



## **ABI RESPONSE TO OFT DISCUSSION PAPER ON BUSINESS LEADERSHIP IN CONSUMER PROTECTION [OFT 1058]**

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### **1. Introduction**

1.1 The ABI is the voice of the insurance and investment industry. Its members constitute over 90 per cent of the insurance market in the UK and 20 per cent across the EU. They control assets equivalent to a quarter of the UK's capital. They are the risk managers of the UK's economy and society. Through the ABI their voice is heard in Government and in public debate on insurance, savings, and investment matters.

### **2. General Comments**

2.1 The ABI welcomes the opportunity to comment on the role of self regulation and industry-led compliance in relation to consumer protection. We believe that self regulation can be an effective way of minimising the risks of consumer detriment and improving outcomes for consumers above and beyond existing regulations.

2.2 Self regulation has proven itself to be an effective tool in the insurance industry. There are numerous examples of self regulation being more responsive to consumer concerns, delivering lower compliance costs, encouraging greater innovation in products and distribution models, and providing wider access to insurance for customers. The full list of ABI-produced guidance and codes of practice can be found on our website<sup>1</sup>.

2.3 The current economic climate may prove a challenge to self regulation. Governments and regulators may be tempted to impose more prescriptive regulation across the board in an effort to be seen to be 'taking action'. However, while the economic crisis has uncovered serious weaknesses in some areas of financial services, insurance has not suffered in the same way. We are keen that regulatory reform is targeted towards the causes of the crisis, and does not spill into areas that are working for consumers.

2.4 There is a need for Government and regulators to be more joined-up in their approaches to regulation. Though we welcome the OFT's discussion paper on self regulation, it coincides with the Law Commissions' review which advocates codification of insurance contract law, despite the lack of evidence of consumer detriment. This inconsistency of approach is unhelpful.

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<sup>1</sup> Link to ABI guidance and codes of practice - [http://www.abi.org.uk/Display/File/796/Codes\\_and\\_Rules.pdf](http://www.abi.org.uk/Display/File/796/Codes_and_Rules.pdf)

- 2.5 We are pleased that the recently published Annual Plan 2009/10 confirms the OFT's intention to work in partnership with Government and other regulators to influence regulatory, consumer and competition policies and to promote the benefits of competition and markets amongst policymakers and stakeholders. We further welcome the OFT's recent consultation on its financial services strategy, in particular its focus on strong competition and open markets.

### 3. Specific Comments

#### **Question 1: What types of market problems are most likely to be suitable for an industry-led solution?**

- 3.1 Industry-led solutions are most effective:
- (i) where there are common interests or problems between different stakeholders.

#### **CASE STUDY: ABI LIFE AND PENSION FUND SECTORS**

There are currently over 8000 different insurance-based life and pension funds on offer in the UK, representing over £700 billion in assets under management. To help consumers get to grips with this huge number of funds, the ABI runs the life and pension sectors (the ABI sectors).

The ABI sectors were introduced in 1997 to ensure that life and pensions funds operating similar investment strategies are grouped together so that consumers and financial advisers can compare them on a like-for-like basis. There are currently 34 sectors for life funds and 34 for pension funds.

The ABI's Investment Classification Committee is responsible for developing the criteria for each sector. It also monitors whether investment funds comply with these criteria. This monitoring process involves a detailed analysis of the assets held by a fund to ensure each fund continues to meet the criteria for the sector and is therefore comparable with other funds in that sector. Funds that fail to meet the designated sector's criteria for three consecutive months, or five months out of the preceding twelve, will be moved out of their current sector.

The classification, monitoring and strict enforcement of the ABI sectors ensures that consumers can be confident that, for example, a fund that bills itself as a North American Equities does in fact invest at least 80% of their assets in North American Equities.

This self regulation not only provides consumers with the confidence to invest but also brings consistency and governance to this market. This consistency ensures that data providers, advisers and firms use the same sector populations in comparisons, in marketing materials and in other performance management activities. Without the sectors each of the market participants would develop their own sector classifications, leading to confusion amongst consumers and advisers and potentially damaging competition.

- (ii) where changing markets require flexible and responsive regulation.

