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Dear CEO,

FCA Thematic Review: Fair Treatment of With-Profits Customers

Today we published our thematic review on Fair Treatment of With-Profits Customers. The review will be useful to all firms that have with-profits business in considering how they can improve their management of with-profits funds and in turn improve outcomes for customers.

The review details our key findings and provides examples of good and poor practice we observed. We expect all firms managing with-profits business to consider the findings and examples of good and poor practice set out in the review and to assess whether they need to make any changes to their management of with-profits business.

Our approach

We assessed the practices of a sample of firms in the areas we believe present some of the highest potential risks of significant harm to with-profits customers. These areas were tested at firms by considering the following outcomes firms should aim to achieve in line with our existing rules and guidance for with-profits firms.

Outcome 1 - The firm has implemented an appropriate investment strategy for the fund and regularly monitors its ongoing appropriateness and the terms on which it is implemented.

Outcome 2 - The firm has an overall capital management approach for the with-profits fund that fairly balances the interests of different generations of with-profits customers.

Outcome 3 - The firm appropriately considers the risk borne by different stakeholders in allocating rewards from use of with-profits fund capital.

Outcome 4 - The firm's governance framework results in the fair treatment of with-profits customers.

Key findings for you to consider

Most firms we assessed are taking reasonable care to manage the risk of customer harm in their with-profits business. Our findings for investment strategy and management and overall governance underline this.

We did not find evidence of widespread customer harm arising from firms' practices across the areas we assessed. However, there were some areas of poor practice. Customer harm may occur in the future if these practices continue.

In the limited instances where we found practices presenting a higher risk of customer harm a key cause was a failure of governance. In particular, we found ineffective oversight and challenge by senior individuals and the Board.

We set out the key areas of poor practice below.

1. Run-off plans

Most firms with closed with-profits funds were not using their run-off plans fully as intended and described in our rules and guidance, namely as a tool to manage the ongoing run-off of a closed with-profits fund in a fair manner. In particular, many firms were not keeping their run-off plans up to date and not using them as living documents in their day-to day management of with-profits funds.

A run-off plan is required to show how a firm will ensure fair and full distribution of the closed with-profits fund and any inherited estate. It should cover (among other things), investment strategy, governance, and financial projections. If a run-off plan is not up-to-date, or does not contain all the expected information as described in COBS 20.2.56R and SUP Appendix 2.15 there is a risk that a firm's approach to distribution of the fund and inherited estate is either not fair, or cannot be shown to be fair, to different groups of customers.

2. Assessments of excess surplus

Several firms were not carrying out assessments of excess surplus as required by FCA rules. COBS 20.2.21R requires firms to carry out at least annual assessments for both open and closed funds. Failure to identify an excess surplus, where one exists, may result in surplus that should be distributed being retained. Timely distribution may be necessary to ensure inter-generational fairness among with-profits customers. Not carrying out an annual assessment of excess surplus carries a high risk of customer harm. This is due to customers exiting the fund in the short-term not receiving a fair share of the fund's estate; and customers remaining longest in the fund receiving unfairly large distributions. Failure to distribute an excess surplus, which has been identified and is not fair to retain, may indicate a breach of Principle 6.

3. Fund-level capital management approaches

Some firms could show they had implemented appropriate policies and procedures to ensure they struck a balance between ensuring fair pay-outs for exiting customers and the security of benefits for continuing customers.

However, some firms lacked a clear definition of the desired level of reserves to protect against risks in their funds. This could have been provided by, for example, establishing fund-level capital risk appetites as was the case at some other firms. The absence of clear fund-level risk appetites or similar processes and practices increases the risk of firms not balancing appropriately fairness of pay-outs for exiting customers and the security of benefits for continuing customers.

Next steps

We expect your firm to consider its practices for its with-profits funds in light of the contents of the thematic review, and to take remedial actions for any shortcomings you identify.

We plan to take taking the following actions:

- We will engage with certain senior managers across firms through round-table discussions later this year. We want to hear their views on our findings and understand what actions are being taken across the industry in response to these.

- We will discuss the findings from this review with firms operating with-profits business as part of our normal supervisory processes.

- If firms do not address the areas of poor practice highlighted in this review we will consider the need for further action.

We are also considering carrying out some focused work about the use of With-Profits Advisory Arrangements (WPAAs) before the end of the FCA's 2019/20 business year. This will give insight into the conduct of smaller firms which manage with-profits funds, and allow us to evaluate the impact of WPAAs now being senior managers for the first time under the Senior Managers & Certification Regime (SM&CR).

Yours sincerely,

Deborah Jones
Director of Life Insurance and Financial Advice Supervision