Financial Services Authority

With-Profits Review:

Issues Paper 3

Disclosure to Consumers

January 2002

FSA

Contents

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The Financial Services Authority invites comments on the issues raised in this Issues Paper. Comments should be sent to:

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It is the FSA's policy to make responses to this Issues Paper available for public inspection unless the respondent requests otherwise. The names of all respondents will be published.

Responses should reach us by 15 February 2002.

1 Disclosure to consumers

Introduction

1. At the With-Profits Review Open Meeting on 18 June 2001 the FSA undertook to consult on the issues raised in a series of sub-projects being carried out under the Review. Paragraph 9 of the Open Meeting Discussion Paper, available on the FSA web-site, sets out those sub-projects. This is the third Issues Paper. It considers whether the information given to policyholders and their advisers on with-profits policies, both at and post point of sale, can be improved to give them a better understanding of the nature and the risks of the investment.

2. This Issues Paper:

   a. sets out the main findings of research undertaken to gauge consumers' understanding of their with-profits policies, and the concerns that have been raised over the information currently provided on such policies;

   b. considers what is the key information that consumers need to know in order to decide whether to buy a with-profits policy, and to follow the progress of their investment after purchase; and

   c. considers the tailoring of information for different audiences.

3. The purpose is to seek views on several issues and questions that have been raised throughout the paper. There is a summary list of questions in Annex A. The FSA will draw on the responses to this paper, and those to other Issues Papers, in bringing together the conclusions of the With-Profits Review in Spring 2002.

Background

4. The need to ensure that consumers are given enough information to allow them to obtain the best deal, to make an informed decision on whether to buy,

and to make them aware of the risks inherent in the product once purchased, is not specific to with-profits products. The FSA has in place a point of sale disclosure regime with these objectives for packaged investment products more generally, including with-profits. In 2000, the FSA published a Discussion Paper[1] which reviewed the effectiveness of the current product disclosure regime in meeting its objectives. It also considered whether these objectives were still valid in the current market and proposed changes for a more effective way to help consumers make better-informed decisions.

5. The Discussion Paper concluded that the existing regime was not effective in meeting the stated objectives and that changes were needed. In particular, FSA research[2] has shown that Key Features Documents (KFDs) currently given to consumers at the point of sale are not widely used by consumers. To address the concerns raised, the FSA is undertaking a review of the product disclosure regime, 'the Disclosure Review'. This review aims to identify the most effective ways to give consumers meaningful information in a way that will encourage them to read it, including the development of a possible new model for KFDs.

6. The FSA is taking forward this work in the light of comments on the Discussion Paper published last year, and further detailed consumer research. A consultation paper will be published in the summer setting out detailed proposals for a new disclosure regime.

7. Also, in June 2001, the FSA published a Discussion Paper[3] on treating customers fairly after the point of sale. A key recommendation of this paper was to compare current practice in providing post-sale information with consumers' needs, and to consider what mandatory information should be provided. The FSA will be taking these issues forward in a 'Post Point of Sale' review.

8. The specific features, and complexity, of with-profits products has led to particular concern over the extent to which consumers understand the nature of their investment, and the risks attached to it. This Issues Paper considers, in the context of the above reviews, what information should be provided on with-profits products, both at and post point of sale, to give consumers a better understanding of:

   a. the nature of the with-profits product, including features such as smoothing, bonuses, guarantees;

   b. the benefits and the risks of the product;

1 Informing consumers: a review of product information at the point of sale. DP4. November 2000.

2 Informed decisions? How consumers use Key Features: a synthesis of research on the use of product information at the point of sale. Consumer Research 5. November 2000.

3 Treating customer fairly after the point of sale. DP7. June 2001

c. the provider's approach towards managing its with-profits business, including its practices and policies on smoothing, bonuses, and market value reductions (MVRs);

d. how investment returns are calculated;

e. any factors that may affect the returns to policyholders, other than investment performance; and

f. post point of sale, how their investment is progressing.

9. Communicating with consumers in a way that will help them better understand their investment is consistent with FSA Principles. Principle 6 requires firms to pay due regard to the interests of their customers and to treat them fairly. Principle 7 requires firms to pay due regard to the information needs of their clients and to communicate information in a way that is fair and not misleading. Under Principle 8, a firm must manage conflicts of interest fairly. One of the main factors considered by the 'Treating Customers Fairly' Discussion Paper to cause a consumer to feel they have been treated unfairly, is when they feel unpleasantly 'surprised' by an event or decision.

