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Towards Regulation of the Prepaid Funeral Planning Industry

Fairer Finance

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Foreword

By James Daley

Funeral plans can be an excellent way of removing the logistical and financial strain from your loved ones when you're gone. They can also be a cost-effective way of protecting against any increases in the cost of funerals.

Last year, Fairer Finance's report into sector, sponsored by Dignity, revealed numerous failings in this important market. Crucially, the lack of statutory regulation and compensation scheme meant customers' money could be at risk.

While most providers are acting responsibly, a minority continue to conduct themselves in a manner that would simply not be tolerated in a regulated market. A cocktail of high commissions, aggressive sales tactics and a lack of transparency indicated that customers did not always understand the limitations of what they were buying, and that some newer providers were not maintaining the financial discipline which would be expected in a regulated market.

Our initial report called for statutory regulation of the market, and this second report looks in greater detail at how that can be achieved.

We want policymakers and regulators to act as a matter of urgency, so that bad practice in this market can be eliminated, and the responsible players can thrive.

We're thankful to Co-op Funeralcare, Dignity, Ecclesiastical Planning Services and Golden Charter for sponsoring this second piece of work – and to all the providers who gave up their time to provide input.

We'll be sharing this report with stakeholders in government and within the FCA and very much hope it can lay the path towards stronger consumer protection in this market.

Executive summary

This report follows on from Fairer Finance's July 2017 report entitled *"Is the prepaid funeral planning market working well for consumers?"*. This was commissioned by Dignity, but full editorial control rested with Fairer Finance.

That report uncovered a number of failings in the prepaid funeral market – including concerns about the way plans were being sold, as well as the security of customers' money.

The prepaid funeral plan market is essentially unregulated. And while the industry's voluntary regulator, the Funeral Planning Authority, has been working to raise standards, not all plan providers are members of this body.

Our initial report called for statutory regulation of the market. All major providers in the market have supported this call – although the majority favour the current voluntary regulator being granted a statutory remit, rather than the sector being brought under the wing of the Financial Conduct Authority. The Co-op has said it would favour FCA regulation of the market.

This follow up report has been funded by four of the largest companies in the market – Co-op Funeralcare, Dignity, Golden Charter and Ecclesiastical Planning Services (including Perfect Choice). Once again, Fairer Finance has retained full editorial control over the report.

The report looks in detail at possible routes towards statutory regulation, as well as considering how the existing voluntary framework could be improved.

Chapter 1 provides some background, including a precis of the findings from the first report and details of progress in the months since.

Existing regulation

Chapter 2 of the report looks in detail at the existing consumer protections and the workings of the Funeral Planning Authority, including budgets and monitoring activity.

Current legislation allows funeral plan firms to avoid FCA regulation by adhering to a list of conditions listed in the Financial Services & Markets Act (Regulated Activities) Order 2001 (RAO). Although most providers in the market purport to meet these conditions, there is little monitoring of this for those firms who are not members of the FPA.

It is the FCA who is ultimately responsible for policing these breaches around its perimeter – but the FCA claims that to the best of its knowledge, all firms in the market meet the terms of the RAO.

Our research found evidence to the contrary, and we believe the FCA is failing in its duty to properly police the perimeter of this market.

The industry's voluntary regulator, the FPA, has had a positive effect on the conduct of the firms which have registered with it. However, its key weakness is that as a voluntary regulator it can't compel all providers to register with it.

It is a small body run by two main staff working three days a week. The current CEO joined in December 2014 and has since been working on a programme of modernisation for the organisation. Key achievements include delivery of an independent board and compliance committee and an increase in the levy for members. The FPA is also currently reviewing its Rules and Code of Practice.

While the FPA has regular contact with most of its members and has had some success at raising standards, its greatest weakness is its inability to police those who don't wish to join. We also question whether it can adequately monitor and enforce against its current membership with its low level of resource.

It charges members £4 for every plan they sell – but caps membership fees at £70,000 per year. We believe that this unnecessarily limits its resources and recommend that the cap be removed. The FPA says it does not feel restrained by its budgets.

Improving security of customer money

Chapter 3 of our report looks at what protections there are for customer money, and how these need to be improved.

As funeral plans are unregulated, there is no formal Financial Services Compensation Scheme (FSCS) coverage. While there is some limited FSCS coverage for plans backed by insurance

schemes (as opposed to trusts), there are still potential gaps in coverage if a plan provider of an insurance-backed scheme were to become insolvent.

We note that Co-operative Funeralcare has received written confirmation from the FSCS that its structure would ensure FSCS protection in the case that the underlying insurer went out of business. However, the situation is less clear with some other providers, and there is little clarity for consumers on this issue, as the plans themselves cannot be said to be covered by the FSCS.

The RAO has a number of requirements that firms who operate trusts are meant to meet. These include having an independent fund manager, and a majority of independent trustees.

However, these do not appear to be effectively policed for firms outside of the FPA. Furthermore, there are no standardised ways of calculating trust values, and there is currently no way for consumers to get a true indication of the financial health of a trust into which their money will be placed.

We would look like to see standardised calculations for assets and liabilities and the publication of a financial health measure – similar to a credit rating – which consumers could see before purchasing a funeral plan. This could apply to both the trust and life insurance models.

We would like to see trust boards be entirely independent, and to see minutes of trustee meetings and full accounts (including actuarial assumptions) put into the public domain.

If statutory regulation of the market is introduced, it will prove challenging to integrate the funeral plan market into the FSCS with two different models for protection of client money.

The two-tier structure also creates added and unnecessary complexity for consumers. If the government consults on statutory regulation, we believe it should include a review of whether a single mechanism for looking after client money should be imposed on the sector. It may be deemed that such a move at this stage in the market's development would be counter-productive, but we believe a full review should be carried out, as there would be clear benefits in terms of consumer clarity.

