



By email to: PureProtectionMS@fca.org.uk

Competition Division
Financial Conduct Authority
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8 October 2024

AFM Response to FCA MS24/1.1, Distribution of Pure Protection products to retail customers

1. I am writing in response to this consultation paper, on behalf of the Association of Financial Mutuals. The objectives we seek from our response are to:
 - Comment on the proposed Terms of Reference for the planned market study.

About AFM and its members

2. The Association of Financial Mutuals (AFM) represents insurance and healthcare providers that are owned by their customers, or which are established to serve a defined community (on a not-for-profit basis). The mutual insurance sector manages the savings, pensions, protection and healthcare needs of over 26 million people in the UK and Ireland, collect annual premium income of over £23 billion, and employ nearly 23,000 staff¹.
3. The nature of their ownership and the consequently lower prices, higher returns or better service that typically results, make mutuals accessible and attractive to consumers, and have been recognised by Parliament as worthy of continued support and promotion. In particular, FCA and PRA are required to analyse whether new rules impose any significantly different consequences for mutual businesses² and to take account of corporate diversity³.

¹ ICMIF and AFM, 2023: <https://financialmutuals.org/wp-content/uploads/2023/10/UK-Market-Insights-2023.pdf>

² Financial Services Act 2012, section 138 K: <http://www.legislation.gov.uk/ukpga/2012/21/section/24/enacted>

³ <http://www.legislation.gov.uk/ukpga/2016/14/section/20/enacted>

Introductory comments

4. We recognise the issues that FCA is seeking to explore via this Market Study. Around one-third of AFM's 45 members companies are directly involved in the pure protection market, so the proposed work may have material consequences for AFM and its members.
5. As FCA's analysis has identified, the pure protection market plays an important role in the UK economy. The £4.2 billion paid out in claims in 2022 provided vital support to individuals, families and beneficiaries, and helped to mitigate the financial consequences of a severe loss, whether caused by death, injury or serious illness.
6. According to ABI, the proportion of pure protection claims paid in 2023 was above 98%⁴, although this varies across different pure protection products. AFM research shows that mutuals who provide income protection products consistently strive to treat customers fairly, and our analysis confirms the mutual sector pays a much higher proportion of claims than non-mutuals⁵. To illustrate, AFM members paid out 92.1% of the income protection claims they received in 2023, compared to an average of 81.3% for all providers. AFM member products also have customer-valued features which mean that they typically receive around half of all income protection claims from retail consumers, despite accounting for less than 20% of the total market.
7. We note that in paragraph 3.2 of the FCA paper, there is an inference that 'loaded premiums' are a means for intermediaries to receive larger commission. Whilst 'premium loading' enables people with pre-existing medical conditions to achieve cover, the premium reflects the greater risk to the insurer, and the commission arrangements are a direct proportion of the premium. This should not be confused with 'loaded premiums', which infers that a distributor requires the insurance provider to raise or load the premiums, to reflect an 'elevated level of service provided by the distributor'. This results in higher commission to the distributor, and it also means the total premium ceases to be directly related to the risk that the customer represents to the provider. We accept this should be a part of the market study.
8. We suggest that another practice that should be explored is 'distributor specific pricing'. We have seen an increase in this, particularly amongst larger protection providers. In this case, the provider offers different pricing scenarios for the same product, and potentially same service, to

⁴ <https://www.abi.org.uk/news/news-articles/2024/9/protection-insurers-pay-out-record-7.34-billion-to-support-individuals-and-families/>

⁵ <https://financialmutuals.org/resource/mutual-income-protection-providers-excel-in-2023/>

different distributors. The provider might adopt this practice in order to drive volume from certain distributors. The key here is that whilst they may not be inflating commission, the distributor and therefore the customer may not be aware that they could obtain the same cover at a lower price from a different distributor. We think providers should specify on their quotes when they are not offering their cheapest premium, so that customers can make an informed view.

9. 'Fair value' as also discussed in paragraph 3.2 is not a binary matter as suggested in the paper. Consumers buy protection products in the hope that they will not need to claim, i.e. that they do not die, become ill or suffer an injury. And they do so in the knowledge that should they suffer an insured event, the stress of this is mitigated by having a solution in place that will soften the financial consequences of that event. In any year the vast majority of policyholders will not claim, but for those that do, their protection product can be life-changing or life-asserting. 'Fair value' might also be realised in other contractual and non-contractual benefits: for example, many mutuals provide a host of valuable features that enhance the consumer experience, and which mean that even where a customer has not made a claim, they can draw material benefit from their product. As we have discussed previously with FCA, finding an appropriate and measurable basis for including these features, in the form of fair value assessments expected by FCA, has not proved easy.
10. In relation to the two questions raised in the paper, we make the following comments:
 - i. *Scope:*
 - We agree that the four products proposed are appropriate for the planned focus of the market study, and we agree that the work should exclude workplace/ group arrangements.
 - Whilst Figure 1 sets out a typical intermediated sale, we think it would be helpful for FCA to explore other distribution methods, and to consider whether those mitigate some of the risks identified.
 - There is a theme within the paper relating to commission arrangements and the possibility that this results in sub-optimal outcomes for consumers. We do not though consider that this automatically gives rise to an RDR-type intervention by FCA (i.e. that commissioned is banned), given that this may have exacerbated- rather than addressed- the advice gap for investment products.

ii. *Issues:*

- We agree with the set of issues set out by FCA. We have included some further areas we think should be explored.
- Increasingly, distributors are operating restricted panels, as opposed to searching the whole of market when advising their clients, and it is often the case that insurers are required to agree to pay specific commission rates to secure a place on that panel. For mutuals, who often sell products to less wealthy consumers, and who tend to be smaller organisation, and to focus on securing the best interests of their members, there is a reluctance to compete on commission terms. As a result they may be prevented from appearing on some panels, and consumer competition is therefore affected.
- FCA earlier raised the prospect of barriers to entry, and we think it would be instructive for this study to consider the degree to which FCA rules have intensified concentration in the pure protection market, and raised the bar too high for new entrants, or for small players to achieve scale.
- We would be interested in any research FCA undertakes as part of the market study, that identifies why consumer do, and don't, buy pure protection, and what actions the industry can take to better meet their needs.

11. We note that FCA is currently involved in a Consumer Duty-inspired exercise involving smaller insurers, including many AFM members, which may provide additional information to this work, without having to make duplicative demands of firms.

12. We would welcome the opportunity to discuss further the issues raised by our response. We are happy to be included in the published list of respondents.

Yours sincerely,

A handwritten signature in black ink, appearing to be 'MS', written over a horizontal line.

Martin Shaw
Head of Policy
Association of Financial Mutuals