

MS24/2.1

Market study into the Provision of Premium Finance

Proposed Terms of Reference

October 2024

How to respond

If you have any comments on these terms of reference please send them by **18 November 2024**.

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- whether you are providing any material that you consider to be confidential and explain why this is the case

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Chapter 1

Introduction

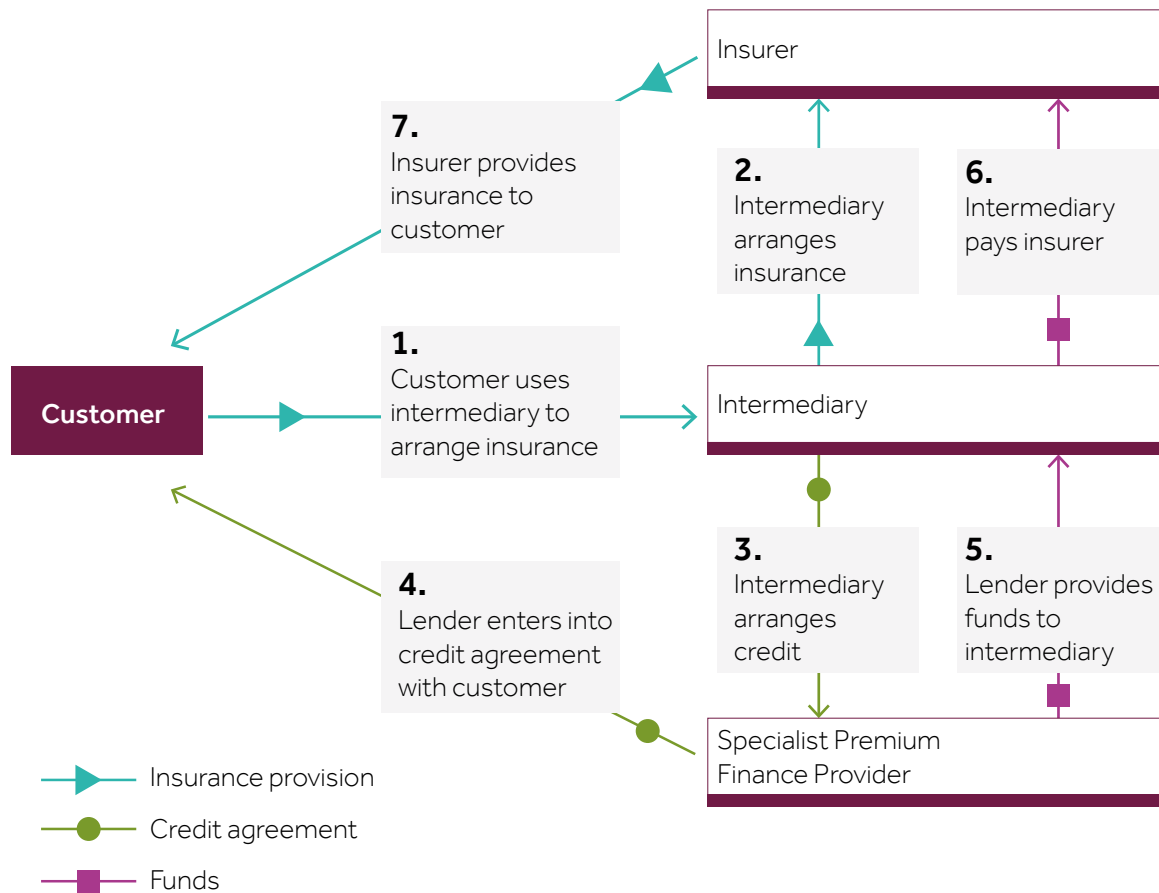
- 1.1** With recent increases in motor and home insurance premiums and the challenges brought about by the cost of living crisis, many customers are increasingly looking to find ways to spread the cost of their insurance products. According to a recent premium insurance index, around 32% of customers said they borrowed more to ease financial pressures. Meanwhile 24% said their premiums had increased and 20% pointed to rising energy bills as a cause of the increased usage of premium finance. Customers are often offered premium finance – a specialist form of credit sold to insurance customers when they buy a policy that allows them to spread the annual upfront cost of the premium over time, typically in monthly instalments. We estimate that over 20 million adults pay their premiums in instalments on one or more insurance policy.
- 1.2** Some providers charge the same total amount for a policy whether paying in monthly instalments or in a lump sum up front. However, in most cases using premium finance and paying in monthly instalments leads to higher total payments as there is a charge for offering credit, with Annual Percentage Rates (APR) being as high as 30% in some instances. We estimate that outstanding premium finance loan balances exceeded £5bn in 2022, generating up to £1.2bn revenues to providers.
- 1.3** Given the demand for this product and how vital it is for some consumers to be able to afford their insurance, it is important that it offers fair value to those customers that use it. But there are concerns that this is not the case and that competition may not be functioning effectively.
- 1.4** We are launching a market study on premium finance to investigate these concerns. This market study is part of our wider portfolio of work on motor and home insurance, which includes our General Insurance Pricing Practices (GIPP) Evaluation and a review of motor insurance business models.
- 1.5** Our Terms of Reference set out why we are doing the market study, its scope, the key issues we will explore, the potential outcomes that our work might lead to, and our next steps. As with all our market studies we will take an evidence-based approach, analysing whether there are issues in the premium finance market, and if so, what these are. We will consider the evidence and findings from the other concurrent projects which form part of our portfolio of work on motor and home insurance. Where we find evidence that the market is not working well, we will consider whether and how we might use our regulatory tools to improve outcomes for customers. We expect to publish a progress update and proposed next steps during the first half of 2025.
- 1.6** This study is relevant for a range of parties, including:
- Current and potential suppliers of premium finance and other products which allow UK insurance customers to pay their policy premiums in instalments.
 - Premium finance and motor and home insurance customers.
- 1.7** We invite all stakeholders to share their views on the issues set out in these Terms of Reference, including supporting evidence where relevant by **5pm on Monday 18 November 2024**.