Improving conduct

Chapter 4 looks at FPA rules around conduct and considers what gaps may need to be filled in a statutory environment.

We believe a clear set of principles should be laid down – akin to the FCA's Treating Customer's Fairly regime – to complement a more comprehensive rulebook.

We believe the FPA rulebook needs greater detail around monitoring of third party sales agents, clarity of communication, disclosure, and the fit and proper persons test. And there should be a cap on, or much tighter guidance around, cancellation fees – some of which run to as much as 20% of the plan value.

Some providers want to see a cap on commissions within the market, with disclosure to consumers of the amount paid. High commissions of up to £900 per plan continued to be paid, and we acknowledge concerns that this is likely to be driving poor outcomes for consumers.

However, publishing commission levels could disadvantage those who do not have established distribution channels and ultimately harm competition. A maximum commission level – as a percentage of plan value – may be more appropriate. This is a matter which requires further exploration.

Examples from overseas

Chapter 5 looks at regulatory solutions for the prepaid funeral sector in other countries. In the Australian state of Victoria, funeral directors are banned from imposing top ups on customers once the plan is claimed upon.

While both Ontario, Canada and Florida, USA have compensation schemes in place should a prepaid funeral plan provider collapse.

Routes to statutory regulation

Chapter 6 looks at the two main potential routes to statutory regulation.

Although most of the industry favours the creation of a standalone statutory funeral regulator, from a practical perspective this remains an unlikely outcome. We explain the reasons why in detail in Chapter 6.

Creation of a new statutory funeral regulator would require primary legislation. With the current legislative agenda full with Brexit, civil servants made it clear that even if there were political appetite for such a move, it was implausible that there would be room on the agenda before 2022.

Although our analysis suggested a statutory standalone funeral regulator would be cheaper for the industry, it would likely take up more time and cost more for government. We don't believe the additional costs will be so high as to severely damage competition in the market.

Bringing the funeral plan market under the wing of the FCA would be much easier to do from a practical perspective. The Treasury would need to consult on an amendment to the RAO and could make the necessary changes through secondary legislation.

The process would be lengthy. Even once the RAO had been amended, the FCA would need to consult on how to amend its own rulebook. If the Treasury committed to statutory regulation today, it is unlikely the process would be completed before 2021. However, this remains quicker than creating a statutory funeral plan regulator, which would be, in our estimation, unlikely to be achievable before around 2024.

Our hope is that by starting the process of moving towards FCA regulation, standards would immediately start to improve amongst firms which aren't registered with the FPA. Several non-registered firms have now applied for registration but haven't completed the process at the time of writing.

We'd also like to see the FPA develop a better public profile, so that consumers are aware of the benefits of choosing an FPA-registered firm.

Conclusions

In the short-term, we want to see the FPA continue its programme of modernisation. Even with the introduction of statutory regulation, the FPA will have an important role to play for at least another three years – during which time it can continue to have a material impact on conduct and consumer protection in the industry.

The FPA should aim to strengthen itself to the point where it becomes difficult for firms outside of the body to continue participating in the market.

At the same time, the FCA needs to urgently step up its activity in policing the perimeter of this market – ensuring that firms who are not meeting the terms of the RAO are appropriately sanctioned.

Concurrently to the FPA's programme and an increased FCA presence on the perimeter, we would like to see government fire the starting gun on the process of introducing statutory regulation to this market. Given the practical challenges of creating a statutory FPA, we believe the government should move to amend the RAO and bring the industry into FCA regulation. This needs to happen as a matter of urgency to protect consumers, and we fear that it may already be too late to protect all consumers in this market.

Once statutory regulation is introduced, the FPA needn't disappear. It could potentially transition to become the industry's trade and professional standards body. It could then ensure that the infrastructure and expertise that it has built continues to work towards improving standards in the market. However, it is unclear if the FPA has the desire to move in this direction, and industry reaction to this suggestion is mixed.

CHAPTER ONE

Introduction

Prepaid funeral plans (PFPs) are a financial product which allow consumers to pay upfront for some of the costs of their funeral before they die.

As well as helping to reduce emotional and financial pressure on the deceased's loved ones, they can also provide an effective way of protecting against any increase in the cost of funerals.

The market has grown rapidly over the past decade. According to numbers released by the Funeral Planning Authority (FPA), the industry's voluntary regulator, plan sales rose from 46,340 in 2002 to 210,700 in 2016. A number of non-FPA members have also joined the market in recent years, and these providers are estimated to have accounted for up to another 40,000 plan sales a year.

In 2017, plan sales by FPA members fell slightly to 207,700 – the first decrease since 2006.

Unlike similar financial sectors, the PFP market is largely unregulated. As long as plan providers meet a small list of conditions laid out in the Financial Services & Markets Act 2000 (Regulated Activities) Order 2001 (RAO), they are not required to be regulated by the Financial Conduct Authority.

The majority of plans are sold by companies who are members of the FPA, which requires them to abide by a Code of Practice and a set of Rules. A small but significant minority of plans are sold by firms which are not members of the FPA.

Last year, Fairer Finance published its first report into the sector, entitled *"Is the prepaid funeral planning market working well for consumers?"* [1]

The report was commissioned and paid for by Dignity, one of the largest sellers of PFPs in the UK. Dignity commissioned the report as a result of its concerns about the conduct of some of its competitors in the market. It also commissioned independent research from Matter Communications, which informed Fairer Finance's conclusion.

Fairer Finance retained full editorial control over the report, including the right to criticise Dignity.

The report uncovered a number of consumer protection issues within the PFP market. Chief amongst these was a concern about the safety of customers' money in a market that has no compensation scheme safety net. The report also shed light on a number of conduct issues.

