



# **AFM Annual Conference**

## **Consumer Duty: impact on with-profits**

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# Agenda

- A new Consumer Duty – key FCA goals & expectations
- Applying outcomes 1 and 2 to with-profits – why is it difficult?
- Possible means to assess with-profits fair value
- Outcome 3 – Consumer understanding
- Outcome 4 – Consumer support
- Questions

# A new Consumer Duty – key FCA goals & expectations

# FCA's case for change across Financial Services

FCA frustrated by evidence of continued poor practice:

Firms providing information which is misleadingly presented or difficult for consumers to understand, hindering their ability to assess products/services properly and make good, timely decisions.

Products and services that are not fit for purpose in delivering the benefits that consumers reasonably expect, or are not appropriate for the consumers to whom they are targeted and sold.

Products and services that do not represent fair value, where benefits consumers received are not reasonable relative to the price they pay.

Poor customer service that hinders consumers from taking timely action to manage their financial affairs and make use of products and services, or increases their expense in doing so.

Other practices which hinder consumers' ability to act, or which exploit information asymmetries, consumer inertia, behavioural biases or vulnerabilities.

# Consumer Duty – package of changes (1 of 2)

## Consumer Principle

An overarching principle which sets out the overall standard of behaviour the FCA wants from firms.

Option 1: *‘A firm must act to deliver good outcomes for retail clients.’*



Option 2: *‘A firm must act in the best interests of retail clients.’*

## Cross-cutting Rules

These rules develop the FCA’s overarching expectations and articulate the standards of conduct the FCA expect under Principle 12.

Firms must:

- Act in good faith toward retail customers
- Avoid causing foreseeable harm to retail customers
- Enable and support retail customers to pursue their financial objectives.

# Consumer Duty – package of changes (2 of 2)

## Four outcomes

The cross-cutting rules inform and are supported by the following four Outcomes in a suite of rules and guidance.

- Outcome 1 – Products and services
- Outcome 2 – Price and value
- Outcome 3 – Consumer understanding
- Outcome 4 – Consumer support

## Private Right of Action for breach of FCA Principles

- A right for consumers to seek damages for loss caused by the breach
- Would enable the FCA to use its powers under section 404 of FSMA to impose an industry-wide redress scheme where there are breaches of the Consumer Duty or other Principles



The FCA has published the policy statement (PS22/9) and Finalised Guidance (FG22/5) summarising responses with new rules coming into force by 31 July 2023 for new/existing products, and 31 July 2024 for closed products.

# Applying outcomes 1 and 2 to with-profits – why is it difficult?



# Causes of difficulties for WP products: Product & Services and Price & Value outcomes

- Complex product lines, in particular older-style with-profits
- Complexity and opacity of charges and their effect on with-profits funds/individual outcomes
- Multiple variants of the same product
- Allowing for benefits and less straightforward features such as guarantees and smoothing
- Unclear surrender values – CWP SV basis, MVRs, any exit charges
- Long term nature of many contracts
- Concerns about retrospectivity
- Articulating, quantifying and measuring value across the distribution chain
- Pricing policy and implementation by intermediaries
- Obligation – express or implied – to offer or move customers to a better value alternative or product simplification

# Possible means to assess with-profits fair value

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## Non-exhaustive measures at COLL 6.6.21 R

- Quality of service
- Costs
- Classes of units
- Economies of scale
- Performance
- Comparable market rates
- Comparable services

## Quantitative metrics

### Investment management and performance

- Actual vs. expected returns – investment performance, after impact of charges, within parameters deemed to constitute fairness (tailored to different investment levels, or over different rolling periods)
- Extent to which current value, surrender value, maturity value, MVRs etc. are within target parameters constituting fairness
- Comparisons over different time periods with competitors' similar products
- Identify points triggering investigation or action, e.g. benchmarks to a proxy fund (artificial or actual) + x%
- Measure the extent to which smoothing is achieved
- 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
- Tracking actual charges levied for each component against expected / advertised rates
- ‘Cost to fulfil’ – quantify the difference between 'all-in' costs and revenues that constitutes fairness
- Measure extent to which cost allocation 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

# Possible means to assessing with-profits fair value

## 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 and customer service, 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
- Availability and ease of access to vulnerable customers
- Value across the distribution chain and distributor 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)

# Outcome 3 – Consumer understanding

## Mutuals / with-profits challenges

- Mapping and assessing customer journeys – what information do customers need to know when?
- Benefits, risks and costs of remaining in WP
- Availability and accessing alternatives
- Customer-facing documentation
- Salience / prominence of key info / T&Cs balanced against complying with disclosure requirements
- Tailoring communications for the particular characteristics of the customer, the product, the communication channel used (e.g. app based)
- Behavioural biases
- Provision of information to intermediaries and outsource providers

## Questions to consider

- How will we ensure that customers (and intermediaries) get the information they need, at the right time, to help them make good decisions?
- How will we test our communications, and get assurance that our customers understand them and act appropriately as a result?
- How will we cater for a wide variety of customers with different characteristics?
- How will we oversee the quality of documents produced by third parties or co-manufacturers?
- How do we obtain and use customer feedback?
- What other data might provide insight into customer understanding?

# Outcome 4 – Consumer support

## Mutuals / with profits challenges

- What support is available to customers and intermediaries, and how accessible and reactive is it?
- Identification and prevention of unreasonable barriers, delays and poor outcomes, e.g. *‘Sludge practices’*
- Uneven support between servicing channels (e.g. telephony vs. digital) / gaps in service
- Identification and support for customers in **vulnerable circumstances** (including ability to share information between stages of customer journey)

## Questions to consider

- How will we provide consistent levels of support and service across the various communication and distribution channels?
- How will we ensure good outcomes and support at ‘moments of truth,’ e.g. poor value with profits performance?
- How will we achieve consistency of customer experience irrespective of product or service, and point in the customer journey?
- How will we identify and support customers in vulnerable circumstances? How will we record and share information on this between different parts of the business?

# Questions



