Institute
and Faculty
of Actuaries

Our Future Mission

IFoA response to the Financial Conduct Authority

26 January 2017

About the Institute and Faculty of Actuaries

The Institute and Faculty of Actuaries is the chartered professional body for actuaries in the United Kingdom. A rigorous examination system is supported by a programme of continuous professional development and a professional code of conduct supports high standards, reflecting the significant role of the Profession in society.

Actuaries' training is founded on mathematical and statistical techniques used in insurance, pension fund management and investment and then builds the management skills associated with the application of these techniques. The training includes the derivation and application of 'mortality tables' used to assess probabilities of death or survival. It also includes the financial mathematics of interest and risk associated with different investment vehicles – from simple deposits through to complex stock market derivatives.

Actuaries provide commercial, financial and prudential advice on the management of a business' assets and liabilities, especially where long term management and planning are critical to the success of any business venture. A majority of actuaries work for insurance companies or pension funds – either as their direct employees or in firms which undertake work on a consultancy basis – but they also advise individuals and offer comment on social and public interest issues. Members of the profession have a statutory role in the supervision of pension funds and life insurance companies as well as a statutory role to provide actuarial opinions for managing agents at Lloyd's.

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Submitted via email: FCAMission@fca.org.uk

26 January 2017

Dear Mr Bailey,

IFoA response to FCA's 'Our future Mission'

1. The Institute and Faculty of Actuaries (IFoA) welcomes the opportunity to respond to the FCA's Mission. The IFoA regulates its members to assure public trust and support business. We support the FCA's commitment to proportionate and effective regulation, as well as the inclusion of public policy objectives. Our approach to regulation is fundamentally about the protection of the public and assuring public confidence by maintaining quality and professionalism. We welcome that the Mission lists three of the principles we consider as crucial to good regulation:
    a. Proportionate – such that regulatory intervention is undertaken only to the extent necessary and appropriate to the risk;
    b. Transparent – regulation, and the process by which it is determined, should be clearly articulated and readily comprehensible; and
    c. Targeted (efficiency and economy) – regulatory action should be focused on identified problem(s), such as to minimise side effects, and should avoid imposing disproportionate cost on the regulated community

2. The two additional IFoA principles for good regulation not separately listed, but which are discussed within the Mission, and therefore to which the FCA may wish to consider making explicit reference are:
    a. Accountable – the regulator should be ready to justify regulatory action (and inaction) and should be, and be seen to be, open to scrutiny by the public as well as its members; and
    b. Consistent – regulatory action (and inaction) should be coherent, according to a clearly defined and comprehensible policy. Specifically, in Chapter 6 the FCA states the importance of a consistent approach in conducting regulation to overcome public policy challenges.

3. We support the cross-sector approach that the FCA has taken for its Ageing Population project. Where a number of financial services are facing similar challenges and where these challenges have a clear link with public policy an interaction between legislation and regulation for these different services is sensible. It is important that the FCA remains independent from Government, however both are responding to the same societal, technological and economic transformations. Therefore, consideration of public policy within the FCA's regulatory framework, to satisfy the public interest, is a constructive approach. However, there must be a clear and consistent framework for the demarcation between regulator and government responsibilities and the cooperation between the two.

4. It is right that the FCA is seeking to 'future-proof' its Mission as it is noted that it too is subjected to the same societal, economic and technological transformations as the firms it regulates. Financial services are still grappling with the ageing population, the low interest

rate environment and data science. It is encouraging to see that the FCA is considering how it can best reflect these ongoing changes. As well as ensuring that the structure of its regulatory function is future-proof in a flexible and changing landscape.

5. We have answered those questions where our members have relevant expertise.

Q1: Do you think our definition of a well-functioning market is complete? What other characteristics do you think we should consider?

6. We agree that in a well-functioning market failure can occur. However, a regulator should ensure that the distribution of the cost of failure is in such a way that it does not incentivise similar behaviour in the future. If the cost of failure is passed on to the wider market, it does not penalise those who have caused the failure. We wonder whether in addition to fines for previous infractions, that the regulator increases its focus on taking action to limit or ban participants from the market if the FCA found them to be at risk of further failure. This could also be helpful where the cost is not necessarily financial (e.g. reputational), and where there is an interaction between regulatory and public policy requirements which need to be considered.