Chapter 2

Market overview

2.1 Premium finance is typically sold by the insurer or intermediary selling the insurance, either on their own behalf or as the agent of a specialist premium finance provider (SPFP). Paying monthly usually costs more than paying upfront due to interest and commissions/fees being charged to customers. However, there are some instances where customers do not incur additional charges when they choose to pay in instalments.

Figure 1: The purchase of premium finance from a specialist lender through an intermediary



2.2 Figure 1 above is an illustration of one possible customer journey. The diagram shows a consumer purchasing insurance through an **insurance intermediary** who arranges for coverage to be provided by an **insurance company**, and premium finance to be provided by a **specialist lender – SPFP**. Several alternative ways of purchasing premium finance exist. Consumers can deal directly with an insurer for example and both intermediaries and insurers may offer their own in-house premium finance.

Chapter 3

Why are we doing this market study?

- 3.1** The Consumer Duty has brought greater focus on good consumer outcomes. In 2023 when we laid out its strategic priorities in the insurance market, we highlighted that firms needed to consider premium finance as part of their fair value assessments under the Consumer Duty. Our concern is that the premium finance market is falling short of the standards we want to see from firms.
- 3.2** We are launching this market study because:
- **Premium finance is an important product for many consumers.** Of the over 20 million adults that pay their premiums in instalments on one or more insurance policy, this is particularly prevalent in motor and home insurance. Around one-third of policyholders in motor insurance pay in instalments, compared to 36-52% in contents and/or buildings insurance. Premium finance is an important product because it allows customers who are unable to afford paying for their insurance in one lump sum to get the insurance they need, by paying in instalments.
 - **We have been concerned about premium finance for some time.** In 2022 we wrote to CEOs expressing our concern that premium finance products which have low associated credit risk but high Annual Percentage Rates (APR), sometimes up to 30%, could potentially mean some products were falling short of our expectations that non-investment insurance products (including when sold with premium finance) represent fair value for customers.
 - **We are concerned that premium finance may not represent fair value for some customers and that competition may not be functioning effectively.** There are different factors that raise potential concerns for us. These include premium finance charges potentially being too high relative to the credit risk and cost of providing the service, complex commercial arrangements between parties across the supply chain, commission structures, and business practices (such as how and when information is provided to consumers). These may create poor incentives and limit customers' ability to make effective decisions.
 - **Rising premium prices may be making the situation worse.** For example, in 2023 motor insurance policyholders faced a 25% average increase in premiums compared to the prior year, driven by factors such as inflation and rising insurance claims. This may have increased the number of people needing premium finance, or other credit alternatives, to spread their insurance premium cost. We are concerned that vulnerable customers, who are more likely to pay their insurance premiums in instalments, may have been impacted more severely.
- 3.3** We will be seeking to understand how competition works in the premium finance market and the outcomes it produces for consumers. Based on our findings, we will consider whether there is a need for regulatory action that allows for a proportionate response to any harm uncovered.