A small but significant minority of firms were found to be using aggressive telesales tactics, driven by high commissions of up to £900 per plan

A large number of firms were found to be lacking clarity in their marketing and customer communications.

PFPs are complex products, and tests showed that consumers often struggle to understand what they include and what they don't. In particular, understanding of the differences between funeral director costs and third-party costs (known in the industry as 'disbursements') was poor. Research for our first report showed that risks often weren't surfaced in a clear way before purchase,

1 www.fairerfinance.com/assets/uploads/documents/Funeral-plan-report-FINAL-6-July-2017.pdf

increasing the likelihood that customers did not understand all the benefits and shortcomings of what they have bought.

Matter Research carried out a series of tests with elderly customers, showing them brochures from funeral plan providers and then asking them questions around what was included. All providers were found to require improvement, although the larger more established companies were generally clearer.

The research also identified a lack of understanding about the level of consumer protection surrounding funeral plans. Approximately 75% of funeral planholders wrongly believed that the product they had bought was FCA-regulated. Those who knew that it wasn't regulated by the FCA thought that it should be.

Our first report called for the implementation of statutory regulation in the PFP sector. At that time, we suggested FCA regulation was

the most practical route forward. We believed that the influence of a well-known established regulator with far reaching enforcement powers would have an immediate effect on conduct in this industry.

Since then, Fairer Finance has interviewed and asked for input from all the PFP firms named in our first report. We also hosted a roundtable session with the industry in late 2017 to discuss the issues the report raised.

During our roundtable, there was unanimous agreement from those taking part in the discussion[2] that the industry is in need of some form of statutory regulation.

While the FPA is undertaking a programme of work to raise standards in its industry, the biggest concerns about conduct and security of client money relate to firms that sit outside of the FPA. Our initial research identified that non-FPA members were engaging in the largest volumes of telemarketing and were paying large commissions of up to £900 a plan. In some cases, there was no clawback on the commission if the customer cancelled – giving the sales operative less incentive to execute a responsible sale.

In terms of security of client money, the sector lacks transparency, which makes it impossible for consumers to have any certainty around which companies are managing client money responsibly.

Nevertheless, since the publication of our last report, most FPA members have been willing to share trust accounts and actuarial valuations of both trust and insurance assets with us (as relevant) – albeit mostly subject to non-disclosure agreements. No non-FPA members agreed to share this information with us.

2 In attendance: Open, Co-op, Choice, Dignity, Ecclesiastical, Golden Charter, Golden Leaves, Open, Pride Planning, Royal London, Safe Hands, Sunlife.

At Fairer Finance's roundtable, most industry representatives said their preferred route to regulation would be to give the FPA a statutory mandate. Only the Coop has been publicly supportive of the FCA taking responsibility for regulation of the sector – although others have since told us that they would prefer FCA regulation to no statutory regulation at all.

Towards statutory regulation

Following our roundtable, Fairer Finance asked providers to fund a second report into the sector, exploring what the path to statutory regulation would look like.

Subsequently, four FPA-registered providers – Co-op Funeralcare, Dignity, Golden Charter and Ecclesiastical Planning Services – agreed to fund this further piece of research. Once again, Fairer Finance has retained full editorial control.

This report will explore existing consumer protection and look at what improvements need to be made to better protect customers' money and to improve conduct. It will look at the routes to statutory regulation and the potential costs of these different options. And it will explore how funeral plans are regulated outside of the UK.

We have met with the Treasury three times since publication of our last report and continue to engage with them on securing better protection for consumers in this market.

CHAPTER TWO

Existing consumer protection

Background

The Financial Services & Markets Act 2000 (FSMA) underpins most modern-day regulation of financial services. It was this Act which created the Financial Services Authority (since renamed the Financial Conduct Authority) and defined the territory over which this new body would regulate.

When FSMA was being drafted, the government was under pressure to include PFPs within the remit of the FSA's oversight. In 1995, the Office of Fair Trading had published a damning report into the PFP industry[3], highlighting concerns about the safety of customer money and about the way in which the plans were being sold.

In subsequent years, concerns were also raised about the financial security of one of the market's biggest players, SCI[4]. And in 1999, the Treasury launched a consultation looking at how to improve protection for consumers who buy PFPs.

At this time, the average PFP cost around £1,200[5] – around half of today's prices if adjusted for inflation – and annual sales of the plans were no more than 50,000. The government concluded that regulation by the FSA would be too heavy-handed and elected to give the PFP market an exemption.

Nevertheless, the exemption was to be contingent on firms meeting a number of requirements that were designed to protect

3 www.independent.co.uk/news/business/fears-over-pay-now-die-later-1620299.html

4 www.telegraph.co.uk/finance/4462757/How-safe-are-your-funeral-savings.html

5 www.webarchive.nationalarchives.gov.uk/20000709164701/http://www.hm-treasury.gov.uk:80/press/1999/p7_99.html

consumers. These were laid out in the RAO[6], which came into force on 1 January 2002.

The RAO stated that to remain exempt from FSA regulation, PFP providers would need to either pay the customers' money into a whole of life insurance policy or a trust. If the money was paid into a trust, then there were further conditions to be met:

- the trust deed would need to be established by a written instrument
- more than half of the trustees had to be independent of the provider
- the trusts' assets must be managed by an independent fund manager
- annual accounts had to be prepared for the trust
- the trust must be subjected to an independent actuarial assessment at least every three years.

When the Economic Secretary to the Treasury, Patricia Hewitt, announced the consultation which led to these measures, it was very much positioned as a tightening of consumer protection. In a statement released in January 1999, Ms Hewitt said:

> *"It is generally elderly people on modest incomes who take out these plans. They want peace of mind for their family after they die - and these proposals will help to provide it.*
>
> *"We want to ensure pre-payment plans are properly regulated. But where plan providers make the necessary safeguards they can be exempted from regulation by the FSA."*

6 www.legislation.gov.uk/uksi/2001/544/article/60/made

The Funeral Planning Authority

To provide additional protection for consumers, the industry set up the Funeral Planning Authority. This is the market's voluntary regulator. Its mandate is to protect consumers and maintain standards in the industry.

