



AFB response to CP07/11: 'Insurance selling and administration' Proposed amendments to the Insurance: Conduct of Business sourcebook

This response is submitted on behalf of the Association of Finance Brokers (AFB). The AFB is the trade association representing intermediaries operating in the secured loan (second charge mortgages over residential properties) industry. Our members hold insurance permissions with FSA.

The AFB represents brokers who are responsible for approximately 75% by volume and value of secured loans in the intermediary channel. Intermediaries active in this market act on behalf of the consumer in selecting an appropriate lender and product from within their panel of lenders to meet the individual consumer's loan requirements. Our members also provide access to associated protection products such as payment protection insurance.

Summary

We welcome the opportunity to respond to the consultation, and thank FSA for their time at our recent meeting.

Whilst in principle we support the FSA's work to reform and improve regulation, the entire concept of a 'differentiated regime' causes us some concern. We feel that FSA is potentially moving towards product specific regulation, which does not fit comfortably with a principles based approach. We also feel that in creating a tiered approach the potential to cause confusion and consumer detriment by variations in the areas of disclosure, suitability requirements and provision of demands and needs statements is highly likely.

Whilst we welcome proportionate and appropriate regulation, and broadly support the move to principles by sourcebook simplification, we do continue to have concerns over the ability of smaller firms to engage with principles based regulation and the FSA.

We also have substantial reservations about the un-level regulatory playing field that the consultation appears to create in direct to consumer sales forces, and the consumer detriment to which this could lead.

Consumer Detriment

We believe that introducing an un-level regulatory playing field will have significant potential to cause consumer detriment.

The lack of consistency with regard to disclosure requirements, demands and needs statements, suitability and eligibility requirements could all potentially cause confusion for consumers, which could lead to consumer detriment. There are also crucial safe-guards being lost for consumers who purchase on an 'information only' basis.

On a regulatory level, the variation in regulations between insurers and intermediaries could result in a variation in pricing, which itself could penalise a consumer for seeking out advice. We believe that a level playing field is essential in maintaining a fair market for consumers.

We feel that with so many aspects of the proposals creating variations in regulatory requirements, FSA could inadvertently create an environment where regulatory factors drive business models with little or no regard for consumer outcomes, and therefore with implicit consumer detriment.

Un-level regulatory playing field

As addressed in our interim response, our understanding of the term 'super-equivalence' remains as 'rules, whether newly proposed or already in the Handbook, whose effects fall within the scope of the Directive being implemented and that by any means go beyond the minimum requirements of that Directive.' To this extent, we do not see that imposing the IMD on insurers is super-equivalent, as they are not subject to the terms of the directive. It is in fact a regulatory decision, not super-equivalence, and one that we would welcome.

Referring back to CP160 in December 2002 (section 4.13), FSA comment "*Although the IMD only applies to intermediaries, the government has decided to extend conduct of business regulation to insurers as well, to avoid consumer confusion and to create a level playing field*".

In CP187, which includes responses to CP160 (paragraph 3.10), FSA continue "*Our approach has been to extend the application of the various directive requirements to firms that are not covered by the directives only where we consider there is a strong consumer protection justification for doing so. This varies by issue and type of customer. In broad terms, in this CP we have: applied more or less all the IMD requirements to insurers when the transaction involves a retail customer*".

By implication, FSA clearly felt that there was consumer protection justification in applying IMD terms to insurers. However, throughout the latest CP we have seen no evidence that the insurance market is working anything other than efficiently and correctly. We therefore do not necessarily believe this warrants the reduction in rules for insurers. Whilst we agree that the removal of some rules will not necessarily have a negative impact on consumers, we feel that the CP in no way addresses the issues as previously identified by FSA, of consumer confusion, un-level regulatory playing fields or addresses how FSA intends to monitor such situations to identify potential failings in the new proposed structure.

Complementary Work

We appreciate FSA's acknowledgement of the ongoing work by the Law Commission, Competition Commission and potential read-across from other FSA work such as the Retail Distribution Review. In light of this extensive work, and given the significant role PPI is taking in this work, we suggest delaying this work on ICOB until the results of this other work are clearer. Whilst we understand that FSA can incorporate CC results into their Policy Statement, we are concerned that other stakeholders will not benefit from due consultation on any substantial issues raised by the CC that FSA wish to incorporate, or that FSA will be unable to include substantial changes in their Policy Statement without further consultation.

