i) if the policy is compulsory or optional; and (ii) the insurance premium – separate from the price of the connected goods or services. But the policies sold as part of a packaged bank account raise fundamentally different concerns for consumers. This is because they know that the policies are not optional (i.e. they form part of the package) and the price (monthly fee) is set for the package they choose.

⁸ ICOBS 6.1.13R Price disclosure: connected goods or services: (1) If a *policy* is bought by a *consumer* in connection with other goods or services a *firm* must, before conclusion of the contract, disclose its *premium* separately from any other prices and whether buying the *policy* is compulsory.

3.6 Although we agree that price transparency is important for consumers, we think it is unlikely that not having a breakdown of the insurance premiums will have affected the consumer's decision to choose a packaged bank account, and also that it is unlikely that consumers will have suffered any recoverable loss as a result of a firm not complying with ICOBS 6.1.13R when selling packaged bank accounts. Taking this into account, seeking to ensure compliance with this rule (for these sales) would not be proportionate or achieve a better outcome for consumers. Our reasons are set out below.

- a) To be effective, the disclosure of the premium for individual policies must be relevant to the consumer making a decision, i.e. they can use it to compare and shop around. But our consumer research indicates that, in considering a packaged bank account, the consumer is focused on the overall price. So, whether or not the consumer knows that the individual monthly insurance premium is £5 a month/£60 a year, they can still only purchase it as part of a bundle which costs £15 a month/£180 a year.
- b) Any premium disclosure must also be meaningful and not artificial. The banks bulk-buy⁹ the insurance cover from insurers and the cost to them is an aggregated premium for the book of business. This will change from time to time, factoring in commercial arrangements such as profit sharing and the fact that not all customers will use all of the bundled insurance policies, i.e. a number of customers will either be ineligible or have no need for the policies. In calculating the account fee there may also be cross-subsidies. The combination of these factors means that the disclosure of individual premiums may not be meaningful to consumers. Disclosure of the premium may therefore distort competition in the standalone insurance market and would not help consumers compare an element of the package with what they might pay for an equivalent standalone policy. This could lead to unintended negative consequences in the stand alone market.
- c) Many consumers are able to superficially compare the option of taking the packaged bank account with bundled insurance policies, or taking a non-fee based current account and keeping their insurance cover separate. The superficial assessment of value is often based on one or two of the products in the bundle that interest the consumer most. When these are insurance policies the consumer compares the monthly account fee with the cost of buying relevant standalone insurance cover. For example: *I pay £5 a month for my mobile phone insurance and £10 a month for my car breakdown cover so a monthly account fee of £15 or less seems like good value with added convenience.* For these consumers, it is unlikely that a breakdown of the premium for each insurance policy in the package would alter their behaviour or improve their decision-making as they are aware of the market price for the policies they want/need.

⁹ We had some concerns that the insurance products might be of inferior quality in order to keep the price down, but this does not appear to be the case.

- d) It is likely that the insurance policies are not the main reason for the purchase, e.g. the customer may choose a packaged bank account because it offers them a preferential mortgage, loan or overdraft rate. Whether or not they have a breakdown of the insurance premiums would have no impact on their decision to buy.
- e) There is evidence, in terms of consumer behaviours, to suggest that a breakdown of the insurance premiums would add to the complexity of the decision-making process and lead to information overload for many consumers, particularly those who find it difficult to understand financial matters generally.

3.7 Currently there is no evidence of significant consumer detriment crystallising due to firms' interpretation of disclosure (in relation to packaged bank accounts), but we will be exploring the wider question of price transparency further.

