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Dear CEO,

Funeral Plans Sector Priorities 2023-2025

We want to update you on the FCA's priorities for the Funeral Plans sector between 2023-2025, the specific risks of harm we are concerned about and what we want firms to do about them.

We started regulating funeral plans on 29 July 2022 and this is the first Sector Priority letter that we have issued. The Funeral Plans sector sits within the Insurance Market Division at the FCA. There are common risks and challenges across the insurance market that apply to your sector. In this letter we talk generally about the insurance market and how we believe it is relevant to the Funeral Plans sector.

The UK insurance market, including Funeral Plan Providers (the Market), provides a vital service for millions of consumers and businesses.

As with all of financial services, the insurance market has faced, and continues to face, significant challenges. These include the aftereffects of COVID-19, supporting customers with cost-of-living pressures and adjusting to higher inflation and interest rates. In addition, climate change, artificial intelligence, resourcing challenges and strains on profitability have the potential to significantly increase the existing risks of harm we are concerned about. Ensuring we have the right data to assess both current and emerging risks of harm is one of our key priorities.

Our strategic objective under the Financial Services and Markets Act (FSMA) is to make financial services markets function well. A key aim for the UK insurance market is that it continues to be a successful industry that supports customers to achieve their long-term financial goals and is there for consumers and companies when the worst happens.

We have seen good practice such as Funeral Plan providers stepping in to take over books and provide 'at-need' funerals to many thousands of consumers who were affected when other firms failed. However, there is still significant work for the industry to do to regain market and consumer confidence. With the sector new to our regulation, we will continue to focus our supervisory resources both on ensuring that firms are adapting to the regulatory environment and meeting the resulting expectations, where customers get good outcomes from the products they buy.

Firms need to maintain adequate financial resources and monitor their prudential risks closely. In our Business Plan 2023/24, we set out our focus on reducing harm from firm failures. The external economic environment, including inflation and the cost-of-living crisis, has presented challenges to the Funeral Plans sector. It has become increasingly important that firms closely and robustly monitor their financial resources to ensure they maintain adequate capital, of appropriate quality, to meet their capital and liquidity requirements and liabilities. Any weaknesses can lead to poor consumer outcomes where consumers are unable to redeem their funeral plans when needed.

We have seen that failure of firms in this sector can result in material harm and financial loss to consumers. This in turn can deter potential consumers from buying these products. We expect firms to ensure that they robustly support assessments of their capital adequacy and liquidity with appropriate controls and governance arrangements, and that they take appropriate steps to address any shortfalls. We will continue to monitor firms' regulatory returns data and may evaluate firms' documented risk assessments, if we think it necessary. We will also continue to review the Solvency Assessment Reports (SARs) we receive. We have concerns that the level of detail reported in the SARs does not enable us to fully understand and validate the key assumptions used to assess the solvency levels and risks faced by the trust. To ensure future consistency, we have recently held a 'Roundtable', jointly with the Financial Reporting Council (FRC) and the Institute and Faculty of Actuaries (IFoA) and gave our observations to actuaries completing the reports. Where necessary, we will use our supervisory tools to address areas we believe are a risk to good consumer outcomes.

Firms offering trust-backed products should ensure a diversified mix of appropriate investments for their funds, and proactively monitor their trust solvency. We will challenge instances where we see evidence of inadequate financial resources, such as habitual capital injections to maintain required solvency levels. We consider that such practices may indicate embedded problems in a firm, such as poor governance or poor trust management practices. Firms offering insurance-backed products should keep in mind the need for investment plans to bridge any gap between insurance asset growth and the impact of inflation on funeral delivery costs. Wind-down plans should be reviewed annually to ensure that the business can be run-off in an orderly way if needed and include clear triggers for implementing the plan. Firms should also consider how macro-economic factors affect both their business models and consumers. You must be able to demonstrate that your firm remains viable and sustainable through severe but plausible stress scenarios, with a range of management actions to manage any risks of harm.

Addressing these areas is paramount in preventing consumer harm, ensuring good consumer outcomes and building financial resilience and trust in the market.

Sector specific priorities

While the UK insurance market covers a broad and diverse range of firms for Funeral Plans our focus is on the priorities listed below. These are consistent with our strategic outcomes and commitments:

Setting and Testing Higher Standards

Putting consumers' needs first: Embedding the Consumer Duty

Throughout the Funeral Plans sector, the Consumer Duty must play a pivotal role in focusing firms' attention on the need to deliver fair price and value for funeral planning products. We expect firms to take appropriate action to ensure that their products and services offer fair value and meet consumers' needs, that consumers get clear information they can easily understand and that they get the support they need when they need it. This applies to both open and closed products. The Consumer Duty has introduced a requirement for firms to conduct a review of their closed books, revisiting historic product terms and conditions to ensure consumers do not suffer negative effects. Firms have until 31 July 2024 to complete these reviews. As a sector new to regulation, we expect this exercise could highlight adverse outcomes for consumers, and we will expect firms to take appropriate action where they identify poor outcomes. Firms must ensure fair value for consumers throughout the consumer journey, from the time a consumer contacts a firm to the point of delivering the funeral.