We also note that FSA do not comment on the recent 'Wilson vs. Hurstanger' ruling which appears to set precedent with regard to commission disclosure, far in excess of ICOBS requirements. The consultation was issued prior to the implications of this case becoming clear. Accordingly ICOBS does not currently require the disclosure of commission by an intermediary. We would welcome clarity from FSA as to whether they consider this case now supersedes ICOB in requiring specific disclosure of the amount of commission earned by intermediaries to consumers.

In answer to the specific questions of the consultation:

(1.a.) Do you agree with our proposals to include PMI in the 'other' group of products?

No, we do not agree with the proposal to include PMI in the 'other' group of products.

Whilst PMI is an annually renewable contract, there is significant consumer apathy to reviewing it. Given the importance attached to continuity of cover and to potential exclusions relating to 'existing conditions' when seeking replacement policies, we believe PMI should be included in the protection products group.

It is also often provided through employer benefit schemes, where consumers receive the product as a P11d benefit. As so, it again doesn't necessarily receive sufficient attention from consumers, but they continue to pay tax on it and consider it a valuable benefit.

On leaving employment PMI providers often offer an individual policy on preferential terms – providing continuity of cover for conditions that might carry exclusions on a new policy.

Under the consultation, PMI would receive the same regulatory treatment as a health cash plan. We feel this undermines the importance, value and complexity of PMI and could lead to substantial consumer confusion and detriment.

Finally, in the Interim paper in March, FSA commented that the risk of detriment to consumers was higher for PMI than for other products in the 'other policies' group, again encouraging the view that PMI should be in the higher-risk protection products category.

(1.b.) Do you agree with our proposals to include all term assurance in the protection group?

Yes, we strongly agree that term insurance should remain in the protection group. However, we strongly disagree with the statement that 'there is less complexity...for term assurance than for other protection products'. As highlighted in the consultation document, your own research indicates that consumers 'attach more importance' to the purchase of term assurance, in part due to the 'long term nature' and 'lack of repeat purchasing opportunities'.

Further to this, term assurance includes a wide variety of products, with significant variations in cover. These include non-investment whole of life through to term assurance or decreasing mortgage protection, and protection policies such as family income benefit. These variations make term assurance anything other than 'less complex' than other protection products, with substitution a key consideration. These plans also often require advice as consumers often need to consider trust

arrangements. Without appropriate advice, consumers risk significant detriment, and by nature of the policies, at a particularly vulnerable time. Due to their long-term nature the detriment could also take considerable time to become evident.

If FSA did not maintain TA products in the high-risk group, we assume they would have to differentiate between certain TA products, splitting them into either high-risk or the lower-risk products. For example, we would be extremely worried if non-investment whole of life or TA extending past age seventy, which until recently could only be sold under the COBS regime, was suddenly placed in the lower-risk 'other' category. We therefore feel that further differentiation within the TA product group and the definitions that would be required to fulfil it would be unworkable. We also note that TA is often sold as a bundled product with Critical Illness, which would be complicated by differing levels of regulatory regime.

We also observe from the collated research in Annex 2, the average annual gross written premium of term assurance is quoted as over £400; the average annual critical illness premium appears to be only £55 and income protection £350. Whilst we find these statistics very surprising, given the proportionally larger premium, we would be highly concerned by the potential for proportionally increased consumer detriment, and therefore strongly support the retention of term assurance in the protection products group.

We are aware that other industry representatives have put forward cases that term assurance has a comparatively low penetration rate by intermediaries because of the low-commission paid on the product. This is factually inaccurate. Aside from the fact that advisers 'sell to need' and are not biased by commission, we can confirm that the commission paid on a TA product is normally identical to the commission paid on for example a CIC product for the same monthly premium. Clearly CIC is more expensive than TA so the equivalent level of cover is more expensive, but if you were advising a client with a set limited budget there would be no financial advantage or disadvantage to arranging a TA policy or a CIC with the same monthly premium. We therefore do not accept that TA policies have 'low commission' payments or that advisers do not appropriately or sufficiently sell them. We would be happy to share our commission calculation data with FSA.