10. A central feature of current with-profits products is the high degree of discretion retained by the insurer over how the with-profits fund will be managed, in particular smoothing and bonus policies, and the application of MVRs. However, the information currently provided often does not help consumers understand the nature of that discretion or how it might be exercised. This Issues Paper takes account of the need for significant improvement in this information both at and post point of sale.

11. A further Issues Paper on 'Discretion and Fairness in With-Profits Policies' will be published shortly. It will give more detailed consideration to issues arising from the nature of the discretion retained by insurers, and the way in which it is exercised.

12. The responses to this Issues Paper, and that on Discretion and Fairness in With-Profits Policies, will be made available as input to the wider Disclosure and Post Point of Sale reviews. The way in which these reviews, and the With-Profits Review, contribute to the wider work the FSA is undertaking to strengthen insurance regulation is set out in the FSA's report on the future regulation of insurance published on 3 December 2001.

13. A separate sub-project under the With-Profits Review is looking at possible improvements to the transparency of information provided in the annual regulatory returns to the FSA, particularly with respect to giving 'informed users' of the information access to certain key indicators of performance of with-profits funds. These informed users include IFAs and other professionals who advise consumers on their choice of investment. Improvements to the regulatory returns may lead to information being provided in a form that

could be used to develop key indicators which would allow consumers more readily to understand the performance of insurance companies in which they have invested, or are considering investing. An Issues Paper on Regulatory Reporting was published on 14 November 2001.

Issues

Consumer Understanding

14. As part of the With-Profits Review the FSA commissioned qualitative research to find out how much consumers understand about their with-profits product. The research, which was undertaken by Conquest Research, was targeted at less financially sophisticated consumers. There is a summary of the findings in Annex B.

15. The findings indicated that the understanding of with-profits among the respondents was generally poor, especially in terms of the key features of the product. These include bonuses, guarantees and the application of smoothing. Whilst some aspects of with-profits were better understood than others, such as the long-term nature of the product and the existence of penalties on surrender, there was variable understanding of how and where their money is invested, and little clear understanding of what risks are involved. The understanding of the existence, and potential application, of MVRs was limited.

16. The research showed that the format and volume of information currently given in point of sale literature, and the complexity of language used, did not encourage consumers to read it before sign up. Where they did read it first, it did not lead to a good understanding of the with-profits product features. Consideration of alternative options and the degree of consumer involvement in the decision process was variable (differing by product, age and gender). However, as has been demonstrated through other research undertaken for the FSA,[4] a heavy reliance was generally placed on advisers and the reputation of the provider in offering reassurance over product choice.

17. Similarly, the wide variation in the current format and content of the post point of sale annual statements did not help understanding or customer expectations of what the product would deliver. Also, some information that would help consumers to understand better the progress of their policy is currently not widely provided. For example, the investment return achieved on the underlying assets in the with-profits fund and how those returns relate to the bonus declaration. There was, however, an overall requirement from consumers that communications over the course of the policy should be

4 Informed decisions? How consumers use Key Features: a synthesis of research on the use of product information at the point of sale. Consumer Research 5. November 2000.

confined to key information regarding the performance of their policy. This finding is supported by research undertaken by NOP for the Association of British Insurers (ABI).[5] This indicated that consumers, post point of sale, are primarily interested in:

a. the current value of their policy;

b. the predicted maturity value; and

c. the value upon death.

Information 'overload'

18. There is a difficult balance to be struck between providing enough information to help consumers understand the product they are about to buy, or have already bought, and overloading them with information. This is particularly so for products such as with-profits with features that can be difficult to understand and explain succinctly. It needs to be recognised that disclosing all the information ideally required to understand the nature of the product and how it operates will not necessarily be effective at getting consumers to take it in. Indeed, presenting large amounts of information in one block may well result in none of it being read.

19. As raised in the 'Informing Consumers' Discussion Paper, there is a need to be realistic about what can be achieved through disclosure. Its effectiveness will be limited by the extent of consumers' appetite for information and their ability to understand and act on it. The range of information which potentially could be given to consumers to explain the features of with-profits (in paragraphs 33 and 34), including the operation of discretionary bonuses, smoothing policies, guarantees, surrender policies and MVRs, is extensive. A key issue to be addressed will be how to get the right balance so that the amount of information provided before and after the point of sale helps, rather than hinders, consumer understanding.

