SUMMARY OF FEEDBACK RECEIVED

Consultation title	Proposed guidance on traded life policy investments (TLPIs)
Date of consultation	The consultation period ran from 28 November 2011 to 23 January 2012
Summary of the issue	TLPIs invest in life insurance policies of US citizens. They are sometimes also known as traded life settlements or senior life settlements. We have found serious problems with how many TLPIs are designed, marketed and sold to retail clients. Customer experience to date has often been poor. In February 2010 we raised our concerns with the industry. We also highlighted our concerns in the 2011 *Retail Conduct Risk Outlook* and the *Product Intervention* Discussion Paper in January 2011. The TLPI industry failed to act to address our concerns and the market still showed signs of growing investment by consumers for whom these risky products are unlikely to be suitable. We published further guidance for consultation, on 28 November 2011, strongly recommending that these products should not reach the vast majority of retail clients in the UK. Later this year we intend to consider introducing a marketing restriction on TLPIs to prevent the promotion of this type of investment to the vast majority of retail clients. As the process for introducing new rules via consultation takes time, we issued the guidance consultation as an interim measure.
Summary of feedback received	55 respondents provided submissions to the consultation. The following bullet points summarise the key points that were made: • the guidance should clarify which TLPI models can be sold to retail customers; • while a number of respondents, including some of the firms involved in this market, agreed that TLPIs are not generally suitable for the retail market, some felt that certain retail customers, particularly sophisticated investors who believe they understand the risks, should be able to invest in TLPIs; • when publishing the guidance consultation, the FSA should have taken into account the possible impact of its warning on existing TLPI investors as part of our statutory objectives of consumer protection and maintaining market confidence; • many felt that the use of the terms ‘death bonds’ and ‘toxic’ were overly emotional and inflammatory; • we should not have said that certain TLPI models carry risks that make them appear to share some of the characteristics of Ponzi schemes. On the other hand, some responses from firms in the industry agreed that

	certain models do lead to unsustainable value transfers in the manner we outlined; • governance issues, as well as problems with the underlying assets, are often important factors in leading to problems with TLPIs. For example, significant conflicts of interest can exist among firms involved in the product, leading to high charges and possible detriment for investors. Other respondents suggested that governance could be improved if regulated legal structures were used and criteria set for the quality of counterparties, custodians, valuation methodology and acceptable levels of charges; • we should confirm that the guidance does not apply to Traded Endowment Policies; and • we should clarify how the guidance relates to the marketing of TLPIs to other types of investors, such as professional or institutional investors.
Response to feedback received	• **Distinguishing among different models**: While some TLPI models are higher risk than others, we do not regard any TLPI model as generally appropriate for distribution to the retail market. • **Recognising that some retail investors are willing to accept the risks involved:** There may be some retail investors willing and able to take the risk of significant capital losses, perhaps with a small proportion of their capital and after having undertaken sufficient due diligence to understand the various and complex risks involved with TLPIs. However, these are unlikely to be investors of ordinary means and experience. Generally speaking, TLPIs are unlikely to be suitable investments for retail clients. We consider that this approach is already set out in the guidance. We note that many of the responses from firms in the industry agreed with this position. The reason the guidance is needed is that unfortunately this message has not been acted upon and inappropriate marketing has continued, creating scope for significant consumer detriment. Many TLPIs are structured as unregulated collective investment schemes (UCIS). These types of investment, whether or not they are TLPIs, are subject to strict restrictions on how they may be promoted to investors. Because they are not subject to the usual rules and safeguards applying to (regulated) collective investment schemes, UCIS are usually high risk products. As a general rule, marketing of these schemes to the public in the UK is unlawful. Our 2010 thematic review of UCIS uncovered high levels of poor practice: in 76% of the cases reviewed, promotions were in breach of the marketing restrictions and advice to invest in UCIS was only rated as suitable in 26% of the cases reviewed.

