



Institute
and Faculty
of Actuaries

FCA Unit Linked Thematic Review

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3 October 2013

Agenda

1. Background to the FCA approach
2. Unit Linked Thematic Review
3. Thematic reviews - Key Learnings
4. Unit Linked Thematic Review - Actions to take

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FCA Views

Focus on 'the risk of poor outcomes for consumers'

Clive Adamson, January 2012

"We will have a greater expectation of a strategic approach to the conduct agenda and senior management and board engagement in it."

Martin Wheatley, July 2013

*"We are not just asking: Is this product compliant? Does it tick every legal box?
But actually: is the outcome good? Is the market competitive? And is fair treatment of consumers designed into products and culture?"*

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FCA 2013 Business Plan and Risk Outlook

- Key forward looking risks from the FCA Risk Outlook:
 - Firms do not design products/services that respond to real customer needs or are in their long term interests
 - Distribution channels do not promote transparency for consumers
 - Over reliance on and inadequate oversight of payment and product technologies
 - Shift towards more innovative, complex or risky funding strategies/structures.
 - Poor understanding of risk and return, combined with a search for yield, leading customers to take on more risk than is appropriate

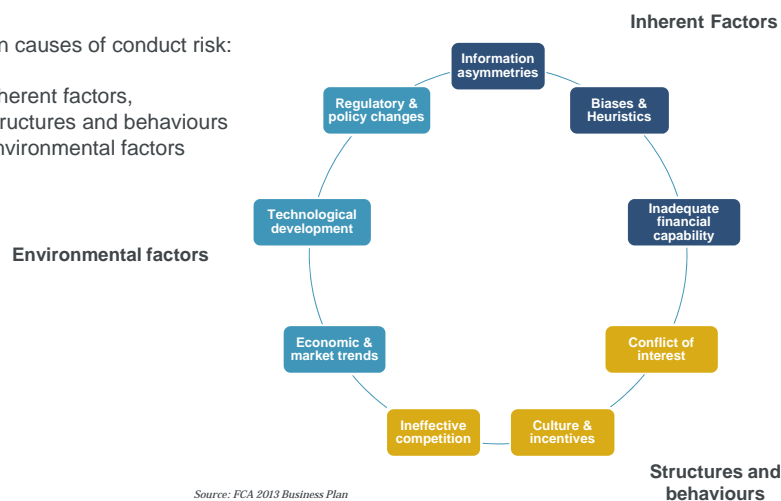
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FCA 2013 Business Plan and Risk Outlook

Three main causes of conduct risk:

- Inherent factors,
- Structures and behaviours
- Environmental factors



Source: FCA 2013 Business Plan

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FCA assessment approach for Conduct Risk

- FCA is adopting a three pronged approach:
 - **1) "Firm Systematic Framework"** - Seeks to identify and focus on the key conduct risk in individual Firm's business model, processes, governance and culture
 - **2) Event driven** - specific problems
 - **3) Issues and products** - where FCA identifies significant risks
- Thematic reviews is the approach the FCA is using for the 3rd of these
- May involve a small representative sample of firms or whole market
- Use data requests and visits to assess the extent of issue
- Feedback to sample firms, but requirements likely to affect all firms
- Dedicated team of FCA staff undertaking the reviews

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Some Recent and Current Thematic reviews

Governance of unit-linked funds

Annuities

Motor legal expenses insurance

Mobile phone insurance

Claims handling

Cash savings

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Failures can be costly...

- Serious system and control failings resulting in misleading marketing material for Pension Sterling Fund.
- £2.45 million fine. Cost of compensation at least £103 million.

Standard Life
January 2010



- Poor administrative procedures. Multiple issues including failures in allocating funds to policies.
- £2.8 million fine. Cost of compensation £60 million

Scottish Equitable
December 2010



- Failures in relation to the sale of 2 Aviva funds.
- £7.7 million fine. Cost of compensation approx. £59 million

Barclays
January 2011



- Failure to comply with Principle 9 in connection with sale of an AIG fund.
- £6.3 million fine

Coutts
November 2011



- Failings in sale of an AIG fund.
- £9.45 million fine. Cost of compensation approx. £10 million

UBS
February 2013



10/2/2013

Slide 8

FCA Unit Linked Review

Lack of sufficiently robust controls could lead to mismanagement and policyholder detriment

Why?