20. An important factor to take into account is that different audiences have different needs. So, a targeted approach could be considered. For example, simple, 'headline' information could be given to all consumers and more detailed information (perhaps in a separate document) could be available on request to advisers and more 'informed' consumers should they wish to use it. The Disclosure Review has been developing an approach more widely on these lines.

5 ABI ' Response to FSA With-profits Scope Paper of May 2001'. 31 August 2001.

Use of Plain Language and Standardised Terms

21. The research has shown that consumers often find the complexity of language used in product literature confusing and difficult to understand. Similarly, a consumer holding products from different companies may encounter different terms which, in practice, can have the same meaning. This is particularly the case for charges where companies use a range of different terms often with limited or no definition to describe them, for example, similar administrative and management charges. Examples include: administrative charge, service charge, establishment fee, policy fee, expense charge, annual management charge, management charge, fund related charges and fund management charge.

22. The FSA recognises that, given the nature of with-profits, some terms are unavoidably technical in their meaning. However, improving the clarity of product literature through the use of plain language, and possibly including the use of standard terms or explanations, will make literature more accessible to consumers. This should also help them more readily to compare different products. As well as using more consistent terminology for charges of a similar nature, the following terms would seem candidates for clearer explanation:

- Terminal bonus
- Reversionary bonus
- Smoothing
- Market value reduction
- Guaranteed
- Discontinuance charge
- Bid offer spread
- Allocation rates
- Maturity
- Investment risk
- Business risk

23. Similar considerations apply to policy documents and would give consumers a clearer explanation of the provisions of the contract into which they were about to enter, or had already entered. The Treating Customers Fairly Discussion Paper noted that contract and product information can be drafted defensively and in legalistic language. Instead of acting to inform the consumer, its prime purpose can become to protect the firm in the event that things go wrong.

24. The FSA asked the Plain Language Commission (PLC) to review a representative sample of with-profits contracts and product literature. The PLC proposed that documentation could be improved through:

    a. clearer text lay-out:

        i. using larger and more legible fonts, including the use of italics, bold type and colour;

        ii. using more appealing formats, such as conveying information though questions and answers, bullet points to aid mental digestion, and more headings and sub-headings designed to help the reader negotiate their way through the text; and

        iii. using accurate and relevant case studies as an effective way of enlivening and explaining the text.

    b. applying general plain language principles, notably:

        i. using short, simply constructed sentences and short paragraphs;

        ii. using words in common use, where possible;

        iii. using personal pronouns and, generally, active-voice rather than passive-voice verbs;

        iv. avoiding the use of double negatives; and

        v. avoiding excessive cross-referencing between documents.

25. The Raising Standards Quality Mark Scheme has taken steps to improve the clarity of product literature through supporting standards for clear communications and the use of plain language. The Pensions Protection and Investment Accreditation Board (PPIAB) provides an independent assessment of whether these standards have been met, and has produced guidelines and examples for product providers seeking accreditation under the Scheme. These guidelines and examples could form the basis of further work by the FSA and other interested parties to develop more standardised, and simpler, terminology and explanations of with-profits terms for wider use.

26. This work would also need to ensure that the terms used are consistent with the requirement that communications with customers must be clear, fair and not mis-leading. For example, it is for further consideration to what extent this requirement is met by terms such as ‘with-profits’(and whether this implies losses cannot be made), ‘bonuses’ (to describe a return on the consumer’s investment); ‘smoothing’ (whether the use of the term implies an automatic process which is always a benefit) or ‘guaranteed benefits’ (when those benefits may only be guaranteed in certain circumstances).

Improved disclosure requirements for new and past business

27. Any requirements for improving the disclosure to consumers of information on their with-profits policy obviously should apply to new business, and for which it is likely change could be made most cost effectively. The FSA considers that the same principles of improved disclosure should also apply to existing business. Existing customers equally stand to benefit from receiving information about how the insurer, going forward, will manage the fund they have invested in, and the practices and policies on smoothing, bonuses and market value reductions that will be applied. Similarly, existing as well as new customers would benefit from clearer information every year on the progress of their policy to help them identify what further investment decisions they may need to make.