Chapter 4

Scope of the market study

- 4.1** The scope of this market study is premium finance products, sold to UK consumers, in relation to motor and home insurance policies.
- 4.2** These products are regulated by the FCA and so we will carry out this market study using the FCA's competition powers under the Financial Services and Markets Act (FSMA) 2000. FSMA gives the FCA the strategic objectives of protecting consumers and ensuring that relevant markets function well.
- 4.3** Although premium finance may be used on other insurance products we are focusing on motor and home insurance because:
- They are two of the largest general insurance markets. For the motor insurance market, around 27.6 million motor insurance policies were sold in 2023. Comparatively, for the home insurance market, around 16 million home insurance policies were sold in 2023.
 - They are typically "must have" products. Motor insurance is mandatory, and home insurance may typically be required as part of a mortgage arrangement or where a customer views this as a necessity to protect their most significant asset. This makes consumers in these markets less likely to lower their demand due to price rises and hence more likely to be in a position where they have to use premium finance.
 - We have wider concerns about the rising costs of insurance premiums within the motor insurance market. The findings in this market study will form one part of a broader investigation of these issues.
- 4.4** We will consider whether there are any wider implications from our investigation for premium finance offered on other insurance products.
- 4.5** Although price comparisons websites are not the focus of this study, we will also need to understand whether and to what extent these digital intermediaries influence competition dynamics in this market and outcomes for consumers.
- 4.6** Understanding how competition works requires that we assess the market forces that determine how firms and customers make decisions. To do this, we will gather information on premium finance products offered by insurers, intermediaries and specialist premium finance providers. We will also gather data on other agreements that enable customers to spread their insurance costs. We will consider how firms' other business activities, such as insurance underwriting or broking, affect the provision of premium finance. When gathering information, we will consider the burden on firms and do so proportionately.

Chapter 5

Issues we will explore

- 5.1** Our market study will assess how the market for premium finance works and will focus on the following key areas:
- The extent to which the premium finance market is leading to poor customer outcomes
 - What factors could be driving this, specifically:
 - A lack of competitive constraints
 - Obstacles to effective customer decision making and the role firms' practices may be playing
 - Incentives created by commercial arrangements between different providers in the supply chain, and whether these may be creating conflicts of interest and shaping misaligned incentives that result in higher prices for customers

The extent to which the market is leading to poor customer outcomes

- 5.2** Our preliminary evidence indicates that the price of premium finance may be high on some policies. Average APRs fall in the range of 20-30%, however we also found that certain providers offer the product for free on some policies. It is possible that some customers may be paying prices that do not appropriately reflect the benefits of being able to pay in instalments, and that premium finance providers may be earning margins that are higher than what we might expect.
- 5.3** High prices would hit those customers who are vulnerable harder. Our preliminary evidence suggests that vulnerable customers are more likely to use premium finance.
- 5.4** We will explore if the market is leading to poor customer outcomes, particularly whether firms are failing to provide fair value. We will primarily focus on the extent to which some customers are paying prices that are high relative to the cost of providing premium finance and whether these customers have features of vulnerability. We may also look at whether some customers may not be accessing premium finance when this would be their most preferred option.

The extent to which there is a lack of competitive constraints

- 5.5** We will explore the key features of the premium finance market to assess whether there are any obstacles to firms entering and/or expanding that could be leading to weak competition and poor customer outcomes. We will focus on assessing the structure of the premium finance market and potential barriers to entry, expansion and exit. We will

also assess the nature of competition (e.g. how providers of premium finance compete) and how they sell premium finance and set prices for this product.

Obstacles to effective customer decision making

- 5.6** Insurance policy holders may face barriers or limitations to accessing information on premium finance options, to identifying best value offers and to acting on that information. These barriers can adversely limit competition, leading to poor customer outcomes.
- 5.7** There are many factors that could be driving these barriers. Some may stem from customer behaviour or structural features of the market.
- 5.8** Firms' practices can be critical in shaping customer behaviour. Firms may make it costly for customers to obtain information on the price of premium finance or may provide it late in the consumer journey, when there is limited practical opportunity for it to facilitate shopping around. Firms may also make it more difficult for customers to identify best value offers, for instance making information complex to assess or exploiting customer behavioural traits when displaying or providing information (e.g. firms may just present the monthly cost for premium finance and hide the total annual cost that it would imply).
- 5.9** In the past we have looked into whether general insurance intermediaries and insurers provided timely and appropriate information to their customers, when arranging or providing premium finance. We found that in some cases firms were not providing clear and appropriate information to customers to enable them to make informed decisions.
- 5.10** We will primarily focus on the extent to which customers may be facing obstacles that hinder their ability and incentives to make effective decisions when purchasing premium finance and whether firms are engaging in practices that reduce premium finance customers' ability and incentives to shop around and switch. We may also look at whether firms' practices may impact different customer groups differently (e.g. if firms are making information more complex, this may impact relatively more those customers that face more difficulties navigating markets, due to conditions leading to cognitive limitations or impairment).

Incentives created by commercial arrangements between different providers in the supply chain

- 5.11** The provision of premium finance is enabled and governed by multiple commercial arrangements and relationships between different firms across the supply chain (see Figure 1 in Section 2 above). While these arrangements may drive positive outcomes in certain circumstances, they could also result in competition not working well if there is no alignment between the interests of firms and customers.