Wider transparency issues in the packaged bank account market

- 3.8** Price transparency in the packaged bank account market is much wider than disclosure of the insurance premiums within the bundle. Importantly, it is also about the other key elements such as the bank account and preferential interest rates for any overdraft, loan, mortgage or deposit. This complexity, created by bundling so many products and features together with a bank account, creates a lack of transparency which may adversely impact on switching, shopping around and consumer choice in this market and buying better value products.
- 3.9** Many consumers are unaccustomed to paying upfront charges in the form of an account fee. To some degree the charging of a monthly fee might improve consumer awareness that there are costs of operating personal current accounts and packaged bank accounts, and therefore incentivise consumers to shop around and to consider switching across providers. However, overall the real or perceived higher switching costs (i.e. arranging standalone insurance policies or seeking out new overdraft or loan arrangements) are likely to be a stronger influence on consumer behaviour. Even a small amount of extra inconvenience can reduce switching substantially and providing a bundle of products in the package may exacerbate this risk.
- 3.10** We therefore want to explore the question of price transparency more and welcome respondents' views about the price information that would be most effective in achieving appropriate price transparency and help consumers shop around – leading to reduced risk of consumer detriment due to excessive prices and/or low quality products.
- 3.11** We agree that the wider lack of transparency and complexity (for consumers) created by bundling may lead to detriment. Consistent with our strategy to intervene earlier, we will be monitoring how the packaged bank account market evolves. Starting in early 2012 we will begin collecting regular information from firms selling in this market.
- 3.12** This information will help us assess the impact of our proposed new rules and inform our view on whether more robust policy intervention is necessary in the future. This means that we will also be looking for changes in levels of switching and/or prices for packaged bank

accounts and changes in levels of customers being ineligible to claim or future product development (of packaged bank accounts), which might increase the complexity and risks and may require further policy intervention.

- Q6:** Do you have any comments on our interpretation of ICOBS 6.1.13R or our view on the merits of separate disclosure of individual premiums for each insurance policy sold as part of a packaged bank account?
- Q7:** What price information do you think consumers would find most helpful when choosing a packaged bank account?

Annex 1

High-level market failure analysis and cost-benefit analysis

High-level market failure analysis

1. Packaged bank accounts are generally sold rather than bought, i.e. consumers do not tend to proactively search for this type of account but are more likely to be upgraded by their existing bank or offered a packaged bank account rather than a fee-free account when opening a new current account. Packaged bank accounts are offered by all the major high street banks and are becoming an increasingly important product offering as banks seek to differentiate themselves in the market and both attract new customers and retain existing ones.
2. These accounts are designed and marketed with convenience for customers in mind, but the bundling creates complexity for consumers when they need to understand what they are being offered and the alternatives to a packaged bank account. It is therefore important that firms have an appropriate sales process to mitigate the risk that consumers might opt for a packaged bank account when there are other more appropriate options.
3. The type of insurance policies provided in a packaged bank account are normally considered low-risk insurance products but, because a number of these are being sold in a bundle together with a current account, there is a risk that firms may not give adequate attention to the insurance policies in the sales process. So consumers may not receive the information they need to properly consider the option of the packaged bank account being offered, shop around with other providers, or consider the alternative of a non-packaged bank account.
4. As a result, there is a risk that consumers may purchase insurance policies which they are ineligible to claim under either at the point of purchase or later, but do not know this, or the policies may be unsuitable for their needs. Consumers will suffer detriment if they

purchase insurance policies under which they are unexpectedly unable to claim. In addition, consumers may purchase policies within a packaged bank account that they do not need.

5. The number of consumers holding packaged bank accounts has increased considerably in the recent past and might be expected to grow further. This growth may include less sophisticated consumers who are more at risk of experiencing detriment due to a lack of understanding of the policies they have purchased.
6. There are other potential risks associated with the complexity created by bundling many products together in a packaged bank account. For example, consumer groups have raised concerns that consumers are not getting good value for money and that this could be a symptom of ineffective competition, leading to potential consumer detriment.