28. However, it is recognised that in some circumstances, for example in small closed funds, the benefits of improved disclosure may not necessarily outweigh the direct or indirect costs to an already diminishing fund. It is for consideration, therefore, in the light of the likely costs and benefits, whether some form of differential approach should be adopted in these circumstances.

Q1: Do you agree with the description in paragraphs 14 to 28 of the issues arising over the disclosure of information on with-profits products?

Q2: Are there any other issues arising besides those mentioned in paragraphs 14 to 28?

Q3: Do you have any relevant research on with-profits policyholders that the FSA should consider?

Q4: Should standardised, and simpler, terminology and explanations of with-profits features be developed for use across the industry?

Q5: Do you agree that the same principles of disclosure should apply to both new and existing business? In what circumstances should a different approach to existing business be considered?

Information on With-Profits

29. This section sets out the range of information specific to with-profits which is considered, ideally, to be necessary to provide a reasonably full explanation of the way these products work, their benefits and their risks. As discussed in paragraph 10, this includes information on the key areas of discretion held by insurers. It also covers information that would be relevant both before the decision to buy is taken, and after purchase, on the progress of the investment. Added to that, it sets out the FSA's views on how consumers would be expected to use this information. It does not, however, seek to prioritise the information at this stage.

30. The section does not cover information or issues which are important but also generic to disclosure for all packaged products, such as the presentation of charges, the use of projections rates and the form of the documents in which the information should be provided. These are currently the subject of the wider Disclosure Review.

31. Specific concerns have also been expressed about the transparency and operation of the price disclosure rules as they apply to with-profits, including the presentation of this information in the FSA's Comparative Tables. ‘Price’ is the effect on the policy of charges and expenses. Where a policy does not have fully explicit charges, and this applies to most with-profits policies, firms are required to assess the level of expenses and to calculate their effect. For example, the effect of expenses and charges is open to variable treatment due to the different extent to which companies take advantage of the offset allowed for any sustainable surplus arising from non-profit business. The resulting figures therefore lack transparency, do not necessarily provide a meaningful indicator of 'price', and may not be wholly comparable with other with-profits policies and unit-linked policies. This reduces their value as a useful guide to consumers and in facilitating competition.

32. The With-Profits Review is looking to improve the transparency of with-profits policies. In the light of relevant outcomes the FSA will consider whether changes are needed to the price disclosure rules and the factors that can be taken into account, in order to promote clear, fair and comparable price disclosure for with-profits products.

33. **At Point of Sale**

    a. <u>Nature of the with-profits product</u>

        i. What the product could be used for: such as to repay a mortgage, finance a pension, provide a regular income, to serve as a general investment/savings vehicle.

        ii. The extent of life insurance included.

        iii. The long-term nature of the product, including the consequence of missing or stopping premium payments before the full term has been completed.

        iv. Explanation of what ‘with-profits’ means, including a definition of ‘profit’ and how it applies in this instance.

        v. What part of the benefit is guaranteed, and what part is not.

        vi. Whether the product is a unitised or conventional with-profits product, including a definition of the relevant form.

        vii. Explanation of tax position, including the payment of tax from the fund on life insurance business, and position of higher rate tax payers.

viii. For mutual companies, whether the policy confers membership.

ix. The consumer should also be informed that, post-sale, they will receive an annual statement and what this will include.

How consumers should use **–** consumers should understand the concept of with-profits and its long-term nature. They should be encouraged to read on and gain a greater understanding of the factors which affect the risk, performance and return on their investment. This information addresses the suitability of the product.

b. <u>What the money will be invested in</u>

i. What type of assets will form the investment i.e. target ratio of stock, fixed interest, property etc of the with-profits fund.

ii. The investment objectives of the with-profits fund.

iii. What factors may affect the investment strategy of the with-profits fund.

iv. The proportion of premium used to provide life cover, and the proportion used for savings investment.

