



Guernsey Financial
Services Commission

REPORT ON THE THEMATIC REVIEW OF THE SALES OF GENERAL INSURANCE ADD-ON PRODUCTS

December 2015

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1. Background, Overview and Methodology

In February 2015 the Guernsey Financial Services Commission (“the Commission”) issued a letter to all general insurance intermediary licensees (“Licensees”) which set out the Commission’s expectations in respect of the manner in which Licensees would handle the sale of add-on products to its customers.

In particular the letter referenced reports produced by the Financial Conduct Authority (“FCA”) in 2013 and 2014, following thematic reviews which highlighted evidence of significant poor practice relating to the sale of motor legal expenses (“MLE”) and other general insurance add-on policy types. The letter suggested that Licensees should consider whether or not their procedures and practices in respect of the sale of add-on policies were compliant and consistent with the Commission’s Principles of Conduct of Finance Business (“the Principles”), Code of Conduct for Authorised Insurance Representatives (“the Code”) and The Insurance Intermediaries (Conduct of Business) Rules 2014 (“the Rules”).

The letter gave notice that the Commission would undertake its own thematic review of add-on insurances (“the Review”) and that site visits to licensees would commence in the fourth quarter of 2015.

The Commission subsequently selected four Licensees as the subject of on-site visits, which took place in the first two weeks of October 2015. Prior to the visits, a questionnaire was distributed to the selected Licensees requesting them to provide information about the basis of add-on sales, premium earned, commissions received, claims information and remuneration policy for their authorised insurance representatives (“AIRs”). The visits themselves consisted of a series of interviews with both senior management, compliance officers and AIRs, checking of files and processes and the collection of evidence, where relevant.

In addition, the websites of a number of Licensees which offered options for customers to complete tasks on-line were analysed on a desktop basis by Commission staff. The web-sites examined offered different levels of functionality, ranging from the submission of quotation request forms, through to full, interactive quote and buy facilities.

The UK-based consultancy firm RWA Compliance Services Ltd was contracted by the Commission to assist with undertaking the Review and compiling this report.

2. Scope of the Review and Terms of Reference

The Review primarily sought to validate Licensees' compliance, or otherwise with the Principles, the Code and the Rules in so far as they relate to sales of add-on insurances.

Most specifically (but not exclusively) the Review examined Licensees' and Licensees' AIRs compliance with Principle 1 Integrity, Principle 4 Information About Customers, and Principle 5 Information For Customers, of the Principles as well as Section 4 Assessing Suitability and Section 5 Policy Recommendation of the Code.

On a broader basis, because the sale of add-on policies is inextricably linked to the sale of the primary policies to which they are added, the manner and processes by which the primary policies are sold has also been considered. As a result, some observations which have been made in respect of the sale of add-on policies apply equally to the primary policies to which those sales are attached. Where this is the case the issues raised are highlighted in this report.

In addition a number of pertinent findings arose which were only peripherally related to the scope of the Review. Where these findings have a bearing on the compliance, or otherwise, of Licensees and Licensees' AIRs more broadly with the requirements of the Principles, the Code and the Rules these are referenced in this report.

3. Executive Summary

The Review found that some practices undertaken by Licensees in respect of their sales of add-on products are not in keeping with the principle of ensuring that they embrace the concept of ‘fair dealing’ in their transactions with customers.

A number of instances were identified where compliance by Licensees and their AIRs with requirements of certain aspects of the Code is weak, in the context both of sales of add-on products and of sales of the primary products to which those add-ons are attached.

In respect of broader compliance with the Code, the Review identified that it may, in practice, be difficult for Licensees to be compliant with a limited number of the Code’s requirements that were initially established in 1998, given current trading methodologies and rapidly changing and developing customer behaviours.

This is not the case in respect of the Rules. The Review uncovered some significant shortcomings in respect of Licensees’ compliance with some areas of the Rules. Licensees should take note of the need to achieve higher standards in those areas.

4. Summary of Key Findings

4.1 The Principles

4.1.1 Principle 1

Principle 1 states that *a financial institution should observe high standards of integrity and fair dealing in the conduct of its business.*

The Review found instances where Licensees might not always have at the forefront of their minds the requirement of the Principles to undertake “fair dealing in the conduct of its business” with its customers when sales of add-on insurances are made.

There are large variations in the amount of commission that the Licensees examined have negotiated with their add-on suppliers and the Review found some evidence that the prices set for the add-on covers by some Licensees reflected the income requirements of the Licensees concerned, rather than the quality or extent of cover provided by the products.

The Licensees reviewed do not generally collect any significant volume of management information about the add-on products sold and do not use any information that they do collect in a meaningful way. In not considering relevant information, such as claims frequency and costs, Licensees lose what can constitute a valuable tool with which they can assess the extent to which they have “fair dealing” with their customers.

4.2 The Code of Conduct for Authorised Insurance Representatives

4.2.1 Disclosure Requirements

Sections 3.2.1, 3.2.2 and 3.2.3 of the Code set out the requirements in respect of initial disclosures to be made prior to providing advisory services to a client.

