

Market Study

MS24/1.1

Market study into the Distribution
of Pure Protection Products to
Retail Customers

Proposed Terms of Reference

August 2024

How to respond

If you have any comments on these terms of reference please send them by **11 October 2024** to:

Competition Division
Financial Conduct Authority
12 Endeavour Square
London E20 1JN

Telephone:

020 7066 1000

Email:

PureProtectionMS@fca.org.uk

Disclaimer

When responding, please indicate the following alongside the submission:

- the interest or organisation that you represent, where appropriate
- whether you are providing any material that you consider to be confidential and explain why this is the case

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Chapter 1

Introduction

- 1.1** Pure protection products are designed to help an individual and/or their dependants with existing financial commitments or lifestyle adaptations if the policyholder dies or becomes incapacitated, injured or infirm. They include term assurance, critical illness cover, income protection insurance, and whole of life insurance including guaranteed acceptance over 50s plans.
- 1.2** Consumers rely on pure protection products to provide financial resilience, often when faced with vulnerable circumstances. This is a particularly important sector with the rising cost of living in the UK. Around £4.2 bn was paid out in pure protection claims in 2022 to support people suffering bereavement, illness, and injury.¹
- 1.3** The main distribution channel for pure protection products is via intermediaries. Distributing via intermediaries can be a cost-effective way for an insurer to reach consumers, while consumers can benefit from intermediaries' expertise and access to the market.
- 1.4** We intend to launch a market study into the distribution of pure protection products to individuals, to understand whether the market is functioning well and whether consumers are receiving good outcomes. Where markets work well in the interest of consumers, we see consumers able to buy products and services which meet their needs and provide fair value, sold to consumers in a way that is clear, fair and not misleading.
- 1.5** The market study links to our wider work on the Consumer Duty. It links to all the outcomes we expect of firms, including price and value. We will therefore consider whether the consumer outcomes that we observe align with those we expect to see under the Duty, including whether they represent fair value. Where we refer to fair value requirements under the Consumer Duty in this document, we are referring to our Consumer Duty rules and/or the PROD 4 rules as relevant.
- 1.6** As we have said previously, a product or service that meets all of the other elements of the Duty (eg if it is designed to meet the needs of its target market, is transparently sold, customers are able to exercise choices to switch or exit, and are properly supported) is more likely to offer fair value. This is both because of the benefits customers receive and because they have the information they need about the product or service they are buying (including the ability to pick something else should they prefer).
- 1.7** We intend to launch this market study later in the financial year 2024/25. We will keep this timing under review as we consider other pending priorities. However, we want to set out our intention to undertake this work now, to allow firms in this sector to plan accordingly.

¹ All figures from Mintel reports; UK Critical Illness Cover Market Report 2024; UK Term Assurance Market Report 2023; UK Income Protection Market Report 2024; UK Over-50s Guaranteed Acceptance Life Insurance Market Report 2024.

- 1.8** We will engage with firms, industry groups and stakeholders to gather their views on these Terms of Reference and to begin discussions over what data we may need.
- 1.9** Although we are not formally consulting on these Terms of Reference, we welcome any views on the scope of the market study and the themes we are exploring by 11 October 2024. Please provide any views in writing to PureProtectionMS@fca.org.uk. We will update the Terms of Reference when we launch the market study if there are any changes.

Chapter 2

Market overview

- 2.1** In 2022, sales of new individual pure protection policies in the UK were estimated to be around 2.5m, generating around £928m in new premiums. Meanwhile, the payout per claim ranged from around £8,000 on average for income protection, £53,000 on average for term assurance, and £66,000 on average for critical illness cover.²
- 2.2** The provision of pure protection insurance is concentrated. In 2022, the top 5 firms accounted for 70 to 80% of the market in critical illness cover, term assurance and income protection, and around 90% in guaranteed acceptance over 50s plans³, by volume of new sales. Insurers may choose to distribute their pure protection products directly to customers or via third-party intermediaries, for example price comparison websites (PCWs) and independent financial advisers (IFAs). The main distribution channel for pure protection products is via intermediaries: in 2023, around 92% of income protection and 82% of critical illness premiums from new sales were generated through intermediaries.⁴
- 2.3** Distributing via intermediaries can be a cost-effective way for an insurer to reach customers. Moreover, an insurer's distribution strategy and remuneration arrangements (including commission) can help to align the interests of insurers and those distributing their products, while consumers can benefit from intermediaries' expertise and better access to the market.