7. However, where the failure was caused by the existence of risk, rather than behaviours, then it is possible that the cost of failure should be carried elsewhere.

Q2: Do you think our approach to consumer loss in well-functioning markets is appropriate?

8. When poor behaviour is penalised through fines rather than customer redress it is not clear to customers how this benefits them. We therefore suggest that customer redress should be the first option. In the pursuit of transparency, it should also be made clear to consumers where the revenue raised from any fines is directed.

9. We also recommend the regulator encourages actions that enable consumers to understand both the upside and downside of risk. It is important that consumers have realistic expectations about the potential for loss associated with certain financial products.

Q3: Do you think we have got the balance right between individual due diligence and the regulator's role in enforcing market discipline?

10. As the FCA notes, there is an increasing shift towards individuals taking greater financial responsibility. However, even where individuals have been informed of the risks, we are concerned about levels of financial literacy and therefore understanding. We support the FCA's preventative approach, but question whether this is always happening in reality. For example, the increase in choice arising from the introduction of the pension freedoms is inherently complex and whilst firms should do all they can to alleviate this complexity, there is a risk that consumers may well still be drawn to the easiest option. Firms can actively help to prevent consumers making poor, or even financially dangerous, decisions by providing simple documentation that explains exactly what products offer.

Q4: Do you think the distinction we make between wholesale and retail markets is right? If not, can you tell us why and what other factors you believe we should consider?

11. There is an underlying assumption that wholesale markets are between parties with similar levels of expertise – the regulator should ensure that both parties have access to appropriate information – otherwise a transaction should be treated more like a retail transaction.

Q5: Do you think the way we measure performance is meaningful? What other criteria do you think are central to measuring our effectiveness?

12. It is important that the public has confidence in the performance of the regulatory system and this will be driven by perception as well as reality. The regulator could play a useful role in improving public perception by proactively promoting the role of regulation and the outcome of regulatory interventions for consumers. Therefore we suggest an additional measure could be activity undertaken to promote the role of regulation in protecting consumers.

Q8: Where do you believe the boundary between broader policy and the FCA's regulatory responsibility lies?

13. This is a judgement where there is no unique correct answer. However, the limits, once decided should be clear so firms can understand them and manage them effectively. Unclear mandates create confusion and do not support the goal of well-functioning markets.

Q9: Is our understanding of the benefits and risk of price discrimination and cross subsidy correct? Is our approach to intervention the right one?

14. We agree that greater transparency will be helpful where the FCA believes there is an unacceptable level of cross-subsidy. Cross-subsidy as a result of firms capitalising on passive consumers to attract new business is not in the public interest, however there will be cases where cross-subsidy is in the public interest, as demonstrated by Flood Re, or where it is fundamental to the nature of a product, as is the case in many insurance policies. Where markets are increasing premiums for 'naïve' consumers we agree that regulatory intervention can be appropriate.

Q10: Does increased individual responsibility increase the need and scope for a greater and more innovative regulatory response?

15. Placing increased responsibility on individuals to manage their own personal risks does require a particular regulatory response, although not necessarily "greater" regulation. As stated in our response to question three, consumers may be led to the easiest, rather than the optimal option. It is important that the regulatory approach focuses on consumer needs, rather than simple "compliance" with a rulebook. For example, comparing the value of an annuity against an income drawdown product is not easy. Nor is it straightforward to compare income drawdown products between providers as they may have different features. Even for those consumers with a good level of financial literacy, figuring out which type of product, and then which specific product, best meets their circumstances will be difficult and time-consuming. This could result in sub-optimal decision-making or inertia. It also highlights the potential benefit from providing consumers with information at a digestible.

16. One possible solution could be a requirement for market participants to set aside funding to aid with the financial education of potential consumers. The incentive would be that should a complaint against the market participant arise, the regulator's response would take into account the extent to which the vendor has made a commitment to financial education of its potential customers.

17. In addition, as stated in our response to question two, increased individual responsibility also requires consumers to understand both the upside and downside of risk. Good disclosure

would mean consumers have realistic expectations about the potential for loss associated with certain financial products and their ability to bear any potential losses.

Q11: Would a Duty of Care help ensure that financial markets function well?