3.2.1. An AIR shall disclose to the client that he represents a regulated entity who assumes responsibility for his conduct while advising clients on their insurance requirements and/or arranging contracts of insurance between insurers and their clients.

3.2.2. An AIR shall disclose to the client in writing the classes of insurance and products upon which he is authorised to provide advice.

3.2.3. An AIR shall disclose to the client in writing the range, scope and any limitations in the product providers and/or products upon which he is able to provide advice.

Notwithstanding that the Commission issued guidance to Licensees as recently as July 2015 to clarify its requirements and make their application more practically achievable, the Licensees considered in the Review are generally not complying with some of the disclosure requirements outlined in the Code and the Rules.

For example, two of the Licensees visited each rely on a single insurer, also a related party, for the majority of their motor policies. However, this was not disclosed to the customer prior to giving them a quotation or arranging a policy, and in one case, was not explained to the customer at any stage.

4.2.2 Assessing Suitability

Sections 4.1.1 and 4.1.2 of the Code set out the requirements for assessing the suitability of an insurance product.

4.1.1 An AIR shall at the outset of its provision of advisory services to a client, ensure that he has obtained and recorded sufficient knowledge of the client's circumstances and understanding of their objectives to ensure that any advice is suitable to the needs and wishes of the client.

4.1.2 An AIR shall ensure as far as possible that the policy proposed is suitable for the needs and financial position of the prospective policyholder.

In most cases it was found that Licensees are not complying with the requirements of the Code in respect of collecting the necessary information to enable them to assess the suitability of add-on products for customers, though this does not imply that such products are necessarily unsuitable for most customers.

The Rules and the Code do not differentiate between a primary and an add-on policy, therefore the requirement to assess suitability applies equally to both products. An assumption that the policy is suitable for all, e.g. sold on an opt-out or mandatory basis, is not considered to be compliant with this section of the Code.

For example, whether breakdown cover was 'bundled' or offered separately, the AIR would not ask the customer if they had existing cover, but would only address if this cover was required if the customer informed them of another policy being in place. Where the breakdown was 'bundled' with the primary policy, we saw evidence that the AIR would advise the customer to cancel their existing policy without making an assessment as to which policy was more suitable for the customer.

The majority of Licensees visited offered their most frequently sold add-on products on an "opt out" basis, meaning that the Licensees would assume that the customer required the cover with no consideration of suitability and that customers would have to specifically ask the Licensee to delete cover and remove the charge that had been included in the premium quoted.

All Licensees questioned were aware that the FCA has identified this as poor practice during the course of their recent reviews into add-ons and that this practice will not be permitted in the UK market from April 2016.

One Licensee 'bundles'¹ add-on products into sales of the primary products on a mandatory basis. The FCA has identified this as a particularly poor practice in its recent reviews of the sale of add-on products. Although this practice gives the customer no effective choice in the purchase of the product and can lead to replication of cover, in the instance examined the financial cost to the customer of the bundled covers was quite low.

While the Commission did consider business transacted by Licensees' websites, the scope of the Review meant that there was necessarily only a limited examination of these activities. The Review

¹ "bundles" or "bundling" can be defined as the inclusion of a number of different products within an offering which is then presented as a single proposition to the customer.

did find that in undertaking full, interactive quote and buy transactions via websites it is unlikely that Licensees would be able to comply with the requirements of the Code to assess suitability, both in respect of add-on products and the primary products to which they are attached.

4.2.3 Explaining Principal Benefits and Exclusions

Section 5.1 of the Code states that *prior to the inception (or any other material change to a contract of insurance including cancellation) of a contract of insurance, the authorised insurance representative shall:*

5.1.1 use his best endeavours to explain the principal terms of any contract of insurance recommended by him, and generally to make full and frank disclosure of any matter which may affect the client's decisions; and

5.1.2 draw the client's attention to any conditions, warranties or exclusions in the proposed contract of insurance which may affect the client's decision or result in avoidance of the policy or repudiation of a claim.

The Review found that all the Licensees visited only explain the key benefits and exclusions of the add-on products that they sell to a very basic level and relied on the customer reading the key facts booklet or policy wording. The Licensees cited limitations of time and lack of appetite on the part of many customers for receiving such information (verbal or written) as their justification for their partial failure to comply with requirements of the Code in this respect.

We also saw evidence that the premium for the add-on policy is not always displayed separately from the primary policy, therefore the customer is not being provided with material information upon which to make a decision.

4.3 The Insurance Intermediaries (Conduct of Business) Rules 2014

4.3.1 Compliance Monitoring Programme

The Rules require that:

3.3.1. The Board of a licensee must, in addition to complying with the preceding requirements of the Intermediaries Rules –

(a) establish such other policies, procedures, and controls as may be appropriate and effective for the purposes of ensuring compliance with the Intermediaries Rules, the Law and any other rules or codes made under the Law;

(b) establish and maintain an effective policy, for which responsibility must be taken by the Board, for the review of its compliance with the requirements of the Intermediaries Rules, the Law and any other rules or codes made under the Law and such policy shall include provision as to the extent and frequency of such reviews.