How consumers should use **–** this information will help consumers to evaluate the likely risk of the product, and give a sense of the uncertain nature of the investment. It will also allow consumers to compare whether it would be more cost effective to buy the elements of life cover and savings separately.

c. <u>Factors that will affect the return achieved (risk attached to the investment)</u>

The basis of with-profits policies is an entitlement to share in the profits (or losses) of the insurer through a system of bonuses. However, the extent of these 'participation rights', and hence the level of risk exposure, of any given policyholder vary according to the terms of their particular policy. Some will be entitled to receive a return based only on the investment performance of the assets in the with-profits fund (i.e. exposure to 'investment risk'). Others may also carry, to varying degrees, an exposure to 'business risk' and will participate in the profits (or losses) arising from the operations of the company more generally. Disclosure to consumers should include information on whether they are exposed to investment risk only, or the extent to which they are also exposed to business risk (where material) which will reflect their right to participate in some or all of:

i. the profits (or losses) arising from the company's with-profits business, such as those arising from:

- the expenses of selling and administering policies, and investing in assets, being higher or lower than anticipated;
- levels of mortality (death) and morbidity (sickness or critical illness) being higher or lower than anticipated;

- surrenders or transfers being settled at claim values above or below the actual value of the policy; and
- the costs of guarantees over or under any charges already made for such guarantees.

ii. the profits (or losses) arising from business, other than with-profits, written by the company.

How consumers should use – as above, this information will help consumers to evaluate the likely risk/opportunity of the product, and give a sense of the uncertain nature of the investment.

d. <u>Bonus policy and the nature of guarantees</u>

i. Definitions of both annual and terminal bonus.

ii. When bonuses are applied.

iii. The discretionary nature of bonuses.

iv. When bonuses added are guaranteed.

v. The definition of guarantee.

vi. When bonuses are not guaranteed and, if not, why not.

vii. The principles applied, and key factors taken into account, in setting bonus rates.

viii. Any special dates on which guaranteed benefits apply, or on which no MVRs will apply.

ix. Inform the consumer that an annual statement giving details of the annual bonus applied will be supplied post-sale.

How consumers should use – this information should give a sense of the uncertain nature of future bonuses, and should tell the consumer which benefits are guaranteed. It should help ensure that there are no post-sale surprises.

e. <u>Smoothing</u>

i. Definition of smoothing.

ii. Description of present smoothing policy operated and the principles that will be applied in the future.

iii. An explanation of the concept, including why a % figure for a bonus may not reflect the % figure for the performance and profit achieved in that year.

iv. A warning that smoothing does not provide a means to defy the effect of a sustained decline in investment returns.

How consumers should use – this information should help consumers to evaluate the risk of the product. It should also ensure that there are no surprises post-sale.

f. Surrenders and MVRs

   i. Fixed charges that will apply on surrender or transfer in the early years of the policy to cover costs, including marketing costs and commission, and over what time period they will apply.

   ii. Any charge made on surrender or transfer for profit.

   iii. Deductions made on surrender or transfer for the effects of investment performance:

   - possibility of the application of an MVR, including a definition;
   - when an MVR may apply, and the factors that will be taken into account in deciding whether to do so; and
   - how an MVR will be calculated.

How consumers should use – this information should reinforce the notion of the product as a long term investment and influence the suitability decision. It should also familiarise the consumer with the concept of an MVR, so that it does not come as a surprise post-sale.

34. Post-point of Sale (by way of an annual statement)

a. Reminder of the purpose of the product and how it works

   i. A summary of the product, its purpose and how it works. For example, basic descriptions of the long-term nature of the product, what sort of assets it is investing in, smoothing, bonuses, surrender penalties, MVRs and any factors other than investment performance affecting returns.

   ii. Any significant changes in the firm's approach towards managing its with-profits business that may affect the operation of the consumers' investments.

   iii. Any special dates on which guaranteed benefits apply, or on which no MVRs will apply.

   iv. Details of life cover (how much, who is covered).

How consumers should use – to remind customers what they have bought, to see whether any changes to the practices and policies of the firm affect their decision to remain invested and to help judge whether the investment is still applicable to their circumstances.

b. How the investment has performed so far

   i. Premiums paid in during the year.

   ii. Amounts withdrawn during the year.

   iii. Current surrender or transfer value, in £s, of customer's policy (including breakdown of any exit penalties and/or MVR applicable).

   iv. Rate of current annual bonus, and bonuses added to date.

   v. Projection of how much the customer is likely to receive at maturity (or at X date).

   vi. Value on death.

How consumers should use – to tell them how their investment is progressing towards its goal, whether they need to increase the amount of money they save each month (into the with-profits product, or elsewhere) or whether to surrender the with-profits product or not (assuming there is an alternative course of action available).

c. Returns achieved by the with-profits fund

   i. The investment return achieved from the fund in which the customer's policy is invested.

   ii. The average amount of that return credited to asset shares, and an explanation of any difference.

   iii. A statement of the company's average payout on maturing policies as compared to the measure it uses to track the starting point from which to calculate a policyholder's 'fair share' (e.g. asset shares).