Cost-benefit analysis

7. When proposing new rules, we are obliged under section 155 of FSMA to publish a cost-benefit analysis (CBA). Its purpose is to provide an estimate of the costs and an analysis of the benefits of the proposed rules.
8. To inform the CBA, we sent an electronic survey to 12 firms which sell packaged bank accounts, of which 11 responded. The respondents are representative of firms which currently supply over 90% of these products: as of 1 January 2010 they collectively had more than 9.5m open packaged bank accounts.

Costs

Compliance costs

9. We anticipate that there will be both one-off and ongoing costs to firms of implementing our proposed new rules. All of the respondents to our survey of firms anticipated some costs as a result of implementing the proposed rules.

One-off costs

10. One-off costs include staff training, changes to IT systems, changes to marketing material and product literature and the costs of senior management time in considering and implementing these changes, including any changes to product design. The largest one-off cost to firms arises from changes to IT systems, at over £10m for all firms. It should be noted that one respondent indicated one-off IT costs of £5m, which was out of line with other firms' estimates, and has a significant impact on the size of the overall estimated cost.
11. The total estimated one-off costs of our proposed new eligibility rules are around £13m, and of our proposed new suitability rule around £8m, resulting in total costs of around

£21m¹ for the industry. The respondents to our survey provide more than 90% of packaged bank accounts, and we are therefore confident that costs to the industry as a whole will not significantly exceed these figures. As noted above, the number of packaged bank accounts is currently estimated at around ten million, meaning that the one-off costs will be around £2 per account.

Ongoing costs

12. Ongoing costs of our proposals include staff training and the costs of maintaining more complex IT systems (including systems to maintain a record of sales). We estimate that the ongoing costs of the eligibility and suitability rules of this type (including the three-year record keeping requirement) for the industry are £2m and £0.4m per year respectively.
13. We also asked firms how the duration of each sale may increase as a result of our proposals and to provide the costs associated with this increase. Most firms did anticipate an increase in the time taken to complete sales. They estimated that it will, on average, take around 15 additional minutes per sale. Therefore, on average, the incremental cost per sale due to the new eligibility rule is around £2, with a slightly higher cost for telephone sales, compared to face-to-face sales. There is an additional cost due to the new suitability rule of around £1.40 per sale. Firms did not anticipate any increase in the ongoing costs to them of internet sales.
14. The provision of an annual eligibility statement will also involve ongoing additional costs for firms, and we asked firms to estimate this cost per customer and as an annual total. We found that the average cost of providing the annual statement is less than £1 per customer per year, or around £6m per year for all packaged bank accounts open in 2010.
15. Taking into account all of the costs above, our estimate of the total ongoing costs of our proposals, assuming sales of packaged bank accounts at 2010 levels, is £13.5m per annum across all firms that currently offer such accounts. Of this total, £6.6m relates to the eligibility rule, £6.0m to the costs of the annual eligibility statement rule and £0.9m to the suitability rule. As noted, these costs are on average around £1-2 per sale, and around £1 per customer for the annual statement.
16. As noted above, the sales process may take longer (around 15 minutes longer on average), and this will result in opportunity costs for consumers. We estimate that our proposals will result in a cost to consumers of around £2.50 per sale.² These opportunity costs need to be assessed against the benefits described below, resulting from consumers not purchasing insurance policies under which they are ineligible to claim or that are unsuitable. For example, if the average cost of a packaged bank account is £10 a month, the cost to consumers can be compared to a potential saving of £10 a month or £120 a year for those consumers not purchasing the packaged bank account due to lack of eligibility/suitability of

1 This total includes the £5m cost that one firm stated for the costs of IT changes which, as noted above, was a significant outlier. We might conclude therefore that the actual total costs seem likely to be lower than this figure.

2 The valuation of customer time is based on a NERA report for the FSA on the Compliance costs of Conduct of Business Regulation for General Insurance 27/6/2003, p.48. (www.fsa.gov.uk/pubs/cp/187/nera.pdf)

the insurance policy and the benefit of their claims being paid in the future, which might be of significant benefit to them, both financially and in terms of inconvenience.

