Grant Thornton

Consumer Duty - Fair Value Assessments

How to meet the FCA's expectations

2024

Background

Now that the FCA's Consumer Duty rules are in force (for open products), the financial services industry has moved from a world where it was arguably enough to demonstrate fair treatment and the avoidance of poor customer outcomes, to a world in which detailed rules require firms to proactively demonstrate good customer outcomes.

This is a significant shift in regulatory expectations, requiring firms to do much more than enhance their policies and management information (MI) dashboards if they are to truly embed the behaviours and culture sought by the regulator.

The rules on Fair Value Assessments (FVAs) are some of the most challenging for firms to interpret and apply. While general insurers and some asset management firms already had rules on value (in the PROD and COLL sourcebooks), for most of the industry, specific and relatively prescriptive rules in this area were new. Moreover, while relatively prescriptive, the rules apply to all firms and all products and services available to retail customers, and so are subject to interpretation. Some firms have struggled with this, and the related questions of: how much is too little and how much is too far?

It's surprising that the FCA has focused on value and price assessments, including intermediary remuneration, both before and after the rules coming into force in July 2023. The regulator's review of FVAs, published in May 2023, raised questions over the effectiveness of some firms' value frameworks and their capacity to meet the price and value outcome rules. Several insurance market focused events have reinforced those concerns – in theory, this sector should be leading the way, as it has already been subject to specific fair value requirements. The lending sector is also under scrutiny, with the regulator starting supervisory action over intermediaries' remuneration.

Since the rules came into force in July 2023, the FCA has reviewed numerous individual firms' FVAs, to understand how firms and sectors have interpreted and applied the new rules. While it is pleased that some firms have overhauled their pricing models, the regulator has expressed some disappointment that some firms' approaches are insufficiently detailed and do not fully capture its intentions. It is arguable that general insurance firms have less scope to fend off regulatory criticism, given similar PROD rules to which they are already subject. FVAs for closed products may involve some uncomfortable and deep questions around the viability of some products.

The FCA has also expressed disappointment that it has not seen as much activity to amend product features or pricing, to remove products, or to move customers away from poor value products, as it had anticipated. The industry can expect very close scrutiny of FVAs over the next year at least, including on the FVA approaches for closed book products and the actions firms take as a result.

We set out in the following pages our observations and practical guidance on what firms should be doing now to ensure they meet the new standards.

It is critical that firms invest the time and resources to get this right. This is clearly a key focus area for the FCA, as seen by the Consumer Duty being heavily referenced within the FCA's 'Commitment 2: Putting consumers' needs first' within the 2024-2025 Business Plan.

A reminder of the FVA requirements

The FCA's rules, are different - albeit designed to be complementary - for manufacturers and distributors of products and services, in the PRIN 2A.4 rules. The key rules are, in summary:

What is value?

- Value is the relationship between the amount paid by a retail customer for the product and the benefits they can reasonably expect to get from the product
- A product provides fair value where the amount paid for the product is reasonable relative to the benefits of the product

Manufacturers must

- Ensure that its products provide fair value to retail customers in the target markets for those products
- Carry out a value assessment of its products and review that assessment on a regular basis appropriate to the nature and duration of the product

Distributors

- Must not distribute a product unless its distribution arrangements are consistent with the product providing fair value to retail customers
- Arrangements will be consistent with providing fair value to retail customers where they enable the distributor to obtain enough information from the manufacturer to understand the outcome of the value assessment