At the outset, the Co-op, SCI (which later became Dignity) and Golden Charter accounted for around 80% of new business in the market – and growth was relatively modest. Between 2003 and 2007, sales of plans by FPA members grew 10% to 67,519 plans[7]. However, over the following five years, plan sales increased almost 80% - and other non-FPA members began to enter the market.

Interviews with industry practitioners suggest that in the early days, the FPA was not an effective voluntary regulator and was ill-equipped to cope with the rapid pace of change in its market. Until two years ago, its board consisted of senior executives from the largest companies that it was charged with regulating.

The current chief executive of the FPA joined in December 2014, since when the body has undergone a programme of modernisation.

Experienced and independent figures from the financial services and legal professions now sit on the board of the FPA and on its compliance committee. A review of the Rules and Code of Practice is under way, and discussions are ongoing about the possibility of creating an industry compensation scheme which could provide additional protection for consumers.

7 www.funeralplanningauthority.co.uk/statistics/

Structure of the FPA

The FPA is a small organisation. Its last publicly available audited accounts – to March 2017 – shows its annual turnover at £200,000. This will have increased in the year to March 2018 due to an increase in membership fees. Annual accounts had not been published as this report went to press.

The body has two main members of staff – its chief executive and its head of compliance, both of whom work three days a week. There are an additional three members of its compliance committee who each contribute roughly two or three days per month, dependent on the need of the FPA.

It also has staffing for administrative support, and outsources various other services such as IT, accounting, PR and public affairs.

Rulebook

The FPA regulations consist of two parts; a set of Rules[8], and a Code of Practice[9]. Registered providers must follow each of these.

The Code of Practice is a very broad 1,300-word document which lays out expectations around conduct, marketing, communication, contracts and complaints.

The rulebook is a longer document which is much more legalistic and specific in its requirements of members. It includes details around the FPA's decision making processes, and detailed requirements in relation to management, valuation and auditing of trusts. It also lays out the FPA's powers to sanction members.

8 www.funeralplanningauthority.co.uk/regulations/rules/

9 www.funeralplanningauthority.co.uk/regulations/code-of-practice/

Monitoring activities

The FPA's main proactive tool in monitoring compliance of its rules is its annual re-registration process. This requires firms to submit a large amount of information to the FPA – including trust deeds (if relevant), marketing literature, terms and conditions as well as reports from auditors and trustees.

The re-registration pack includes a lengthy list of self-audit questions which must also be completed by the member.

The FPA's compliance committee assesses these responses and takes a risk-based approach to where it applies its time and resource. After giving firms reasonable notice, it can instruct providers to answer further questions, attend interviews, produce documents for inspection or arrange site visits.

The FPA interacts with firms directly on a routine basis. Most firms said they had regular contact with the FPA – mostly conversations directly between senior management and the FPA's CEO or Chair of the Compliance Committee.

Many firms reported that contact with the FPA had significantly increased over the past few years. For example, one large firm explained that the FPA had written to it during the past year, demanding improvement in several areas. The firm felt this showed that FPA standards were steadily improving, as they hadn't received similar demands in the past.

Several providers told us that they're able to share new print and online resources for customers with the FPA, to get its view on whether these were suitable for consumers.

A minority of members said that had very little contact with the FPA other than around the re-registration process.

The FPA said that as well as making regular contact with its members, it made a number of site visits – including visits to listen in to customers calls, or interview staff within the business. Over the 12 months to the end of March, the FPA said it had made 13 site visits to members, and a further 5 site visits to non-members.

One criticism raised about the registration process itself is that it involves a lot of hard copy paperwork. Firms are asked to submit four paper copies of all re-registration forms and supporting material. This often amounts to several boxes of paper being mailed to the FPA. Development of a digital portal for registration and reporting might help to speed up the process, and lower costs.

The FPA recently set up a stakeholder group, a forum for members to meet and discuss the development of regulation. As at the end of March, the FPA said it had held two of these meetings, with more than 15 member groups represented at each – including all the major providers.

What enforcement powers does the FPA have?

As a voluntary regulator, the FPA relies to a great extent on the goodwill and buy-in of its members to achieve its goal of improving standards in the industry. Although its rulebook outlines a disciplinary process, this is not something that it has ever used.

Disciplinary process

If a matter is referred to the FPA Board (or if it considers that action is necessary), the FPA may take disciplinary action.

Its rulebook sets out the procedure, which takes place in front of a Disciplinary Panel. It allows for the FPA and the provider under investigation to produce evidence, witnesses, and cross-examine evidence.

The Disciplinary Panel chooses what penalty, if any, a firm should face. We've listed the potential penalties below[10] – a penalised firm may face more than one of these:

- A reprimand
- A fine of up to £5,000
- Termination of registration
- Conditions for the continuation of registration

The Disciplinary Panel may also order a provider to pay up to £5,000 compensation to a customer[11]. The most expensive plans on the market cost around £4,000 at the time of writing. So a £5,000 compensation limit seems high enough to put things right for most consumers.

But a £5,000 fine for the company seems unlikely to be a major deterrent, even for smaller PFP firms.

Terminating a firm's registration isn't a good outcome for the firm, the FPA, consumers, or the industry. It might cause reputational damage, but it would not prevent a firm from operating. This would then be cut free from the oversight that the FPA provides.