17. We also asked firms to say whether our proposed rules might lead them to change their product offering. Responses varied from an expectation that no changes would result from our proposed new rules, to firms which stated that they might decide to make changes following further examination of our proposals or that changes might include a reduction in the exclusions and limitations on the bundled insurance policies so as to be more certain of customer eligibility. One firm commented that any significant changes to the elements included in a package may involve costs to them of around £1.5-3m, since this may require exiting a contract with a third party and communications with a significant number of customers. The costs of these secondary effects are necessarily speculative, and as such are not included in the total estimate above.

Benefits

18. The benefits of our proposals arise from reducing the risk that consumers purchase insurance policies for which they are ineligible to claim key benefits and/or that are unsuitable. Information provided about the insurance policies for our CBA survey shows there is evidence of claims being rejected because the customer is ineligible; complaints about policies bought within a packaged bank account for which the complainant is ineligible, and about the suitability of insurance policies recommended in advised sales. The proportion of claims rejected and the number of complaints relative to the number of customers is not significantly out of line with equivalent standalone policies. This may be partly because not all packaged bank account customers use all the bundled insurance policies. It might also be a reflection of the commercial arrangements between the banks and the insurers such that claims are less likely to be rejected than in the standalone insurance market, even if the customer is actually ineligible.
19. The central mechanism through which the proposals are designed to improve market outcomes is that consumers who are better informed about the proposed arrangements make purchases more appropriate to their circumstances. In some cases, the difference in outcomes may be that consumers make no purchase at all, in others they may make a purchase that better reflects their individual circumstances, or they may make better value purchases because the information provided prompts them to shop around. The feedback from survey respondents indicates that the proposals may enhance customer switching between products from the same provider and between providers. The estimates for the increase in the number of customers switching were in the range 0-5%.
20. As noted above, some responses given by firms to our survey suggest that our proposed measures may cause some firms to change the quality and variety of products on the market. The improvement in the market will largely depend on how effective the sales process is at embedding the rules in a way that results in more consumers understanding, focusing on and acting on information received than is currently the case.

21. We expect most of the benefits of our proposals to come from the eligibility and suitability requirements at the point of sale. The annual statement will give consumers an opportunity to re-assess if their circumstances have changed and whether the insurance policies in the package continue to meet their needs. Given what we know about consumer behaviour in acting on this type of information, we cannot be certain that they will act on it.³ However, it will be of benefit as an important reminder so consumers are in a position to make an informed decision.
22. The implementation of these rules may result in some consumers deciding not to buy a packaged bank account, deciding instead to opt for a non-fee current account and buy standalone insurance products as required. Although this would lead to some foregone income for firms offering packaged bank accounts, this would be a beneficial transfer from these firms to consumers arising from prevented inappropriate sales.

Price transparency

23. We are not persuaded that providing consumers with a breakdown of the individual insurance premiums in a packaged bank account would necessarily ensure that they are able to make sufficiently informed decisions or that the market is operating efficiently, leading to better outcomes for consumers.
24. We think that it is unlikely that not having a breakdown of the individual insurance premiums will have affected the consumer's choice of a packaged bank account and that it is unlikely that consumers will have suffered any recoverable loss as a result of current disclosures. As such, we do not expect that the discussion of premium disclosure will lead to changes in firms' behaviour. Therefore, we do not expect material costs to arise as a result.

Conclusion

25. In summary, firms will incur some compliance costs due to the implementation of our proposed new rules, with the most significant of these costs being incurred at the point of implementation. However, we believe that the long-term benefits to consumers in a large, and growing, market are proportionate to these costs.

Q8: Do you have any comments on our cost-benefit analysis relating to the proposed new rules for eligibility and suitability?

