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## *AMI Factsheet: GI pricing practices*

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### Introduction

This factsheet has been prepared by the Association of Mortgage Intermediaries following the publication of [FCA PS21/5 General insurance pricing practices market study](#).

The aim of the factsheet is to draw out key areas that are applicable to mortgage intermediary firms. It is intended as a summary of the rules and guidance. We strongly encourage firms within scope of the requirements to read the FCA rules and guidance in full.

Despite the title of the FCA's Policy Statement, the rules and guidance in some sections apply more widely than GI only and do not only relate to pricing. **All AMI member firms that distribute pure protection (non-investment insurance) e.g. term life insurance, critical illness, income protection (not an exhaustive list) and/or GI (e.g. home insurance) are likely to be impacted by the changes in some way.**

### The rules and guidance

The FCA's rules and guidance can be broken into four sections:

- Pricing (applicable to home and motor insurance).
- Pricing reporting (applicable to home and motor insurance).
- Product governance (**applicable to all GI and pure protection products**).
- Auto-renewal cancellation and disclosures (**applicable to all GI products except for private health or medical insurance, and pet insurance**).

### Pricing

The FCA has introduced a rule that requires home and motor insurance renewal premiums to be set at a price that is no higher than would be offered to an equivalent customer at new business. This is referred to as the equivalent new business price (ENBP). A firm cannot therefore discriminate against a customer on the grounds of how many years a customer has held their policy with them (i.e. tenure).

This means firms in these markets will no longer be able to dual price and effectively bans the practice known as "price walking", where a premium is offered at an introductory price and is gradually increased over time at renewal until it bears no resemblance to the premium that would be offered if the same customer was a new customer. Although it is too soon to know for sure, whilst the industry

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stabilises charging structures to accommodate the new requirements, new customers including those customers who shop around at renewal are likely to see insurance premiums increase. This captures all new insurances and renewals.

### **Will the pricing rules apply to my firm?**

Pricing rules (applicable to home and motor insurance) will impact all intermediary firms either directly or indirectly depending on the arrangements they have in place with their insurance providers. A firm will be captured directly if they:

- Set any portion of the renewal price of a home or motor insurance policy, including setting the price for any additional product offered to the customer at renewal (this includes retail premium finance). An intermediary that sets the gross price paid by the customer for the core product or sets the price of any add-on policy or retail premium finance, is deemed price-setting.
- Rebates any portion of its commission (the FCA deems forgoing commission to be a 'cash or cash equivalent incentive'). Firms should ensure that where a commission rebate discount is given, it reflects the equivalent commission rebate discount that the renewing customer would be eligible for if they were a new business customer, and that the firm's approach does not discriminate against customers of a longer tenure.
- Are a principal firm that has price-setting appointed representatives (ARs), as the principal firm is responsible for ensuring AR compliance with the FCA's rules.

### **What is required of a price setting intermediary?**

A price setting intermediary must ensure that when setting any portion of the renewal premium, the portion they set or their contribution to that portion is set at a level that is no higher than it would be set for a new business customer.

This means that if an intermediary has any input or influence on the price setting of home or motor insurance premiums, even rebating commission, they must consider their pricing models in conjunction with the specific manufacturers to ensure future pricing offers fair value to the end consumer. This is likely to impact the profitability of some firms and as such the FCA will be continuing to oversee the remedies firms put in place to overcome this complex new requirement. The FCA will also be taking an interest in any firm who is seen to either reduce the quality of the insurance product or attempt to upgrade renewing customers for the purpose of charging higher premiums.

Fees are not strictly captured under the pricing rules; however, the inclusion of an anti-avoidance rule sets out that a fee cannot be higher for renewal customers than the fee charged to new business customers. This only applies to arrangement fees and does not apply to contingent fees, e.g. fees for mid-term adjustments. This means that increasing advisory/arrangement fees to mitigate against potential lost renewal revenue is unlikely to offer customers fair value and may breach anti-avoidance measures.

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A firm will not be directly captured by the pricing rule changes if they:

- Receive commission that is determined by another firm and make no adjustment to this.
- Operate under a delegated underwriting authority (DUA) arrangement where they are required to set renewal rates using a formula determined by the insurer and have no ability to change the premium paid by the customer.

Although not directly captured by the price setting rules, intermediaries who do not have control over the insurance premiums charged will potentially see changes to client premiums and, depending upon the size of business book, an impact upon future revenue streams. It is therefore important that although not responsible for price setting, intermediaries remain alert to practices which may contravene anti-avoidance measures or consumer fair value outcomes.