	TLPIs have been subject to regulatory attention for some years now, both in the UK and globally. We are not the only regulator to have expressed concern about these products. • **The impact on existing investors:** In publishing the guidance and the accompanying cost benefit analysis, we recognised that there may be an impact on retail investors with existing TLPIs. However, the crystallisation of liquidity risks for existing investors is a potential impact that must be seen in its proper context: these investments had previously been identified by the FSA as problematic and may well have been mis-sold to them. The reaction of retail customers to the publication suggests many did not understand the risks to which they were exposed until the guidance clarified it for them. The fact that many had invested substantial proportions of their assets, indeed even borrowed money to invest, is indicative of the seriousness of the problems in this market. We also note that, generally, a fund's suspension of trading does not necessarily mean existing investors will lose their investments, though receiving the proceeds from the redemption of their share of the fund may take some time. We worked with TLPI providers before publishing the guidance to ensure they had plans in place to deal with an increase in redemption requests. Ultimately, firms are responsible for ensuring they have adequate resources to weather both good times and bad. Liquidity risks within TLPIs mean that a suspension of trading is always a possibility and TLPI contract terms usually allow for it. By setting out our concerns in stronger terms than in previous communications, we hope our guidance will prevent new retail customers from being inappropriately exposed to these investments. Without regulatory intervention, we would expect the level of retail investment in TLPIs to grow, increasing the scope for consumer detriment arising from these risky products. • **Use of the word 'toxic':** We published our guidance for consultation because we have very serious concerns about how TLPIs have been marketed to retail investors for whom they are unlikely to be suitable. We believe the scale of the risk to consumers renders these products 'toxic' in relation to the UK retail market. One of the aims of our publication was for it to be accessible for ordinary investors and to avoid its message being lost in the use of technical terms. We have previously used the term 'toxic' in our communications when discussing the risks presented by certain features of products (or certain combinations of features) and/or the way they were being distributed.

	We have used the term then, and now, as a way to highlight the extent and seriousness of our concerns. However, we accept that the expression 'toxic assets' has been used in the press in relation to financial instruments such as CDOs and CDSs and that our use of it here may have led to some confusion for some customers. • **Use of the term 'death bonds':** While some respondents felt that this is an emotionally charged choice of words, it is a recognised term used to describe TLPIs and one that reflects the nature of the investments. • **The comparison to Ponzi schemes:** We have found that liquidity problems and issues with actuarial assumptions are widespread in this industry and that, as a result, some funds appear to rely to some extent on contributions from new investors in order to meet the funds' obligations to existing investors. In this way, some TLPIs appear to share some of the characteristics of Ponzi schemes. This does not mean that we have found that some TLPIs are Ponzi schemes and no such allegation is made in our guidance or accompanying communications, nor have we said that this is a trait common to all TLPIs. We will, however, update the wording of the guidance on this point to clarify our meaning. • **Governance issues:** We agree that governance issues are important. Some of these issues were flagged in the guidance on which we consulted but we recognise that other governance issues may arise. We do not, however, propose to set rules mandating minimum requirements for governance structures. As most TLPIs are based outside the UK, these rules would have almost no effect. Furthermore, it is not our intention to encourage the development of a retail market for TLPIs because we consider these products as unsuitable for the vast majority of retail clients in the UK. • **Traded Endowment Policies:** We confirm that the guidance relates to the promotion and sale of TLPIs and does not comment on the market for, or risks of, Traded Endowment Policies. • **Institutional investors:** Our guidance seeks to address the FSA's serious concerns about how TLPIs have been designed, marketed and sold to retail clients in the UK. We have not included sales to professional or institutional investors within the scope of the guidance.
Changes made to the guidance as a result of feedback received	As a result of feedback received we have made some changes to the guidance to clarify our meaning and added some further information related to our concerns with governance issues in some TLPIs. For the reasons set out above, we do not propose to make any further changes to the guidance. As part of our consultation on new rules for the sale of UCIS, scheduled for the second quarter of this year, we plan to consult on

	new rules preventing the marketing of TLPIs to the vast majority of retail clients. If rules are introduced following this consultation, we would expect them to come into force some time in 2013.
Full text of the guidance consulted upon can be accessed here	