3 See FSA Consumer Research Paper 69, www.fsa.gov.uk/pubs/consumer-research/crpr69.pdf

Annex 2

Compatibility statement

1. This annex explains our reasons for concluding that the proposals and draft rules in this Consultation Paper (CP) are compatible with our general duties under section 2 of the Financial Services and Markets Act 2000 (FSMA) and with the regulatory objectives set out in sections 3 to 6. Sections 155 and 157 of FSMA require us to make this statement.

Compatibility with our statutory objectives

Consumer protection

2. The aim of our proposals is to put consumers in a position to make informed decisions when thinking about buying insurance policies as part of a packaged bank account.
3. Our objective is to limit the potential that a customer may later find that they are not eligible to claim under one or more of the bundled insurance policies, or that a policy is unsuitable for their needs.

Compatibility with the principles of good regulation

4. Section 2(3) of FSMA requires that, in carrying out our general functions, we must have regard to the principles of good regulation. Those relevant to our proposals are proportionality, innovation, competition and public awareness.
5. Our proposal for new eligibility and suitability rules for the sale of insurance policies as part of a packaged bank account are aimed at raising the standard of future sales and to enable consumers to make an informed decision about the package. Ultimately these rules allow consumers to choose whether the overall package provided with the bank account meets their needs, even if one or more of the insurance policies does not. We think that this is a proportionate response to the risks identified and facilitates innovation by firms developing and marketing packaged bank accounts. In addition it supports the principle of public awareness by way of better informed consumers.

6. We have also had regard to proportionality in proposing new rules for eligibility and suitability. Informed by our CBA, we consider that the overall benefits of these proposals are proportionate to the costs both overall and for the size and type of firm providing packaged bank accounts.

Why our proposals are most appropriate for the purpose of meeting our statutory objectives

7. In developing our proposals we have engaged with a wide range of stakeholders and interested parties, including consumer representatives and industry practitioners. For the reasons stated above we believe that our proposal is the most appropriate option for the purpose of meeting our objective of securing the appropriate degree of protection for consumers.
8. We considered the alternative of relying on the existing rules and working with industry to make appropriate changes to sales practices to achieve the right outcome for consumers in future sales. We also considered whether to propose guidance.
9. However, in view of the issues we identified with the complexity created by bundling many products and services with the packaged bank account, we think it is necessary to provide more prescription in our rules for firms. Because the existing rules are open to interpretation, we think that proposing new detailed rules is the better option to achieve the right consumer outcomes.

Annex 3

List of questions

- Q1:** Do you agree with our proposal for a new eligibility rule for the sale of insurance policies as part of a packaged bank account?

- Q2:** Do you agree with our proposal for a new rule requiring an annual eligibility statement of the insurance policies provided as part of a packaged bank account?

- Q3:** Do you agree with our proposal for a new suitability of advice rule for the sale of insurance policies as part of a packaged bank account?

- Q4:** Do you have any comments on our draft rules?

- Q5:** Do you agree our proposals are proportionate considering any equality and diversity issues?

- Q6:** Do you have any comments on our interpretation of ICOBS 6.1.13R or our view on the merits of separate disclosure of individual premiums for each insurance policy sold as part of a packaged bank account?

- Q7:** What price information do you think consumers would find most helpful when choosing a packaged bank account?
- Q8:** Do you have any comments on our cost-benefit analysis relating to the proposed new rules for eligibility and suitability?

Appendix 1

Draft Handbook text

PACKAGED BANK ACCOUNTS INSTRUMENT 2011

Powers exercised

- A. The Financial Services Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
- (1) section 138 (General rule-making power); and
 - (2) section 156 (General supplementary powers).
- B. The rule-making powers listed above are specified for the purpose of section 153(2) (Rule-making instruments) of the Act.

Commencement

- C. This instrument comes into force on [*date*].

Amendments to the Handbook

- D. The Glossary of definitions is amended in accordance with Annex A to this instrument.
- E. The Insurance: Conduct of Business sourcebook (ICOBS) is amended in accordance with Annex B to this instrument.