How consumers should use – to give them information on how the fund they have invested in is performing, and the company's approach to payouts. It will also give them information to help them decide whether it makes sense to switch to a different fund, or to a different product entirely (e.g. in response to poor performance, or due to dissatisfaction with the company's policy on payouts).

Q6: Do you agree that the information in paragraphs 33 and 34 is that which would be necessary to ideally provide a reasonably full explanation of the mode of operation, benefits and risks of with-profits products? If not, what information do you think is missing, or not necessary?

Q7: What are the most important pieces of information to convey pre-sale and post-sale?

Q8: Are there any other sources of profits (or losses) other than those listed in paragraph 33(c) which policyholders may participate in?

Q9: Do you agree with the FSA's view on how customers should use the information?

Q10: How might the transparency and consistency of the price disclosure for with-profits policies be best improved?

Tailoring of Information

35. As discussed above, disclosing all the information ideally required to understand the nature of the product and how it operates will not necessarily be effective at getting consumers to take it in. Different audiences also have differing capacities to absorb and understand information. As noted in paragraph 20, the Disclosure Review has been considering a tailored approach to providing information. In particular, the possibility of a continued role for a document separate from the KFD (currently in the form of the with-profits guide) to cover more detailed information on with-profits products.

36. So, Tables 1 and 2 below propose a two-tier approach. A distinction is made between information that could be considered to be 'core' to be provided to all consumers, and that which could form supplementary information which could be tailored towards advisers, but also to be available to more informed consumers should they wish to use it. The basis for the distinction of 'core' information is that which consumers are considered most likely to use and, if not disclosed, would most likely lead to consumer detriment.

37. The voluntary Raising Standards Quality Mark Scheme also requires a similar tailored approach to the provision of information, with accredited companies providing a 'with-profits summary' for customers that must describe all the main elements of the management of the with-profits business. This includes how the bonus system works, how payouts are managed, investment policy, smoothing and payouts on maturity and surrender. The insurer must also produce a more detailed version of the summary, to be given to customers on request, which covers the same ground but in more depth. The ABI's response[6] to the FSA Discussion Paper on With-Profits submitted proposals, and illustrative model documents, for enhancing the information required by Raising Standards in with-profits summaries, and annual statements. The FSA found these proposals helpful and they are reflected in the tables below. In drawing up conclusions on how to improve the disclosure of with-profits information to consumers, the FSA will further evaluate the proposals and the extent to which they could be incorporated into a revised regime.

6 ABI 'Response to FSA With-profits Scope Paper of May 2001'. 31 August 2001.

Table 1: Pre-Point of Sale Information

Core Information	Supporting Information
What the product could be used for	
The long-term nature of the product, including the consequences of stopping or missing premium payments	
Extent of life insurance included	Whether the policy confers membership of a mutual
Definition of with-profits, including what 'with-profits' means	Whether the product is unitised or conventional with-profits
What money is invested in	Proportion of premium used to provide life cover, and proportion used for savings investment Investment objectives Asset mix of the fund Factors that will affect investment strategy
	Tax position
Risks attached to investment, including investment risk and extent of 'business risk' (where material), with sources of potential profits or losses identified	
Description of annual and terminal bonuses, and their discretionary nature	Principles applied, and key factors taken into account in setting annual and terminal bonus rates
What part of the benefit is guaranteed, and what part is not Definition of 'guaranteed' Any special dates on which guaranteed benefits apply, or on which no MVRs will apply;	Where benefits are not guaranteed, an explanation of why not
Description of smoothing Warning that smoothing does not provide a means to defy the effect of a sustained decline in investment returns.	The smoothing policy operated Explanation of the concept, including why a % figure for a bonus may not reflect the % figure for the performance and profit achieved in that year.
Consequences of surrender or transfer: - fixed charges - any charge for surrender profits - possibility that an MVR may be applied, and its effect	Factors that will be taken into account in deciding whether to apply an MVR How the level of MVR will be calculated