- Growth of unit linked fund under management
- Recent fines due to the inadequacy of systems and controls environment
- Area not as closely regulated as with-profit

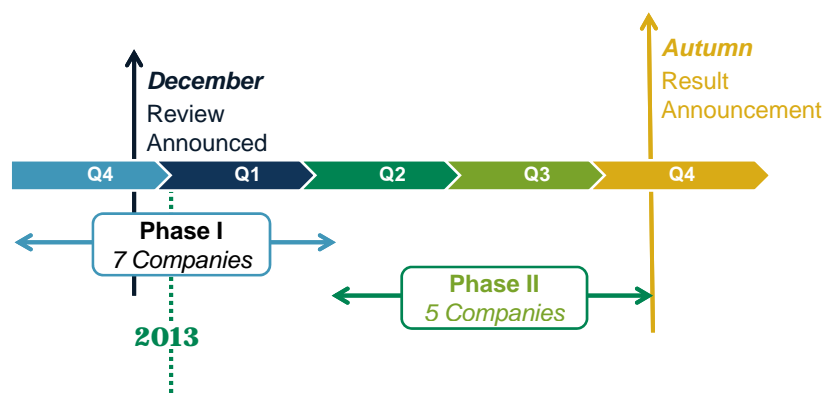
Key areas

- Overall **governance and controls** of linked funds
- Are the **assets being invested** in line with customer expectations?
- How the day to day **operation** of the funds work

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FCA Unit Linked Review - Timeline



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FCA Unit Linked Review

Focus of the Review		
Governance	Investment Management	Fund Administration
<ul style="list-style-type: none"> • Strategy & approach • Structure • Risk management & compliance • Breaches identification & rectification • Notification to the FCA • Managing conflicts of interest • Outsourcing 	<ul style="list-style-type: none"> • Mandate compliance • Permitted links compliance • Liquidity management • Reinsurance • Fund launches • Fund closure & mergers • Stock lending 	<ul style="list-style-type: none"> • Valuation of assets • Unit pricing process • Unit pricing rounding • Unit pricing bid/offer basis • Taxation of fund • Charges & expenses • Unit allocation /de-allocation • Box management

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FCA Unit Linked Review - Governance

Governance structure	<ul style="list-style-type: none"> • Fitness for purpose • Potential for any conflicts of interest • Effectiveness of controls
Outsourcing arrangements	<ul style="list-style-type: none"> • Intra-group and third party controls • Disaster recovery policies and procedures • Second line oversight

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FCA Unit Linked Review – Investment management

Compliance with mandates

- Policy and procedures for dealing with 'non mainstream' assets
- Consistency between policy, fund literature, mandates and asset holdings
- Funds appropriately mirror performance of underlying collectives

Reinsurance

- Company position on counterparty risk
- Whether counterparty risk on third party funds is recognised and has been disclosed
- Clarity on the extent of FSCS coverage

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FCA Unit Linked Review – Fund administration

Policies, procedures and methodologies

- Breach policies and procedures
- Taxation of internal linked funds and comparison to the tax position of the Firm

Unit allocation and de-allocation

- Potential for customer detriment
- Availability of historic prices
- Delays between policyholder transaction and fund investment
- Change in pricing basis

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Thematic reviews – Learnings

New style thematic reviews

- Preparation
- Review Approach
- End to end view
- Value added

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Unit Linked Thematic Review – Actions to take

Companies need to be able to demonstrate

- Board takes decisions and has sufficient understanding to do so
- 2nd and 3rd lines of defence guard policyholder interests
- Have robust processes, controls and monitoring in place
- Provide customers with sufficient and clear information
- Have clearly communicated their approach to policyholders
- Do what they have said!
- Conflicts of interest are recognised and managed to treat all customers fairly

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Unit Linked Thematic Review – Actions to take

Review your current position/past behaviour against the issues mentioned

Report findings to the Board so they can take the appropriate actions

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Questions

Comments

Expressions of individual views by members of the Institute and Faculty of Actuaries and its staff are encouraged.

The views expressed in this presentation are those of the presenters.

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