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Financial Conduct Authority

14 May 2020

Dear Terence,

AFM Response to FCA guidance consultation

"Product value and coronavirus: draft guidance for insurance firms"

1. I am writing in response to this consultation, on behalf of the Association of Financial Mutuals. We support FCA's work in exploring how the insurance sector takes its obligations seriously during the pandemic, and in particular how it seeks to assure that products and services continue to offer value. We consider this is a responsibility that is equally relevant to product providers and distributors. We responded separately to the FCA guidance on customers facing temporary financial difficulty as a result of the coronavirus.

2. The scale of the current pandemic is unprecedented, and the effect it is having on normal life is profound. The ensuing lockdown and economic consequences naturally go beyond the medical emergency, and touch on all aspects of the way we live. Needless to say, insurance seeks to offer a solution to people in managing uncertain risks, including the likelihood of an adverse event taking place and the mitigation needed to resolve that. As a result, all insurance products are affected by the pandemic, either in making some feature more, or less, likely to happen, or in affecting the quantum of loss that results. Many of those effects will run for significantly longer than the lockdown.

3. In the immediate aftermath of the lockdown, AFM members focused on how they could maintain an effective service to customers and other stakeholders. This included paying claims and making administrative changes, whilst adapting their operational approach to enable staff to perform well in new circumstances. That short term focus means that

as yet we have not witnessed any fall in customer satisfaction, or negative feedback from intermediaries. Insurers have also needed to make appropriate changes to their underwriting criteria, to ensure that changes in the likelihood of claims are reflected in product pricing and features.

4. Even before the prompt by FCA, we have seen insurers start to consider whether existing customers are continuing to receive good value for money in their insurance product. That has resulted in actions to safeguard value for money, including a commitment to share with policyholders any excess surplus, as a result of lower claims experiences, or an offer to provide premium holidays to small businesses that have been forced to close. We have also seen mutuals offer extended support, such as GP24 and mental health support, which ensure product features adapt to the current circumstances, and which help to retain value even where some features cannot be delivered.

5. One AFM member offering income protection is purposefully recording the actions they are taking now to support the fair treatment of customers, and any challenges in delivering product value, to enable them to review fully at the year end the net effect of the actions delivered. Given an increase in claims volumes this is unlikely to provide any excess surplus, but should this be the case they will explore how to share that with customers.

6. We are mindful though that in deciding whether and how to reassess product value, that it is important not to retroactively cover losses that are specifically excluded at present. This is covered in the IAIS statement dated 7 May[1].

7. The FCA guidance implies that there is a risk that some insurers will seek to profit from the lockdown, and presumably that they will seek to direct the higher cashflow to restoring their dividends. For mutual organisations, who have no external shareholders, any surplus produced in a period is retained within the business, for the future benefit of members/ policyholders. There is therefore no prospect of profiteering in the way alluded to.

[1] The IAIS statement states: " IAIS cautions against initiatives seeking to require insurers to retroactively cover Covid-19 related losses, such as business interruption, that are specifically excluded in existing insurance contracts. In such cases, the costs of claims against losses have not been built into the premiums that policyholders have paid for their insurance. Requiring insurers to cover such claims could create material solvency risks and significantly undermine the ability of insurers to pay other types of claims. Such initiatives could ultimately threaten policyholder protection and financial stability, further aggravating the financial and economic impacts of Covid-19."

8. That is not to say that the claims ratio for some products is not changing or that this is not a matter for careful review. However, the assessment of change in product value may be complex, and may take some time to become apparent. For example, many health cash plans cover dental cover, and during the lockdown consumers are unable to visit their dentist, except in emergencies. However, any cashflow impact may only be temporary, as customers re-book cancelled appointments with the dentist later in the year. Similarly, where fewer miles are being driven by customers, there is growing concern that there is a greater proportion of reckless driving, and that this may result in a lower volume of higher value claims. A medical defence provider indicates that whilst claims values are low, these are expected to increase in due course, and given the nature of claims, may take many years to resolve.

9. Given the above, we do anticipate that organisations should be undertaking a product level assessment. This would involve reviewing each of the relevant features of a product, and assessing whether there has been any change in the economics of that feature. That would mean reviewing the combined ratio, which would include the incidence of claims, the value of those claims and the continuing provision of the feature, given that scarcity of supply and more complex working arrangements may mean that the administrative costs associated with that feature will change. For many insurance products, the combined ratio varies significantly from one time period to another, and is often more than 100%, meaning that the cost of providing a product is greater than the premiums recovered. Often, investment returns help to offset the potential loss, though in the current period, investment returns are sharply negative.

10. We consider that only in a minority cases can insurers confidently quantify the consequences of the pandemic in a matter of months. Others will undoubtedly take much longer: for example, the projected increase in morbidity and mortality rates is uncertain, and would be expected to increase both as a result of illness, and in the aftermath of the higher unemployment and lower levels of prosperity.

11. We consider that the assessment required will be both technical, and financial. The technical review, assessing how specific product features have remained available and used, can be completed within the six months FCA has advocated. We suggest that rather than undertake a financial assessment in Q4 2020, this is undertaken as part of the year-end actuarial review, and is therefore extended into early 2021. We welcome views from FCA on whether this is a practical approach.

12. We were disappointed that FCA did not make greater effort to alert AFM- as a significant trade body in the sector- on its proposals, particularly given the short deadline for response. As a result, we have not been able to reflect the wide range of members and their interests that we represent, or the wide diversity of consumers that they support.

13. We would welcome the opportunity to discuss further the issues raised by our response.

Yours sincerely,

Martin Shaw
Chief Executive
Association of Financial Mutuals

About AFM and its members

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). Between them, mutual insurers manage the savings, pensions, protection and healthcare needs of over 30 million people in the UK and Ireland, collect annual premium income of £19.6 billion, and employ nearly 30,000 staff[2].

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 businesses[3] and to take account of corporate diversity[4].

2 ICMIF, https://www.icmif.org/publications/market-insights/market-insights-uk-2016
3 Financial Services Act 2012, section 138 K: http://www.legislation.gov.uk/ukpga/2012/21/section/24/enacted
4 http://www.legislation.gov.uk/ukpga/2016/14/section/20/enacted