Finally, we also share concerns over the commercial impact of downgrading TA to the 'other' group of products. Given that we feel advisers currently 'sell to need' we would not expect to see an increase in intermediary penetration, as where it is currently a consumer need and an appropriate product we would expect it to continue to be sold as such.

However, we also urge FSA to consider that some advisers could choose to limit their product range to just 'other' products if TA was downgraded. This could lead to an equivalent level of term assurance being advised upon, but a noticeable decrease in the penetration of other important products which up to now have been sold as a suite of protection products – such as critical illness, income protection and MPPI. This could lead to an increase in the overall protection gap.

(1.c.) Do you agree with our proposals to include all PPI products in the protection group?

Yes, we broadly agree that PPI should be in the protection group. We understand that FSA anticipates incorporating any work from the CC into their policy statement. It is our understanding that the CC may find that Mortgage PPI (MPPI) is a comparatively sound product, sold through robust sales procedures and offering an

important and valuable service to consumers. When FSA are in receipt of the CC findings, we would urge them to consider whether MPPI deserves separate treatment to other forms of PPI.

We also refer FSA to their own third round thematic work on PPI which found that regular premium MPPI sold through intermediaries for prime mortgages sound. Given the consistently better standards of MPPI sales we consider that MPPI could benefit from a lighter-touch than other forms of PPI in the final policy statement.

(2.) Do you agree with our proposed definition of PPI? If not, please give reasons.

We are concerned by FSA's apparent desire to 'product regulate'. Whilst we understand the issues surrounding PPI, we are also aware that specific product regulation flies against the move to principles, and wonder if principles would better serve the purpose. We are also concerned that the tighter the definition the clearer the boundaries are for firms to work around.

As currently stated we are concerned that the definition of PPI could inadvertently capture other products, such as income protection products with limited benefit payment periods for example. The addition of one other key differentiating factor, the inclusion of which potentially could also reduce consumer detriment, is the medical underwriting of a contract at application, rather than at claim. By including 'medical underwriting at point of claim' in the definition we feel that PHI products would be sufficiently safe-guarded and that anyone attempting to manoeuvre on the boundaries would have to offer a product with medical underwriting at application, which would in itself address one of the key concerns that the enhanced PPI rules had sought to resolve, that being rejections of claims due to non-disclosure of medical information.

(3.a.) Do you agree with our proposals for moving to a more principles-based approach for the rules on inducements?

Whilst we support in general the move to principles based regulation, we have concerns over the ability of small firms to engage with FSA in this manner. These have been highlighted to FSA previously. Please accept this as a prefix to answers of all parts of question 3.

Specifically on the rules relating to inducements we note that ICOBS takes the MiFID definition of inducements and question if this is appropriate for a non-MiFID market.

(3.b.) Do you agree with our proposals for moving to a more principles-based approach for the rules on reliance on others?

Whilst we broadly support the move to principles based regulation where possible, with the caveat that FSA needs to help smaller firms to engage on the subject, we strongly feel that 'reliance on others' is a particularly important area for smaller intermediary firms.

For example, firms are often reliant on sourcing software. Whilst direct feed systems are accurate, there are some individual portals that lack verification. The mere continuing existence of these systems suggests that retention of specific rules in this area is still required.

The use of sourcing systems by smaller firms is a particularly difficult issue for them to tackle individually, and therefore retention of the rules would be beneficial for the whole industry.

We are also acutely aware of the development of price comparison, lead generator and aggregator sites in new virtual mediums. Aside from ongoing work that we are involved in with FSA and OFT on these areas, we feel that the retention of this rule would also offer a degree of security to firms whilst wider issues surrounding the regulatory status of these organisations are addressed.

(3.c.) Do you agree with our proposals for moving to a more principles-based approach for the rules on exclusion of liability?

The draft sourcebook text appears to contradict the consultation, with 2.5.1 of the draft text being a rule relating to regulatory exclusion of liability, and 2.5.2 being guidance about exclusions under general law. The consultation states that FSMA is sufficient to warrant the regulatory exclusion being reduced to guidance, but that the general law exclusion should remain a rule in order to avoid consumer detriment. We assume this is an error.

With regard to exclusion of regulatory liability, the draft wording appears to be sufficiently similar to the existing rules, and we therefore expect it to continue to allow a firm to offer focused advice within ICOBS. This is particularly relevant to firms given FSA's current ambitions with regard to access to advice and stratification of advice under the RDR.