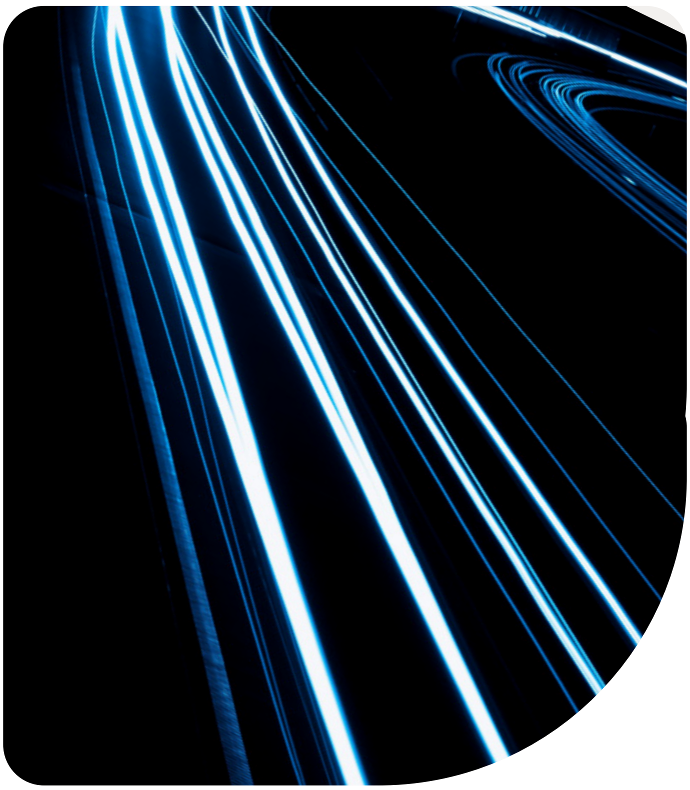
The FVA must include (but is not limited to) the following considerations:

- the product nature, including benefits and any limitations
- the expected total price to be paid or due including:
    - pricing structures (e.g. different price for different customers, features or service types)
    - repayment plans
    - all charges and fees payable over the lifetime of the product (e.g. annual management charges)
    - any contingency fees or charges (e.g. administrative, payment fees)
    - any non-financial costs (e.g. permissions and use of personal data)
- Any characteristics of vulnerability retail customers display including impact and likelihood of customers not receiving fair value.

The FVA may also consider:

- the costs incurred by the firm in manufacturing and / or distributing the product or service, and the revenue / profit they derive in return
- market rate and charges for a comparable products
- any accrued costs and / or benefits for existing or closed products and services
- whether there are any products are priced significantly lower for a similar or better benefit.

Firms must not rely on individual retail customers to determine whether a product or service provides fair value in place of the firm's own assessment.



Designing and conducting FVAs

Given the FCA's scrutiny of firms' approaches to FVAs, and what they do with the outputs, it is vital to be able to show that the assessment is a genuine and robust piece of analysis, and that firms take meaningful action to address any actual or potential instances of products and services not meeting an appropriate threshold of fair value.

Understanding and defining 'value' – just as a firm cannot measure a 'good outcome' without having first understood and articulating what this means, so too must firms arrive at an articulation or a threshold of 'fair value' from the product or service in question. This articulation must be measurable and product / service-specific, using a variety of inputs and MI data points, which are likely to include both quantitative and qualitative information. The FCA expects firms to understand, quantify and then be able to justify the relationship between the price the customer pays for a product or service and the benefits they derive in return.

Itemising costs and benefits – it is important, related to an articulation of 'fair value,' to itemise all the costs that customers will or could pay, at every stage of the product / service lifecycle, and all the benefits that they will or could receive in return. These benefits can and should be both financial (and therefore perhaps more readily quantifiable) and non-financial.

For example, firms could produce summary matrices that look like this:

	Monetary	**Non-monetary**
Costs to the customer	• Direct price paid by the customer • Exit fees • Contingent fees • Wider surcharge	• Time spent onboarding • Time spent to reach support • Proportion of customers reaching support of sufficient quality and within internally set time limits • Use of personal data
Benefits received by the customer	• Product / service performance, including extent to which 'good outcomes' as defined by the firm, are achieved, with reference to threshold, tests or parameters • Replacement costs • Peace of mind	• Access to other products and services • Availability of support and product / service use through multiple channels, including customers choice • Identification and support for vulnerability • Quality of service and communications

Possible means to measure value – the FCA has made it clear that the four Consumer Duty outcomes (including regarding price and value) are mutually reinforcing, so it is perfectly legitimate for firms to include, when itemising and measuring benefits from the product or service, evidence of good customer outcomes and experiences in respect of the product / service reviews, customer understanding and customer support.