Suspension of registration

The Compliance Committee may also suspend a registration where it believes that it's "necessary for the protection of consumers to do so"[12]. This is equivalent to a public censure, which may be one of the most effective tools of a voluntary regulator. Again, this is a tool that has not yet been used.

10 FPA Rules 7.5

11 FPA Rules 7.6.1

12 FPA Rules 6.8.1.2

Enforcement history

The FPA does not have a history of taking enforcement action against its members. It also does not publicise the outcomes of investigations into providers on its website. Some other regulators, like the FCA or ICO, do publish these details.

This makes it hard for consumers to see what the FPA is doing to improve conduct. This isn't necessarily a criticism of the work the FPA is doing. But the fact disciplinary action only occurs behind closed doors means consumers can't see why FPA registration is important.

While it would be disproportionate to 'name and shame' firms for minor infractions of the rules, public censure in serious cases could give consumers confidence that FPA regulation is something to put their trust in. And it would also send a strong message to the rest of the industry.

Last year, a Mail on Sunday investigation exposed poor conduct within Avalon, an FPA member. Some other FPA members were critical that the FPA had taken no public action in response to the newspaper report.

Voluntary regulation versus statutory regulation

The main issue with voluntary regulation is that, by definition, participation isn't mandatory. While the FPA regulates most of the market, at least one parallel system has sprung up.

For example, one provider operates under the National Federation of Funeral Directors (NFFD) Code of Conduct[13]. While this outlines some basic expectations, it has a far less clearly defined set of rules

13 www.nffd.co.uk/funeral-director/code-of-conduct

than the FPA. It is also owned by at least one of the same individuals who has a controlling interest in the firm that it regulates.

Meanwhile, some providers are operating with no regulation whatsoever.

At the time of writing, PFP providers who aren't FPA-regulated include:

- Beyond (plans sold are backed by Open Prepaid Funeral Plans)
- Capital Life Funeral Plans
- Fosters Funeral Directors (Scotland only)
- Open Prepaid Funeral Plans
- Pride Planning
- Prosperous Life
- Safe Hands

We're aware that some of these providers are currently applying to the FPA for registration.

Compensation structures

There's no statutory mechanism to provide consumers with compensation within the PFP market.

This is a key weakness in the current market which needs to be urgently addressed.

If a trust had a major deficit or collapsed, and there wasn't enough cash to cover funeral costs, it's unclear how customers would receive the funeral they'd paid for. The same goes for cases where

a plan provider goes bust at a time where it has insufficient assets in its life insurance assets or trust to cover its liabilities.

The FPA has begun discussions with its members about the idea of creating a compensation scheme. The chances of this becoming a reality through a voluntary regulator remain slim. We discuss this in more detail in the next chapter.

Current dispute resolution facilities

The FPA offers a dispute resolution facility to which customers can escalate complaints if they feel dissatisfied after complaining to their provider.

If a consumer takes a complaint to the FPA, the FPA refers them to a conciliation service to try to reach a resolution. The Chartered Institute of Arbitrators appoints the conciliator. If this isn't successful, The Chartered Institute of Arbitrators then appoints an adjudicator to resolve the matter.

This seems like a thorough process. However, the FPA deals with a low volume of complaints. It resolves most itself, without the need for the full arbitration process.

In 2017, the FPA dealt with 87 complaints of which 43% were upheld in favour of the customer. The complaints related to the following main issues[14]:

- Customer Service (26) – a range of general admin issues
- Sales Process (24) – mis-selling, vulnerable customers
- Additional payments (13) – family having to pay more at need
- Cancellation terms (12) – timing and amounts of cancellation

14 Information provided by the FPA

The low volume may be because customers won't ever know if their funeral meets their expectations. It may also be low because of low sales volume in this industry in the past. Annual sales figures among FPA-registered firms were below 100,000 until 2010.

The majority of the plan sales that have been made since the market expanded are unlikely to have yet resulted in a claim. So it is likely that complaints levels will rise as more of these plans are claimed on over the coming years.

Data from Barnett Waddingham also suggests the time between buying a plan and death is also increasing, and that life expectancies of those who buy plans through funeral directors are less than those who buy them through other channels.

Even if complaints levels remain low, this doesn't necessarily speak to a lack of problems in the industry – as the person who bought the plan is likely to be the deceased and is hence not around to measure delivery against expectations.

What does the FPA cost the industry?

Regulatory fees

FPA-regulated firms pay a fixed annual fee of £500 to cover (re-) registration costs. They also pay £4 to the FPA for each plan sold in the previous calendar year. This was increased from £2 a plan last year.

FPA-regulated providers sold 207,700 plans in 2017[15].

At this volume of yearly sales, the FPA could receive up to £830,800 in plan fees at £4 per plan. Plus £12,000 in registration fees in total from its 24 registered providers[16].

15 www.funeralplanningauthority.co.uk/statistics/

16 www.funeralplanningauthority.co.uk/hideout-app/app-uploads/2017/11/Provider-List-29-November-2017.pdf

However, fees are capped at £70,000 + VAT per member. This means the FPA receives substantially less funding than this in practice.

How much would firms pay without the cap?

The largest firms in the market had a market share of close to 30%[17] in 2016.

A 30% share of the 210,700 plans sold in 2016 would account for the sale of around 63,210 plans.

With this sales volume, a provider could pay £253,340 in fees to the FPA, but the cap holds its contribution at £70,000 + VAT.

Each 1% share of the market that an FPA provider generates FPA fees of approximately £8,400. This means that a firm with around 8.5% of FPA market share or above will hit the cap. No matter how dominant that firm becomes in the market after this point, it will not pay a single penny extra to the FPA.

The FPA says it imposes a cap so as not to become dependent on the funding of specific providers. Given the size and concentration of the market, the FPA could find a third of its income is provided by a single firm if the cap was removed.