Good consumer outcomes will continue to be the focal point of our supervision of the market. Effective product governance, fair selling practices and strong corporate governance are vital in ensuring positive outcomes. These include preventing consumers from over-paying for products and services, and ensuring they buy products that meet their needs. Over the past year, we have continued to identify instances where firms failed to achieve good outcomes for their consumers, including insufficient disclosure during the sales process and publishing misleading financial promotions. So, firms need to further improve and strengthen their control frameworks and governance. Using a combination of data and mystery shopping, we will test how firms are implementing the Consumer Duty. Where we identify firms that fall short of our expectations we will intervene and take action against firms to remedy any issues.

While we generally see good intentions from Boards, we are concerned they are not taking enough action to ensure the positive outcomes for consumers which are essential for full delivery of the Consumer Duty. We therefore expect firms' Boards to take proactive action on our priorities and not treat them as merely a compliance exercise. We plan to organise Roundtables for the industry over the coming months to help firms understand our expectations.

Putting consumers' needs first: Consumer support

Our analysis of complaints data for the market has not raised significant concerns to date, but we know that limited data is available given the relatively short time firms have been regulated. Complaints data is a good indicator of whether or not consumers get the support they need from firms. We will continue to monitor and make judgements as we gather data over time. However, trends across the insurance market show an emerging risk of consumer harm from the impact of the wider economic environment on firms' profitability. Harm may occur where customers make poor decisions or fail to take timely action due to a lack of timely and / or accurate information, or where service standards and access to products fall short of what they can reasonably expect. A lack of customer support could occur where firms focus on making profits and cutting costs in a challenging economic environment at the expense of maintaining good customer outcomes. The Market needs to be conscious of this and have appropriate policies, systems and controls in place to analyse complaint information and respond accordingly.

***Putting consumers' needs first:* Supporting consumers in financial difficulty**

Premiums across the Insurance Market are on the rise. While we have not seen significant price increases in the Funeral Plans sector, we know that many plan-holders are vulnerable and so more likely to be affected by the rising cost of living. We expect firms to support consumers where their circumstances change. For example, by considering flexibility to consumers who are struggling to make instalment payments and by ensuring any cancellation charges are proportionate.

Reducing and Preventing Serious Harm

Improving Oversight of Appointed Representatives (ARs)

At the start of regulation, the market saw a significant shift from the intermediary-based model to firms operating networks of ARs. Nearly 50% of firms in the Market are principals, with networks ranging from 1 to over 800 ARs. An AR carries out a regulated activity under the responsibility of the authorised principal. The principal is responsible for making sure an AR is fit and proper and complies with our rules. Firms acting as principals are required to have sufficient controls in place to monitor and oversee their ARs. Poor oversight can increase the risk of significant harm to consumers. This harm is increased where customers have characteristics of vulnerability, which is a key feature of the market and the circumstances surrounding the purpose of the product.

We recognise the potential differences the AR and principal relationships in this Market have to other markets. These include that a principal is the product manufacturer, and the AR is the distributor, but with the principal retaining responsibility for the sales process under our rules. Also, much of an AR's business may not be connected to a regulated funeral plan. Other interdependencies, where our rules apply, relate to the responsibility of the principal to make adequate provisions, and manage these provisions effectively, to pay for funerals as required and for funeral services to be delivered by ARs to customers' expectations. Also, some business models may include competing commercial interests between an AR and their principal. Despite the challenges these characteristics represent and with potential competing interests, we expect principal firms to have effective oversight of their ARs and ensure they are competent, financially stable and deliver good outcomes for consumers.

In August 2022, we confirmed new rules to strengthen the oversight of ARs by their principals. Our rules came into force in December 2022 and clarify and strengthen the responsibilities and our expectations of principal firms. We require principals to provide more information on ARs including Introducer ARs (IARs). These new requirements go hand-in-hand with the Consumer Duty rules. A firm that acts as principal should ensure that it has set clear standards for its ARs to meet, that it has appropriate controls in place to effectively oversee its ARs' activities and ensure that its ARs comply with the Consumer Duty. We will expect to see principal firms taking assertive action with ARs that fall below the standards set by the principal firm, including restricting their regulated activities and cancelling their AR status. We have recently gathered important data on ARs in the market via an information request to principal firms. We will use this to identify outlier firms and risks of harm and will act where necessary.

