FINANCIAL CONDUCT AUTHORITY

**Thematic Review**

TR24/2

# Product Oversight and Governance thematic review – General Insurance and Pure Protection (PROD 1.4 and PROD 4)

**August 2024**

# Contents



# Chapter 1

# Executive Summary

## Introduction

**1.1** Financial products and services should meet customers' needs and offer fair value. As customers across the country are affected by the current cost of living crisis, fairness and value are increasingly important.

**1.2** As a result, we have intensified our focus on ensuring customers achieve good outcomes. We strengthened our Product Governance Sourcebook (PROD 4) in 2021, including a requirement for firms to ensure that insurance products provide fair value to customers in the target market. The introduction of the Consumer Duty in 2023 set a higher standard of conduct for products and services for retail customers.

**1.3** This thematic review considers whether firms are meeting their product governance obligations for general insurance (GI) and pure protection (PP) products under these new rules. We have assessed insurance manufacturers and distributors' product oversight and governance arrangements against what is required under PROD 4. This report sets out our findings.

**1.4** This report supersedes our letter to manufacturers dated 23 February 2024. That letter only set out our key observations for manufacturers, while this report sets out all our findings for both manufacturers and distributors. It is our final report for this review.

## What we did

**1.5** We looked at whether firms had:

- appropriately implemented the rules introduced under PROD 4, which make them responsible for ensuring the products they manufacture and distribute offer customers fair value
- assessed and could clearly demonstrate their products and services provide fair value and how their product governance arrangements delivered good outcomes for customers.
- introduced appropriate systems and controls necessary to effectively implement these requirements
- taken appropriate action where they had identified actual or potential issues where products may not be providing the intended value.

**1.6** We requested and analysed information from 28 manufacturers and 39 distributors covering 10 different GI and PP products. Chapter 3 sets out our full scope and methodology.

**1.7** This review did not independently assess the value of the products and the impact of the distribution arrangements, including remuneration, on the value to customers. Its purpose was to understand whether firms were meeting their obligations under PROD 4. However, we have included some examples which indicate poor customer value and potential harm as a direct consequence of firms' shortcomings in their product governance, oversight and controls.

**1.8** Our findings are not specific to any product. Most of the issues applied broadly, rather than to individual products, and existed across both GI and PP products.

## Key Findings - Manufacturers

**1.9** Most product manufacturers have materially strengthened their product oversight and governance arrangements and appointed appropriate senior managers responsible for product governance. However, we saw shortcomings or inconsistencies in many firms' arrangements and how they applied them. Many firms were not fully meeting the requirements under PROD 4 and could not ensure and evidence that their products are delivering fair value. We summarise these shortcomings below and give more detail in Chapter 4.

### Product Governance arrangements

**1.10** Many product manufacturers did not appear to have implemented effective product governance frameworks compliant with PROD 4. This meant they were unable to adequately evidence how and why they concluded that their products offered fair value and give their customers good outcomes. This included being unable to show that:

- there was robust challenge when considering the value of their products
- they made clear judgments supported by appropriate evidence in their product reviews and the FVAs
- they had appropriate MI and analysis to support decision-making
- they had proactively identified products with value problems and acted to address them

### FVAs and regular review of products

**1.11** We saw shortcomings in the quality of the FVAs undertaken by many firms. These included firms:

- not adequately considering the total price paid, including the impact of remuneration on the overall value of the product
- not having sufficient MI to monitor distributors' remuneration and ensure that it was consistent with providing fair value to their customers
- not having sufficient, good quality MI to assess value, or appropriate metrics to identify fair value problems

- being unable to demonstrate how they assessed whether the product was delivering fair value to all customers, including vulnerable or outlier groups of customers
- not identifying value problems even where these were apparent

## Other key areas

**1.12** Target market statements were often too high level and lacked granularity. If firms do not adequately define the target market, there is a real risk that the product is then sold to customers outside this group who are unlikely to get fair value or achieve good outcomes from the product.

**1.13** Where several parties were involved in manufacture, many firms did not understand or meet their responsibilities under PROD 4.2.

**1.14** Many manufacturers had not appropriately considered their distribution arrangements or choice of distributors, given the product and target market. Many were also not providing appropriate and timely information to their distributors.

## Summary conclusion on manufacturers

**1.15** Many manufacturers are not adequately assessing and evidencing that their products deliver fair value and good outcomes. This means firms are not identifying instances where products are not delivering fair value for customers. This allows these products to cause harm, as seen in some of the examples in Chapter 4.

**1.16** Where we saw manufacturers doing a better job of meeting PROD 4 requirements, some of the key drivers were:

- robust product approval processes overseen by the Board and where senior managers provided real challenge
- the business being fully involved in FVAs that reached clear, well-evidenced conclusions and identified any problems
- appropriate monitoring, including the use of high-quality MI, to ensure the product continues to provide fair value, customers are getting good outcomes and to identify any potential problems
- prompt escalation and action where problems were identified, including changing or withdrawing products
- timely sharing of appropriate product information with distributors

**1.17** Manufacturers should focus on these key drivers as they work to improve their product governance and oversight to ensure they meet their PROD 4 obligations. We believe manufacturers who appropriately incorporate these elements will be better able to assess and evidence their products provide fair value and will enhance the outcomes their customers receive.

## Key Findings – Distributors

**1.18** Some distributors have strengthened their governance and oversight of their product distribution arrangements, and we can see that relevant senior managers have taken responsibility for this. These firms can evidence they have considered the impact their activities and remuneration have on the products and value to customers.

**1.19** However, some distributors have made much more limited progress in understanding and meeting their responsibilities under PROD 4.3. We summarise these shortcomings below and give more detail in Chapter 5.

### Product distribution arrangements, distribution strategy, remuneration and value

**1.20** The product distribution arrangements and related governance are essential parts of the control framework firms must have to ensure they understand the insurance products they distribute, the target market and the intended value. When effective, they reduce the risk of customer harm. However, we found shortcomings in many firms including:

- a lack of clarity around the governance structures and processes with limited or no clear responsibility, rationale, or evidence for key decisions, including any actions taken when they identified value problems
- product distribution arrangements without enough detail and failure to adequately consider key areas like distribution strategy, target market, remuneration and the product's intended value
- a lack of effective processes to get appropriate information from the manufacturer to allow them to understand the target market, distribution strategy and the product's intended value
- not having a distribution strategy which met the requirements of PROD 4.3 and was appropriately aligned to the manufacturer's distribution strategy for the product
- insufficient MI and analysis to assess their remuneration, its relationship with their costs and the benefits and services they provide and its impact on product value, and a lack of evidence of any such assessment and its outcomes

### Target market statements

**1.21** Distributors must understand the target market and ensure that the product is distributed in line with it. In most cases, the target market statement distributors used was aligned to the manufacturer's statement. However, we saw some cases where the statement used by the distributor differed materially. For example, it was less granular than the manufacturer's or less clear in identifying customers for whom the product is not expected to provide fair value. This raises concerns about the product being sold to customers outside the target market and the resulting risk of harm.

## Summary conclusion on distributors

**1.22** Many distributors appear to be failing to adequately and consistently meet their obligations under PROD 4.3. We are particularly concerned that many distributors do not get sufficient information from the product manufacturers or fully understand the distribution strategies in place. Most distributors also do not appear to have fully understood their responsibilities to consider their remuneration, its interaction with the services and benefits they provide and its impact on the product's value.

**1.23** These create real risks, including firms using inappropriate distribution strategies and distributing the product to customers outside of the target market. Firms may also be getting levels of remuneration which adversely impact the product's value and do not bear a reasonable relation to the services and benefits they provide. Where there is insufficient MI and monitoring this could result in products causing harm, as set out in some of the examples in Chapter 5.

**1.24** Some of the key drivers of distributors doing a better job of meeting PROD 4 requirements were:

- Robust governance processes around product distribution arrangements with appropriate business input and senior management oversight and challenge. This delivers clear, well-evidenced outputs that allowed the firm to identify and address value problems
- Effective processes and mechanisms to get information from and share information with manufacturers
- Producing complete and sufficiently detailed product distribution arrangements, including distribution strategy, target market, remuneration and the product's intended value
- Having appropriate MI and robust analysis of the firm's own costs and the benefits and services to customers. This allows the firm to assess and evidence if their remuneration is reasonable and its impact on the product's intended value.

**1.25** Distributors should focus on these key drivers as they work to improve their governance and oversight of their product distribution arrangements to ensure they meet their PROD 4 obligations. We believe distributors who appropriately incorporate these elements will be better able to assess and evidence that their product distribution arrangements and remuneration are consistent with delivering fair value to customers.

# Next steps

**1.26** We are very disappointed to see many firms, both manufacturers and distributors, failing to meet their regulatory obligations under PROD fully, despite our extensive previous work and the clear expectations we have set.

**1.27** Our PROD rules are designed to ensure that firms consistently deliver fair value to customers. This means that these shortcomings create the real risk of actual and potential harm to customers, as seen in some of the examples in this report.

