

Rules applicable to firms who are within the scope of the Insurance Distribution Directive (IDD) Financial Conduct Authority (FCA) RPC rating: **validated**

The impact assessment (IA) is now fit for purpose as a result of the regulator's response to the RPC's initial review. As first submitted, the IA was not fit for purpose.

Description of proposal

The proposal introduces the Insurance Distribution Directive (IDD) minimum standards, alongside several extensions, into the Financial Conduct Authority (FCA) Handbook. The extension includes further protections when purchasing General Insurance (GI) and life insurance and also ensures that the requirements firms must adhere to are appropriate across the industry, after applying IDD minimum standards to a wider range of firms and aligning standards within the Markets in Financial Instruments Directive II (MiFID II). The FCA has (appropriately) only appraised where the areas of the directive have gone beyond the IDD minimum, since HM Treasury (HMT) will appraise the IDD minimum requirements separately.

The regulator has gone beyond the minimum requirement in 8 areas, including: conflicts of interest; good repute record keeping; product oversight and governance (POG); information disclosure to customers; inducements; employee competence and training; knowledge and competence record keeping and pre-contract disclosures. In addition, in three areas (employee competence and training; knowledge and competence record keeping; and pre-contract disclosures) the regulator has extended the scope of the regulations to include Ancillary Insurance Intermediaries (AIs) whose primary business is outside the scope of insurance distribution.

The general intent of the FCA's additional regulation aligns insurance-based investment products (IBIPs) proposal with products regulated by MiFID II, because IBIPs are often substitutable for MiFID II investment products, and creating consistent standards enables firms to expand and diversify their products more easily. The FCA understands that there are scenarios whereby the MiFID II suitability and appropriateness tests may deliver better consumer outcomes. Therefore, the FCA's main intention is to retain these and include the additional IDD wording in the

FCA regulations. In most cases the two requirements should lead to similar outcomes, so there is not expected to be any significant change. Adding the extra requirements will also help lead to ongoing and consistent consumer protection benefits across different distribution channels; reduce the risk to firms that staff are not of good repute; and reduce the risk of insurance mis-selling. Overall, the extensions are expected to increase competition in the market whilst benefiting consumer trust and protections.

Impacts of proposal

The extension of the IDD proposals will affect insurers; GI intermediaries and non-GI intermediaries; life providers and AILs. The FCA expects total benefits to firms of £6.4 million per annum, as an expected result of a reduction in insurance complaints driven by the extension of the IDD. The main costs of the changes would be compliance for product oversight and governance, £9.3 million one-off costs and £5.5 million for ongoing costs. These costs relate to the systems and controls firms must have in place for the design, approval, marketing and ongoing management of products throughout their lifecycle. The 8 areas where the minimum requirements of the IDD will be surpassed and extended, carry the rest of the costs.

For instance, the IDD has a set of provisions designed to help prevent conflicts of interests leading to consumer harm in the distribution of IBIPs. Therefore, the conflicts of interest rule extension creates estimated industry costs of £2.1 million for one-off costs and £2.2 million for ongoing costs. Furthermore, the costs to firms of the additional record keeping requirements would have one-off costs of £3.4 million and £1.1 million for ongoing costs. There are also familiarisation costs of £4.5 million. In addition, the extension to IDD requires in-scope AILs to comply with the same requirements as insurance intermediaries. Therefore, the remainder of the main costs fall under competence and training, which amounts to one-off costs of £0.8 million and £5.0 million for ongoing costs.

Impacts on small and micro firms are not expected to be proportionately different from larger firms. This view is based on the response from small firms in the compliance cost survey where the FCA estimated that costs to small firms (defined as firms having insurance income below £1 million) would be between £250 to £500 per area for one-off costs and minimal for micro firms (defined as firms with insurance income below £150,000).