- 5.12** Commissions paid by specialist premium finance providers to intermediaries are an important feature of such commercial agreements. Commissions may help remunerate the costs of brokerage and facilitate competition but depending on their inner workings and how they are structured they may also create misaligned incentives and reduce competition.
- 5.13** We will primarily focus on whether commission arrangements between specialist premium finance providers and premium finance intermediaries are creating misaligned incentives and not working in the interest of customers. We will assess the impact of these commercial arrangements on the prices paid by end customers of premium finance and whether they are leading to consumer harm.

Chapter 6

Next steps

Potential outcomes of the market study

- 6.1** Market studies can lead to a range of outcomes. Where harm is identified, there may be a range of proportionate interventions available to make the market work better. Remedies can include, but are not limited to: making, removing or amending rules; publishing guidance; proposing greater industry self-regulation; supervisory action/engagement within the current rules framework; introducing firm-specific remedies or taking enforcement action.
- 6.2** The Consumer Duty, and our existing rules, require firms to consider whether the price of their premium finance products would provide fair value, require that consumers are given adequate information at point of sale, and specify that distributors that offer premium finance through a third party cannot be influenced by remuneration they receive.
- 6.3** It may be possible to address any harm in the market by reference to these rules. If evidence provides justification for FCA intervention (such as further rules and guidance), however, we will need to consider the potential benefits and costs to consumers and firms of amending our current regulatory framework. Any such changes will need to be designed to create appropriate incentives in the market and avoid unintended consequences.
- 6.4** Alternatively, we may decide to take no further action following the market study. This could be because we do not identify any harm, or because harms are likely to be addressed by actions agreed with the relevant firms during our diagnostic activity.

Related work

- 6.5** This market study is part of a comprehensive program of work to address issues in motor insurance:
- We are undertaking a review to better understand motor insurance business models. This review will focus on how income and expenditure is broken down, with a particular focus on profitability, how claims costs are controlled and the distribution model. This work will not only help us to better understand the potential drivers of motor insurance premiums but it will aid our assessment of whether motor insurance products are being offered on a fair value to customers.
 - We are evaluating the pricing rules introduced at the start of 2022 to address harm identified by the General Insurance Pricing Practices (GIPP) Market Study. This aims to quantify the causal impact of these rules on prices paid by consumers,

firms' expected margins, and policy switching rates. We intend to publish the results of our review in Q2 2025.

- 6.6** We propose to incorporate findings from this overall programme of work into our market study and any work on potential remedies, to ensure coherence and to prevent unintended consequences.

Next steps

- 6.7** Given the urgency of the wider issues in motor insurance, we are launching this work now.
- 6.8** We will engage with firms, industry groups and stakeholders to gather their views on these Terms of Reference and to begin discussions over what data we may need. We expect to start these discussions shortly.
- 6.9** Although we are not formally consulting on these Terms of Reference, we welcome any views on them, in particular:

Question 1: Scope. For the products and activities listed in the 'Scope of the market study' section, are there any areas we should focus on? Are there any other products or activities we should consider within our scope? If so, why?

Question 2: Issues. For the issues listed in the 'Issues we will explore' section, are there any areas we should focus on? Are there any other issues or themes we should consider to understand whether competition in premium finance is working in the interests of consumers? If so, why?

- 6.10** Please provide any views in writing to PremiumFinanceMS@fca.org.uk by 18 November 2024.

Chapter 7

Glossary of terms used in this document

Term	Description
The Consumer Duty	Where we refer to the Consumer Duty in this document, we are referring to the Consumer Duty and/or the PROD rules where applicable.
Fair Value	As part of the FCA's Consumer Duty, firms must undertake 'fair value' assessments as a way of demonstrating if the price a consumer pays for a product or service is reasonable compared to the overall benefits they can expect to receive.
Annual Percentage Rate (APR)	This measures the total cost of borrowing money over a year. It is calculated by combining the interest rate and any additional fees charged by the lender.

Annex 1

List of questions

Question 1: **Scope.** For the products and activities listed in the 'Scope of the market study' section, are there any areas we should focus on? Are there any other products or activities we should consider within our scope? If so, why?

Question 2: **Issues.** For the issues listed in the 'Issues we will explore' section, are there any areas we should focus on? Are there any other issues or themes we should consider to understand whether competition in premium finance is working in the interests of consumers? If so, why?

Annex 2

Abbreviations used in this paper

Abbreviation	Description
SPFP	Specialist Premium Finance Provider
GIPP	General Insurance Pricing Practices
Duty	The Consumer Duty (including the PROD rules where applicable)
FSMA	Financial Services and Markets Act 2000
APR	Annual Percentage Rate
PCW	Price comparison website
UK	United Kingdom

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