**1.28** We are currently considering the most appropriate supervisory and regulatory actions we can take to urgently address these issues. We are requiring firms to take remedial actions supported by attestations from senior management and using our skilled person review tool, where appropriate. Where we have more material concerns about product value, we are intervening including getting firms to withdraw products from the market. In the event we identify significant harm to customers, we will ensure that firms and their senior managers are held accountable for these failings and remediate the harm, including providing any customer redress necessary.

**1.29** This report also gives examples of better practice alongside some of the cases with shortcomings. We expect all firms involved in the manufacture and distribution of GI and PP products to urgently consider the contents of this report, assessing whether and to what extent these issues apply to their manufacturing and distribution activities. Where they identify shortcomings in their product governance arrangements, we expect them to act promptly to remediate including providing redress to customers where harm has been identified.

**1.30** We are currently providing feedback to the firms involved in our review. We will intervene as necessary to address the issues and risks in those firms who are not meeting their regulatory obligations, using the full range of our regulatory tools.

**1.31** We have set out our expectations for firms within this report and we will also engage further with the GI and PP sectors, including relevant trade bodies, to ensure that these are understood and acted upon urgently. Firms (supported by relevant trade bodies) need to do much more to work together and ensure they share information, as required by the rules.

**1.32** Firms who still fail to fully meet their obligations in this area, and who cannot demonstrate that they are delivering fair value consistently, can expect us to intervene using the full range of our regulatory tools.

# Chapter 2

# Background

## Our product governance rules

**2.1** In recent years, we have materially strengthened our rules on product governance. This included provisions to ensure products offer fair value and customers are getting good outcomes.

**2.2** On 1 January 2021, the product governance rules for the general insurance value measures (PS20/9) under PROD 4 came into effect. They required firms to ensure that the value measures products offered fair value on an ongoing basis.

**2.3** In May 2021, we published Policy Statement 21/5 (updated in PS 21/11). This set out our final rules on general insurance pricing and improving the product governance rules under PROD 4 . These product governance rules came into force on 1 October 2021, and applied to manufacturers and distributors of all general insurance and pure protection products (except contracts of large risks or reinsurance contracts). It also applied immediately for new or significantly adapted products. For all other products, firms had a 1-year transitional period, ending 30 September 2022, to implement the enhanced PROD 4.

**2.4** On 1 July 2023, the Consumer Duty rules (PS 22/9) came into effect for all financial products and services open to new business. Two of the outcomes of the Consumer Duty - Products and Services and Price and Value - were disapplied for GI and PP. These firms were already subject to requirements in these areas under PROD 4.

**2.5** Our PROD 4 rules require manufacturers to (among other things):

- maintain, operate and review a process for approving products, including assessing whether they will provide fair value
- regularly review these products (annually, or more frequently where appropriate considering any event that affects the potential risk to customers) to ensure that they are performing as expected and delivering the intended value
- make information available to distributors to enable them to understand:
  - the outcome of the value assessment undertaken by the manufacturer
  - the impact of the distribution activities on the overall value of the product and
  - the type of customer for whom the product is unlikely to provide fair value

**2.6** Distributors must have adequate product distribution arrangements to assess the potential impact of these arrangements on the product's intended value, and to regularly review these arrangements. Distributors must promptly inform the manufacturer and, if needed, amend their distribution strategy for that product if they become aware:

- the product is not in line with the interests, objectives and characteristics of its identified target market or
- of other product-related circumstances that may adversely affect the customer

## Background to our thematic review

**2.7** Our previous work showed customers were not always getting good outcomes when they buy financial products. For insurance, our review of Value in the Distribution chain and the General Insurance Pricing Market Study identified material levels of customer harm due to poor product value. In some cases, this was due to the considerable amount of remuneration to those in the distribution chains which reduced the product's intended value.

**2.8** We also saw indicators of poor value in the Value Measures data for lower cost products, such as key cover and missed event, to some higher priced products, such as Guaranteed Asset Protection (GAP) insurance. Our reviews of multi-occupancy buildings insurance (published in September 2022 and April 2023) and supervisory work on pure protection products raised similar concerns of potentially poor outcomes for the end customer, both retail and commercial. After we started this review, we intervened in the GAP market due to longstanding concerns about fair value.

**2.9** In February 2022, we sent a survey to 96 firms to assess product manufacturers and distributors' preparations and work to comply with PROD 4 by 30 September 2022. We concluded the review in July 2022, giving feedback to both manufacturers and distributors setting out our disappointment at their lack of readiness as well as the further actions firms needed to take to comply with PROD 4. These included, among other things, improving their governance arrangements, product approval and monitoring processes, management information and the sharing of information between manufacturers and distributors. We also committed to undertake a post-implementation multi-firm review for product manufacturers and distributors to assess their compliance with PROD 4 rules.

# Chapter 3

# Scope and Methodology

## Manufacturers

### Firms

**3.1** We included 22 GI and 6 PP manufacturers firms in our sample, broadly representative of firms within the market. This included firms of varying sizes as well as those from the retail insurance and London market sub-sectors. We also included Managing General Agents (MGAs) and other intermediaries who are product co-manufacturers. The 22 GI manufacturers told us that they account for a total £23bn of Gross Written Premium and 107m policies. The 6 PP manufacturers told us they account for £4.4bn of Annualised Premium Income and 13.4m policies. These numbers are for products in scope of PROD 4. The 22 GI manufacturers account for over 50% of home, motor, pet and travel products in the UK market.

### Products

**3.2** We reviewed home, motor, travel, pet, health cash plans and private medical products for GI. We also reviewed commercial GI products for some firms. We reviewed whole of life over-50s, term assurance (and critical illness if sold jointly) and income protection products for PP. We reviewed 45 GI and 11 PP products in total.

### Methodology

**3.3** Our review of manufacturers considered the key provisions of PROD 4. This included:

**a.** Firm's Product oversight and governance arrangements
**b.** FVAs and regular review of products
**c.** Target market
**d.** Manufacture by more than one firm (co-manufacturing)
**e.** Distribution arrangements including information given to distributors

## Distributors

### Firms

**3.4** We included 39 distributor firms in our sample, 29 GI and 10 PP distributors. The firms represented varying sizes, market sub-sectors, business models and distribution methods.

### Products

**3.5** We then reviewed the same products from the perspective of one of the distributors for the product. We reviewed 47 products for distributors; the remainder were directly distributed. We reviewed no more than 2 products for each distributor.

### Methodology

**3.6** In our review of distributors, we considered the relevant provisions in PROD 4.3. This included:

- Product Distribution Arrangements
- Target market
- Distribution strategy

**3.7** We also met with a subset of our sample of manufacturers and distributors to clarify our understanding of the information they provided and confirm our findings.

## Chapter 4

# Our findings - Manufacturers

**4.1** Below we set out our findings for manufacturers under these headings:

- Product Oversight & Governance arrangements
- Fair value assessments, ongoing monitoring and regular review of products
- Target market
- Manufacture by more than one firm (co-manufacturing)
- Distribution arrangements including information disclosure to distributors

## Product Oversight & Governance (POG) arrangements

**4.2** Firms must have robust product governance arrangements in place, with an appropriate POG framework that includes a rigorous product approval process. These arrangements must include effective risk management processes and mechanisms for ongoing monitoring and review of products, supported by clearly defined roles and responsibilities. This helps ensure manufacturers design products which provide fair value and deliver consistent fair outcomes for customers. It also helps to underpin a culture that prioritises customers' interests and aligns to our expectations of firms under PROD 4 and the Consumer Duty.

**4.3** As required by PROD 4.2.9 R, we expect firms to evidence how and why they approved their products for distribution, including that they offer fair value, and the approval by their governing bodies and relevant senior managers. This process is a core component of the control framework to ensure customers achieve good outcomes. It is essential that the process is appropriate and firms clearly document any changes to it.

## Findings

### What we did

**4.4** We assessed whether firms had appropriate POG arrangements. We considered how the governing body and other relevant forums/committees approved the product, senior management roles and responsibilities, decision-making (including challenge) and issue escalation.

### What we found

**4.5** Most firms had updated their POG frameworks, including the product approval process, to meet the enhanced PROD 4 requirements. They had a POG framework broadly consistent with the requirements of PROD 4. However, some firms fell short of their obligations.

**4.6** Although many firms had POG frameworks broadly consistent with our requirements, we often found these frameworks did not operate effectively or consistently to provide the appropriate level of challenge and oversight. In many firms, we saw a lack of a comprehensive or consistent approach to product oversight. Firms were often unable to evidence how they had assessed products in line with the rules, and the rationale for key decisions including product approvals.

**4.7** Ineffective product oversight and governance, a lack of appropriate challenge by decision-makers and weak product approval and review processes can cause customer harm. They can lead to poorly designed products which do not provide fair value. This can also mean that firms do not promptly identify or understand product problems and do not make or act on decisions to reduce customer harm.