Table 2: Post-Point of Sale Information

Core Information	Supporting Information
	Summary of the product, what it can be used for, and how it works (e.g. basic descriptions of the long-term nature of the product, what sort of assets it is invested in, smoothing, bonuses, surrender penalties, MVRs, and any factors other than investment performance affecting returns)
Details of life cover (how much, who is covered).	
Any special dates on which guaranteed benefits apply, or on which no MVRs will apply.	
Any significant changes in the firm's approach towards managing its with-profits business	
Premiums paid in during year	
Withdrawals during year	
Current annual bonus Bonuses added to date	
Current surrender or transfer value in £s Projection of maturity value Value upon death	Breakdown of any exit penalties or MVRs The investment return achieved from the fund in which the customer's policy is invested. The average amount of that return credited to policies, and an explanation of any difference. A statement of the company's average payout on maturing policies as compared to the measure it uses to track the starting point for calculating a policyholder's 'fair share' (e.g. asset shares).

Q11: How should information be tailored to take account of the different needs of different audiences? How could information overload best be avoided?

Q12: Do you agree with the analysis in paragraph 36 of what might form 'core' and 'supplementary' information? If not, what information do you think should be provided to all customers as standard?

Summary list of questions

Q1: Do you agree with the description in paragraphs 14 to 28 of the issues arising over the disclosure of information on with-profits products?

Q2: Are there any other issues arising besides those mentioned in paragraphs 14 to 28?

Q3: Do you have any relevant research on with-profits policyholders that the FSA should consider?

Q4: Should standardised, and simpler, terminology and explanations of with-profits features be developed for use across the industry?

Q5: Do you agree that the same principles of disclosure should apply to both new and existing business? In what circumstances should a different approach to existing business be considered?

Q6: Do you agree that the information in paragraph 33 and 34 is that which would be necessary to ideally provide a reasonably full explanation of the mode of operation, benefits and risks of with-profits products? If not, what information do you think is missing, or not necessary?

Q7: What are the most important pieces of information to convey pre-sale and post-sale?

Q8: Are there any other sources of profits (or losses) other than those listed in paragraph 33(c) which policyholders may participate in?

Q9: Do you agree with the FSA's view on how customers should use the information?

Q10: How might the transparency and consistency of the price disclosure for with-profits policies be best improved?

Q11: How should information be tailored to take account of the different needs of different audiences? How could information overload best be avoided?

Q12: Do you agree with the analysis in paragraph 36 of what might form 'core' and 'supplementary' information? If not, what information do you think should be provided to all customers as standard?

Annex B

Summary of consumer research on with-profits undertaken by Conquest Research

Objectives of research

1. The objectives of the research were:

   a. to determine consumer expectations of the with-profits policy;

   b. to ascertain what with-profits policyholders understand with regard to their policy; and

   c. to determine why the with-profits policy was purchased against other alternatives.

Research findings

Attitudes to saving

2. An underlying insecurity about what the future holds is driving a ‘savings mentality’, savings offering peace of mind and the perception of reducing risk. Whilst some save for a specific objective, others have no long term goal and view savings simply as a means of enforced financial discipline or transferring worry/responsibility.

3. The endowment decision often has low involvement, with consumers rarely considering alternative options on initial take up:

   a. for mortgage linked policies it is often secondary, a means to an end of obtaining a mortgage;

   b. those holding endowments as a sole savings vehicle tended to select on the basis of habitual / historical reasons (i.e. family has always done it), or they are aware that it is uneconomical to surrender (i.e. have to continue).

4. There is mixed involvement in the pension decision, often varying by pension type (i.e. company vs. personal pension). However most adopt simply as a

gesture to alleviate concern over not having a pension rather than a serious consideration regarding future provision. Real product understanding is low.

5. There is higher involvement in Bonds, with a shift into an investment rather than a 'savings mentality'. The motivation to retain money, often meaningful on a personal level, means a greater emphasis is placed on seeking security from experts/reliable providers.

The decision process

6. The complexity of the market/products and associated literature results in heavy reliance on advisers and the reputation of the provider in offering reassurance over product choice. There is a strong tendency to transfer responsibility.

7. Consideration of alternative options and degree of involvement in the decision process is variable (differing by product, age and gender). Even where this occurs, the comparisons are rarely understood and essentially people opt for the policy recommended by their adviser. Thus advisers are in a position of great power.

8. There is recognition of a need to become more involved and informed, particularly in light of the current economic climate.