Nevertheless, the imposition of a cap is contrary to the models used by regulators like the FCA, where payments are charged in proportion to size. This is not simply about passing the cost of regulation onto those with the broadest shoulders, it is also about reflecting the additional cost of effectively regulating a larger business.

17 www.co-operative.coop/media/news-releases/annual-results-2016

Without the cap, it's true that the FPA would be financially vulnerable if one of the larger firms walked away. But it could be argued that in this situation the body would have lost the ability to have any meaningful control over the market. We believe imposition of a cap has little benefit – and unnecessarily restrains the FPA.

Several PFP firms agreed. They suggested the FPA could be more effective at monitoring and sanctioning poor behaviour if it had more resources.

Several larger firms whose fees hit the cap indicated that they would be in favour of its removal if this meant the FPA could do more, and that there was greater visibility of the FPA's work. Although others also said that they would like to see a risk weighting applied to the fee calculation – so that better managed, more compliant firms, paid less.

The FPA said that it did not feel constrained by resources and had no desire to lift the cap. In its March newsletter, it included the following statement: "Fairer Finance are…beginning to articulate that they believe the Funeral Planning Authority has insufficient resources to carry out our role. We disagree with that view and believe Fairer Finance are misguided in their understanding of what extending regulation in this market might mean."

Compliance resources

FPA fees aren't the only cost for businesses to cover in relation to compliance. They must also pay staff to monitor and maintain standards within their organisations, as well as bear the cost of software packages and adequate hardware to support the compliance function.

Through our interviews with firms, we found there was little consistency in the way that companies have built their compliance and risk functions in the sector. Some of the larger firms had relatively few individuals focused on risk and compliance functions – with senior management being the main day to day contact with the FPA.

At the same time, some smaller firms had as many as 8-10 people focused on internal monitoring, vetting of third parties and complaints handling.

It's hard to get a clear picture of each company's internal compliance and risk costs – but it seemed that all companies would be likely to need to increase headcount in this area if statutory regulation was introduced. Some were closer to already having the set up and headcount that would be equivalent to an FCA-regulated organisation of their size. Some also outsourced certain compliance functions.

Role of the FCA

Technically, the FCA has responsibility for policing the perimeter of the PFP industry. If providers don't meet the terms of the RAO, then they automatically fall under the remit of the FCA.

A number of firms said they had reported breaches of the RAO to the FCA, and the FPA said it had regular meetings with the FCA where it had raised concerns about non-FPA members.

There is no evidence that the FCA has been very active in this area – though industry representatives report that one non-FPA member was asked by the FCA to change its trusts' trustees, as a majority were not independent.

The FCA told us that as far as it was aware, there are no providers that are currently in breach of the terms of the RAO. We don't believe this is the case.

During the course of our research, we found a number of examples of firms falling short of the requirements of the RAO. Some trusts do not appear to have fully independent managers, evidenced by the fact that they hold the plan providers' real estate in their portfolio.

A number of smaller firms in the market would not provide us with detailed trust accounts and details of the underlying assumptions. As a result, we have been unable to reassure ourselves that these trusts are in good financial health. If the current voluntary regulatory system is to have any chance of success, it relies on the FCA playing a more active role in policing the perimeter. If any of the businesses fail as a direct result of not meet the terms of the RAO, the FCA will have to bear responsibility.

CHAPTER THREE

Improving security of customer money

Existing protections

For firms to qualify for an exemption from FCA regulation, customers' payments must either be held in trust or used to buy a whole of life policy.

Currently, Ecclesiastical Planning Services, Co-op Funeralcare (as well as some smaller Co-ops), Sunlife and Choice invest client money in life insurance funds. The remainder of firms invest client money via trusts – or use either method, depending on how their customers choose to pay.

Although these arrangements provide some security for client money, the RAO does not stipulate how much money may be taken back by providers of the plans. This leaves the door open to firms being imprudent in terms of how much money they leave in the trust – or life insurance plan – for each funeral.

The FSCS does not offer protection for funeral plans. However, there is some indirect protection for holders of life insurance plans. Not only is this an imperfect solution, the lack of consistency creates confusion for consumers.

Protection for insurance-backed plans

Those who operate a life insurance-backed model buy individual whole of life policies from an insurer (currently Royal London, Sunlife, and Scottish Friendly manage all life-backed assets in the market[18]). As the lives covered by the policies are retail customers,

18 www.statista.com/statistics/304398/company-life-insurance-plan-ownership-in-the-uk/

the assets should be protected by the FSCS in the event that the insurer becomes insolvent.

In a letter to the Funeral Planning Authority in 2015, the Prudential Regulation Authority (PRA) confirmed that FSCS protection would apply to whole of life policies bought on behalf of individuals. However, the letter conceded that its stance on this issue had changed over time. Two years previously, Dignity had received a letter from the FCA stating a position to the contrary.

Following the publication of Fairer Finance's first report into the sector last summer, the FSCS issued a statement seeking to clarify the position:

> *"In some limited circumstances where the provider of a Whole of Life insurance policy or provider of a product held within a trust goes bust, FSCS may be able to pay compensation to the provider of the funeral plan or the trustees.*
>
> *"It would then be for the funeral plan provider or the trustees of the investment fund to decide what to do with any monies that are paid out as a result. Having paid compensation, FSCS is not responsible for the decisions that funeral plan providers or investment fund trustees may make. It is unlikely that FSCS would be able to pay compensation directly to individuals."*

Although this statement suggests that trust-backed plans could have some call on the FSCS in the event that an asset manager goes bust, asset management claims are limited to £48,000, which is likely to be immaterial to a trust. Where the FSCS offers coverage to life insurance policies, it covers 100% of the liability.

The FSCS statement highlighted that there remains ambiguity around where FSCS coverage starts and ends in this sector – but at the very least confirms that there are gaps in protection for providers of both types of plan.