## Governance structure, senior managers, and committees

**4.8** Most firms in our sample had appointed an appropriate senior manager to be accountable for product oversight and governance and established a broadly appropriate governance structure. This consisted of the firm's governing body endorsing and being ultimately responsible for the product governance framework, individual product approvals and ongoing monitoring. This was supported by other relevant governance committees and forums undertaking the day-to-day process.

**4.9** However, some firms had not put in place or not clearly identified a process for their governing body to have ultimate responsibility for the products and their overall performance. This included the responsibility for ensuring products provided fair value and to verify the ongoing compliance of the firm's POG processes. Some firms had several different committees responsible for different aspects of product oversight, with each committee responsible for certain elements of the product or performance. In these cases, it was often unclear how the work of these different committees came together to provide a holistic view of the product through its lifecycle and whether it offers fair value.

**4.10** Many firms did not provide any minutes or other records to evidence that the product approvals, including FVAs and ongoing monitoring/periodic reviews, were approved by the designated governance committees and then by the firm's governing body. In other cases, the minutes or records did not always provide evidence of challenge, or that the product was approved as providing fair value.

**4.11** A small number of firms used a senior committee in their product governance processes, but this committee did not have any decision-making powers. Its role was solely advisory, and an individual undertook the product approval.

**4.12** To provide visibility and oversight, many firms had introduced processes to escalate certain POG issues. However, we saw many cases where these processes were not being applied in practice, including those for the Board's engagement. We also saw cases where the triggers for escalation did not appear to be set at an appropriate level.

**4.13** In some firms, material POG issues appeared to have arisen during the FVAs or during the product monitoring. However, these firms could not give examples of where and how they had escalated product governance matters to the governing body or Board

committee. Examples of issues that should be escalated promptly include products where customer harm has been identified or where the product is not performing as intended and has a material impact on customer outcomes.

## Governance of product approval and review processes

**4.14** All the manufacturers within our sample had implemented a product approval process, but the effectiveness of the design and the implementation varied materially. Only a few of the firms met our expectations, with senior management able to consistently evidence they had appropriate control and oversight during the product approval process or that decisions were being taken at the appropriate governance level. These firms had a product approval process which sat within a clear governance framework, with appropriate remit and escalation points, and had implemented it consistently across all areas of the business. This was supported by appropriate and timely management information.

**4.15** In other firms we saw a range of concerns with the product approval process and its governance, including cases where:

- senior management had more limited input to, or oversight of, the product approval process and the decisions reached through this process
- the product approval process was not embedded within all business units, or was not used consistently across the different business units
- different areas of the business were responsible for different elements of the product approval process, but the firm did not have centralised oversight of this
- the individual product MI presented to senior decision-making bodies was not always sufficient to enable sound decision-making

**4.16** We had material concerns where we saw issues with the product approval process and associated governance. This included senior management's ability to provide effective challenge throughout the process and ensure that products are delivering fair value and were suitable for approval.

**4.17** These shortcomings create a real risk that customers receive products that do not offer fair value and should not have been approved. For example, products may be approved because the governing body, relevant committees or senior managers did not receive appropriate information to enable sound decision-making or challenge the FVA's outcome. Or a firm's customers may get different outcomes due to the product governance processes applied, depending on which business unit manufactured the product they buy.

**4.18** We also saw cases where firms' product approval and review processes did not appear to have worked appropriately, including products identified as not performing as intended or with material concerns about value. In these examples, we saw a lack of appropriate challenge or action, such as making significant changes to the product or withdrawing it. Where we saw firms taking such actions, this was more often because of commercial interests rather than those of the customer.

**4.19** Below, we give some examples of better and poorer practice and potential customer harm.

**Examples of better practice where firms could demonstrate they were meeting the requirements of the PROD rules**

1. A POG framework supported by a proportionate and appropriate product approval process which was aligned to the manufacturers' responsibilities under PROD 4.2. This ensured that there was a consistent and cohesive approach to undertaking the FVAs, even when done by differently-experienced staff or by different business areas. We also saw the product approval process being consistently applied in practice, with quality assurance processes to ensure this would continue.

2. Some firms provided evidence clearly demonstrating how their senior management gained assurance that products offered fair value and customers were achieving fair outcomes. This evidence included:

   - Output of the product reviews, product approvals and FVA that:
     - Were easily digestible and clearly identified and demonstrated if and how the product offered fair value along with the data/evidence used as part of the product reviews and FVAs. This included appropriate MI to support the outcome of the approval, reviews and FVAs. This output was produced consistently for all products we reviewed
     - Included any concerns from the product reviews, product approvals and FVA processes, along with proposed actions for senior management discussion and approval
     - Clearly set out any limitations of the analysis or evidence used to regularly review and approve products and to assess their value. It also included what actions were taken to manage risks due to these limitations
     - Were summarised and presented in a way that enabled decision-makers to have robust, well-rounded discussions including appropriate challenge and sound decision-making
   - The governing body being able to show they had explicitly approved the product, with written evidence that clearly showed how a product provided fair value and so could continue to be distributed in line with the distribution strategy
   - Records of the governing body and senior management showed key discussions, decisions and any actions taken including evidencing robust challenge about the output of the product reviews, product approvals and FVAs

3. We saw instances where the governing body and senior management had clear oversight and accountability where product issues were identified and acted on promptly to ensure these were resolved. This included setting clear responsibilities for the actions needed to address problems with the value of the product, through to conclusion. Some examples of appropriate action taken by senior management show they:

   - took prompt and appropriate decisions when a product needed to be amended or withdrawn from the market
   - allocated responsibilities to an appropriate person to carry out the actions

- made and evidenced their decisions whether and when it would be appropriate to reintroduce a product to the market after it was withdrawn
- made decisions supported by appropriate evidence and rationale on whether and when they should provide redress to customers where harm was identified, including the methodology for doing so
- oversaw, approved and recorded the actions taken along with the resulting outcomes

4. We saw examples of a clearly defined and effective process for escalating issues and the outcomes of product reviews, product approval and FVAs, along with subsequent approval by the governing body with accompanying reports and MI.

**Examples of poor practice and potential customer harm**

Some examples that show shortcomings in product governance and oversight could potentially result in customers getting poor value.

**Example 1**

The manufacturer assessed a product as providing fair value and approved it for distribution. However, one of its distributors did not consider it offered fair value for the target market identified by the manufacturer. The distributor decided not to sell the product but continued to offer other products from the manufacturer which they felt did provide fair value. The distributor informed the manufacturer of this.

In these circumstances, we would expect the manufacturer to take proper account of the distributor's feedback and review the product's FVA. However, we saw no evidence the manufacturer captured this information or considered it through its product governance arrangements. Where this product continues to be sold there is a risk that customers buying it via other distributors may get poor value.

**Example 2**

Some firms simplified the information they presented to product governance forums and the responsible SMF holder or senior manager in the case of Gibraltar firms. This took the form of a RAG rating system with minimal underlying data or analysis to support the rating. This limited the ability of these forums and senior managers to challenge the value assessment, even for higher risk products. It also meant that it was not always clear how the firm assessed the product's value and concluded it offered fair value. As a result, we saw products with RAG indicators showing they may not be offering fair value, but with no evidence the firm's own governance processes had identified or considered this.

The information presented to the governing body, senior managers and product governance committees must be sufficient to enable decision-makers to understand and challenge the assessment of whether the product offers fair

value. This information needs to include enough detail to understand any material changes in the product's value for groups of customers in the target market. It is unlikely that high level indicators alone, without any supporting evidence or rationale, would inform the robust product approval and value assessment processes and discussions we expect of firms. Firms need to consider what is relevant and proportionate for the nature, size and complexity of their business.

## Fair value assessments (FVAs), ongoing monitoring and regular review of products

**4.20** A FVA requires firms to undertake a comprehensive evaluation of product components, pricing, services, and customer benefits throughout the product lifecycle, to ensure products offer fair value. Value considerations must be integrated into every stage of the product approval process, including when identifying target markets, product testing and selecting distribution channels (PROD 4.2.14D R).

**4.21** Value is defined as the relationship between the total price to the customer (including consideration of each of the individual elements that make up that price) and the quality of the product(s) and/or services provided. The value assessment must include consideration of various factors. These include the nature of the product, type and quality of services and expected total price the customer pays (PROD 4.2.14E R).

**4.22** Firms must ensure that insurance products provide fair value to customers in the target market. Where a product is distributed with additional products, firms must identify whether the individual components and the package as a whole provide fair value. This assessment must ensure the product provides fair value not just at point of sale but for a reasonably foreseeable period, including renewals. Firms must clearly demonstrate how products provide fair value and retain records of value assessments. If firms cannot identify and clearly demonstrate fair value, they must stop distributing the product or make appropriate changes to it (PROD 4.2.14A R – 4.2.14C R).

