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Good Practice Guide

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A practical guide to Consumer Duty: Insurance

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This paper is in response to members' requests to provide a summary of good practice within one source document and is based upon the Chartered Insurance Institute's understanding of the regulators rules and current stance. Whilst a summary, it is not intended to be exhaustive and should not be relied upon at the exclusion of other sources of information.

Introduction

– What is the Consumer Duty? How did it come about?

The Consumer Duty began with a campaign by the Financial Services Consumer Panel to create a statutory ‘duty of care’.

In January 2017, the FCA Consumer Panel published a paper arguing that the FCA’s requirement to ‘Treat Customers Fairly’ (TCF) allowed firms ‘to be able to adopt a “let’s see if we can get away with it” approach’ to compliance. In contrast, it contended that under a Duty of Care firms ‘would have to avoid conflicts of interest and take their customers’ best interests into account at every stage of their engagement... in short, a duty of care would effectively deliver what TCF is intended, but so clearly fails, to do.’¹

In 2018 the FCA responded by publishing a *Discussion Paper on a duty of care and potential alternative approaches*. This document challenged respondents to the consultation to describe what benefits new rules would have ‘...over and above the existing regulatory framework...’.²

In 2019 the FCA published a feedback statement on the Duty of Care, acknowledging that ‘Most respondents consider that levels of consumer harm are high and change is needed to better protect consumers.’³ It summarised the main arguments for change as:

- A need for culture change, moving firms to ask themselves: ‘is this right?’ rather than ‘is this within the regulations?’
- Greater regulatory clarity, allowing the FCA to act against firms exploiting gaps in existing regulations to create consumer harm
- An emphasis on prevention
- Clarity for consumers and firms

It went on to say that it would look at a range of possible measures, including ‘new/revised Principles to strengthen and clarify firms’ duties to consumers’

In May and December 2021, the FCA published two more rounds of consultation on the Consumer Duty⁴, setting out the proposed changes to its Handbook, and published its final Policy Statement and Guidance in July 2022.⁵

The Consumer Duty and the FCA Handbook – what's new?

The new Consumer Duty appears at several levels in the handbook. At the highest level, it is summed up in a new principle:

'A firm must act to deliver good outcomes for retail customers'

This principle is elaborated in cross-cutting rules, or obligations. They are:

- A firm must act in good faith towards retail customers
- A firm must avoid foreseeable harm to retail customers
- A firm must enable and support retail customers to pursue their financial objectives

Finally, these cross-cutting rules, which form 'inputs' to the work that firms do, are linked to four outcomes. They are:

- **Products and services** – this covers elements of product governance for providers, distributors and advisers
- **Price and value** – this does not imply a price cap, or a requirement to be the cheapest in the market. It does, however, mean that firms cannot simply charge as much as they think they can get away with. The FCA has said 'Firms should avoid designing products and services to include elements that exploit consumer lack of knowledge and behavioural biases to increase the price paid.'⁶
- **Consumer Understanding** – the FCA makes clear that this does not mean firms must 'verify that all individual consumers have in fact understood the information provided.'⁷ However, it suggests that 'One question firms can ask themselves is whether they are applying the same consumer support standards to deliver good consumer outcomes as they are to generate sales and revenue.'⁸
- **Consumer Support** – this requires firms to 'enable consumers to get what they paid for...without unreasonable barriers.'⁹

Organisations' systems and culture – the heart of the Consumer Duty

What is even more important than the changes in rules is the anticipated change in culture that the FCA talked about in its 2019 feedback statement – looking to firms to ask themselves:

“‘is this right’ rather than ‘is this within the rules’”¹⁰

During the build up to the Consumer Duty, the FCA has referenced a good practice model that was developed as part of its guidance to customers in vulnerable circumstances.

This is a dynamic model that requires firms to monitor the effect their proposition is having on consumer outcomes. Firms are then expected to analyse the outcomes and learn from them. This means that having a ‘cottage industry’ of management information is not enough. Firms’ senior management are expected to show that they have understood feedback and have used it in refining their firms’ proposition, ready to be monitored and analysed again (see Figure 1).