Quality of submission

The IA provides a clear rationale for intervention and a clear breakdown of all the costs for the 8 areas which extend the IDD. The FCA has clearly explained the minimum requirements of the directive and set out the additional requirements of the extensions it has imposed. For example, the IDD requires that insurance and reinsurance undertakings establish, maintain and keep records to demonstrate compliance with good repute requirements, whereas the FCA has extended the IDD requirements to apply to all firms carrying on insurance intermediation business. The IA has provided clarity on what firms are required to do on top of the IDD minimum and how the costs quantified in the IA relate to these actions.

The FCA has proportionately discussed the burden on small and micro businesses and explained that it does not expect the proposals to have a disproportionate impact on them compared to larger firms. The consultation has identified minor costs relating to changes to documentation and processes because firms are already required to comply with current Conduct of Business Sourcebook disclosure rules, and the FCA has explain why these costs are not anticipated or are not proportionate to calculate.

The FCA has calculated logically and with a clear methodology where all the costs lie, with regards to the extension of the IDD. It has taken into consideration where the IDD standards (including the extensions) and MiFID II standards will be aligned and appraised accordingly. Furthermore, it has used proportionate estimation for costs where the FCA has collected a range of estimations from consultation to ensure that they appropriately reflect the numbers and types of firms affected.

Overall, the FCA has provided a clear and detailed assessment of the impacts of the proposal. The overall net present value (NPV), business NPV and equivalent annual net direct cost to business (EANDCB) figures are all proportionately evidenced and calculated correctly, with appropriate evidence presented from the regulator's statutory cost benefit analysis and consultation papers.

Issues addressed following the RPC's initial review

As initially submitted for RPC scrutiny, the EANDCB could not be validated as there were apparent discrepancies in the approaches to calculating different costs, and therefore the calculations and origins of costs could not be verified. In particular, there were discrepancies between the costs presented in the IA and in the BIT calculator submitted alongside it. Following the RPC's initial review, the FCA has:

- helpfully clarified its methodology and updated its BIT calculator to reflect this. The costs presented in the two documents are now consistent; they are also clearly and logically set out and can be validated;
- updated its narrative in all 8 of the cost sections to distinguish clearly between one-off and on-going costs;
- confirmed that the £0.1 million of costs which originally could not be verified related to life providers, whereas as the wider industry costs included costs for GI insurers and GI intermediaries. In total, the FCA estimated industry costs at £2.1 million for one-off costs and £2.2 million for ongoing costs. The FCA has updated the narrative in the conflicts of interest section to make this clearer;
- confirmed how the costs for good repute record keeping were split up, which now confirms the narrative in the IA and cost benefit analysis (CBA);
- explained clearly how its objectives would be reached and implemented in practice;
- confirmed that the costs of making individual calls to inform customers about the nature and basis of remuneration to comply with the IDD standards arise as a result of the minimum standards imposed by the IDD. These costs are not included in this IA as the minimum requirements of the IDD will be appraised separately by HMT;
- presented all impacts clearly and systematically in the IA and summary tables;
- helpfully included clear references to its consultation papers and CBA, which provide appropriate supporting evidence for its assumptions;
- in respect of the product oversight and governance provisions, the cost estimates from insurers for the additional product oversight governance ranged from between £30,000 and £345,000. The FCA has clarified that it has calculated the one-off cost to insurers based on the average cost of £89,917 per affected firm, which can be seen in the Annex of the IA. This assumption reflects the smaller size of the firms in the wider insurer population compared to the insurers who responded to compliance cost survey;
- explained that it would be disproportionate to quantify the opportunity costs to firms for the increased time that will be taken to make sure that they adhere to new standards. The RPC accepts this argument;
- discussed the impacts on small and micro businesses proportionately; and
- stated that it will undertake a review of the IDD once its handbook has been adjusted to reflect the UK's exit from the EU.

Departmental assessment

Classification	Qualifying regulatory provision
Equivalent annual net direct cost to business (EANDCB)	£9.4 million
Business impact target score	£46.9 million
Business net present value	-£80.7 million (price base year 2018)
Overall net present value	-£80.7 million (price base year 2018)

RPC assessment

Classification	Qualifying regulatory provision
RPC rating (of initial submission)	Not Validated
RPC rating (of final submission)	Validated

Regulatory Policy Committee