## Information to be used to assess value

**4.23** Firms must use all relevant data and information available when assessing value (PROD4.2.14J R). This includes:

- internal information such as customer research, claims data (including handling times, frequency, severity, ratios, acceptance/decline rates), and complaints data (including root cause analysis and handling times)
- public information from external sources, including analysis of similar insurance products from other firms and data published by regulatory bodies like the FCA
- information from distribution arrangements, including details on remuneration and its impact on the product's value, service levels, and results of monitoring and oversight
- any other relevant information/data

The specific information needed will vary depending on factors such as the type of insurance product, package, distribution arrangements, target market, existing customer outcomes data and the nature of any actual customer base.

## Our findings

### What we did

**4.24** We reviewed firms' product approvals including the FVAs of products, and their monitoring arrangements. We looked at whether firms could evidence whether and how their products offered fair value and whether customers were getting good outcomes. We did not independently assess the value of products, but we did identify indicators of poor value and/or the risk of poor customer outcomes. This report gives some examples of these.

**4.25** We also assessed actions firms took to identify and manage the risks to customers and whether this led to improved product design and better customer outcomes. This included reviewing firms' data and information used for product approval, including for assessing fair value and ongoing monitoring.

### What we found

#### *Completion and recording of FVAs*

**4.26** Most firms had reviewed the selected products, including assessing how they provided fair value to customers. However, a few insurers gave limited or no evidence to demonstrate the steps they had taken to ensure the firm had met its obligations under the rules, particularly where a co-manufacturer of the product had undertaken activities in the product approval process including FVAs (see section below – Manufacture by more than one firm).

**4.27** A few firms had not undertaken any FVA and could not demonstrate how they were meeting our rules. We also saw some firms had not been meeting the requirement to review their products at least every 12 months. Some had not considered if this review should be done more frequently, where the product's potential risks meant it was appropriate to do so.

**4.28** Even where many firms had included a FVA process in the product approval process, most had not embedded this properly or used it effectively and consistently. For example, the value assessment framework usually required the assessor to answer a series of questions. However, in many examples, the responses to these questions were not given due consideration or were not supported by appropriate evidence. The responses were often very generic and did not address the question properly, so did not provide any real insight or assurance to support the product providing fair value. The minutes of meetings also gave no evidence this was challenged.

**4.29** The recording of many firms' FVAs and their outcomes was not sufficient. They did not clearly demonstrate how the products were delivering fair value and would continue to do so for a reasonably foreseeable period. The records often did not show the rationale and justification for how the total price (including the individual elements) paid by the customer was consistent with providing fair value.

### *Quality of FVAs and ongoing monitoring*

**4.30** Most firms tried to comply with PROD 4.2 by completing a FVA, but we found there was significant room for improvement. In many cases, the FVAs and product reviews did not meet PROD 4's requirements.

**4.31** We found many manufacturers did not meet the core requirement to consider the total price the customer paid. Where firms had undertaken a FVA, they did not always consider the expected total price and the elements that make up the total price. There was also no clear rationale and justification of how each element of the total price was consistent with providing fair value. FVAs must consider all the elements that make up the total price the customer pays.

- Most firms considered the risk price and the cost of underwriting the product, including the cost of paying claims. However, many did not adequately consider any other elements that make up the total price. For example, any costs to the firm for operating the product, including claims handling and policy administration
- The remuneration paid to distributors is usually a significant component of the price customers pay and must be considered as part of the FVA. However, most manufacturers had not adequately assessed the impact of the distribution arrangements on the product's value. We saw the following issues:
  - Many firms could not show they had assessed the remuneration of distributors (any commission, fee, charge, or other payment) or how it was consistent with providing fair value. This included not considering the type and quality of the services the distributor provided and if this was reasonable compared to the level and amount of remuneration
  - Some firms did not include all forms of remuneration for the distribution arrangements in the FVA, for example profit commission. This was either due to oversight or failure to get the necessary information from the distributor
  - Fewer than 5 firms in the sample provided an appropriate justification and rationale of how and why the remuneration paid to distributors was consistent with delivering a fair value product. Even where firms had done some work on this and provided a basic rationale, significant improvement was needed to meet our expectations, through better analysis and clearer documentation/ evidence
  - Where commission was based on a percentage of the premium, many manufacturers did not have controls to manage the risk of commission automatically increasing due to premium rises, which could affect the product's value over time. So, for example, they had not considered creating a cap on the pound value of commission or the level at which the remuneration would be inconsistent with providing fair value.

**4.32** We saw little evidence of firms considering the nature and complexity of the products' existing or intended customer when considering fair value. For example, the FVA can help a firm identify unexpected consequences for different groups of customers. These could be vulnerable customers or outliers, such as groups with low claims ratio compared to the average for the same product. This type of analysis may suggest changes to the design of the product or the scope of its target market.

**4.33** Some firms undertook the FVA at an aggregate level for the target market and did not consider whether there were groups of customers who may be getting different outcomes.

**4.34** Most firms' assessments did not consider how the product would continue to provide fair value for a reasonably foreseeable period. For pure protection, some firms were using a customer value metric that considered value for the foreseeable future. However, these did not always include the cost of commission and/or the erosion on policyholder value of early surrenders. It was also unclear how firms decided that the standard/tolerance limit for their customer value metrics was appropriate.

**4.35** Firms must have adequate and appropriate MI to carry out appropriate FVAs and enable effective monitoring of their products. We found the following issues:

- Many firms did not have a complete or appropriate suite of product-specific MI showing how the product was performing and how this aligned to expectations
- We saw shortcomings in firms' MI for all elements of the total price of the product to the customer, and thus their ability to appropriately assess whether these are consistent with delivering a fair value product
- Only a few firms had data for monitoring distributors' remuneration to ensure it was consistent with providing fair value to customers. These firms were unable to show they had considered how to address remuneration that may become inconsistent with delivering fair value. For example, setting a cap on the amount of remuneration or setting a risk tolerance limit to identify when remuneration reached a level inconsistent with providing fair value
- Most firms had identified and established some metrics, with standards or tolerance limits set for each metric. They used these to monitor and support their assessment of whether a product provided fair value to customers. However, in many cases the standards or tolerance limits were not supported by a rationale of why these limits would enable the firm to ensure the product provided fair value or to take prompt action if there were problems
- The suite of metrics and standards/tolerance limits used were often under-developed. In some cases, these limits were not coherently linked to identifying when the product was not offering fair value to the target market. There was no clear explanation of why the limit was set at a particular level. This meant when the firm was considering fair value either at approval or the product monitoring stage, outcomes were rated green. We give an example of this below
- Where firms had not established any metrics (including standards/tolerance limits) to support their assessment of a product's value, they often based their conclusion on inadequate data and analysis. Or they simply made a subjective assertion that the product offered fair value. For example, some firms assessed

value by comparing to historical performance but did not assess if or how historical performance represented fair value
- Some firms assessed the product's fair value based on a market benchmark only. In some circumstances, benchmarking could be useful evidence. However, firms must assess and be able to explain how the product is delivering fair value, using a broad range of available information, without relying solely on the benchmark. Benchmarking alone would not identify whether a product is not delivering fair value if other firms' products were of poor value, as we found with GAP insurance
- We noted that, following the first set of FVAs by firms after the enhanced rules came into force, some re-assessed their standards and tolerance limits and had reset these at a level more likely to represent fair value

### *Actions from FVAs and identification of value issues*

**4.36** The purpose of FVAs is to make an appropriate assessment which identifies any value issues and then to act promptly to address them. FVAs allow firms to reduce the risks of customers getting poor outcomes or suffering harm. However, many firms' product approval processes did not include sufficient measures to ensure they identified and consistently reported product issues or circumstances that may harm the customer. They also did not always have clear frameworks for ensuring they acted promptly and appropriately to reduce and prevent customer harm.

**4.37** Some firms had identified issues indicating the product may not be providing fair value. However, very few products were suspended or withdrawn from the market or otherwise adapted to ensure this was resolved. Where firms had withdrawn products, this was often purely for commercial reasons. It is a clear breach of the rules for firms to fail to act when they identify issues that may cause customer harm, including the risk that a product does not provide fair value. And where they do so for their own commercial interests this would be a breach, not only under PROD, but also wider obligations under the customer's best interests rule and the Consumer Duty.