Indeed, firms may look to positive outcomes in these areas as differentiators of value compared to alternative products and services available in the market.

Apply quantitative and qualitative metrics and benchmarks, including thresholds or other means to measure, assess and ultimately determine value – the PRIN 2A.4 rules do not prescribe the thresholds, quantitative and qualitative metrics, data points or any other inputs that firms should use when determining value. The FCA believes – rightly, in our view – that doing so would be overly burdensome and counterproductive, given the enormous scale and variety of the financial services industry, and both the FCA's and the industry's desire for it to be innovative and agile. This is positive in providing scope for subjectivity, but negative in that firms do not have a 'safe harbour.'

Some example quantitative and qualitative metrics that firms can consider using including thresholds and benchmarks, are shown in the tables below.

Quantitative metrics

Management and performance

- Actual vs. expected performance – e.g. investment or claims performance, after impact of charges, within parameters deemed to constitute fairness (tailored to product types, and / or over different rolling periods)
- Benchmarking performance against similar or equivalent products / services, e.g. investment returns / claims ratio
- Benchmarking features and benefits against those for similar or equivalent products / services
- Comparisons over different time periods with competitors' similar products / services
- Identify points triggering investigation or action, e.g. benchmarks to a proxy product (artificial or actual) + x%
- Measure extent to which individual product features perform as expected, in return for the price paid
- Identification of customers outside the target market criteria

Costs and charges

- Identify all costs and charges levied, including by intermediaries, or devise proxy estimates for these costs, as part of an overall fairness assessment – e.g. some form of "reduction in yield" calculation
- Benchmarking costs and charges against those for similar or equivalent products / services
- Tracking actual charges levied for each component against expected / advertised rates
- 'Cost to fulfil' – quantify difference between costs and revenues that constitutes fairness, e.g. profit margin
- Measure extent to which cost allocation or dispersion is carried out in line with a method deemed fair
- Clarity and timeliness of costs and charges disclosure, at point of sale and during policy lifetime
- Value-based pricing – i.e. identify the 'nearest alternative,' explain / justify any price gap
- Reasonableness of contingent charges e.g. change of address, switching costs and any exit charges

Qualitative metrics

Customer experience

- Customer feedback on ease of the experience, quality of interactions and firm doing what it said it will
- Customer surveys, trial promotions, focus groups
- Net Promoter Scores and staff survey results
- Complaints data
- Persistency data
- Social media analysis
- Customer and intermediary survey responses, focus groups, mystery shopping
- Quality of communications, including operations measures
- Availability and customer awareness of a better value alternative
- Ease of transfer / dis-investment / off-boarding
- Number and proportion of dormant / orphan clients
- Reasonableness of non-financial costs