(3.d.) Do you agree with our proposals for moving to a more principles-based approach for the rules on excessive charges?

Yes, subject to our concerns with smaller firms engaging with FSA we agree with the more principles based approach to excessive charging rules.

(3.e.) Do you agree with our proposals for moving to a more principles-based approach for the rules on record keeping?

To an extent, we feel that information holding has become more of a commercial issue, particularly in the absence of long-stops and FOS wide-ranging jurisdiction. We therefore agree that reliance on principles should allow firms sufficient flexibility to address needs, in all likelihood in excess of current requirements.

(3.f.) Do you agree with our proposals for moving to a more principles-based approach for the rules on financial promotions?

We note that the reduction of ICOB 3 into barely a page in ICOBS is a substantial reduction in both rules and guidance. Financial Promotions is an area where our members often seek guidance. We would therefore suggest that if FSA make such substantial cuts to financial promotions rules and guidance in ICOBS, they should consider producing further easily accessible guidance for firms on the subject to complement the new ICOBS regime.

(4.) Do you consider there are any areas where important consumer protections are being removed, as a result of our simplification proposals, in ways that will expose consumers to significant risk of detriment?

We acknowledge that the replacement of rules by reliance on high-level principles should not affect the underlying standards required by firms. However, we feel that FSA is proposing wide-ranging and imbalanced modifications to the rules that will result in consumer detriment.

We feel that the un-level regulatory playing field, caused by variations in disclosure standard, demands and needs statements, notification of 'information-only' sales, suitability and eligibility will combine to create confusion amongst consumers. This confusion creates significant and ongoing risk of consumer detriment. Whilst any singular instance of replacement of rules by a reliance on simplified principles may not cause detriment, we feel that the cumulative effect of the changes as currently proposed in ICOBS could have far reaching consequences.

For example, as detailed in our response to Question 5, the removal of rule 4.4.2R (1A) from ICOB will result in a notable lack of clarity for consumers purchasing products on a non-advised basis from the 'other products' category. This will cause consumer detriment.

Whilst we concede that providing examples of significant risk to consumers is difficult, if not impossible, when considering motor insurance, if FSA, subsequently to this consultation, downgrade a current member of the 'protection products' category to the lower-risk 'other' group, we feel evidencing real life consumer risk would be easier. However, we cannot address every potential variation of the consultation in this response. We have highlighted our specific concerns to FSA on this subject.

(5.) Do you agree with our proposals on status disclosure? If not, please give reasons.

No. Whilst we understand that FSA is bound by the minimum disclosure requirements of the IMD for intermediaries, we believe that these minimum standards should apply across the board. This should include both intermediaries and insurers and cover both product groups. We believe this is a regulatory decision and not a super-equivalent measure.

By creating variations within the regime for insurers, and with further variations depending the product group being sold, removing status disclosure requirements will create consumer confusion and potential detriment. As previously highlighted, the government, and FSA in subsequent policy statements, felt there was strong consumer protection justification for the retention of consistent disclosures across the industry previously, and we have yet to identify any reason to remove them. The market is working well and there is currently no consumer detriment which should be reason enough not to delete rules and rely on principles. To simultaneously also simplify the regime, removing rules altogether has the cumulative potential to risk damaging a market that is functioning well for consumers

We believe that consistent and standardised disclosure for all firms for all products is desirable. If the minimum requirement is thus IMD copy-out then that is the level at which all firms should operate.

Further to this, we are particularly alarmed to see the requirement to disclose whether advice or information is being provided removed for insurers in the 'other' general insurance group. Given that this is required for intermediaries, and that FSA requires it for higher risk products it yet again creates an un-level playing field.

To the extent that FSA propose removing the requirement to disclose advice or information, it is considerably more disturbing that they also propose removing the requirement for an insurer offering information only to provide retail customers with a statement that the insurer has not personally recommended the contract for non-advised sales, as per rule [ICOB 4.4.2R (1A)]. This has not been replicated in ICOBS and has the potential to cause much consumer detriment.

Finally, from ongoing work with FOS we are aware that many consumers mistakenly believe they are receiving advice when they are not. This causes FOS severe difficulties, as a consumer genuinely believes that they have received advice when they have not. This will be exacerbated by the proposals, and we would expect more consumers to be misled by this. This also evidences the difficulty in educating consumers of the 'information only' sales process, and what this actually means, and by removing the disclosure requirement it can only make it more complicated for consumers.