**4.38** We set out below examples of:

- firms able to demonstrate they took action to prevent harm
- processes that carry a potential risk for customer harm
- better practice where firms demonstrated they were meeting the requirements of PROD 4

**Examples of firms able to demonstrate they took action to prevent harm following product approval**

We saw firms who were meeting the requirements of the enhanced PROD 4 rules delivering better customer outcomes. Following product review and approval, including the FVA, some firms decided to withdraw a product or make a significant change to it. Examples included:

- A firm identified the commission on their travel product was high, particularly where sold as part of a package with other products. The firm got MI from the manufacturer of the add-on products and decided that, given the usage of the policy and associated commission levels, the add-on was not providing fair value to their customers. They withdrew it from sale
- Through its FVA, a firms identified an add-on to their core travel product may not be meeting the requirement to provide fair value, due to a low claims frequency rate. The firm discontinued the sale of this add-on
- A firm used their MI as part of their FVA and their claims metrics showed the product may not be providing fair value. The firm initially tried to improve the product's utility by reducing its cost and adding additional benefits under the policy. It ultimately withdrew the product from the market due to the continued low levels of claim frequency and claims ratio
- A firm's FVA identified the claims ratio for an add-on to their core motor product was lower than expected. They reduced the cost of the cover and put in place additional monitoring to assess the impact of this change and ensure the overall package provides fair value
- A few firms had set their standards/tolerance limits to act as an early indicator of the product not performing as intended, instead of setting them at a level which would indicate the product was not providing fair value. This meant the firm could take early action to prevent consumer harm

**Examples of processes with a potential risk of customer harm**

*Example 1 – Overreliance on benchmarking of product value*

A FVA that relies only, or heavily, on benchmarking against the price of other providers would not be consistent with the considerations required under the rules and so cannot conclude that the product offers fair value. This is particularly the case where there are a limited number of providers in a market. Benchmarking information may provide some valuable insight for manufacturers and, as part of a wider assessment, can help to identify where a product may not be providing fair value. However, firms should consider how the benchmark they use is consistent with providing fair value.

For example, if all firms in the market are paying 50% commission on a particular product, this does not show that this level of commission is consistent with delivering fair value. As this report sets out, firms need to provide a justification and rationale, based on the activities undertaken and the quality of service provided by the distributor, to show how this level of commission represents fair value. Firms should not rely only on the market benchmark.

*Example 2 – Use of inappropriate metrics or thresholds when assessing value*

A firm had set a 20% standard/tolerance or lower limit at which the claims ratio would indicate potential fair value issues for all the GI products they underwrite. They set it at this level as the individual products claims ratios ranged from 20% to 60%. The firm explained that the standard was set at 20% as this was the actual claims ratio for a few of their products. It did not document or explain any additional rationale for this decision, and it seemed it had chosen the threshold to avoid needing to consider if there were value issues across the entire product suite. This posed clear risks to customers as, for many products, this lower limit of claims ratio would be well below the market norms and a strong indicator of a poor value product.

**Examples of better practice from product approvals including FVAs and monitoring arrangement, with firms demonstrating they were meeting PROD 4 requirements**

*We saw some better examples of product approvals including FVAs and monitoring arrangements. These are some of our key observations, are not complete or exhaustive and do not relate to a particular firm or product.*

Some firms regularly reviewed their products' performance and fair value. This meant they could proactively identify any emerging risks or problems and take action to address them.

1. We saw examples of monitoring arrangements that included, among other things, assessing the performance of products by:

    - monitoring whether customers were satisfied through customer surveys and complaints data
    - conducting appropriate call-monitoring and file reviews to ensure the product was sold to the intended target market
    - reviewing claims metrics to ensure the product was meeting customer needs and that customers could make claims based on their understanding of the cover the product provided

2. We saw examples of FVAs where firms assessed the value of each element that made up the total price paid by the customer, not just the risk price or underwriting cost. The FVA demonstrated how each element of the price offered fair value. This included the operational costs of the insurer or manufacturer, the underwriting cost or risk price and the distributors' remuneration.

- Firms had a comprehensive suite of MI to assess value. This included defined standards or tolerance limits for each metric, along with the rationale of why this limit represented fair value. The firm's governing body and senior management played a key role in setting these by robustly challenging how limits set for each metric represented fair value for each product or group of similar products

- Firms also regularly reviewed these standards/tolerance levels to ensure they remain appropriate and relevant
- The standards or tolerance limits were tailored for each product or group of similar products) rather than being set a global product level. For example, firms did not use the same metrics for all home products, as individual products performed differently, had different target markets and provided different levels of cover
- Any limitations in data or MI were clearly set out, along with the potential risks of these limitations and how these risks were mitigated
- Clear rationale and justification were given for why the distributors' remuneration was reasonable, given the activities carried out and services provided

3. Firms considered the value provided to different cohorts of customers in a distribution channel.

4. Firms took swift action to remediate where they identified value issues. They also investigated the root causes and whether their customers suffered harm. Where appropriate, products were withdrawn from the market until value issues were resolved.

## Target market

**4.39** Identifying the target market is a core component of the work a firm needs to do when manufacturing a product to identify a group of customers with common characteristics at an abstract and generalised level. This enables the firm to adapt the features of the product to the needs, characteristics and objectives of the intended customers. This work, overseen and validated by the firms' product approval process, should enable the manufacturer to design a product which is well adapted to this group of customers.

**4.40** Firms should identify the target market at a sufficiently granular and detailed level, taking into account the characteristics, risk profile, complexity and nature of the product. When identifying the target market, firms must also clearly identify groups of customers for whom the product would not provide the intended level of value. (PROD 4.2.16R – 4.2.17R).

**4.41** A firm must also ensure its product approval process identifies whether the product will continue to provide fair value to customers in the target market for a reasonably foreseeable period, including following renewal (PROD 4.2.14A R). This approach makes it more likely these customers will get a product that provides fair value and will support the firm's ability to deliver good outcomes for customers. We consider this in the FVAs section above.

**4.42** Manufacturers must also ensure the intended distribution strategy is consistent with the identified target market and take reasonable steps to ensure the product is distributed to this target market (PROD 4.2.15R). We consider this under the Distribution arrangements section for manufacturers.

**4.43** Firms can greatly reduce the risk of customers buying products which may not provide fair value and lead to poor outcomes when they comply fully with these requirements. This includes appropriately identifying the target market and distribution strategy and distributing the product accordingly.

## Findings

### What we did

**4.44** We reviewed the manufacturer's target market statements and considered the governance around these to assess whether their target market work fulfilled the requirements for identifying the target market. This included considering the level of granularity and detail, against the nature and complexity of the product.

**4.45** We also considered whether distributors understood the target market and whether any separate target market statement used by the distributor was the same as or closely aligned with the manufacturer's specified target market. We used this along with other information that we would expect to be available to a manufacturer, to understand what action the manufacturer had taken to monitor whether their products were being distributed as intended.

### What we found

**4.46** We found few products had a target market statement that met our expectations fully. However, most of these statements were too high level and not detailed or granular enough in many ways, depending on the product. The shortcomings we saw included:

- Target markets that were too vague or too broadly defined and did not adequately consider whether there were groups of customers for whom the product would not provide the intended level of value. For example, the product had exclusions that could be inconsistent with the identified target market, but the firm had not identified the market at a sufficiently detailed or granular level to consider the nature of the product. Inadequate consideration of the nature of the product, such as exclusions, creates a risk that the firm may miss groups of customers that may not get the intended level of value.
- For motor, a mass market product, we saw target market statements that described it as 'anyone who owns a car as it's a legal requirement.' However, the product may not cover all types of vehicles, or there may be other exclusions or restrictions that means the product is not suitable for everyone who owns a car
- We saw many statements that only defined demographic factors (such as the age, gender, income, occupation, geographic location) of the groups of customers. In some cases, there appeared to be a need to consider other factors. For example, some of the target market statements failed to consider and reflect:
  - The risk appetite and tolerance of both the firm and the customer. Some of the underwriting criteria for the product may be helpful in defining not only the characteristics of the target market but also groups of customers for whom the product is compatible.

  - The customer's objectives. Insurance covers against unforeseen events. When these events happen, firms need to consider how the product would meet the customer's needs.
- Instances where the insurer's target market statement materially differed from that used by the intermediary in our review, despite being for the same product.

These shortcomings all create a real risk that products may be sold to customers who would not get the product's intended value.

**4.47** Below we give examples of poor practices that could cause customer harm and an example of a better target market statement in line with the requirements of PROD 4.

**Examples of poor practices that could cause customer harm**

*Example 1*

We saw a target market statement for private medical insurance (PMI) which did not adequately consider key underwriting criteria or customers' characteristics and risk appetite. This product excluded pre-existing medical conditions, as do many PMI products. However, this core part of the underwriting criteria (the nature of the product) was not reflected in the identification of the target market, though it suggested the product may not be compatible for customers who wanted cover for pre-existing conditions. The product also had a range of excesses, but the firm did not adequately consider the customer's risk appetite or ability to cover the excesses.

*Example 2*

We saw a target market statement which was not granular enough for an income protection product. It stated the product was aimed at anyone in paid employment and covered all occupations. This broad statement gave no consideration to the cover that some customers may already have from their employment that provides this protection or any need to protect their income. For example, customers who are close to retirement may have adequate savings for immediate retirement. Further, it stated distributors could sell the product to a customer who was not included in the target market. For any product, this would not meet our expectations. Given the complexity of this product, and the interaction between a customer's needs and their income sources, this was particularly concerning and created a real risk of customer harm.

