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AFM Response to Consultation Paper TR16/2, *Fair treatment of longstanding customers in the life insurance sector*

1. I am writing in response to this consultation paper, on behalf of the Association of Financial Mutuals. The objectives we seek from our response are to:

   - Comment on the approach taken in the consultation;
   - Provide observations relating to the mutual sector.

2. 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 £16.4 billion, and employ nearly 30,000 staff[1].

3. 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 take account of corporate diversity in discharging their regulatory principles[2], and to analyse

[1] ICMIF, http://www.icmif.org/global-mutual-market-share-2013
[2] http://www.legislation.gov.uk/ukpga/2016/14/section/20/enacted

whether new rules impose any significantly different consequences for mutual businesses[3].

4. AFM is pleased to respond to this consultation on behalf of its members. This is an important review, and as FCA will know from the media response to the original launch that the approach needs careful and sympathetic handling. The measured approach taken by FCA to issuing the review paper is therefore appreciated: though that does not mean we underestimate the very significant potential consequences for the life industry in the approach set out within the paper.

5. We are pleased that FCA intends to convene an 'industry-wide discussion' on improving customer outcomes. To ensure the mutual sector, and in particular our smaller members are properly represented in those discussions, we feel strongly that there needs to be continued engagement with trade bodies. For example, the suggestion that FCA is seeking to promote a 'voluntary solution to capping or removing exit and/ or paid up charges' requires both a full understanding of the range of products that this might involve, as well as some form of industry standards to facilitate effective buy-in and co-ordination. Most of our members are not a member of another trade body, and rely on AFM to represent their interests with regulators.

6. Mutual insurers have grown up over more than 100 years, to serve large parts of the UK population; as a result, many of our members have a significant book of aged policies. By nature of their mutuality, many such products attract membership rights, so a key challenge for those organisations is to deliver fair outcomes to longstanding policyholders: as customers; as owners; and as a significant proportion of their overall customer base.

7. Very often this means striving to satisfy the competing interests of different stakeholders in the business. For example, in a book of industrial branch business, the relative cost of dealing with gone aways may be greater than the value of the policy, so the cost of identifying a potential beneficiary may fall onto other policyholders in a disproportionate manner.

8. Establishing de minimus arrangements will ensure there is a broadly fair approach: FCA indicates that the average value of policy included in the review was £18,000 for endowments and £23,000 for personal pensions, and that the findings are based exclusively on the sample reviewed. Mutuals, by nature of their history and market focus have a greater focus on lower value products. In addition, their organizational

[3] Financial Services Act 2012, section 138 K: http://www.legislation.gov.uk/ukpga/2012/21/section/24/enacted

size may preclude them from undertaking the form of product review proposed, covering target market alignment, and customer research etc (as per paragraph 3.40), without the risk that costs have to be passed onto all customers: as is generally the case in mutuals. However, with new modelling required by Solvency 2, more of this kind of data may become available over time: and we encourage FCA to share more good practice in future years.

9. As FCA states in paragraph 1.16, the findings from this review are likely to be relevant to other sectors selling retail investment products. That is inevitable, as is the possibility that the guidance is extended to lower value products, and to products that remain open to new sales. We would have anticipated FCA would have made the boundaries to the guidance clearer in the paper, and to be more specific about the wider consequences.

10. We are concerned by the potentially retrospective nature of some of the proposals: in a general sense, the terms and conditions of a policy represented the best assessment of fairness in the context of the time at which the policy was written. Terms and conditions are designed to protect the consumer and the intermediary, as well as the insurer, so any assessment today of the merits of the original terms, and any proposals to disregard them, need to take account of the possible risks or detriment to policyholders. We would appreciate further elaboration from FCA, including examples of occasions where they had seen a firm make a substantive change to a policy, beyond the expectations set within the terms and conditions, and how that firm satisfied itself that the actions being taken were fair and legal, and properly costed against future income streams.

11. The paper considers that where investment performance is much lower than expected, this may in part be explained by charges. This may be the case where the firm has set in place rapidly escalating charges in anticipation of high investment performance, as set out in Example 1 on page 27. The inference more broadly though appears to be that the provider should adjust charges downwards when the investment climate is poor: but for a mutual this would only likely to be achievable via cross-subsidy of costs from other products, which would inevitably fail a test of fairness.

12. The paper considers how firms should compare with-profits performance against comparative products: in paragraph 3.190 FCA highlights benchmarking against deposit-based savings is unlikely to be appropriate. We tend to agree: for many years AFM has tracked the performance of with-profits payouts from mutuals, compared to PLC insurers and balanced managed funds. It has always been the

case the mutuals significantly outperform PLC insurers and other comparable products[4]. However, the range of performances can be significant, and closed books in particular often have regulatory restrictions on the types of investment they can make, so this benchmarking is not always useful.