(6.a.) Do you agree with our proposals for general rules on suitability?

We welcome the clarity provided in drafting rule 5.2.1 drawing on Principle 9. We also understand FSA's obligations under IMD, and accept the new guidance for the 'protection products' group based on existing rules.

However, whilst we note the new requirement for non-advised protection-product sales for a consumer to be informed of their responsibility to ensure suitability (4.2.3), and we note the IMD copy-out for intermediaries, we remain concerned by the 'gap' which is neither covered by IMD copy-out, nor the 'protection products' group, thus broadly non-advised sales by insurers of general insurance products.

Consumers purchasing 'other' general insurance from insurers on a non-advised basis lack considerable protection. With regard to suitability, there are no requirements what-so-ever, not even an obligation to ensure a customer is aware that they need to ensure their own suitability. This, combined with the lack existing rule 4.4.2R (1A) in ICOB as detailed above, will cause consumer detriment.

(6.b.) Do you agree with our proposals for general rules on eligibility?

We welcome the consistency of approach applied by FSA towards 'Material Facts disclosure (5.1.3)' and through guidance on eligibility (5.1.1). Given the un-level application of regulation being proposed in other areas of the consultation it is reassuring to see consistency in these areas.

However, we are unsure of the reasoning behind the creation of a rule specifically for PPI. Whilst we understand FSA's concerns relating to PPI we feel that a rule on this occasion is unnecessary. Given FSA's move to principles, the imposition of this single rule does not fit well with FSA's PBR agenda.

We are also concerned that in singling out PPI from the 'higher risk' protection group FSA are verging on 'product regulation'. This would represent a marked change from current regulatory styles, and in particular from PBR. We therefore propose that FSA should retain the guidance as published in the draft consultation for all products, and not include a rule specifically for PPI.

(7.) Do you agree with our proposals for demands and needs statements? If not, please give reasons.

The proposal removes significant areas of consumer protection, particularly for sales by insurers.

For example, not only is there no status disclosure, nor requirement to inform of provision of advice or information, but the proposals include the withdrawal of demands and needs for advised sales for the 'other' general insurances products grouping.

Overall, we believe it is imperative that demands and needs are offered to all customers who are seeking advice, and that those not receiving advice continue to be informed of such.

For example, non-advised sales of PPI products formed a significant area of concern for FSA's recent third-round thematic work on PPI, and we are concerned that this is not replicated in the regulatory approach in ICOBS. Whilst we acknowledge that PPI products have a heavier burden of regulation, including demands and needs statements, we are concerned that the evidence from FSA's PPI work demonstrates the inherent poor practices by some direct sales organisations which could spread across the 'other' product group. We therefore believe that the retention of demands and needs statements for all products across all sales channels would support better practice which recent evidence demonstrates is poor.

(8.) Do you agree with our proposals for general rules on product disclosure? If not, please give reasons.

Yes, we broadly agreed with your proposals on product disclosure. We welcome the standardised approach taken by FSA, with the new high-level standard of product disclosure for all firms and all products. We therefore question whether this standardisation should be carried across other areas of the consultation, such as disclosure requirements. It seems strange to consider standardisation across one part of the sales process but not others.

(9.) Do you agree that we should retain the cancellation right for non-distance sales of 'other' insurance products to consumers? If not, please give reasons.

Yes, we agree. As highlighted in other areas of our response, we feel that this reduction in rules would offer little savings in terms of compliance costs, but would have the potential to create risk of unfair consumer outcomes. We therefore support the retention of the cancellation right as a consumer protection measure.

(10.) Do you agree with our assessment of the likely costs and benefits of our proposals for the 'other' group of products? If not, please provide information to support your views.

We agree that the scope of savings is limited, due to the directives limiting the potential of the simplification. However, we would urge caution towards any assumption that cost savings would be passed to consumers; anecdotally, we would not expect savings made from reduced infrastructure and/or compliance costs to have any bearing on product price, as price is set by the provider and compliance with sales practices is managed by a separate sales cost/revenue function within the business. We would of course welcome any savings being passed onto consumers.

(11.) Do you agree with our proposal to require oral disclosure of information on all the main characteristics of a protection policy in sales where part of this information is given orally? If not, please give reasons.