5.1.2. A licensee must have adequate and effective systems of control in place to ensure that its financial advisers comply with the Code of Conduct for Financial Advisers and its authorised insurance representatives comply with the Code of Conduct for Authorised Insurance Representatives.

The Licensees visited were found to not be fully complying with the Rules, and compliance monitoring procedures were generally found to be informal and in some cases unrecorded. Some Licensees relied on the size of the office and proximity of staff to pick up on issues. Examples and areas of particular non-compliance are provided in sections 4.3.2, 4.3.3 and 4.3.4 of this report.

4.3.2 Training and Competence

Rule 3.5 sets out the requirements in relation to employee training, including, but not limited to:

3.5.2 Every licensee shall create and implement a training and competency scheme for all authorised insurance representatives and financial advisers appropriate to the nature and scale of the licensee's business.

3.5.3 In meeting the requirements of rule 3.5.2, the licensee shall refer to the Guidance Note on Training and Competency schemes issued by the Commission as amended or replaced from time to time.

Most Licensees reviewed were not complying fully with the requirements of the Rules in respect of training and competency schemes. These failures to comply with the Rules do not in themselves necessarily mean that members of staff, including AIRs are not competent to complete the tasks allotted to them, but it does mean that in some cases Licensees cannot demonstrate compliance or that their staff members are adequately competent.

4.3.3 Training of AIRs

The Rules require that:

3.5.4 A licensee shall ensure that relevant employees receive comprehensive ongoing training to ensure competence for duties including but not limited to
(a) the Law and the rules made thereunder;

Some AIRs appeared not to have a detailed understanding of the requirements of the Code that they are obliged to adhere to.

4.3.4 Recording of Complaints

Rule 8.3.1 states that *every licensee shall maintain a register in which it records any complaints received, along with sufficient detail to allow it to be able to demonstrate it has dealt (or is dealing) with such complaints in accordance with the Intermediaries Rules.*

A complaint is defined in the Rules as *any oral or written expression of dissatisfaction, whether justified or not, from, or on behalf of a person about the provision of, or a failure to provide a financial service which alleges that the complainant has suffered (or may suffer) financial loss, material distress or material inconvenience.*

The Review identified that some Licensees did not have an adequate understanding of how complaints are defined in the Rules and that, as a consequence, not all complaints are correctly logged. The analysis of complaints is a key tool which Licensees can use to improve outcomes for customers which, in turn, may assist in maintaining and/or enhancing its reputation. Licensees

should therefore re-acquaint themselves with the requirements of rule 8 of the Rules in this respect. For example, some Licensees and their AIRs stated that only a complaint they felt was justified, or could not be dealt with immediately by an AIR would be treated and logged as a complaint.

5. Conclusions

Although the Review did not find evidence of serious detriment to customers, it did find evidence of poor practice on the part of Licensees and their AIRs in respect of sales of add-on products. Where shortcomings were identified in respect of the sale of add-ons, these deficiencies often applied also to sales of the core products to which the add-ons are attached.

In particular, the Commission expects that Licensees will take steps to ensure that they are complying with the principle to have “fair dealing” with their customers and to consider outcomes for customers as a fundamental element of the operation of their business and the way in which they plan the future of their business. For the avoidance of doubt, the Commission does not consider that offering add-ons on an opt out basis represents “fair dealing”, and expects all general insurance intermediaries to take the necessary steps to phase out the sale of add-on policies on an opt out basis, or as part of a breakable bundle. A breakable bundle is considered to be a bundle where the add-on is provided by a different insurer to the primary policy and/or a separate premium is payable.

Licensees should be able to demonstrate at all times, and in respect of all aspects of their dealings with customers that this is being done. Where necessary, the Commission will take specific action where it believes that this is not the case.

In 2016, the Commission will consider, in consultation with industry, the appropriateness of the Code and will where necessary make revisions to the Code and make it suitable for the way in which business is transacted in practice, including online, whilst maintaining good and reasonable standards. The Commission is minded to simplify certain aspects of the Code, or introduce the option for intermediaries to sell on a “non-advised” basis.

Licensees are not expected to make changes to their sales procedures, other than those mentioned above, whilst the Commission conducts its review of the Code.

Notwithstanding this, all Licensees (not only those subject to the Review) and their AIRs should be completely familiar with and be mindful of their obligations under the Code.

In respect of the Rules, the Commission does not consider that any revisions are necessary. In particular the Review noted that some Licensees did not have in place the necessary arrangements required by the Rules in respect of training and competence and that Licensees are not correctly identifying and recording complaints. All Licensees (not only those subject to the Review) should take appropriate steps to ensure they are fully complying with all sections of the Rules, and where there are deficiencies, the Licensee must take action to rectify these shortcomings.