13. FCA highlights in paragraph 1.11 the risks relating to products that fail to meet customer needs, and those where performance is significantly different from the product's design, or from what was communicated to the distributor or customer at the point of sale. The helpful set of possible remedies we have derived from the paper include:

    a. an effective culture in the firm, supported by effective governance arrangements for closed books, a focused strategy and relevant management information on expected customer outcomes;
    b. clear communication to longstanding customers on a regular basis, particularly at key events, or to highlight a potential shortfall or a failure to meet the initial need (such as a targeted lump sum on maturity), and taking steps to re-initiate contact with customers who have lost contact;
    c. regular and meaningful reviews of products to ensure they achieve fair outcomes;
    d. ensuring the right incentives and risk management of staff, particularly for employees of outsourced call centres, to help achieve fair outcomes; and
    e. management action where the terms and conditions might have too limited a focus to consider a wide range of customer outcomes: for example, where performance is poor due to badly explained charges, or where customers incur unreasonable charges when trying to move from a product that no longer meets their needs.

    FCA sets out a longer set of outcomes in the paper, and repeats these as questions (copied at the end of this response). We consider that these represent a helpful framework from which firms can undertake a gap analysis of their current approach, and have encouraged our members to explore these areas.

14. It is helpful to see the analysis of provider communications included within the paper: it is perhaps surprising that where all of the firms that took part in the review issues annual statements, some customers were omitted from this exercise, whilst for many the quality of information provided was poor or incomplete. We have offered FCA

[4] see for example: http://www.financialmutuals.org/resources/mutually-yours-newsletter/mutuals-with-profits-performance-review-2015

support in benchmarking this data more generally, and whilst this is not required at present, we will consider whether and how we can meaningfully undertake this form of exercise across our members.

15. FCA has issued guidance as part of the review paper, and whilst guidance is by its nature intended to be indicative or voluntary in nature, the assertion, as per paragraph 1.31- that firms that do not follow the guidance will be assessed according to the regulatory principles- appears to set a higher benchmark. In our view, the announcement that six of eleven firms in the review had been referred to FCA enforcement appears to reinforce the sense that FCA should consider consulting on whether it is appropriate to either write the guidance more formerly into the rulebooks, or to stipulate more clearly what discretion firms have to deviate from the guidance.

16. On a general point, the paper has not considered whether the proposals have any significantly different effect on mutuals, as required under section 138K of the Financial Services Act 2012 (see above). Whilst we appreciate the paper does not contain any specific rule changes, the cost benefit analysis does assume new costs will be incurred by insurers, and in such cases we would expect s138K to apply.

17. We have not responded to the specific ‘questions’ in the paper, as these take the form of a statement of outcomes, that individual firms will more easily be able to address: we have though considered the outcomes in the comments above. We would be pleased to discuss further any of the issues raised by our response.

Yours sincerely,

Chief Executive
Association of Financial Mutuals

Specific questions/ outcomes set out in the paper

Q1: The firm's overarching strategy, including any outsourcing arrangements, takes proper account of the fair treatment of customers?

Q2: The firm checks, through periodic product reviews that closed-book products remain fit for purpose and continue to provide the benefits they were originally designed to?

Q3: The firm has adequate governance arrangements for its closed-book business?

Q4: The firm's remuneration, reward and performance management arrangements are consistent with the fair treatment of customers?

Q5: Regular communications to customers provide them with sufficient information to make informed decisions?

Q6: Communications to customers at the time of key policy events are clear, accurate and enable them to make informed decisions?

Q7: Communications with customers make them aware of guarantees or options (whether time critical or not)?

Q8: The firm takes effective action to locate and make contact with 'gone away' customers?

Q9: The firm takes steps to deal with poor performance with closed and actively marketed products given equal attention?

Q10: Overall expenses are allocated fairly to closed-book products?

Q11: The firm regularly reviews the overall fairness of cost allocations and actual customer outcomes and applies a consistent basis for these reviews?

Q12: The firm proactively monitors the actual experience of its closed-books of business and consistently passes on benefits and costs to customers, to the extent permitted by policy conditions?

Q13: Exit and paid-up costs are not excessive and are not driving poor customer outcomes?

Q14: Target ranges for with-profits pay-outs appear reasonable and firms meet these target ranges without the variation of pay-outs being too wide?