It is also worth reflecting on the ‘learning’ stage of this cycle. For example, a firm that has a diverse range of employees, or access to a diverse network of experts, is more likely to learn about the implications of feedback than a firm that only looks at analysis through one lens. As the FCA has said in its 2022 Policy Statement, ‘diversity is a lens that can help firms to better understand and meet the needs of their customers, including those in vulnerable circumstances. We see significant practical benefits in firms exploring customers’ needs from different perspectives.’¹¹

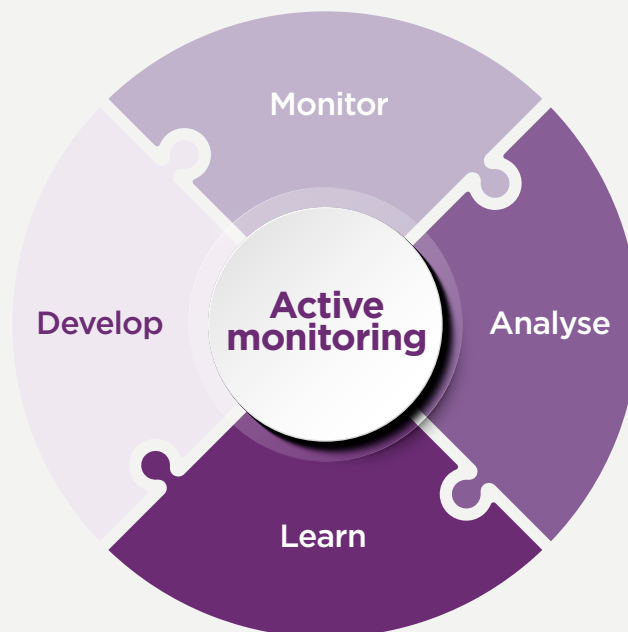


Figure 1: Active monitoring

Consumer Duty and Product Governance – how do they interact?

Some key areas that the FCA is likely to scrutinise most closely have already been identified as risk areas in the past. For example, the way in which firms monitor the impact of their outsourcing decisions and the way in which consumer outcomes are impacted by decisions about the overall architecture of the value chain will continue to be significant.

The FCA is not looking for firms to become responsible for the actions of other authorised firms, but it is looking for firms to consider how their business model, and their choice of business partners, is impacting consumer outcomes - and what kind of thought processes are going on at senior management level to improve consumer outcomes where necessary.

It should be stressed that the key changes the FCA is looking for are around mindset, culture, and the transparency of decision-making, rather than additional processes designed to limit liability or blame. For example, for product governance rules around insurance, the FCA has said that firms that comply with existing product governance rules for insurance and investment are already meeting the requirements of the products and services outcome.

Timeline for changes

The timeline for the Consumer Duty has been extended to 2024, but the FCA has also set out milestones within this time that it expects firms to meet. They are:

- By the end of October 2022, firms' boards (or equivalent management body) should have agreed their implementation plans and be able to evidence their thinking behind these plans in a range of documents such as board minutes.
- Manufacturers should aim to complete all the reviews necessary to meet the four outcome rules for their existing open products and services by the end of April 2023 and share all necessary information with distributors.
- From the end of July 2023, the Duty will apply to all new products and services and all existing products and services that remain on sale or open for renewal.
- Finally, from the end of July 2024, the Duty will apply to all closed products and services.

Case studies

As part of its consultation on the Consumer Duty, the FCA has published a series of case studies highlighting good and poor practice.¹²

One theme that recurs during the examples of good practice is the prioritisation and layering of information. Where firms find that a key piece of information is not getting through to consumers, the FCA expects firms to create simple, specific communications to bring important issues directly to their customers' attention – for example, on their website or in a summary document.

The impact of communications must also be tested, where appropriate.

Some of the case studies that are particularly relevant to insurance are:

Good Practice

A firm seeks feedback from its customers on the first anniversary of a product purchase. The survey responses highlight that a high number of customers say that they have paid unexpected fees in the first year. In this situation, we would expect the firm to act reasonably to avoid causing harm to customers by reconsidering how understandable their initial product communications are and making appropriate changes to enable customers to understand the fees and make effective decisions.

A firm is developing a communication about a simple product designed for the mass retail market.

It drafts the content, where possible, to support the understanding of customers with low literacy or low numeracy skills involving financial concepts.

It signposts a clear way for customers with a hearing or visual impairment to request communications in a format that meets their needs.

