Consumer Investments and Promotions Policy
Financial Conduct Authority
12 Endeavour Square
London E20 1JN

29 September 2021

AFM Response to FCA consultation CP21/23, PRIIPs- proposed scope rules and amendments to RTS

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 proposals in the consultation, and
- explore the consequences for mutual insurers.

About AFM and its members

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 £19.6 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 analyse whether new rules impose any significantly different consequences for mutual businesses[2] and to take account of corporate diversity[3].

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

AFM comments on the proposals

4. The shortcomings of the current PRIIPs arrangements are well-understood, both in the EU and the UK, so we are pleased to see FCA consult on changes to the rules relating to PRIIPs. AFM, and others, have highlighted to FCA some of the shortcomings in the past, and in particular the difficulty consumers have in understanding some of the information generated, where the current rules create ambiguity and confusion.

5. To illustrate, we wrote to FCA in July 2020 about the ambiguity of KID illustrations; a copy of our note is attached. The response focused on the need for firms to revise projections where necessary, and promised the opportunity for further engagement. And whilst we were not invited to engage further prior to this publication, we are pleased that the consultation addresses some of the key issues we raised.

6. With regard to the specific proposals in the consultation, as AFM members do not issue corporate bonds, we have not commented on the proposals in Chapter 2. However, we note the reference to 'Holloway sickness policies' in paragraph 2.5, and reinforce the point we have made to FCA previously, that as a Holloway contract is overwhelmingly protection based, the surplus funds paid to the policy offer a valuable incremental benefit to consumers. Though as this is in addition to the primary aim of protection, submitting the product to an investment style disclosure creates confusion, and a risk that consumers do not act in their own best interests.

7. We agree that the current structure of performance information has failed. We note that the proposals to simplify the performance information and rely on a narrative description may prove to be a stop-gap solution. We are pleased to see FCA is undertaking consumer testing to help assess the impact of the proposed changes, and we consider it would be helpful if, as a result, FCA was able to specify the minimum set of factors that should be included in the narrative.

8. We consider though that in many cases, an unambiguous presentation of performance information is helpful to consumers, in deciding on the appropriate course of action. Its absence will reduce the relevance of the KID.

9. We consider that for with-profits products, where the design includes smoothing, consumers will better understand the inherent features of the product, where performance data is provided. In this respect, should the assessment be that past performance data is required, as per paragraph 3.15, we consider that the draft text in Annex 4A needs to clearly reflect

these features to enable them to be reflected in any graphical or other representation of past performance.

10. The removal of performance scenarios may result in retail investors placing more reliance on the summary risk indicator (SRI) which is also subject to some industry concern. As outlined in the CP, the current methodology excludes some risks and may result in an SRI which is too low. The proposal to allow manual additions to the SRI will be subject to judgment from firms. A prescribed method may be more appropriate based on a list of excluded risks outlined by the FCA. This would remove the need for the FCA to individually assess each manual addition and ensure consistency within the industry.

11. We have not commented on the proposals in Chapter 4, since these have limited relevance to our members.

12. We are pleased to see the carefully considered overview of cost and benefits in Annex 1, however we disagreed with the contention in paragraph 45 that there are no costs to consumers. This is because as mutual organisations, the firm's costs (as per paragraphs 35,36,39 and 41) will inevitably be passed onto customers.

13. The paper assesses the incremental cost of £8.50 per policy, which is not a cost a small mutual could reasonably expect to cover from a small value annual premium policy. The analysis in paragraph 52 appears to focus on lump sum investments, so if FCA has a more detailed assessment on how that cost might vary, for different products, it would be helpful to understand that. Otherwise the changes appear to offer poor value for money to less affluent customers.

