

Guidance consultation

Traded Life Policy Investments (TLPIs)



November 2011

- 1.1 We are issuing the following guidance for consultation.
- 1.2 We strongly recommend that Traded Life Policy Investments (TLPIs) should not reach retail investors in the UK. This is not the first time we have warned the industry about these products.
- 1.3 Next year, as part of a review of the rules relating to unregulated collective investment schemes, we intend to consult on a ban of all marketing – including marketing delivered in the context of financial advice – of TLPIs to mass market retail investors. Such interventions were envisaged in our product intervention Discussion Paper (DP11/1). As the process for introducing new rules via consultation takes time, we are issuing this guidance as an interim measure.

What are TLPIs?

- 1.4 Traded Life Policy Investments (TLPIs) – also known as Traded Life Settlements or Senior Life Settlements – are complex products with a number of inherent risks. They are pooled investments into US life assurance policies. They can be sold either directly or indirectly through other investments such as funds of funds.

Why are we concerned?

- 1.5 Our work has found significant problems with the way in which TLPIs are designed, marketed, and sold to UK retail investors. These products are complex and high risk, and generally speaking are unlikely to be suitable for retail investors.
- 1.6 Firms should be aware that TLPIs should not be promoted to the mass retail market in the UK.
- 1.7 Where advisers do not understand products, they should not recommend them: we have seen numerous cases of advisers recommending TLPIs without properly understanding how these products work and what risks are involved. Advisers should also be aware of the underlying assets within the investments they recommend: including TLPIs as a significant component within another investment means, in the FSA's view, that investment is unsuitable for most retail customers.

What we expect of firms

- 1.8 Firms should be mindful of existing requirements on promotions, on the suitability of advice and on managing investments. In particular, Principles 6, 7 and 9 and the rules in COBS 4 and COBS 9 are relevant here.
- 1.9 We believe investments in TLPIs are unsuitable for the majority of retail investors. In the unlikely event that, after conducting extensive research, a firm considers that TLPIs might be suitable for a particular retail investor, or wants to include them within another investment, like a fund of funds, that firm must be able to provide detailed and robust justification for its reasoning. Where a firm promotes an investment without giving advice, they must comply with our financial promotion rules: but given the risks involved, we consider it to be extremely difficult to promote TLPIs in a way that is fair, clear and not misleading such that a retail customer could understand the risks and, crucially, the materiality of any risks crystallising.
- 1.10 If firms identify problems or compliance failures, we expect them to have regard to Principle 6 ('A firm must pay due regard to the interests of its customers and treat them fairly') and consider whether they ought to act on their own initiative regarding the position of customers who may have suffered detriment from, or been potentially disadvantaged by, such failures.
- 1.11 This may include a review of client files by advisers, and firms with investments that include a component in a TLPI reviewing their holdings. Customer detriment may have arisen from a number of causes: if a firm reviews its previous transactions and identifies that it has breached any regulatory requirements, it should consider whether it is liable to the customer for any of the detriment or loss suffered.

Where the FSA finds evidence of poor practice, we will take tough action.

- 1.12 We have a comprehensive regulatory regime in place to deal with these issues and we will continue to supervise and enforce firms' compliance with our standards. In view of the evidence of significant problems in this market, we will consider whether there is a need to put in place further requirements on firms in this area in line with our consumer protection objective.

Key risks associated with TLPIs

- **Longevity risk** – An accurate estimation of life expectancy is the most important factor in assessing the price of each underlying life insurance policy in a TLPI. Based on this, the primary risk is that the underlying policies' lives assured live longer than expected (for example, because of medical advances and the incompatibility of life assurance actuarial models as the basis for investment purposes) so the TLPI needs to continue to fund premiums on the policies for longer than expected. This could negatively affect the return on investment and liquidity on an ongoing basis.
- **Liquidity risk** – The underlying investments are illiquid due to their specialised nature and there is only a limited secondary market for them. This may mean they are sold at a significantly

reduced value if the TLPI needs to raise funds at short notice, which has an impact on the value of the portfolio. Investors may therefore suffer financial loss at the point of redemption.

- **TLPI models / structure** – In some models, yields are promised to previous investors, which can only be sustained by using new investors' money, so the model in effect 'borrows' from itself and therefore appears to share some of the characteristics of a Ponzi scheme.
- **The underlying assets are located offshore** – This means there is an exchange rate risk, both in terms of the costs of meeting ongoing premiums and the final payout for the underlying insurance contracts. Currency hedging instruments may be used by TLPI providers, but these may pose additional risks and involve extra costs.
- **Many TLPIs sold in the UK are operated by firms based offshore** – This means investors may have limited or no recourse to the Financial Services Compensation Scheme (FSCS) if things go wrong and the product fails. They may also not be covered by the Financial Ombudsman Service (FOS) if they have a complaint about the operation of the TLPI. Customers would be able to complain to the FOS if, for example, the advice they have received from UK distributors was unsuitable or if a promotion from a UK provider or distributor was unfair, unclear or misleading.
- **Parties involved in the TLPI may become insolvent** – For example, if an insurance company becomes insolvent and is unable to meet claims upon the deaths of the original policyholders.
- **Awareness of authorisation/compensation arrangements** – Many TLPIs are operated by firms based abroad and outside of the FSA's jurisdiction. There is evidence that providers and advisers have not fully understood or conveyed to investors the risks involved in how or whether the client's product will be authorised and what compensation arrangements apply.

1.13 These factors could result in a significant risk of loss of capital (and any income provided) for customers.

1.14 We have also found evidence of poor practice in a number of firms including:

- **Authorisation** – Some firms have not obtained the correct authorisation with other regulators, leading to the failure of the product.
- **Cross-subsidy risks and lack of segregation** – The structure within a number of TLPIs is such that investors' monies and the assets purchased with those funds are pooled and there is no segregation between tranches. Should conditions deteriorate, investors who redeem early might get a fuller return at the expense of those who remain invested.
- **Use of inappropriate underlying assets** – Not all underlying life policies are structured on a whole of life basis. Some firms use term assurance policies.