The rules apply to home or motor policies sold to consumers (as per the definition of consumers in the FCA Handbook glossary). It includes policies sold to buy-to-let landlords if they are deemed to be a natural person acting outside their trade or profession.

AMI is currently consulting with the FCA on the impact of these pricing rule changes and their impacts upon intermediaries, specifically on the impact of including commission rebates in future renewals.

### **What is deemed an 'additional product'?**

Under the rules, the price setting firm must ensure that the price of the additional product at renewal is no higher than the price at which the additional product would be offered to the customer if they were a new business customer.

An additional product is one that is available to a customer in connection with a home or motor insurance policy and sold as a separate contract to the core cover. This can be optional or mandatory. For example, a legal expenses insurance policy under a separate contract. Additional products do **not** include cover extensions which are optional parts of the core home or motor contract e.g. accidental damage cover extension. However, the rules will apply to the overall price which includes the cost of the cover extensions.

Retail premium finance is deemed an additional product. The cost should be no higher than it would be if the customer was a new customer. The determining factor is the APR if the premium finance is a regulated credit agreement or, if not, the total price paid by the customer.

Should your firm offer customers additional products such as premium finance or other forms of additional services, it is advisable to discuss this with the product provider to ensure these are not subject to price walking. It is therefore important that any bundled pricing can be individually analysed and understood. Further information relating to premium finance is covered later within this factsheet.

### **Closed books**

Specific pricing rules apply to firms with closed books (e.g. products where there are no or relatively few new business customers). The definition of a closed book has been confirmed as a business book which has not been on sale for five or more years and not sold/expect to sell more than 7.5% of active policies to new customers. If closed less than five years, the threshold remains at 15%. If the level of

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new business within these thresholds exceeds 10,000 policies per year, this would not be classed as a closed book.

Firms that have closed book renewals are required to benchmark their renewal prices against a 'close matched' open book policy that it manufactures or distributes or, if there are no close matched products, they must ensure that renewal prices do not systematically discriminate against customers based on their tenure.

The FCA has advised they will ask firms to report separate data on closed books. They will also be expecting impacted firms to retain records on how they have considered close match decisions to ensure consumers are not discriminated against due to tenure. This assessment is to be repeated annually. The FCA has indicated this will form part of their future monitoring plans, so it is important that firms with large closed books who have influence over price setting maintain relevant records in readiness for potential future inspections.

### **Record keeping and attestation**

To monitor compliance and ensure that price walking is not taking place, the FCA requires firms subject to the pricing rules to create and retain written records of how the firm has satisfied itself that it meets the pricing requirements and does not discriminate against customers based on tenure. It is up to firms to decide which records they will create and keep to demonstrate that they meet requirements. The FCA is not mandating the format of any records.

In addition, each firm subject to the rules will have to attest annually to compliance with the pricing rules. The attestation will need to be carried out by an individual in the firm with relevant senior management function (SMF) under the Senior Managers and Certification Regime (SM&CR) or by a director of the firm if the firm is not subject to the SM&CR. The attestation will be carried out via an attestation form submitted through the FCA's RegData platform. The attestation responsibility rests with one single individual and as such, a firm should be satisfied that the individual carrying out the attestation is suitable and capable of judging whether the firm complies with the rules.

### **Anti-avoidance**

If a firm becomes aware that any other firm in the distribution chain is not or may not be complying with the rules in this chapter, then they must notify the FCA.

## **Product governance**

**Please note that this factsheet does not cover all the changes to the rules and guidance that may be applicable/relevant to an intermediary firm and instead focuses on some of the main areas.**

Since the Insurance Distribution Directive (IDD) requirements introduced in 2018, distributors and manufacturers have worked together to ensure products remain suitable for the interests and characteristics of the firms target market and customer base.

The requirements within PS 21/5 strengthens this collaboration further by introducing additional measures upon manufacturers and intermediaries as distributors.

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New rules and guidance have been added to the Product Intervention and Product Governance Sourcebook (PROD). This broadens the scope of PROD to all GI and pure protection products, irrespective of when a product was manufactured, and enhances it through new obligations.

There are chapters that relate to manufacturers (PROD 4.2) and the distribution of insurance products (PROD 4.3). The changes made mean that intermediaries are captured by the PROD Handbook in a way that they have not been previously.

Intermediaries may be captured under requirements for manufacturers if they 'design, develop, create and/or underwrite' a product(s).

A new chapter (PROD 4.6) has been inserted in relation to legacy non-investment insurance products.