2 Ibid.

3 Ibid.

4 FCA pure protection product sales data for year-end 2023

Chapter 3

Why are we doing this market study?

- 3.1** Pure protection products are designed to offer peace of mind, helping an individual and/or their dependants with existing financial commitments or lifestyle adaptations if the policyholder dies or becomes incapacitated, injured or infirm.
- 3.2** There are indications, however, that the pure protection market may not be functioning well and that competition may not be working effectively in the interests of consumers. We have concerns that:
- **The design of commission arrangements may not always support the delivery of fair value.** When commissions are designed well, they can be an effective tool for remunerating intermediaries for providing valuable services to consumers, such as information and advice. When commissions are not designed well, they may incentivize firms to push products that are not consistent with a consumer's needs or do not meet them as well as another product would do. We want to understand the impact that commission has on intermediaries' incentives, both for advised and non-advised sales. We have seen examples of intermediaries encouraging customers to switch unnecessarily (eg to a product that does not meet their needs as well or that provides poorer value) to earn repeat commission. We also want to understand the use of 'loaded premiums' – a mark-up to the standard premium paid by a consumer that enables additional commission to be paid to an intermediary. We will consider the extent of any impact that their use could have on intermediaries' incentives. Commission arrangements, such as loaded premiums, may also impact price and therefore fair value outcomes for consumers. We want to understand whether the distribution arrangements for pure protection products are consistent with the aim of providing fair value.
 - **Some pure protection products may not provide fair value to customers.** Guaranteed acceptance over 50s insurance can be beneficial to some consumers, for example, those with pre-existing medical conditions and those not wanting to undergo a medical assessment. However, some guaranteed acceptance over 50s life insurance products appear to have low average payouts in comparison to overall premiums paid and to other products. We have seen examples where the total premium paid over an average lifetime far exceeds the payout (typically at least 50% greater). And, while the total premium could be higher if the customer lives longer than average, the payout amount is fixed, widening the gap between premiums paid and payout amount. We are particularly concerned that this may not be consistent with providing fair value and in particular, this may be impacting customers in vulnerable circumstances.
 - **Competitive pressures in the market may be weakening due to the recent exit of several insurers providing pure protection products.** We would like to understand the impact of this, and whether this reduces consumer product choice and potentially weakens the incentives on the remaining insurers to meet consumers' needs. We want to understand the drivers for insurers exiting the market, and the extent of barriers to entry and expansion faced by potential entrants who may be able to strengthen competitive pressures in the market.

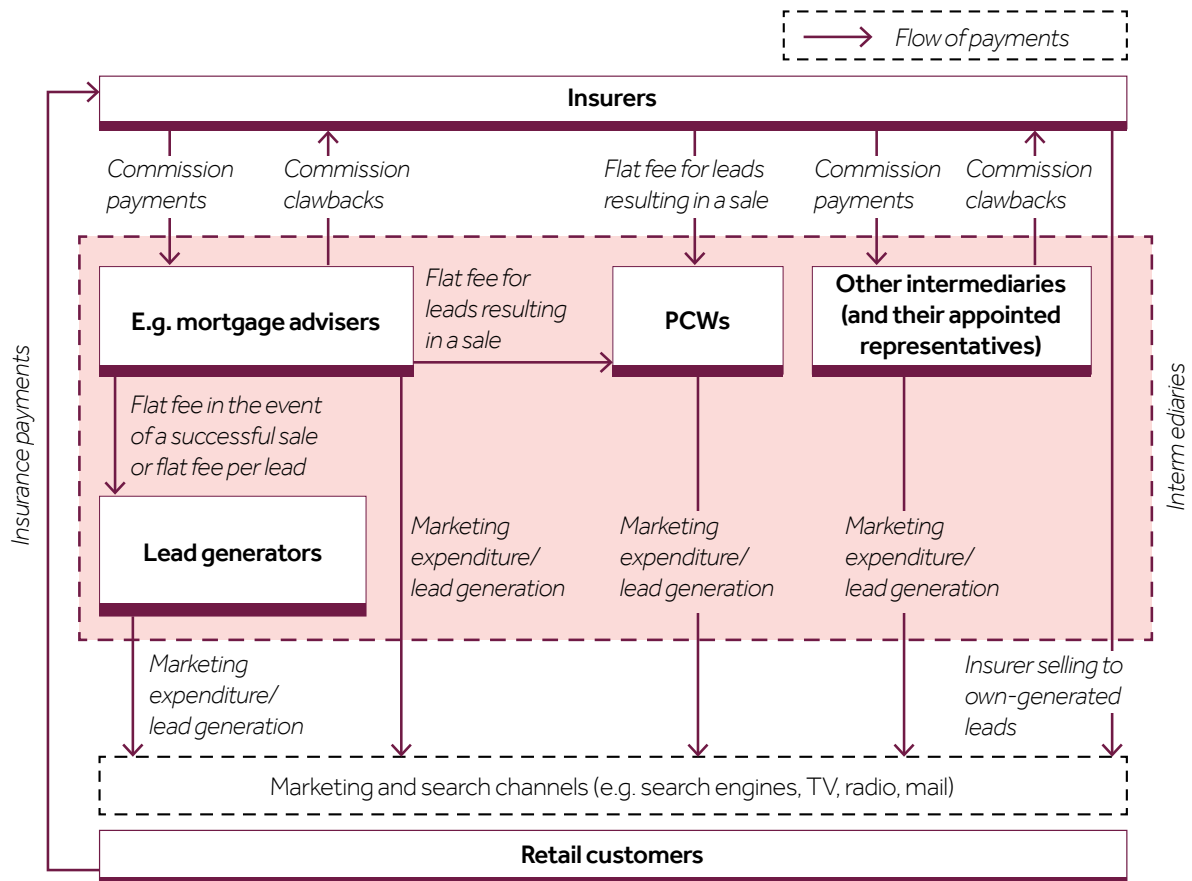
- 3.3** If the market is not functioning well and competition is not working effectively in the interests of consumers, the potential harm to policy holders and their dependants may be significant. We are aware that the impact of the recent exits of some insurers on concentration in the pure protection market increases the likelihood of competition issues and the urgency of understanding and addressing these.

