



Briefing

Financial Regulation Horizons

The FCA's review of the fair treatment of long-standing life insurance customers

Last month, the FCA published its thematic review on the fair treatment of long-standing life insurance customers. The report examines the fair treatment of closed-book customers in the life insurance sector with a particular focus on how firms applied exit and paid up charges. Firms should be aware of the FCA's findings and should ensure they are treating closed-book customers fairly.

Background

Criticism of the charges levied by some insurance companies on legacy products is not new. As long ago as 1999 the Government introduced a maximum annual charge of 1% for stakeholder pensions to encourage lower cost products.

Insurance companies have come a long way and modern policy charges for new business are measured in fractions of one percentage point. Even so, this leaves a back book of policies that are still running on historical fee rates. Remember that many savings and pension plans were taken out in the 1970s and 80 by young workers with decades to run until retirement.

In comparison with their cheaper successors, these old contracts look costly. Some came with exit penalties that made it uneconomical for the customer to transfer.

The FCA's Review

With the benefit of hindsight, regulatory attention has been stirred and the FCA has stepped in. It announced a review of the historic products of life insurance companies in their 2014/15 Business Plan and its thematic review report TR16/2 was published on 3 March 2016¹.

The scope is quite narrow. Products without an investment element were excluded, as were industrial assurance policies, general insurance, pure protection products and group pensions. This left the FCA with:

- individual personal pensions
- whole of life policies
- endowments and
- investment bonds.

The review is focussed on the fair treatment by insurance companies of their customers now. It does not look at the initial sales practices or whether the product design was structured so as to deliver a good outcome for the consumer.

Instead, the review looks at the way in which the insurance companies are servicing these legacy policies. A relatively small sample of 11 insurers was chosen, and most firms were found to be demonstrating good practice in some areas but poor practice in others. However, a small number were found to be delivering poor outcomes in a majority of the areas assessed. The report lists its findings by outcome:

- **Outcome 1: The firm's strategy and governance framework results in the fair treatment of closed-book customers.**

The FCA found that some firms were overly reliant on terms and conditions without taking into account customer outcomes. There was also an inadequate grasp of closed-book customers and outcomes, and of the risks associated with outsource providers' performance management structures.

- **Outcome 2: The firm's closed-book customers receive clear and timely communications about policy features at regular intervals and at key points in the product lifecycle that enable them to make informed decisions.**

Some firms were not communicating at all with their customers, whilst others issued poor quality communications or were not doing enough to maintain contact.

- **Outcome 3: The firm gives adequate consideration to and takes proper account of fund performance and policy values in a way that ensures it treats its closed-book customers fairly and proportionately.**

Although firms are generally dealing with poorly performing funds, customers are not being made aware of the impact of charges in the worst performing funds. Also, many firms are not linking actual experience to the charges being incurred by the customer to ensure they remain fair.

- **Outcome 4: The firm's closed-book customers are able to move from products which are no longer meeting their needs in a fair and reasonable manner.**

A minority of customers were incurring high charges for making policies paid up or for transferring their policies.

¹ Fair treatment of long-standing customers in the life insurance sector <http://www.fca.org.uk/static/documents/thematic-reviews/tr16-02.pdf>

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Next Steps for Insurance Companies

Following the review, the FCA will be following up findings with individual firms. More widely, they expect insurers to make any necessary changes to meet their expectations. The report sets out draft non-Handbook guidance based on existing guidance with an added level of detail.

We would advise firms to review this guidance and the FCA's findings in detail. Firms should review their current treatment of closed-book customers and seek advice if they are unsure whether they are treating customers sufficiently fairly.

Whilst not binding on firms, the guidance is soft compulsion to the extent that it can be taken into account in enforcement cases. Time will tell whether the FCA will decide to take a more formal approach to product charges.

A consultation period runs for three months and the FCA encourages affected firms to submit their replies to the questions raised.

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