Citation

- F. This instrument may be cited as the Packaged Bank Accounts Instrument 2011.

By order of the Board
[*date*]

Annex A

Amendments to the Glossary of definitions

Insert the following new definition in the appropriate alphabetical position. The text is not underlined.

*packaged bank
account*

an arrangement under which a *firm* provides a *retail banking service* as part of a package which includes access to other goods or services, whether or not a fee is charged.

Annex B

Amendments to the Insurance: Conduct of Business sourcebook (ICOBS)

In this Annex, underlining indicates new text and striking through indicates deleted text.

Eligibility to claim benefits: general insurance contracts and pure protection contracts

- 5.1.1 G (1) In line with *Principle 6*, a *firm* should take reasonable steps to ensure that a *customer* only buys a *policy* under which he is eligible to claim benefits.
- (2) If, at any time while *arranging a policy*, a *firm* finds that parts of the cover apply, but others do not, it should inform the *customer* so he can take an informed decision on whether to buy the *policy*.
- (3) This guidance does not apply to policies arranged as part of a packaged bank account.

...

Eligibility to claim benefits: policies arranged as part of a packaged bank account

- 5.1.3A R A firm arranging policies as part of a packaged bank account must:
- (1) take reasonable steps to establish whether the customer is eligible to claim each of the benefits under each policy included in the packaged bank account which must include checking that the customer meets any qualifying requirements to claim each of the benefits under each policy; and
- (2) inform the customer whether or not he would be eligible to claim each of the benefits under each policy included in the packaged bank account so that the customer can take an informed decision about the arrangements proposed.
- 5.1.3B R A firm must make a record of the eligibility assessment and, if the customer proceeds with the arrangements proposed, retain it for a minimum period of three years from the date on which the assessment was undertaken.
- 5.1.3C R Throughout the term of a policy included in a packaged bank account, a firm must provide the customer with an eligibility statement on an annual basis. This statement must set out any qualifying requirements to claim each of the benefits under the policy and recommend that the customer reviews his circumstances and whether he meets these requirements.

...

Suitability of advice on policies included in a packaged bank account

- 5.3.2A R In taking reasonable care to ensure the suitability of advice on a *policy* included in a *packaged bank account*, a *firm* must:
- (1) establish the *customer's* demands and needs by using information readily available to the *firm* and by obtaining further relevant information from the *customer*, including details of existing insurance cover; it need not consider alternatives to *policies* nor *customer* needs that are not relevant to the type of *policy* in which the *customer* is interested;
 - (2) take reasonable steps to establish whether each *policy* included in the *packaged bank account* is suitable for the *customer's* demands and needs, taking into account its level of cover and cost, and relevant exclusions, excesses, limitations, and conditions;
 - (3) inform the *customer* of any demands and needs that are not met; and
 - (4) explain to the *customer* its recommendation and the reasons for the recommendation.
- 5.3.2B R A *firm* must make a record of the suitability assessment, the recommendation given and the reasons for the recommendation and, if the *customer* proceeds with the recommendation, retain it for a minimum period of three years from the date on which the recommendation was made.

Schedule 1 – record keeping requirements

Handbook reference	Subject of record	Contents of record	When record must be made	Retention period
...				
<u>ICOBS 5.1.3BR</u>	<u>Eligibility</u>	<u>Details of whether the <i>customer</i> is eligible to claim each of the benefits under each <i>policy</i> included in the <i>packaged bank account</i></u>	<u>Date of eligibility assessment</u>	<u>3 years</u>
<u>ICOBS 5.3.2BR</u>	<u>Suitability and recommendation given</u>	<u>Details of whether each <i>policy</i> included in the <i>packaged</i></u>	<u>Date of recommendation</u>	<u>3 years</u>

		<u>bank account is suitable for the customer's demands and needs, the recommendation given and the reasons for the recommendation</u>		
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