Once the rules come into force, FG 19/5 (The GI distribution chain: Guidance for insurance product manufacturers and distributors) will be withdrawn.

Both manufacturers and distributors will be required to consider whether products represent fair value for customers and retain evidence of the analysis. This analysis will be required for each insurance product distributed by the intermediary, including pure protection products. Firms will be expected to have a clearly documented operating model that covers the identified target market of each insurance product, the characteristics of that product and how these meet the needs of the firms target market. Without this starting point it will be harder for a distributor to demonstrate fair value outcomes and to collate the information required by product manufacturers.

Fair value is not defined by the FCA, however value is defined as 'the relationship between the overall price to the customer and the quality of the product(s) and/or services provided'. It is down to firms to make judgements on what constitutes 'fair' based on the rules and guidance provided by the FCA; however, the FCA does provide guidance on circumstances where it considers a product may not be providing fair value which should give firms a useful steer on the regulator's expectations.

As part of the value assessment manufacturers will need to consider whether their products provide fair value for a reasonably foreseeable period, such as value throughout the life of a product. This is particularly relevant for the mortgage protection industry as many pure protection products are long term contracts.

A manufacturer must undertake a regular review of products within scope and its product distribution arrangements at least every 12 months (this could be more frequent if a potential risk with the product is identified).

AMI understands there will be an increase in the amount of data that will be requested from distributors by manufacturers, as well as a need for manufacturers to share certain information with distributors. This is a major change for intermediaries and is a result of the requirement on manufacturers to ensure that, as far as reasonably possible, their distribution arrangements avoids or minimises the risk of negatively affecting the fair value of their insurance products.

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## Data and information sharing

Examples of information that manufacturers will be required to provide to distributors includes:

- All appropriate information to enable distributors to understand the intended value of the insurance product. Firms should consider the meaning of value as set out in PROD when deciding what value-related information to share with their distributors.
- The possible impact of the distributor's actions on the intended value. For example, providing the information that may be relevant where a distributor intends to distribute the product with an additional product that could risk leading to duplicated cover, or where the distributor's remuneration could impact the price and lead to the product not offering fair value.
- Any type of customer for whom the insurance product is unlikely to provide fair value.

As part of this, distributors will be required to:

- Make sure they understand the outcome of the manufacturer's value assessment and the intended value of the product.
- Consider the impact of their distribution strategy on the value of the product and amend distribution processes if customer harm is identified.
- Consider whether any remuneration it receives in relation to the insurance product would result in the product ceasing to provide fair value to the customer.
- Understand the target market of an insurance product (characteristics, objectives, interests and needs of the target market).

Examples of the types of information that distributors will be required to provide to manufacturers includes at least the following:

- The type and amount of remuneration where this is part of the premium or otherwise paid directly by the customer, including in relation to additional products.
- An explanation of the services provided by the distributor. This is to enable the manufacturer to identify the person's role in the distribution channel.
- Confirmation from the distributor that any remuneration is consistent with their regulatory obligations such as under SYSC 19F.2 (remuneration and customer's best interests).

Some of this information may already be held by a manufacturer under existing rules.

We suggest that intermediary firms acting as distributors understand not only the rules applicable to them as distributors but also those applicable to manufacturers (PROD 4.2), to ensure that information requested by product providers is in line with the regulator's rules and expectations. This will help distributors prepare in readiness for manufacturer information requests.

There is no standardised information request template provided by the FCA as it wants to give firms the flexibility to carry this out in a way that fits them, their business model, products, target market and distribution arrangements. The FCA has stated that firms should balance what is necessary to meet the PROD requirements with any wider legal obligations, such as competition law. This means that there is no obligation on intermediaries to share commercially sensitive information however

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there will be a requirement to provide appropriate and relevant information that could impact upon overall fair value, e.g. remuneration information.

Where a distributor sells products manufactured by different insurers, they must ensure the package of product is consistent with providing fair value (including whether there is a risk the customer could be sold duplicate cover which could affect the fair value of the individual products).

A distributor is required to take appropriate remedial and mitigating action where it identifies that the insurance product (or package) is not providing fair value for customers or where its distribution arrangements, including remuneration structure, may mean the customer is not being provided with fair value. The FCA outlines its expectations on the steps a distributor may need to take under PROD 4.3.11B G.

### GI value measures

Firms are reminded that under rules and guidance introduced in the FCA's GI value measures PS, there are existing expectations for distributors in relation to certain GI products (listed [here](#) in SUP 16 Annex 48R). This is covered in [PROD 4.5.6R](#) and is separate and in addition to the new PROD rules introduced as a result of the GI pricing practices PS.