The Co-op has put a trust around its life insurance policies, to ensure that in the event the Co-op were to become insolvent, there could be no claim by the Co-op Group on the life insurance policies. And if Co-op were to go bust, the ringfenced assets in the trust would not be accessible by the plan provider. It may make sense for this to be a requirement for all providers who use insurance-backed plans – and in the short term is something that the FPA should consider adding to its rulebook. However, there may be other options which offer similar security, and these should be fully explored before any prescriptive rule is set.

The Co-op publishes details of the surplus in its life fund assets over its liabilities and maintains capital guarantees in its life insurance policies. This currently gives a strong degree of confidence to customers that they will not lose out financially if Coop or Royal London, who manages its assets, were to become insolvent. Ecclesiastical, which also uses a life insurance model, only takes a modest £160 admin fee from each plan, leaving most client funds with the life insurer. This would suggest it reserves one of the highest amounts against each of its plans.

Nevertheless, there are no rules around how firms calculate their liabilities, or around how much they must reserve against them when using customer money to buy life policies.

As a result, there remains a potential for firms using the life insurance model to leave customers' money at risk. If a fund manager and plan provider were to go bust, and there were

insufficient funds allocated to each plan, the FSCS would not pick up this shortfall.

Some providers using life funds told us that their insurers provide something of an extra safety net here – in so much as they discourage their clients from taking out too much money at the start of the plan, to ensure there is enough left when the liability is crystallised. This is partly a concern about reputation to their own brand in the event of a plan provider's collapse.

But it would not be difficult to envisage a scenario where a provider was left with a significant shortfall – particularly if plans guarantee to cover third party costs over which they have no control.

To be clear, we don't have concerns about the financial position of existing players using the life-backed model. But there is a gap in the consumer protection which needs to be closed. In lieu of any comprehensive compensation scheme, we believe customers need to be provided with an easy way of assessing the financial security of insurance, as well as trust-backed, plans.

For insurance-backed plans, this would require a standardisation of the way in which liabilities are calculated. The output for consumers could be a financial health rating for the plan, similar to a credit rating.

Protection for trust-backed plans

If a PFP firm places customer money in trust, that trust must follow certain rules set out by the RAO.

The trust must be established by a written instrument. More than half of the trustees must be independent. The trustees must

appoint an independent fund manager to manage the trust's assets.

Suitably qualified people must prepare and audit the trust's annual accounts. At least once every three years, the assets and liabilities of the trust must be "determined, calculated and verified" by an actuary.

Are trusts a riskier option?

Trust-backed models rely on an appropriate investment strategy to succeed, and all investment comes with risks. It's true that well-managed, mature trusts which maintain a prudent surplus aren't likely to pose major risks. But in their early years trusts can be vulnerable. They haven't had time to build up a surplus to cope with the effects of market downturn or poorer-than-expected investment returns.

Coupled with the very large commission payments some firms are paying their partners, there's a concern over whether some trusts – particularly younger trusts – could meet their liabilities.

Some businesses operate more than one trust to deal with legitimate issues – such as those who do business in other European countries which use different currencies. We're aware that a minority of firms are operating more than one trust, having set up new trusts after their first trust(s) developed deficits. There needs to be clarity on what an acceptable level of funding looks like, and firms need to have plans in place to deal with deficits, should they ever occur.

How and when is money taken out of trusts?

The FPA rulebook says that plan providers must set out "any administration charges which the customer will need to pay." But

there's rarely prominent disclosure of how and when money is being taken from the trust.

Administration fees and commissions are paid out of trust immediately after customer money is paid in. This is reasonable, when the fees are reasonable. Without receiving these fees at the start, firms would wait for years for their payment. This would make starting a new PFP business an unrealistic proposition and damage competition.

But there are questions over the scale of some of these initial payments. Research for our initial report in this space suggested that some of these payments add up to more than £1,000. We continue to see examples of a small number of PFP firms which are offering commissions of around this value. Average commissions amongst larger providers are closer to £500.

These commissions can be a large part of the headline price – PFPs tend to cost consumers between £3,000 and £4,000. Our research found that some smaller firms are paying up to 70% of their staff's total compensation in sales commission. This is likely to drive an aggressive sales culture and increase the likelihood of poor conduct.

We'd like to see every single firm in the market rewarding staff and third parties in a sustainable and rational manner. Some firms, such as Co-operative Funeralcare, have removed sales incentives for staff altogether. This is a move other firms should consider, though as a less drastic measure we'd like to see sensible commission levels and commission-to-salary ratios across the market.

Some trusts make regular payments to the related PFP firms, on top of the initial fees. Some are paid as a drip back to the plan provider in return for administration of the fund. In other cases,

excess investment returns are paid back to the plan provider once the surplus has reached a certain level.

This may be sustainable when the payments are sensible but could potentially pose a threat to security of client money if firms were paid too much from the trust.

A lack of statutory instruction

The RAO does not provide any direction around when and how much money can be taken out of the trust. If the system is working properly, and the trustees are prioritising customers' interests, this should not be a problem. Trusts should protect client assets and only allow for money to be paid back to the firm where it is prudent for them to do so.

In reality, it's easy to see how this system could be open to abuse. Trusts are only required to have a majority of independent trustees – and there is little scrutiny over their appointment and the influence that plan provider trustees may have at trust meetings.

The FPA takes an active role in monitoring trusts and calling for action amongst its members. But there is no proper scrutiny for those who are not FPA members.

FPA rules go beyond the RAO, asking firms to supply an audited set of trust accounts every year, as well as an actuarial valuation.

Although members supply all this information to the FPA, very little of it is out in the public domain. Some trusts publish an abridged version of their accounts, which we see as a positive step, but none include any details around the actuarial assumptions used. This makes it impossible for external parties to get a clear picture of their funding levels.