Chapter 4

Intended scope of the market study

- 4.1** We intend to focus primarily on the distribution of the following pure protection products in the UK:
- Term assurance: a policy which pays a lump-sum to beneficiaries if the policyholder dies within a specified period.
 - Critical illness cover: a policy which pays a lump sum to the policyholder if they are diagnosed with a prescribed (non-fatal) serious illness or medical condition.
 - Income protection insurance: a policy which replaces part of a policyholder's regular income if they become unable to work because of illness, accident, or disability.
 - Whole of life insurance, including guaranteed acceptance over 50s life insurance plans: these policies provide cover for the policyholder's lifetime, paying out a lump sum to beneficiaries on the policyholder's death. Guaranteed acceptance is a type of whole of life insurance which doesn't require medical or health information for an individual to qualify for cover.
- 4.2** The market study will focus on policies purchased by individuals on their own behalf (ie we intend to exclude workplace group policies). Insurance products with a savings or investment element are also outside the scope of the market study.

Figure 1: Indicative view of distribution channels in the pure protection market



- 4.3** Figure 1 illustrates typical distribution channels for pure protection products. Insurers may choose to sell policies to retail customers directly or via intermediaries (for example mortgage advisers, IFAs, PCWs, or dedicated protection intermediaries). We understand that mortgage advisers, for example, typically agree commission levels with the insurer including provisions to return unearned commission to the insurer if the customer cancels their policy early (clawback). Whereas PCWs usually charge fees to the insurer for leads generated; they might also have commission agreements with other intermediary firms for lead generation. Insurers and intermediaries might also rely on third-party lead generators to market their products and/or search for potential customers while retaining responsibility for the sale.
- 4.4** In practice, there may be a range of approaches taken to the distribution of products by insurers and intermediaries. For example, intermediaries may perform roles traditionally undertaken by the insurer: an intermediary can be a co-manufacturer of the insurance product as well (ie design or co-design). They can also distribute products manufactured by an insurer which the intermediary then offers under their own brand (white labelling).
- 4.5** We will focus on certain activities undertaken by insurers and others in the distribution chain in the pure protection market. For insurers, this will comprise the design and distribution (both direct and intermediated sales) of products. This includes the prices of products, benefits consumers receive, and the commissions that insurers pay to intermediaries. We will also consider the impact (including unintended consequences) of mitigants in place to address conflicts of interest created by commission such as clawback arrangements. For intermediaries, this will comprise distribution of products, including where they influence product design, total price paid by the customer, and commission. We will also look at fees/adviser charging and in-house remuneration if it helps us to understand how the market operates, and to better design remedies, if they are required.
- 4.6** Insurers and intermediaries also carry out other activities. These are not directly in the proposed scope of the market study, but may be of interest if they materially impact the nature of competition in pure protection. For example, we may be interested in cross-selling of pure protection products as a secondary sale to a loan.
- 4.7** We intend to conduct this market study under our FSMA powers as the activities in the proposed scope of this market study fall within the FCA's perimeter.