**Target market statement - example**

Below we set out examples of some of the elements of better target market statements. These examples are from our sample and do not relate to a particular firm or motor product. They are not a complete list of what should be included in a target market statement. Other characteristics, needs and interests may also be relevant, depending on the nature of the product.

**Characteristics of the target market**

Alongside this example, we have set out in italics our observations of where the target market's characteristics is likely to lack the detail and granularity to ensure the product is distributed to the intended target market.

The product is designed for UK resident individuals who:

- Are aged 25 to 79 at the time of sale who hold a Full UK/EU or provisional driving licence (*instead of no age restriction being mentioned though cover was not provided for people under or over a certain age or no mention of whether a valid licence is required though a pre-requirement for cover to be valid*)
- Have no more than one motoring convictions in the last 5 years (*instead of stating a low number of minor motoring convictions or making no mention of motoring convictions even though there were underwriting restrictions applying to this*)
- Have two or less fault motoring claims in the last 3 years (*instead of stating a low number of claims in the last 3 years or making no mention of fault claims even though there were underwriting restrictions applying to this*)
- Have no unspent criminal convictions (*instead of making no mention of this where it is an underwriting pre-requisite for cover*)

**Objectives, needs and interests of the target market:**

This product:

- Provides cover up to agreed specified limits for Loss and Damage, Liability to others and Personal belongings cover
- Provides cover against third party claims that arise from the use of their vehicle, for accidental damage and damage caused by fire or theft
- Includes additional benefits – Motor Legal protection, Roadside Assistance breakdown cover and onward travel after an accident
- Provides cover for motor vehicles valued up to £75,000
- Provides cover for driving up to 15,000 miles annually
- Provides cover only for social, domestic, pleasure and commuting and Class 1 & Class 2 business use (Class 1: travel to more than one place for business purposes: for example, on-site visits or driving to various business meetings; Class 2 business use – extension of Class 1 cover to include another named driver to use the car for business purposes)
- Only provides cover when driving in Great Britain, Northern Ireland, the Isle of Man and the Channel Islands
- In the event of a total loss, the settlement will not exceed the market value of the vehicle

**Customers for whom the product would not provide the intended value:**

- Customers who want to insure electric vehicles, motorbikes, motorhomes, or high-performance motor vehicles
- Customers who want to insure more than one vehicle on the same policy.
- Customers who only want temporary cover
- Customers who want to pay an excess of less than £1,000
- Customers who use their vehicle primarily for business other than class 1 & 2 business use, eg taxi drivers, driving instructors, plumbers

## Manufacture by more than one firm (co-manufacturing)

### What we did

**4.48** We assessed whether firms had adequate co-manufacturing arrangements to meet the requirements of PROD 4.2.13R – 4.2.14R. Co-manufacturing agreements are important where several parties are involved to ensure that they have set out their collaboration to comply with requirements for manufacturers, understand their mutual responsibilities and that customers are appropriately protected from the risk of poor value products and associated harms.

**4.49** We also considered whether firms demonstrated that they understood the requirements and how they applied. Under PROD 1.4, an intermediary is only considered to be a manufacturer where their activity shows it has a decision-making role in designing and developing an insurance product. Firms will need to consider their activities and whether it could lead them to be a co-manufacturer. In this context, a decision-making role is assumed where the intermediary itself determines essential features and main elements of the product (including coverage, price, costs, risk, target market and compensation and guarantee rights) which are not substantially changed by the insurer.

### What we found

**4.50** We found that many insurers and intermediaries did not fully understand the requirements around co-manufacturing and how they apply. Firms need to consider the type of activity they undertake and determine whether they are a manufacturer or distributor. Some intermediaries told us they were co-manufacturers when it was not always clear if this was the case. Where there is uncertainty about a firm's role and responsibilities, this often means there is an increased risk around whether all PROD requirements are being met properly, creating risks for customers.

**4.51** Many of the firms in our sample who were co-manufacturers did not have a co-manufacturing agreement in place. Instead, they provided a terms of business agreement (ToBA) as evidence of their co-manufacturing arrangements. We have no issue with ToBAs being used as the vehicle for the co-manufacturer agreement where this adequately includes the required provisions for co-manufacturing arrangements.

However, the ToBAs provided often did not include any of these provisions and so did not meet the PROD requirements. We also saw examples where there was an agreement in place, but it was between 2 intermediaries without the insurer being included as a co-manufacturer.

**4.52** Where there was no co-manufacturing agreement (or other document containing the relevant provisions), we often found that it was not clear how the firms collaborated to ensure that they met the requirements of PROD 4. This included ambiguity around who was responsible for key activities, including identifying the target market and assessing fair value. This meant some firms were unable to demonstrate how the firm and its governing body are confident that they are meeting PROD 4. These failings generate real risks for customers where neither co-manufacturer is meeting their obligations fully and key activities, including those for the target market and assessing fair value, are not carried out.

**4.53** We saw several co-manufacturer arrangements where an intermediary had entered into a delegated authority agreement with the insurer. These arrangements saw the intermediary take the lead for the product approval/design, pricing, distribution strategy, product reviews and FVAs. Most insurers who had entered into these arrangements could not demonstrate how they ensured they had met their obligations under PROD 4.2. PROD 4.2 sets specific obligations on all firms involved in the manufacture of insurance products. This is separate from outsourcing rules in our Handbook which apply to delegated authority. The PROD rules expressly require each co-manufacturer to have its own appropriate product governance arrangements, including a product approval process, independent of other co-manufacturers. Each co-manufacturer must ensure that the product reviews and FVA aligns with their own product approval process, and each must evidence that they have approved the product.

**4.54** We found that where the intermediary substantially undertook all the activities for creating, developing and designing the product, some insurers relied totally on the intermediary's work. The insurer will always be a co-manufacturer of the product and cannot allocate full responsibility to others for how it meets the requirements of the PROD rules. This includes making the required judgements on the product. Some insurers did not provide any evidence to show that they had appropriately considered the intermediary co-manufacturer's work or how this was incorporated into their own product approval process, to meet their own obligations under PROD 4. Some were also unable to show that they had approved the product, providing no evidence that their governing body and relevant senior management had considered the product. All these insurers' supporting documents, including minutes of meetings, were from the intermediary co-manufacturer. Most insurers who delegated authority or outsourced relevant functions to an intermediary were also unable to provide any evidence they had adequate sight of or access to the performance of the product and the delivery of services.

Below we provide examples of better practice where firms were meeting the requirements of PROD 4

**Examples of better practice for co-manufacturing arrangements**

1. Some firms had written co-manufacturing agreements (either as a standalone document or integrated into the ToBA) that clearly set out each co-manufacturer's respective roles. This included full consideration of PROD 4.2.13R, specifying their collaboration, to comply with the requirements for manufacturers under PROD and how they will agree on identifying the target market

2. Some agreements went beyond the requirements of PROD 4.2.13 R. These included provisions for how and when remedial action would be undertaken where a party to the agreement was found to be likely in breach of regulatory requirements. For example, in providing redress to customers or to cease trading with the other party/parties. We also saw evidence of better practice where the agreements provided for regular meetings for all manufacturers to share updates and discuss product performance

3. Each party to the co-manufacturing agreement understood their individual roles. This meant that each co-manufacturer had considered, approved and was able to demonstrate how the products offered fair value and customers were achieving good outcomes. Each co-manufacturer's governing body and senior management had minutes of meetings to show they had approved the outcome of the product reviews and FVA

4. Each co-manufacturer had data on the co-manufactured products that allowed them to review and understand the performance of product

5. The insurer of the product was a party to the co-manufacturer agreement, which is a baseline regulatory requirement

## Distribution arrangement and information to distributors

**4.55** Our rules require manufacturers to choose appropriate distribution channels for the target market, given the characteristics of the relevant products. They should also select distributors with the necessary knowledge, expertise and competence to understand the product and target market (PROD 4.2.27R, PROD 4.2.28G).

**4.56** Manufacturers are also required to give a distributor all appropriate information on the insurance products, the product approval process, the target market and the distribution strategy. This must include information on the product's main features and characteristics, their risks and costs and any circumstances which might cause a conflict of interest to the customer's detriment (PROD 4.2.29R, PROD, 4.2.30R).

**4.57** Manufacturers must make information available to distributors about the target market assessment. This information must be adequate to enable distributors to understand the target market and identify any customers for whom the insurance product is not appropriate (PROD 4.2.32R).

## What we did

**4.58** We assessed whether firms had appropriate policies and procedures in place to ensure the distribution arrangements (including the distribution channel) were appropriate and consistent with providing fair value for the target market.

**4.59** We also assessed whether the information given to distributors, including on the intended value of the product:

- was appropriate and enabled the distributor to understand the intended value of the insurance product
- included how the manufacturer considered the distributor's effect on the intended value (eg their activities and remuneration) when undertaking the value assessment
- any effects the distributor will need to take into account under PROD 4.3

These elements are essential to ensure that products are distributed to customers to whom it will provide the intended value.