**CASE STUDY: MORTGAGE ENDOWMENT POLICY REVIEWS**  
**CODE OF PRACTICE**

Changing economic conditions since the late 1990s have meant that a significant number of people with endowment savings policies bought to support a mortgage now expect a shortfall between the target sum required and the sum expected from the endowment policy.

These conditions led the ABI to establish a Code of Practice for its members in 1999. The code is kept under regular review and was last updated during 2004. The code requires member firms to send reprojection letters to each customer at regular intervals (at least once every two years). The ABI provides a model reprojection letter to ensure standardisation across the industry.

The code also introduced a traffic light system whereby a 'red' letter would mean that there was a high risk of a shortfall at maturity, an 'amber' letter a significant risk and a 'green' letter meant that the policy was still on target to reach the sum expected, and therefore pay off the mortgage loan.

The reprojection letters encourage customers to take appropriate action, and give examples of the kind of action customers should consider. Since 2000, insurers have sent 33.3 million reprojection letters to policyholders. Customers are now regularly informed about the performance of their endowments, and large numbers of those facing a projected shortfall have taken appropriate steps to build up other savings to cover this.

Any ABI member firm with in-force mortgage endowment policies is required, as a condition of membership, to comply with the code. Additionally Chief Executives of member companies are required to sign an annual statement confirming their company's compliance with the code. The code has proved to be an effective tool to inform a large number of consumers of potential shortfalls and to provide consumers with the information they need to react to these potential shortfalls.

- (iii) where there are no existing regulations/laws to tackle 'soft problems' e.g. financial inclusion.

### **CASE STUDY: AGE DISCRIMINATION**

Age is a key factor in helping insurers determine the level of risk posed by an individual. However, while a person's age may affect the price they pay, insurance is widely available for people of all ages.

The industry recognises that some older people do not always know where to look to find cover. This can mean wasted search time or, in extreme cases, not being able to find cover at all. The insurance industry is keen to help older customers find the cover they need. We are therefore developing an industry solution, which will mean older customers are able to find insurance easily. Options being considered include an industry signpost (a requirement that insurers who are unwilling to provide a quote to an individual because of their age must provide details of a signpost which would give contact details of insurers who would be willing to quote to people of that age) and referrals (a requirement that insurers unwilling to quote to an individual because of their age must find a partner who would be willing to offer insurance to people of that age and then refer the customer on). Both solutions would ensure that no one would be unable to find insurance because of their age.

We believe that either industry solution will negate the need for the proposed Equalities legislation to be extended to insurance. Any restrictions on insurers' use of age to determine premiums or other age-related practices – such as requiring insurers to quote for everyone, regardless of age, or forcing insurers to offer the same products features to everyone (e.g. offering the same excesses to all drivers - currently young drivers often pay higher excesses than other drivers) would risk pushing the cost of insurance up for all consumers, reducing consumer choice, and putting UK insurers at a disadvantage compared to many of their European counterparts.

(iv) where action needs to be carried out quickly and efficiently.

### **CASE STUDY: NON-DISCLOSURE AND TREATING CUSTOMERS FAIRLY**

At the beginning of 2008, there was an increase in the number of complaints on long-term protection being referred to the FOS. To address this, the ABI published mandatory guidance on insurance claims for long-term protection policies (this was later upgraded to a code of practice in January 2009).

The guidance led to a dramatic decrease in referrals on long-term protection claims to the FOS by the end of 2008 (85 referrals in Q1 2008 compared with 40 referrals in Q4 of 2008). This example clearly illustrates self regulation working effectively by enhancing protection for consumers, while at the same time allowing the industry to work within a flexible regulatory environment.

This shows that self regulation can address where action needs to be carried out quickly.

4. **Question 2: In which market condition is self regulation more likely to be an effective solution than legislation and enforcement?**

**Question 4: How will the current economic climate impact on the role of self regulation as a solution to market problems?**

- 4.1 Self regulation is most effective in a principles-based environment.
- 4.2 While we are in a period of economic uncertainty, the Government may be tempted to impose new rules in order to show customers that it has the crisis under control. It should resist this urge in sectors that have not caused the current crisis and where consumer detriment is not evident. In fact, at a time when 'quick wins' are important for Government and customers alike, self regulation can be an effective tool as it is quicker to implement than rules and regulations, and much easier to adapt when circumstances change.
- 4.3 It can also go some way to restoring consumer confidence, showing that industry is committed to treating customers fairly and does not have to be forced into particular approaches by Government and regulators.