Strategy for positive change – our Environmental, Social & Governance priorities: **Governance & Culture**

Poor governance and culture in the insurance market can lead directly to poor consumer outcomes and harm to market participants and employees. It has been a key root cause of recent major conduct failings within the Funeral Plans sector.

We expect all firms to uphold good standards of behaviour and professionalism. Firms should also nurture healthy cultures where employees are treated with respect and feel safe to raise concerns without fear.

We have seen indicators in the Market of poor governance and weaknesses in systems and controls. We recognise this sector is new to regulation, but remind firms of the need for appropriate governance, controls and oversight, commensurate with the size and scale of their business. We have seen instances of reported trust deficits, firms breaching our financial promotions rules and firms submitting incorrect regulatory return data. AR networks are also extensive for a few key players and consequently the quality of their oversight is of primary importance.

Minimising the impact of operational disruption: **Operational Resilience**

Operational resilience is the ability of firms, financial market infrastructures and the financial sector as a whole to prevent, adapt and respond to, recover and learn from operational disruption. Across the Market, our data shows incidences of a lack of operational resilience within firms (including failure to protect client data), to the harm of consumers and the wider market. We are particularly concerned with the level of oversight and contingency planning on outsourced services, where adequate controls are not in place, and where consumers experience poor outcomes if a problem occurs. Firms need to have credible plans in place to mitigate and recover from these risks, take remedial action where necessary and notify us and other appropriate regulators promptly as appropriate. Areas of particular concern include the risks of cyber-attacks and ensuring there are adequate controls in place where information is held by third parties.

Promoting Competition and Positive Change

Preparing financial services for the future: **Regulatory Reporting**

Regulatory reporting plays a vital role in our ability to identify, assess and mitigate potential risks of harm in the Market. It is an important source of data to detect trends and potential issues to allow us to act early and prevent further harm. In the first year, we received several sets of conduct and prudential Regulatory Returns from funeral plan firms and these have not always been of the quality we would expect, with inaccurate and missing data.

Firms need to take action to improve the quality of their Regulatory Returns, to ensure they are providing accurate information. We will hold Roundtable sessions over the coming months to help firms understand our expectations, best practices and measures to take to improve data accuracy and quality.

Firms that act as a principal firm with Appointed Representatives (ARs) must also provide regular reporting data about its ARs. From December 2023, this includes AR complaints and revenue data once a year in RegData, reported in line with the Accounting Reference Data (ARD). The principal firm must check, amend and confirm details of its ARs and Introducer ARs (IARs) annually using Connect. In both cases, the data must be submitted within 60 business days of its ARD. Our website gives more information about the data principal firms must report to us about its ARs.

***Dealing with problem firms:* Unauthorised Business**

We have been made aware that there are several ARs holding undeclared legacy funeral plan books without appropriate permissions and therefore conducting unauthorised business. This is a serious concern as it poses significant risk of harm to consumers who are not covered by the protections provided by regulation. The fact that several ARs have been able to hold onto the books undetected shows an urgent need for improvement in the oversight of ARs by their principal firms. We remind all firms with networks of ARs that it is their responsibility to exercise adequate oversight of ARs and to ensure they have appropriate control frameworks to identify unauthorised business or any other conduct that may pose risk of harm to consumers - and to take appropriate action where an AR falls below our regulatory standards or the standards you have set for them. We expect all principal firms to undertake a review of their ARs to ensure that no unregulated activity is taking place.

We will continue to monitor that firms are only carrying out activity they are authorised to for the Market and that Funeral Plans are only sold through regulated entities holding the correct permissions. We will respond where our data shows a concern. We welcome and encourage firms to notify us through our Supervision Hub and, if appropriate, via a SUP 15 Notification, they suspect unauthorised business is taking place.

Action for firms

You are responsible for ensuring that your firm meets FCA requirements, including the obligations and expectations set out above. You should take all necessary action to ensure these are met and that you are prepared for the additional requirements that the Consumer Duty brings to these priority areas. We will use the Senior Managers & Certification Regime to engage directly with accountable individuals on areas of concern.

A significant part of our activity over the next 2 years will be to test firms against our priorities and expectations. We will also continue to use data to identify outliers. Where firms are not meeting our rules and expectations, we will take action.

If you have any questions, please contact your normal supervisory contact or call us on 0300 500 0597. This is the primary point of contact for your firm's day-to-day interactions with the FCA. Our website gives further details of how you can contact us https://www.fca.org.uk/contact.

However, we know there may be occasions when your firm faces urgent issues of strategic importance. In such significant circumstance please contact the Head of Department responsible for the Funeral Plans Portfolio, Lisa Sturley at Lisa.Sturley@fca.org.uk.

Yours sincerely

Matt Brewis
Director of Insurance
Supervision, Policy & Competition – Consumers & Competition