## What we found

**4.60** We found some manufacturers could evidence that their distribution strategies for the products in our review were appropriate. They had considered the variety of distribution channels and distributors they used to reach the target market and could show why these were appropriate. They provided an appropriate level of information to distributors to enable them to understand the product and target market. We also saw evidence that they maintained an ongoing dialogue with distributors to understand any subsequent problems and undertook reviews to ensure there were controls to prevent sales to customers outside the target market.

**4.61** However, we also saw shortcomings in many manufacturers' distribution arrangements and their execution and oversight of these. These include the following:

- Failing to identify and demonstrate how and why the distribution arrangements, including the selected distributors, were consistent with the target market. Many firms' consideration of this seemed limited and the documentation provided was very generic. For example, firms failed to set out how they considered the risks inherent in the selected distribution strategy, including the level of remuneration and the distribution chain. These shortcomings expose customers to the risk of products being sold via distribution chains which may negatively affect the products' value.
- A few firms had little or no evidence to demonstrate the manufacturer was monitoring the product, its distribution and the outcomes for customers outside of its annual review or audit processes. Some firms told us they were working on their product review processes by improving the data and metrics they used in their reviews. In some examples, this appeared to reflect the firm not undertaking any ongoing product monitoring or having any ongoing oversight of customer outcomes due to a lack of data.

These shortcomings expose customers to an increased risk of receiving poor value or poor outcomes, with any value problems likely to affect an increasing number of customers if the lack of regular monitoring means these problems are not identified.

**4.62** We reviewed the information the product manufacturers provided to distributors to enable them to understand value assessment outcomes and any group of customers for whom the insurance products would not be expected to provide fair value (PROD 4.3.2A R).

**4.63** Most distributors told us they had received all necessary information from their manufacturer/s. However, we often found that the quality and extent of information from the manufacturers did not appear to meet the requirements of PROD 4.3.2A R. The shortcomings we saw included:

- Target market statements without sufficient detail or granularity to give distributors enough information on the target market to meet their obligations under PROD 4.3. This finding is consistent with our findings above in the section on target market
- Many FVAs were high-level summaries providing the distributor with very little substance or relevant information. In some examples, we found this information was just an email confirmation that a FVA had been conducted. This was clearly insufficient for manufacturers to comply with the rules. It also would not enable the distributor to meet our requirements under PROD 4.3, to consider the effect the distributor arrangements may have on the overall value of the product and to understand the intended value of the product
- Most manufacturers failed to provide the distributors with other appropriate information. For example, they did not include:
  - Information on the insurance product plus any additional features which are part of the same insurance contract and any additional products, including retail premium finance, offered alongside the product
  - The price paid by the customer for the distribution arrangements. This includes the remuneration of any relevant person in the distribution arrangements and where the final decision on setting the price is taken by another person
  - Any effect the distributor may have on the intended value that the manufacturer has not fully taken into account when assessing value, and which the distributor should therefore take into account

These shortcomings raise a further question about the approach of distributors where there were material gaps in the information from manufacturers. We are concerned that, in many cases, they have simply continued to distribute the product without due regard for the lack of information about the target market or the intended value of the product, creating material risks of customer harm.

**Examples of better practices we observed**

Some manufacturers:

- Gave distributors a sufficiently detailed and granular target market statement that was not too vague or broadly defined. This enabled distributors to understand the groups of customers the product would and would not provide the intended value to, and to ensure their distribution arrangements were appropriate
- Gave distributors a FVA which included a comprehensive evaluation. For example, of the product components, pricing, services, and customer benefits throughout the product lifecycle, and setting out how the product offered fair value. This meant the distributor could better understand the intended value of the product and how customers in the target market would be able get good outcomes
- Gave distributors all appropriate information on the product. This included the nature of the product including the benefits, quality, and any limitations, such as the scope of cover, exclusions, excesses or other features
- Provided the suggested distribution strategy with procedures for distributing insurance products, as well as for taking corrective actions if problems which could potentially cause harm to customers are identified

## Chapter 5

# Our findings - Distributors

**5.1** Distributors must have appropriate product distribution arrangements to meet their obligations under PROD 4.3. The product distribution arrangements and the governance around these are essential components of the control framework firms must have. This ensures they understand the insurance products they distribute, the target market, their intended value and the impact of the distribution arrangements on the intended value. Where these are effective, they can prevent and reduce the risk of customer harm.

**5.2** Below we set out our findings for distributors under the following headings:

- Product Distribution Arrangements
- Target market
- Distribution strategy

## Product Distribution Arrangements

### The product distribution arrangements and governance

### What we did

**5.3** We assessed whether distributors had appropriate frameworks to effectively meet their product governance obligations under PROD 4.3. This included the product distribution arrangements, forums/committees, senior management roles and responsibilities, decision-making (including challenge) and issue escalation.

**5.4** We also assessed whether the distributors' product distribution arrangements contained all the key provisions for intermediaries where they were not manufacturers of the product, as set out under PROD 4.3.This included:

- The provisions set out under PROD 4.3.6AR (1) (2) as follows:
  - The product distribution arrangements must enable the distributor to identify
    - the value the insurance product is intended to provide to the customer and
    - the impact the distribution arrangements (including any remuneration) has on the intended value of the insurance product to the customer.
- any distribution strategy the distributor sets up or uses must be consistent with the aim of providing fair value
- Whether the product distribution arrangements had adequate provisions to:
  - enable the distributor to understand the product, the target market of each product, the outcome of value assessment and the groups of customers the product is not expected to provide fair value to (PROD 4.3.2R, PROD 4.3.2AR)

- get the necessary information from manufacturers about the product and to understand it, including its level of complexity and risks (PROD 4.3.4G, PROD 4.3.5R)
- consider whether these product distribution arrangements under PROD 4.3.5R, aimed to prevent and mitigate harm to customers, supported a proper management of conflict of interest and took into account customers' objectives, interest and characteristics
- regularly review and update the product distribution arrangements, with the governing body endorsing and being ultimately responsible for establishing, implementing and reviewing the product and to continuously verify internal compliance (PROD 4.3.9R – 4.3.10R)
- promptly inform manufacturers if they find an insurance product does not align with the interests, objectives and characteristics of the identified target market or circumstances that may adversely affect the customer
- take appropriate remedial and mitigating action including amending its distribution arrangements if needed, such as where the product or any aspects of it do not provide fair value
- consider any potential detrimental effects on the intended value where the product is distributed as a package or with retail premium finance
- on request, give the manufacturer information on its remuneration, any ancillary product or service that may affect the product's intended value and confirmation that the distribution arrangements are consistent with effectively managing conflicts of interest, including as per SYSC 10 (Conflicts of interest) and SYSC 19F.2 (IDD remuneration incentives)

## What we found

**5.5** Some distributors have strengthened their governance and oversight of their distribution arrangements, and we saw that relevant senior managers had taken responsibility for this. These firms can evidence how they considered the impact their activities and remuneration had on the products and the value to customers. However, some distributors have made limited progress in understanding their responsibilities under PROD 4.3 and in considering the impact of their activities and remuneration.

**5.6** We found many shortcomings in the product distribution arrangements and its governance. These included:

- Many product distribution arrangements we reviewed were too high level and did not have sufficient detail, particularly in key areas such as distribution strategy, remuneration and getting information from manufacturers. Some firms only provided a short 1-page product distribution arrangements document
- There was often a lack of clarity in the governance structures and processes. It was not clear who was responsible for product distribution arrangement decisions and how oversight and escalation of issues worked
- Many distributors did not have adequate relevant MI to assess the impact of their own activities on the product's intended value and whether the product continues to provide the intended value to the target market

- As with manufacturers, many distributors could not adequately evidence their decision-making and did not provide us with any minutes to show the firm had adequate oversight of its product distribution arrangements
- Most distributors did not have adequate processes to enable them to assess and understand the impact that the distribution arrangements (including any remuneration) would have on the product's overall value
- While some distributors had provisions in place for at least an annual review of products, they were often missing details on the triggers to identify the need for more regular review
- Most distributors did not have adequate processes for getting the necessary information (as set out above at 5.5) from the manufacturer that would allow them to meet their obligations under PROD 4.3. This created real problems and risks as not all manufacturers provided adequate information to distributors to understand the intended value of the product (see Chapter 4)
- While distributors acknowledged the need to manage conflicts of interest, many of them lacked comprehensive policies or effective mechanisms to identify and manage these
- For packages, most distributors did not adequately ensure the distribution of products alongside other products did not negatively affect each product's intended value

**Examples of better practice where firms were able to show that they were meeting our requirements under PROD 4.3**

1. Some distributors had arrangements in place to get necessary information from the manufacturer about the products they distribute (PROD 4.3.1R to 4.3.5R)

2. Some distributors had appropriate processes supported by relevant and adequate data/MI to monitor and ensure that the product is sold to the intended target market and continues to provide the intended value

3. The product distribution arrangements clearly set a process that allowed the firm to identify and address the risks to customers where it was distributing the insurance product as part of a package. This included the nature of the risks and actions that should be taken to manage these risks. Example of risks identified included:
   - duplication of cover
   - appropriateness of the package, considering the nature and type of cover provided by the individual products in the package, and
   - the price of the package did not exceed the total cost of the individual products if bought separately

## Assessing the impact of product distribution arrangements and remuneration

**5.7** The product distribution arrangements must enable the distributor to understand the value that the insurance product is intended to provide to the customer as well as the impact of the distribution arrangements (including any remuneration) on the intended value of the insurance product. Any distribution strategy the distributor sets up or uses must be consistent with the aim of providing fair value to the customer.