Product governance reviews

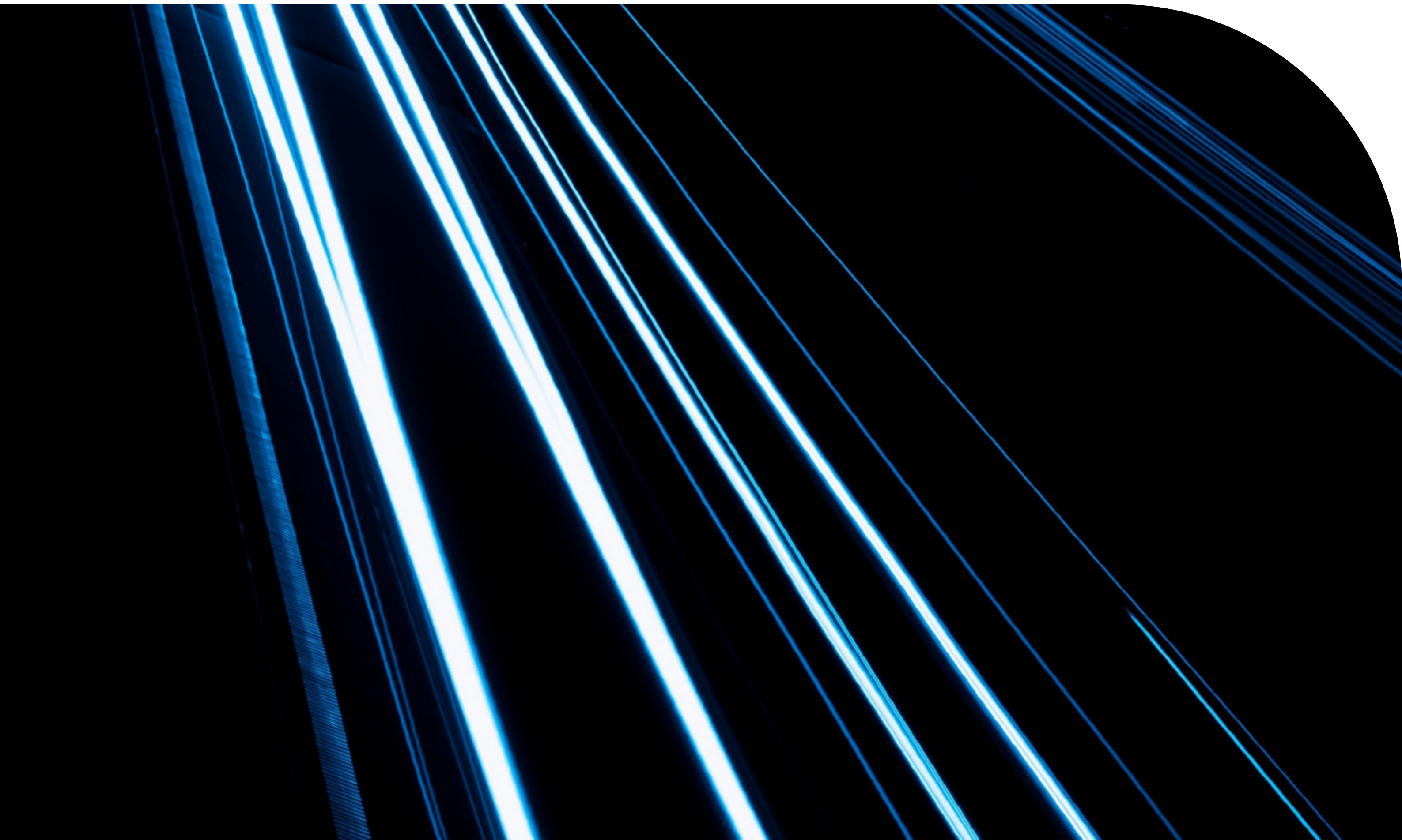
- Product risk rating
- Outcome testing – is the product behaving as the customer expects?
- Extent to which product reaches / remains within its target market
- Extent of customer understanding, from testing and measures
- Extent that customers receive support contributing to good outcomes
- Availability and ease of access to customers with characteristics of vulnerability
- Value across the distribution chain and distributor inputs and feedback
- Terms and conditions in comparable products / services dating from same time period
- Number and proportion of products meeting success criteria (financial and non-financial)

Indicators of poor value – we have already noted that there are no ‘hard and fast’ rules on how to define and measure value to meet the PRIN 2A.4 rules. However, there are some indicators that (in the FCA’s view) are likely to suggest poor value:

- Low claims frequencies / acceptance
- High complaint volumes - relating to utility and price
- Non-alignment of product or service with appropriate target market
- Excessive profitability of a product or service
- Exit fees and barriers and other ‘sludge practices’
- High fees and charges compared to similar products without rationale
- Overly restrictive terms
- Over-emphasis on peace of mind
- Consistent underperformance vs. threshold or parameters of fairness