Chapter 5

Issues we intend to explore

5.1 We will seek to understand how well competition is working in this market and the outcomes that consumers receive including price, quality, and alignment with their needs. We will analyse drivers of these outcomes using 4 broad themes. These themes will provide structure for our analysis and help us to understand the concerns set out above in the rationale for the market study. However, the themes and issues below should not be seen as a complete list of what we will consider as part of the market study. Ultimately, our analysis and conclusions will be driven by the evidence we find. We want to explore:

- **Consumer needs, engagement and understanding:** the benefits and the value of pure protection products to consumers, the nature and complexity of products and whether they are presented in a way that is understandable to consumers, how consumers make choices, the benefits and the value of services provided by intermediaries, how well consumers understand how intermediaries are remunerated, how engaged consumers are with pure protection products they have, and how cross-selling occurs.
- **Competitive constraints on insurers and intermediaries:** the importance of intermediaries as a route to market and the value of services they provide to insurers, the relative bargaining power between intermediaries and insurers, the nature of competition between insurers for distribution channels, the broader macroeconomic environment and its impact on how insurers and intermediaries compete, and the nature of competition between insurers and between intermediaries.
- **Commission incentives and potential conflicts of interest:** the size and structure of commissions in the pure protection market, the incentives that commissions create, and the effectiveness of FCA rules and features of commissions schemes (such as clawback) in mitigating incentives and conflicts of interest.
- **Firms' behaviour and practices:** how firms' incentives impact their conduct in relation to products, the market and their treatment of consumers.

Chapter 6

Next steps

Potential outcomes of the market study

- 6.1** We are starting the market study with an open mind as to whether we will find evidence of harm. However, if we find that the market is not working well, we may intervene to address any harms to consumers. The Remedies section of [Our Approach to Competition](#) sets out a range of ways in which we can do this, for example, supervisory or enforcement action under our existing rules (including the Consumer Duty), rule changes, publishing general guidance, proposing better self-regulation for the industry or introducing firm-specific remedies. These actions can help to strengthen competition and protect consumers. We can also make a reference to the Competition and Markets Authority (CMA) for further investigation – this is known as a market investigation reference.
- 6.2** Previous investigations into intermediated markets resulted in a range of outcomes. In some markets, such as non-advised sales of funeral plans, we found significant harm and banned commission arrangements. But where we have not identified any material harm that regulatory intervention can proportionately address (such as in wholesale insurance broking) we have not taken any action.

Related work

- 6.3** We will continue to engage with our wider work in the pure protection market as it develops, such as the Product Oversight and Governance thematic review and ongoing work on the Price and Value outcome.

Next steps

- 6.4** We will engage with firms, industry groups and stakeholders to gather their views on these Terms of Reference and to begin discussions over what data we may need. We expect to start these discussions shortly.
- 6.5** Although we are not formally consulting on these Terms of Reference, we welcome any views on them, in particular:

Question 1: Scope. For the products and activities listed in the 'Intended scope of the market study' section, are there any areas we should focus on? Are there any other products or activities we should consider within our scope? If so, why?

Question 2: Issues. For the issues listed in the 'Issues we intend to explore' section, are there any areas we should focus on? Are there any other issues or themes we should consider to understand whether competition in pure protection is working in the interests of consumers? If so, why?

6.6 Please provide any views in writing to PureProtectionMS@fca.org.uk by Friday 11 October 2024. We will update the Terms of Reference when we launch the market study if there are any changes.

Glossary of terms used in this document

Term	Description
The Consumer Duty	Where we refer to fair value requirements under the Consumer Duty in this document, we are referring to our Consumer Duty rules and/or the PROD 4 rules as relevant.

Abbreviations used in this document

Abbreviation	Description
bn	Billion
CMA	Competition and Markets Authority
Duty	The Consumer Duty (including the PROD rules where applicable)
FSMA	Financial Services and Markets Act 2000
IFA	Independent financial adviser
PCW	Price comparison website
PROD 4	Chapter 4 of the FCA's Product Intervention and Product Governance Sourcebook
UK	United Kingdom

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