Association of British Insurers

With-profit funds – compensation and redress

The ABI's Response to CP 09/9

Introduction

1. The ABI is the voice of the insurance and investment industry. Its members constitute over 90 per cent of the insurance market in the UK and 20 per cent across the EU. They control assets equivalent to a quarter of the UK's capital. They are the risk managers of the UK's economy and society. Through the ABI their voice is heard in Government and in public debate on insurance, savings, and investment matters.

2. The ABI welcomes the opportunity to comment on CP 09/9 '*With-profit funds – compensation and redress*'.

Overall Comments

3. We welcome the changes the FSA has made to its initial proposals to remove retrospection. We also welcome the clarification that rectification payments will not be caught by the new rules. However, we continue to be concerned that the FSA's views may result in a fundamental change to the nature of the relationship between policyholders and shareholders with, as in this case, firms being required to bear more of the risk and policyholders less. If the FSA decides to implement its proposals then we look to the FSA to confirm its support of with-profits as a valid investment option and to make a commitment not to bring forward any further proposals which seek to change the nature of the relationship between firms and policyholders except where there is clear evidence of market failure.

4. If the FSA decides to implement its proposals then we believe that it would be fair and proportionate to make a distinction between systemic failures and administrative errors, mistakes or mis-sales. All businesses will make administrative errors, mistakes and mis-sales from time-to-time and the cost of rectifying these should be regarded as a normal cost of business and so, in a with-profits context, should continue to be recognised as an ordinary expense of the fund.

5. Additional comments are set out in the annex to this paper.

ANNEX

Questions for Consultation

Q1: Do you agree with the proposals set out in paragraphs 2.1 to 2.4 above?

We welcome the changes the FSA has made to its initial proposals to remove retrospection. We also welcome the clarification that rectification payments will not be caught by the new rules.

However, we continue to be concerned that the proposals, if implemented, are based on a fundamental misunderstanding of the nature of policyholders and shareholders interests in a with-profits business. The FSA accepts that there is an element of risk-sharing between shareholders and policyholders in a with-profits fund but we believe that the FSA's views may in practice result in a change in this relationship with shareholders being required to bear a disproportionate share of the risk. Firms agree that they must treat policyholders fairly but this cannot operate in a vacuum and they believe that the nature of with-profits means that policyholders must continue to bear their share of the risks, and consequent expenses, of the business. Failure to properly share risks and rewards will reduce the attractiveness of with-profits as a business and result in further funds being closed.

We look to the FSA to confirm its support of with-profits as a valid investment option and to make a commitment not to bring forward further proposals for changing the relationship between firms and policyholders except where there is clear evidence of market failure.

Q2: Do you believe that this distinction should be made? If so, how would you suggest that we should differentiate?

If the FSA decides to implement its proposals then we believe that this distinction should be made. All businesses will make administrative errors, mistakes and mis-sales from time-to-time and the cost of rectifying these should be regarded as a normal cost of business and so, in a with-profits context, should be recognised as an ordinary expense of the fund.

Whilst we agree that it might be difficult to readily distinguish these errors from systemic management failures where the FSA believe shareholders should meet the costs of rectification, we believe it would be fair and proportionate to do so.

One possibility would be to limit the recognition of systemic issues to those which the FSA believe have 'wider implications' or otherwise decide require an industry wide treatment. Adopting this test would cover issues such as pension and mortgage endowment mis-selling which have, in the past, given rise to the main concerns on the part of the FSA about the fair treatment of policyholders.

Going forward we understand that the FSA's main concern is about the way that funds are managed. In this case problems are more likely to arise within individual funds than across the industry as a whole. In such circumstances systemic failures might be identified where a skilled persons report has concluded that this is the case or where the FSA has successfully taken disciplinary action against the firm or where the loss of a series of similar cases at FOS led a firm to conclude that there had been a systemic failure and it had embarked upon a redress exercise as a consequence. Firms might also be able to build (taking account of the differences between the products) on the ABI's *'Guide of Good Practice for Unit-Linked Funds'* where section 4.6 (on error correction) provides advice on when firms should recognise that systemic errors might have occurred.

Q3: Do you have any comments on the points made in paragraphs 2.14 and 2.15?

We are concerned that this proposal could result in shareholders being required to put money into the with-profits fund to pay compensation and redress costs which could then be trapped in the fund. This could arise where the amount required to pay compensation is lower than originally expected resulting in shareholders having paid too much into the fund. Under these circumstances it is not clear what mechanisms exist to allow any such excess to be withdrawn form the fund. Therefore, we believe that it should be possible for shareholders to meet any such costs without necessarily transferring money into the fund by, for example, setting up the provision in a shareholders or non-profit account.

Q4: We would be interested to hear firms' views of what such future costs are likely to be.

This is a matter for individual firms.