18. Andrew Bailey notes that market failures have occurred in firms that had a duty to "treat customers fairly", so we do not think it is right to suggest the current regime does provide adequate protection. However, whilst Duty of Care can help to ensure markets function well, if the result is that innovation is stifled because of a perceived or real increased risk to firms of legal action then this may instead have a detrimental effect on the optimal functioning of financial markets. Markets are changing rapidly; any regulation must be able to cope with that, otherwise there is a risk that people will move towards unregulated providers as a result of innovation. Perhaps reconsidering how the duty to treat customers fairly is interpreted might be a more appropriate first step.

19. In addition, a Duty of Care is a subjective measure. The role of the legal system in determining whether this has been breached could lead to complex and expensive legal actions, as well as leading to a lack of clarity between legislation and regulation. A streamlining of the Financial Ombudsman's Service, which allows complaints to be heard more quickly, may be beneficial in avoiding legal action.

Q12: Is our approach to offering consumers greater protection for more complex products the right one?

20. We agree that it appears proportionate to take a different approach for more complex products than it does for less complex products. However, it is important to note that simple products could appear complex for some individuals with low financial capability. When considering which products require greater protection for consumers, this could usefully be coupled with a consideration of consumers' financial capability.

Q13: Is our regulatory distinction between consumers with greater and lesser capability appropriate?

21. Although having greater wealth is likely to mean that someone is better able to bear the risk of product failure (all else being equal), there is not a direct link between those with greater wealth and those with higher capability of understanding financial products.

22. There is a limited resource for regulation and we agree that this should to be used effectively and that it should be used to protect those who are most vulnerable. However, we consider it too simplistic to target lower income groups and we suggest that a more sophisticated approach is necessary. For example, the youngest and oldest consumers may be at greater risk than those in the middle of the age distribution, owing respectively to either a lack of prior knowledge or, for example, cognitive decline.

Q16: Is our approach to giving vulnerable consumers greater levels of protection the right one?

23. We agree with the approach outlined in the Mission document. We consider that the FCA must also be alert to firms acting within the letter, but not the spirit of, regulation, e.g. regulated advisers giving non-regulated advice in relation to transfers of safeguarded benefits, potentially exposing consumers to pension scams.

24. In addition, there is no specific mention of those consumers who are interacting with financial services because of bereavement. We suggest these consumers are also vulnerable and therefore merit special consideration.

Q17: Is our approach to the effectiveness of disclosure based on the right assumption?

25. If the information provided is unclear, or the means of communication is confusing, the benefits of disclosure will fall short of the ultimate objective. We therefore welcome the FCA's incorporation of behavioural economics into its approach for disclosure.

Q18: Given the evidence, is it appropriate for us to take a more 'interventionist' approach where conventional disclosure steps prove ineffective?

26. Yes, but only exceptionally and where it clearly supports the overall aims of having a well-performing market.

Q19: Do you think our approach to deciding when to intervene will help make FCA decisions more predictable?

27. As detailed in our introductory comment, we believe consistency is a key component of regulatory action (and inaction). Consistency in approach will help to make FCA decisions more predictable. Whilst it may be implicit that the FCA would adopt a consistent approach, it may be worth making this point explicit in Chapter 10.

Q23: Do you think it is our role to encourage innovation?

28. We agree that there is a role for the FCA to encourage innovation, for example in new areas such as robo-advice. If the FCA can encourage firms to set this up within a given framework, it could help to reduce risks to consumers and the need for future redress.

Q26: Do you think that private warnings are consistent with our desire to be more transparent?

29. Private warnings could be useful in relation to non-specific concerns, or to events that are not regulatory breaches and unlikely to give rise to any material adverse effects. In particular, we expect that people are more likely to raise precautionary concerns, for example about a firm's culture, if it is clear that there are no immediate public repercussions unless the concern results in uncovering evidence of a more fundamental failure. However, if it appears a breach has occurred, private warnings do seem inconsistent with transparency.

30. We look forward to continuing to support the work of the FCA where it is in the public interest and where it affects the work of actuaries as it embeds its future mission. Should you wish to discuss our response in further detail please contact Rebecca Deegan, Policy Manager (rebecca.deegan@actuaries.org.uk / 0207 632 2125) in the first instance.

Yours sincerely,

C. Wil

Colin Wilson
President, Institute and Faculty of Actuaries