**5.8** Where distributors do not have effective product distribution arrangements, this is likely to result in customers' harm. Harm may occur if:

- The product is sold to customers to whom the product would not provide the intended value
- The distributor does not fully understand the nature and type of products (including their complexity or any related risks) they are distributing to their customers
- They do not understand how the product offers fair value
- Their remuneration would result in the product ceasing to provide fair value
  For example, where the distribution strategy means the firm receives a level of remuneration which does not bear a reasonable relationship to the quality and cost of their service

**5.9** A distributor must consider at least the following:

- the benefits the product is intended to provide to the customer
- the characteristics, objectives, interests and needs of the target market
- the interaction between the price paid by the customer and the extent and quality of any services the distributor (or any person connected to it) provides that benefits the customer
- whether any remuneration it receives for the insurance product would mean the product ceased to provide fair value to the customer
- any potential negative effect on the intended value where the insurance product is to be distributed as part of a package, or agreement which provides another product or service
- where the distribution strategy involves offering, or arranging to be offered, retail premium finance, the firm must ensure that, taking into account the costs (including any charges/interest) of this finance, the customer does not pay a price that means, if seen as a package, they will not receive fair value (PROD 4.3.6A R (3)

## What we did

**5.10** We assessed whether:

- the distributors had ensured they received the outcome of product review information including FV assessment from the manufacturer
- the information from the manufacturer was appropriate and enabled the distributor to understand:
  - the intended outcome of the product's value assessment

  - the identified target market, including those groups of customers for whom the product would not provide the intended value
  - to identify the product's intended value and the impact of the distribution arrangements on the product's overall value
- the distributor had considered any potential detrimental effect on the intended value of the individual product distributed as part of a package and can demonstrate the package does not have a negative effect on the intended value of the individual products in it

## What we found

**5.11** We have concerns about the adequacy of the information the distributors had to allow them to understand the value of the product.

- Some distributors received only limited information from the manufacturer on the FVA outcome. Some manufacturers had published their FVA methodology on their website and gave the distributor a statement confirming the product offered fair value in line with this
- Others simply stated the product offered fair value with no other information to back up the statement. From the information provided to distributors, we could not see how they would be able to understand the intended value of the product
- Most manufacturers provided information on the target market, including the product's suitability and distribution methods, and the product performance. However, it was sometimes unclear how this information demonstrated fair value
- Less than 5 manufacturers in the sample provided adequate information about the impact of the distribution arrangements on the product's overall value. However, distributors have their own obligations under PROD 4.3 to ensure they had adequate arrangements to get this information from their manufacturers

**5.12** Only a few of the distributors in our review provided adequate evidence that they had appropriately assessed whether the remuneration was consistent with the product providing fair value. This included assessing the interaction between the price paid by the customer, the extent and quality of the distributor's services and whether any remuneration would mean the product ceased to provide fair value. There was often no breakdown of the total remuneration, creating a lack of clarity of the impact of the different components, such as commissions and fees, on the total price the customer pays and the product's overall value.

**5.13** After reviewing the information provided, we met with some distributors. Most of these showed us how they had improved their approach to assess the reasonableness of their own remuneration and its impact on product value. This gave us some assurance that these firms are working to meet their obligations to ensure their customers achieve good outcomes.

**5.14** Where commission was based on a percentage of the premium paid, many distributors had not considered the level at which this remuneration might not provide fair value. Many did not have arrangements to manage this, such as setting a cap on the pound value of commission. This could result in poor value or remuneration which did not bear

a reasonable relationship to the benefits or services provided for products. For example, with larger premiums or when the risk price increased.

**5.15** Where the distributor created a package, in most cases they did not adequately assess the impact on the intended value of the product. Where they did so, firms only considered whether the total price of the package was not more than the total of the individual prices for each product in it. Most firms did not consider other issues that could negatively affect the intended value of the individual product sold as part of a package, such as duplication of cover. Or they did not consider whether it was appropriate to package the individual products together, given the type and nature of the individual products in it.

**5.16** The examples of better practice provided above in the section on product distribution arrangements and governance are also relevant to this section.

## Target market

**5.17** Distributors that understand the specified target markets will be better able to distribute products that meets their customers' needs, characteristics and objectives. This is likely to support the firm's ability to deliver good customer outcomes. Where this does not happen, it may lead to products being sold to customers outside the target market or to selling products which do not match the intended customer's needs, interests, and objectives. These customers are unlikely to receive the intended value and the firm may not deliver consistently good customer outcomes.

**5.18** Where a firm sells insurance products it does not manufacture, it must have adequate arrangements to understand the identified target market of each product (PROD 4.3.2R).

**5.19** We expect firms to have effective arrangements to ensure that they get, adequate and reliable product information from the manufacturer to ensure they will be sold in line with the target market's characteristics, objectives and needs (PROD 4.3.4G). The distributor must also ensure that its specific distribution strategy aligns with the manufacturer's distribution strategy and the identified target market (PROD4.3.8R).

### What we did

**5.20** We assessed whether distributors understood the target market and whether their target market statement was aligned with the manufacturers'. Under PROD 4, the manufacturer is responsible for identifying the target market.

### What we found

**5.21** For most products, the manufacturer's target market statement aligned with that used by the distributor.

**5.22** However, we saw examples where the distributor's target market statement differed materially from the manufacturer's, despite being for the same product. This included examples of statements used by the distributor being either more or less detailed than the manufacturer's.

**5.23** As set out under the findings for manufacturers, we found that the target market statement was often not detailed enough to ensure the distributor was considering customers' objectives, interests and characteristics. This also raised concerns about whether the distributor's distribution strategy was in line with the target market identified by the manufacturer.

**5.24** We also saw some examples where the manufacturer provided a comprehensive description of those customers who would not get the intended value from the product.

## Distribution strategy

**5.25** Any specific distribution strategy a distributor sets up or uses must be in accordance with the manufacturer's distribution strategy and identified target market (PROD 4.3.8 R).

### What we did

**5.26** We assessed whether the specific distribution strategy applied by the distributor was in line with the manufacturers' strategy.

### What we found

**5.27** Many distributors failed to comply with PROD 4.3.8R and PROD 4.3.10R (2). However, a few firms provided comprehensive distribution strategies. These included identifying the benefit of the selected strategy and how it aligned with the target market's characteristics, objectives and needs. These were also in line with the manufacturer's distribution strategy. A few firms declined to distribute products where they believed the product would not provide the intended value to the target market.

**5.28** Most firms:

- did not amend their distribution strategy where they identified problems with the outcome of the product distribution arrangements
- did not consider any potential harmful effect on the intended value where the insurance product is distributed as part of a package with another product or service
- where the distribution strategy involves offering, or arranging to offer retail premium finance, failed to take into account the costs of this finance

**5.29** Many shortcomings were partly due to manufacturers failing to provide adequate information to distributors to help them ensure the distribution strategy was aligned to their own and to the identified target market. However, the distributor is also required to get the necessary information from the manufacturer to enable them to meet their obligations under PROD 4.3, as set out above.

# Chapter 6

# Our expectations of firms

## Manufacturers

**6.1** We expect manufacturers and their senior managers to have effective product governance processes and to perform FVAs that:

- provide robust oversight and challenge when considering the value of their products
- are supported by appropriate management information (MI) and analysis
- reach clear and appropriate judgments on a product's value supported by robust evidence, in line with the rules
- proactively identify where there are value problems and act on them to manage and remediate harm

**6.2** Where manufacturers' product oversight and governance arrangements including their FVAs do not achieve this, there is a real risk of harm to customers from products that are not providing fair value.

## Distributors

**6.3** We expect distributors and their senior managers to have understood any distribution strategy set up and the target market identified for the product, by the manufacturer. They must implement controls that ensure they:

- are acting consistently with the distribution strategy and only distribute the product to customers in the identified target market
- appropriately assess the impact of their activities and remuneration on the distribution strategy and product value
- identify distribution or value problems which present a risk of harm to customers and act promptly to address these

**6.4** Where distributors' product distribution arrangements do not achieve this, there is a real risk of customer harm from products being distributed to those outside the target market or where the distributor's activities and remuneration adversely impact the value of the product.

## End of report

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