Methodology and governance arrangements – as the PRIN 2A rules have been in place since July 2023, firms (with open products) should already have designed and tested their FVA approaches and considered the outputs. The FCA expects a culture, facilitated by operational practice, of continuous improvement. Firms should therefore not only have approaches and procedures to perform and consider FVAs, but also monitoring and governance arrangements to assess the robustness of the approaches and procedures themselves. Similarly, the FCA is likely to expect interactions and cross-referrals between FVAs and wider product governance and review arrangements, with the two informing the approach and outputs of each other, including in respect of the forums with oversight responsibilities.

Considering appropriate action following FVAs – the FCA does not want to see firms using FVAs to simply justify existing charging structures or pricing. For example, the regulator has been critical of the financial advice and wealth management sectors on this. The FCA wants the assessments to be meaningful, and for firms to take robust action regarding any actual or potential instances of poor value. This action must also be meaningful and demonstrably address harm, e.g. amendments to pricing (structures and / or amounts), features and benefits; the discontinuation of a product / service altogether, or making arrangements or offers to customers to move to a similar but better value proposition.



How we can help

We have over 50 regulatory conduct specialists who have been immersed in Consumer Duty since it was first proposed by the FCA, and who have already provided extensive support to a wide range of clients across the financial services industry with their Consumer Duty compliance.

One of our distinguishing features is that we can select and deliver the right people to provide you with intelligent and agile solutions for your rapidly evolving business environment. Our resource model ensures that our team of regulatory conduct and Consumer Duty specialists is supplemented by our wider pool of subject matter experts from across our Financial Services Group, which consists of over 650 staff.

Our experts are skilled professionals who bring maturity, pragmatism and deep insight, with a common, overriding objective to add value for the clients they work with. Embedded in our team is economic expertise from colleagues who have worked for and with the FCA.

Our clients range from small, newly authorised firms to FTSE 100 institutions, and we tailor each assignment to the specific clients' needs.

Our work has covered all aspects of firms' preparations, including impact and gap analyses, project plan reviews, assurance and internal audit, technical and regulatory advice, readiness assessments, benchmarking, governance and culture reviews, MI design, board training, programme management and resource augmentation. We offer deep insights into responding to the Consumer Duty challenge in a positive and pragmatic way.

We can help ensure that you are in the best possible position to demonstrate that you are taking Consumer Duty seriously and meeting the FCA's expectations. We can provide practical advice, support and resources to ensure you meet the price and value rules in a way that combines compliance with commercial and operational pragmatism.

We can design, deliver, support or provide opinion or assurance on:

- FVA principles, assumptions, policies, procedures and guidance
- Designing and producing FVAs, including appropriate metrics, data points, benchmarks and value determinants and thresholds
- Assigning meaningful measures and weightings to both quantitative and qualitative metrics, for both financial and non-financial benefits
- Identifying, clarifying and catering for complex and opaque product features and charging structures – including, for example, with profits issues such as cross-subsidies
- Articulating and applying the relationship between 'good outcome' and 'fair value' for the purposes of FVAs
- Identifying, prioritising and planning for products / services representing the biggest risks of poor value, poor outcomes or harm
- Co-ordinating the production, output and consideration of FVAs with product governance arrangements and Consumer Duty MI, aligned within the overall risk management framework
- Advice on effective, proportionate FVAs – striking the balance between too little and too much, including peer comparisons
- Identifying, planning and implementing remediation in instances of poor value.

Please contact us to discuss your specific requirements. We are here to help.

Key contacts

Supriya Manchanda
Partner
T +44 (0)20 7728 3089
E supriya.manchanda@uk.gt.com

Schellion Horn
Partner
T +44 (0)20 7865 2288
E schellion.j.horn@uk.gt.com

Peter Lovegrove
Director
T +44 (0)20 7865 2767
E peter.w.lovegrove@uk.gt.com