A firm notices a trend of customer service calls being terminated by customers before they are answered through its monitoring activity.

It diverts additional resources to handle these calls to ensure they are answered in a timely manner.

It also identifies those customers who terminated their call before it was answered and proactively makes contact with them to see if they require additional support.

Poor Practice

An insurance firm has a complex claims process which deters many customers from pursuing claims. This process includes a requirement for customers to provide hard copies of all evidence. The firm refuses to consider any requests from customers to waive this requirement. A firm may have legitimate claims handling requirements, such as a need to give notice when loss events occur, or to provide adequate evidence of the loss. But the means of making a claim should be easy to find and the firm should not impose unreasonably restrictive, rigid, or arbitrary administrative requirements on customers that create barriers to them making a claim. This firm would be unlikely to be regarded as acting in good faith or enabling its customers to realise the expected benefit of the insurance product they have bought including making a claim without unreasonable barriers.

An insurance product has been updated over the course of several years, but the documents for this product have not been reviewed as a whole to make sure they continue to explain the product's features in a way that supports consumer. The policy summary sets out upfront what is covered by the insurance and some specific exclusions to this cover. However, some newer, but equally important, exclusions are covered elsewhere in the full policy conditions. This makes it difficult for customers to assess the scope of the insurance and understand when they will, and will not, be covered.

Scope of the consumer duty – what’s covered?

In May 2021, the FCA said:

‘Our proposals relate to products and services sold to ‘retail clients’. This is a very wide term that includes all clients other than professional clients (such as large corporate entities and government bodies) and eligible counterparties. So in most cases, where we regulate the provision of financial services to SMEs, these proposals would apply.’¹³

In December 2021, in response to its earlier consultation, it said:

‘We recognise that applying a single standard retail client definition to the Consumer Duty could create challenges in different sectors....

‘We are therefore proposing to align the scope of the Consumer Duty with the existing scope of our sectoral sourcebooks. For example, for insurance, the scope of the Consumer Duty will follow the position in the Insurance Conduct of Business Sourcebook (ICOBS).’¹⁴

This need to reconcile the aims of the Consumer Duty with the realities of the existing handbook has created some complexity.

For insurance, the Insurance Conduct of Business Sourcebook (ICOBS) says:

‘2.1.1 Different provisions in this sourcebook may apply depending on the type of **person** with whom a **firm** is dealing:

1. A **policyholder** includes anyone who, upon the occurrence of the contingency insured against, is entitled to make a claim directly to the **insurance undertaking**.
2. Only a **policyholder** or a prospective **policyholder** who makes the arrangements preparatory to him concluding a **contract of insurance** (directly or through an agent) is a **customer**. In this sourcebook, **customers** are either **consumers** or **commercial customers**.
3. A **consumer** is any natural person who is acting for purposes which are outside his trade or profession.
4. A **commercial customer** is a **customer** who is not a **consumer**.¹⁵

In the rules that apply directly to the Consumer Duty, a retail customer is defined as:

- ‘(1) (other than in PRIN¹⁶) an individual who is acting for purposes which are outside their trade, business or profession.
(2) (in PRIN): ...(b) in relation to activities to which ICOBS applies, a policyholder or prospective policyholder...’¹⁷

This means that the new Consumer Duty Principle and cross-cutting rules use the definition of a *policyholder* in ICOBS, and not the definition of a *consumer* in ICOBS.

Key Documents

FCA

FG22/5 Final non-Handbook Guidance for firms on the Consumer Duty
www.fca.org.uk/publication/finalised-guidance/fg22-5.pdf

PS 22/9 A new Consumer Duty: Feedback to CP21/36 and final rules
www.fca.org.uk/publication/policy/ps22-9.pdf

FCA Consumer Panel

A Duty of Care for Financial Services Providers
https://fs-cp.org.uk/sites/default/files/duty_of_care_briefing_-_jan_2017.pdf

Chartered Insurance Institute

Building trust through ethical culture: A Guide for SME firms
<https://www.cii.co.uk/news-insight/insight/articles/building-trust-through-ethical-culture-a-guide-for-sme-firms-updated/84323>

www.cii.co.uk/media/10125630/chartered-transparency-ethical-companion.pdf 'Transparency and insurance a Companion to the Code of Ethics'

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