With-profits understanding

9. Understanding of with-profits policies is generally poor, especially in terms of the key product mechanics (e.g. bonuses, guarantees and smoothing effect). There are wide variations in the interpretation of the term 'with-profits', and the generic name if not helping product differentiation. Most simply view it as a policy providing profits which cumulate to a sum at the end of a specific period.

10. Some aspects of 'with-profits' policies are better understood than others, and include:

    a. the long term nature of policies; and

    b. that there will be penalties for early surrender. Few, however, understood why or the degree of penalty involved at different stages of the product lifespan.

11. There is variable understanding of:

    a. how or where the money is invested. Different scenarios envisaged are:

        i. provider simply holds funds and provides interest in return (i.e. deposit account);

        ii. it is invested but no idea how or where;

        iii. it is invested in the financial market / other companies:

- stocks and shares only (and types thereof);
- range of equities, property, gilts etc;
- other (e.g. loans to British industry).

b. the end result (i.e. the amount likely to be received). This varies by product:

i. <u>Mortgage linked endowment policies</u>

The policy was initially envisaged to pay off the mortgage, although some now see this as uncertain in the current climate. Some also expected a discretionary additional sum based on performance (for themselves).

ii. <u>Bonds/endowments savings</u>

General belief that the capital sum invested is safe/guaranteed. Most hope or expect to achieve some additional growth, although expectations are fairly conservative.

iii. <u>Pensions</u>

Absence of clear goal or objective. Most simply gain some comfort from having made some provision and hope there will be enough.

c. The risk element: the low awareness of where money is invested makes assessment of product risk difficult or 'back of mind'. There is little clear understanding of what risks are involved. Most appear to believe with-profits policies to be low to medium risk in view of the longer term nature of the policies, the likely spread of investments and the size/reputation of the provider.

12. Respondents generally demonstrated a poor understanding of:

a. <u>Bonuses</u>

Annual bonus: Although some recognised the term 'bonus' from their statements, which was generally equated to the amount of growth/interest, it was not seen as guaranteed. It was not a key motivation for product selection. Some assumed that an annual bonus referred to a cash sum received (as opposed to reinvested), and therefore felt it did not apply to their policy.

Terminal bonus: There is minimal awareness of the term. Even when the concept was understood, there was confusion as to whether it was part of the final amount or something separate (especially for bonds and pensions).

b. <u>Smoothing effect</u>

Very few people were aware of the term or recognised the concept once described. It was not a motivation to product selection. However, there was general recognition of the balancing out of good and bad performance, but this was seen to be due to the long term nature of the policy rather than artificial smoothing.

When explained, the smoothing concept raised concerns over manipulation and holding back of funds, rather than underpinning the potential benefit of reduced risk.

c. Costs/charges

There is generally little consideration of charges, and little recall of conversations on this topic with financial advisers. Charges are generally assumed either:

i. not to apply;

ii. to be funded by the provider; or

iii. to be generally lost in the policy package.

If considered, most assume that all costs are up front, and only a few are aware of ongoing management charges.

d. Unitised versus conventional

There was no active decision to opt for either unitised or conventional policies. There was little recognition of these terms and the difference between, and relative merits of, either type of policy.

e. Tax

There is almost a complete lack of consideration of the tax implications or benefits of with-profits policies. Once the issue is raised numerous tax scenarios are envisaged and it encourages many to re-evaluate their policy.

f. Insurance

Very few were aware of the insurance element as a benefit or as an inclusive element of with-profits policies.

Communication

13. A wide variation in the format and content of annual statements is evident, which is not helping product understanding or expectations. Equally, the volume of information, complexity of language and illustrations, and long winded/indigestible presentation of product literature (i.e. KFDs) fails to encourage customers to read before they sign up.

14. There is a strong desire for products to be de-mystified and made more understandable and accessible. This is especially the case against the current

background of uncertainty and adverse publicity over the performance of many financial products.

15. Communications over the course of the policy should be tailored and confined to key information on performance. Limited communication is acceptable as most prefer their policy to remain 'back of mind'.

16. The research suggests a need for greater standardisation and clarity over what consumers are told and shown both at the outset and over the duration of their policy.

Levels of satisfaction

17. Levels of satisfaction appear to be reasonably good (albeit against fairly conservative expectations). For those who took out policies before the 1990's, performance was at least what they expected. However, more recent policies have generally underachieved against expectations, or are seen as likely to do so.