14. The question the consultation does not properly address, and which may be a useful part of the planned research, is whether and how consumers use the performance information in the KID. Our experience is the numbers using the information is very small indeed, so if part of the rationale for the proposals is that the benefits are achieved by customers who read, and understand, the KID, it may be that this is only true amongst some sophisticated customers and for high value products. For the majority of customers who do not read the KID, there may be no benefit in changing information that isn't used. If the research identifies this, FCA may consider there is a more radical solution to reducing and removing disclosure material.

15. Annex 2, paragraph 17 refers to the effect on mutual societies, and indicates there will be no significant difference, because mutuals are 'not listed issuers of equity shares'. That does not appear to be relevant: some mutuals currently issued KIDs, as per the product list included in

Chapter 2. We also note that for with-profits funds, ring-fencing rules prevent a firm from offsetting costs from one fund to another, so the extra costs diminish the value of funds attributable to policyholders.

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

Yours sincerely,

Martin Shaw
Chief Executive
Association of Financial Mutuals

Covid-19 and Brexit: adopting meaningful data in Key Information Documents

It's been a long-held view by many that the current format of Key Information Documents (KIDs) is flawed, and the data is difficult to generate and potentially uninformative. The market falls in March 2020 have brought this into sharper focus, and created the environment where firms might seek advantage through timing the data used. We suggest that there is an opportunity via Brexit for FCA to re-consider the future format of KIDs, to better protect consumers.

Some of our members are reviewing and revising their unit-linked policy KIDs in light of the Covid-19 impact on market values. The policies concerned have a 100% UK equity linkage. The movement in the KIDs results is quite stark once the market collapse in March 2020 is factored in. Although the risk rating has not changed, the investment return projected for the next 10 years is now near nil, or slightly negative, on the moderate return scenario. This compares with a +4% or +5% return for data taken in the 5 years to the end of February or the end of last year.

The regulations require the provider to use the 5-year period of data of daily price movements; the calculation (for unit-linked policies) is a purely formulaic one based on moments of the movements. Providers are not able to use longer periods. The result is very volatile showing large movements in the projected longer-term values.

We can imagine that this may create confusion amongst advisers ("why is the +4% now -1% for the moderate return, when the investment vehicle has not changed?"). Providers may be tempted, due to competitive pressures, to not revise the document as a result of any review undertaken, in order to maintain a forecast return with a positive story for policyholders rather than an unappealing prediction of no growth in a person's savings over a 10-year period.

The problem is that the 5-year data period is too short. The inclusion of a March 2020 event may be useful within a 20- or 30-year data set, to show the range of results that may be achieved. Obviously, a 5-year data set implies an average of 2 such collapses in value for a 10-year plan.

Three other points are worth reiterating, in the context of AFM members in particular:

- the market falls in 2018 are also affecting projections in the KID and reinforcing the lower rates, albeit not to the same degree as 2020;
- many AFM members continue to offer a diversified with-profits, rather than unit-linked fund, and this has meant fund values have fallen by a much lower amount, and therefore KID projections are not as affected, where smoothing

mechanisms are incorporated and reversionary bonuses set (surrender values however are more significantly affected by current market conditions);
- Holloway friendly societies that issue income protection contracts with a small participating element are required to produce a KID, though its value in the hands of a policyholder is negligible, other than to illustration that a product designed to meet a protection need does not yield an attractive investment return.
- the actual results for (with-profits) members are not as bad as the market falls and projected rates suggest.

As part of Brexit, we would suggest that the KIDs document is examined by FCA. We would suggest that:

- The risk rating is useful, and some such calculation should be made;
- A longer time period for data should be used with data backfilled from indices if fund history is not available;
- Potentially, FCA might consider replacing the statistical calculation of average growth rates over the holding period with projection rates derived by FCA as being suited to the risk category of the investment – i.e. a risk rating of 3 generating a slightly lower moderate return but a tighter spread than a risk rating of 4 and so on;
- In circumstances such as those set out for Holloway contracts, where the KID hinders decision making by customers, FCA might consider whether it would be better removed.

We would welcome the opportunity to discuss further.

Martin Shaw, Association of Financial Mutuals, July 2020