We support oral disclosure of the main characteristics, particularly for non-advised sales. For advised sales this would take place as a matter of course. However, we have concerns with regard to evidencing such disclosure.

We would not support the compulsory recording of conversations with clients. Whilst this may be technically simple for telephone conversations, we feel it could be extremely intrusive, particularly in face-to-face situations, potentially costly in all situations and sends a negative message for an industry. Whilst we acknowledge that there are no proposed rules relating to the evidencing of this, we are concerned that a lack of joined up thinking from the Financial Ombudsman and FSA could lead to unintended consequences in the future in the event of claims. We would welcome specific guidance from FSA on what would be considered acceptable evidence of oral disclosure, in association with FOS.

Increasingly as an industry we are aware that ICOBS is merely the starting point as rules to be complied with in order to satisfy FSA requirements. However, with wider-ranging powers of interpretation, FOS presents an altogether different challenge. We urge FSA to consider this, and whether a small change in ICOBS, such as to require oral disclosure, might have unintended consequences that could potentially add significant burdens to a firm when complying with FOS. In this example, evidencing a process could be particularly difficult. We strongly request FSA and FOS to jointly consider this to provide clarity.

We are also conscious of the potential confusion to consumers around enforced oral disclosure in an 'information only' sale. As previously highlighted, FOS often finds 'non-advised' cases difficult to adjudicate due to the incorrect belief by consumers that they have received advice; we do therefore wonder if oral disclosure has the potential to act against a consumer, adding to their belief that they have received advice when they have not in some situations.

(12.) Do you agree with our proposals on price disclosure for protection products? If not, please give reasons.

We feel that compliance with the protection products price disclosure rule is acceptable for most products. However, we would welcome further clarity over the definition 'regular budget' particularly for single premium policies.

Assuming your consultation means affordability, and that relating to a 'regular budget' is a simple calculation of 'total cost divided by benefit period' we feel that with additional clarity, the proposals are broadly acceptable.

(13.a.) Do you agree that, for PPI there should be a cancellation period of 30 days for all PPI contracts?

We support the consistency of a 30 days cancellation period for all products in the higher-risk 'protection products' category.

(13.b.) Do you agree that, for PPI a full refund of premium should be given on cancellation?

We accept that a full refund of premium for PPI within the cancellation period would deliver consistency within the 'protection products' category.

(14.a.) Do you agree with our assessment of the likely costs and benefits of the proposals for protection products? Is there any evidence that would help to provide a better assessment? In particular on whether the nature or efficiency of competition in these markets may be significantly affected by our proposals?

We do not feel that FSA should be considering the competition elements of the market. This is a role for the Competition Commission, as evidenced by their current work on PPI, and is a commercial issue that the market will resolve. We believe FSA's statutory objectives include creating and facilitating a competitive market, but not promoting competition.

(14.b.) Do you agree with our assessment of the likely costs and benefits of the proposals for protection products? Is there any evidence that would help to provide a better assessment? In particular on the likely systems, monitoring and training costs that different kinds of firms would incur on introducing the proposals?

We are concerned by some elements of the research used in the CBA. For example, taking the headline figures of 632,000 critical illness policies and annual gross written premiums of £35m suggests that the average annual premium for critical illness plans is just £55. This seems remarkably low and we therefore question the methodology of the CBA in combining the two data sets from Mintel and Swiss Re in this manner.

When considering the responses received in the CBA, we are concerned that only 40 responses, excluding those combined from the same business group and category, were used. We are concerned that this might not be a sufficiently large population to make an informed CBA. We also note FSA's comments that the implications of the changes cannot fully be identified, and therefore costed, until full details of the policy statement are clear.

FSA comment that their one-off incremental systems, training and monitoring costs may be 'considerably underestimated' in the CBA. This is a cause for concern, and we question the validity of some elements of the CBA in light of this.

(15.) Do you agree with our proposals on claims handling by insurers? If not, please give reasons.

No comment.

(16.) Do you agree that there should be a transitional period of six months for firms to comply with the new ICOB sourcebook? If not, please give reasons.

Yes, we believe that six months is sufficient for transition.

(17.) Do you have any other comments on any of our proposals?

No.

(18.) Do you have any comments on our draft rules?

No.