**CASE STUDY: CUSTOMER IMPACT SCHEME**

The Customer Impact Scheme is part of the Life and Pension industry's commitment to improve customers' experiences and to be held to account for our performance. It was set up in 2006 and is led by the ABI.

Companies participating in the Scheme have committed to putting customer needs at the heart of how they do business. Customer Impact comprises a series of measures to assist companies improve customer experiences and report on their work. Its main components are 3 Customer Commitments, a series of Good Practice Guides, an independent oversight Panel, Annual reporting and the Customer Impact Survey.

The series of Good Practice Guides produced under the Scheme encourage members to review their business processes to improve outcomes for consumers. The Guides cover areas such as product development, complaint handling and use of clear language and layout in documentation. The provisions in the Guides go beyond regulatory requirements to improve the customer experience.

- 4.4 Further, excessive regulation is inefficient and costly to implement and maintain. We need to avoid imposing unnecessary costs, which will ultimately be paid for by consumers.

**5. Question 3: What type of support from the OFT would be appropriate to encourage more self-regulatory solutions to market problems?**

- 5.1 The OFT's own Customer Code Approval Scheme does not apply to financial services. Insurance industry guidance can only be 'confirmed' by the Financial Services Authority. However, while the OFT does not approve insurance codes under its own scheme, it can still encourage self regulation. For example, although organisations can no longer seek a decision or guidance from the OFT as to whether an initiative (such as a proposed code of practice) is competition-compliant, it can help trade associations and other organisations to assess compliance by continuing to engage with them and offer informal advice.
- 5.2 We are grateful for the strong support we have already received from the OFT in relation to Total and Permanent Disability benefit. The industry has been working, with agreement from the OFT, to find an alternative to the Total and Permanent Disability benefit found within Critical Illness cover. The benefit is not well understood by consumers leading to a large number of declined claims. The aim is to replace the current subjective definition with clear, more easily understood specific definitions tested through consumer research. We have been updating the OFT at key stages to ensure their agreement and approval.
- 5.3 Our experience of the FSA's confirmation process for industry guidance has been limited. Since the process was introduced, there have only been a small number of guides that have received confirmation status. We believe that this is due at least in part to the highly prescriptive process, which requires all content to be directly related to an FSA rule or principle. This means that the FSA cannot grant confirmation relating to parts of a code, which relate to areas where it has no jurisdiction. This can result in a 'dumbing down' of industry guidance, which is clearly not in the consumer interest, and makes the confirmation process less attractive.
- 5.4 Inconsistency between different regulators' approaches to self regulation can also be problematic. Self regulation may often require a business to meet higher standards than a regulator would demand. To get support for high voluntary standards, businesses need to be confident that these higher standards will not be used against them – for example, by the Ombudsman. As well as taking into account the law, rules and market codes of practice, the FOS determines what it thinks is fair and reasonable in the circumstances of each case.
- 5.5 Similarly, there is sometimes concern that good industry practice, which again may go beyond what a regulator might demand, will eventually become minimum standards through codification. There should be scope for some firms to make use of guidance without it becoming a straitjacket for the whole market. Both the FSA and trade associations should ensure that there is a shared understanding that compliance with guidance is optional and it should not become a baseline for regulatory standards.

**6. Question 5: What does effective self regulation require?**

- 6.1 There are a number of common elements to effective self regulation.
- 6.2 Support from the regulator is key; this is in terms of content (i.e. allowing confirmed guidance to promote best practice beyond that which can be tied to a rule or principle), having a streamlined confirmation process for industry guidance, and being clear about its status (how it will be viewed in routine assessments).
- 6.3 Buy-in from the whole industry is beneficial in satisfying regulators that a problem has been resolved, but is not essential where the self regulation is intended to move the industry beyond already existing standards. In this latter situation, the appeal of self regulation is that it differentiates one business from some of its competitors.
- 6.4 Assurance that any self regulation that goes beyond existing standards (i.e. is not in response to evidenced consumer detriment) will not be codified is important in obtaining industry support.
- 6.5 The ability to monitor outcomes and effects of industry-led solutions is key in maintaining the support of stakeholders.

Association of British Insurers  
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