### Premium finance

If a distributor offers (or arranges for the customer to be offered) retail premium finance then it must ensure that the customer does not pay a price that means, if seen as a package, the customer will not receive fair value.

Firms may wish to consider the total price a customer pays for the retail premium finance and the quality of it, including any relevant factors and features such as the benefit to spread the cost instead of paying up front (considering the higher overall price the customer will have to pay) although it is recognised that with premium finance price is usually the determining factor.

Under existing rules firms are required to ensure that when proposing or arranging retail premium finance they are not acting in a way that conflicts with the customer's best interests rule. The FCA has clarified that this includes remuneration that may be derived from premium finance arrangements. For example, remuneration arrangements should not incentivise a firm to offer a retail premium finance arrangement that has greater costs to the client, where there is another arrangement available to the firm in the market that is better aligned with the customer's interests.

Firms that have exclusive premium finance arrangements may need to consider whether these arrangements are consistent with existing FCA requirements, such as the customer's best interests rule.

New pre-contractual disclosures have been introduced for firms that offer retail premium finance. These firms are required to provide clear information about the cost of the premium finance arrangement and that this makes the contract more expensive.

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## Auto-renewal cancellation and disclosures

Firms that sell GI products (excluding private health, medical and pet insurance) will need to inform a customer of the following:

- Whether the policy will automatically renew or whether the customer needs to take action to ensure renewal.
- The effect of automatic renewal.
- Information on the right to cancel the automatic renewal element of the policy at any time.

This information is required in good time before the conclusion of the contract and in writing or another durable medium.

Firms are required to allow customers to opt-out of auto-renewal using at least the same methods by which they allow consumers to purchase a new policy.

This change builds on TCF outcome six (consumers do not face unreasonable post-sale barriers imposed by firms to change product, switch provider, submit a claim or make a complaint).

If a mortgage intermediary firm is involved in the production of renewal documentation and is responsible for administering renewals, they should discuss and agree with the manufacturer how these rules impact upon the renewal process and the customer's rights to cancel the automatic renewal and its effects.

## Pricing reporting

Linked to the pricing requirements, some firms will be required to submit home and motor pricing data annually to the FCA (in the first year firms will need to submit a single report for the six months ending 30 June 2022 by 30 September 2022).

Pricing information report form templates can be found in [SUP 16 Annex 49AR](#).

There are specific forms for price-setting intermediaries to complete (section four and if a price setter of a closed book, section five).

In addition, there is a separate form for intermediaries to complete (section six) if they:

- Charge fees in addition to the premium.
- Set the price of add-ons.
- Set the price of premium finance.

**Note: if the firm setting the price of a premium finance product is a premium finance provider, then the customer facing firm (i.e. the firm that has a direct relationship with the customer) must report the pricing data for that business.**

The reporting form captures premium finance with 0% APR, as the FCA want to understand how many consumers choose premium finance at no additional cost.

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Reporting is based on customer tenure. New business customers are classed as T0, with one-year intervals from T1 (one year) to T9 years, and a category for T10 or more years.

Firms should ensure they understand what information they'll need submit to the FCA. While the first report is not due until the end of September 2022, there is likely to be changes required to the type and volume of management information (MI) collected as well as potential changes to IT systems and staff procedures that will take time to implement.

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## When do the rules come into force?



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## Transition periods

### **Pricing and auto-renewal**

If required, firms can elect to use a transition period until 17 January 2022 to implement processes, provided customers who suffer a loss resulting from the failure to have process in place by 1 January 2022 are compensated.

Firms will need to make good any pricing differences for consumers who received higher quotations than they would have done under the new rules. Firms must have contacted customers by 28 February 2022 to provide the required disclosure information under the auto-renewal rules.

If a firm uses this transitional period, they will be required to attest to a series of statements as part of the first attestation.

### **Product governance**

There is a transition period for any existing products within scope that have been approved for marketing and distribution before 1 October 2021. For manufacturers, this gives firms 12 months (until 30 September 2022) to apply a product approval process to any existing products that did not fall within the original PROD scope (i.e. products manufactured before 1 October 2018) and ensure that products previously approved under PROD 4.2 meet the fair value requirements.

Where a firm distributes a product that has been approved for marketing and distribution under PROD 4.2 before 1 October 2021, they have 12 months (until 30 September 2022) to comply with the fair value requirements (PROD 4.3).

There is no transition period for products approved for marketing and distribution after 1 October 2021, as firms are expected to have the correct processes and procedures in place to meet the FCA's new requirements.

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