The financial health of a trust depends on how the assets and liabilities are valued. It's possible to greatly change the picture by changing assumptions around investment growth, inflation or the cost of liabilities.

Although there is an actuarial standard for actuaries valuing funeral plan trusts, the directions in it are broad[19]. Actuaries in the profession have suggested that the highest standards have not always been upheld when it comes to trust valuations in the past.

During the course of our research, three of the largest users of trusts shared their trust accounts and actuarial assumptions with us, under non-disclosure agreements. We were satisfied that as things stand, the trusts are being managed prudently and the assets are sufficient to meet the liabilities.

Some large providers shared details of the assets and liabilities of whole of life policies held on customer's behalf. And the Co-op publishes headline details as part of its annual report[20].

A number of providers – including some FPA members – would not share trust accounts and valuations with us. We have heard reports of trusts using very high discount rates, which don't reflect the current investment environment. We've also heard of trusts valuing liabilities at unsustainably low levels.

Without information in the public domain, a lot of responsibility lies with the FPA to identify any problems amongst its members and to resolve them. All this is done behind closed doors – with no proper external scrutiny of the regulator.

19 www.frc.org.uk/getattachment/62eac586-5da3-4fdb-8dcb-d15396b179b3/TAS-400-Funeral-plan-trusts-Dec-2016.pdf

20 www.co-operative.coop/investors/reports

Contracting funeral directors

Currently, FPA-registered firms don't have to contract a funeral director to carry out the funeral service when a customer buys a plan. Integrated providers, such as Dignity & Co-op, deliver most of the prepaid funerals themselves, using their own funeral homes. Most other plan providers arrange services so that a funeral director is contracted at the time of purchase.

A minority of providers attempt to arrange plans at the point of need. This practice creates greater uncertainty over the future liabilities and creates additional risk to a trust's assets.

Ideally, every plan sold would be assigned and contracted to a specified funeral director, who has a binding obligation to carry out the services at a pre-agreed price.

Even where plans are contracted, there remains a risk that that the funeral director may go out of business before the plan is claimed on. Processes need to be in place to ensure that plans can be re-contracted to a different local funeral director in these instances, at no extra cost to the consumer.

Instalment plans

Some customers will opt to pay by instalments for trust-backed plans. Firms charge a percentage fee on these payments if the customer is paying their instalments over terms longer than 12 months. This is reasonable. It simulates investment growth over time, which helps to lessen the strain on existing assets held on trust.

Providers tend to take their administration fee upfront when customers pay in instalments – just as they do on plans that are

paid by a lump sum. The first batch[21] of plan payments are paid into the trust and then straight back out to the firm.

This may contribute to a shortfall in assets where a firm has a high proportion of consumers paying by instalments. This isn't such a problem where a mature trust is operating at a surplus. But for newer trusts, which don't have such capacity, the result could be a funding deficit.

If the number of funerals required is high during the trust's early years, this will increase the stress on the fund. This is of greater concern for newer trusts as they are very unlikely to have surpluses in place to deal with shortfalls.

It's also a particular concern where firms are taking out high administration fees and commissions at the outset. This means they are likely to be running a deficit on each individual instalment plan for many months after inception. A large volume of sales in this manner could leave a considerable deficit.

We believe that there should be rules forbidding firms from taking out any more than has been paid into the trust – and clear guidelines as to how instalment plans are accounted for.

Stronger disclosure

Consumers should be able to have some indication of the financial strength of the trust in which their money is going to be paid into – particularly in an environment where there is no compensation scheme safety net.

21 The exact number of payments will vary depending on the scale of the fee and payment term.

We believe full trust accounts and actuarial assumptions should be publicly available and should include a standardised metric to assess the financial stability of the trust.

Most consumers would not be equipped to read and assess a set of accounts. Hence, we believe there should be a risk rating published for each trust – similar to a credit rating.

It should be something that is comparable across different trusts and life-backed products - based on a prudent assessment of what the liabilities are, and a prudent set of assumptions for mortality, investment growth and inflation.

The risk rating should incorporate some element of stress testing.

Better Governance

We would also like to see more information about trustees in the public domain. Some funeral planning trusts have websites which introduce trustees and describe their role and background.

This is completely voluntary – FPA rules don't require this. Other trusts are far more opaque.

The RAO also lacks detail on managing conflicts of interest between the trust, trustees and the relevant firm. More than half the trustees must be independent, but there's no rule against senior employees of the relevant firm sitting as a trustee.

We would also like to see the introduction of a rule which stipulates that all trustees must be independent. Minutes of trust meetings should also be put into the public domain.

Is a fees 'cap' necessary?

PFP administration and commission fees range from hundreds to thousands of pounds in total. The wide range of fees may suggest that the very highest fees aren't justifiable or sustainable. And the lack of clarity for consumers means that it's very hard for them to choose a provider on the basis of these fees.

We talked about the possibility of capping the fees with industry representatives.

Several expressed reasonable concerns that capping or publication of fees would result in problems. Vertically-integrated businesses, with their own funeral director arms, could afford to charge little or nothing at the outset – and instead choose to book their profit at the time of the funeral's delivery. This would be much more challenging for smaller, non-vertically integrated firms, whose business model relies on taking out some money upfront to pay commissions and administration costs.

In these cases, disclosure wouldn't help consumers make an informed choice. It could damage competition as non-integrated firms would appear to be less competitive on fees. The FPA agreed, saying that transparency on this matter could result in strange behaviour.

Investment rules

The RAO lacks rules surrounding what a trust can and can't invest in. It aims to protect client money through its stipulation that the manager of the investments is independent, and that the trust has a majority of independent trustees.

As with trustees, there is no policing of investment strategies or the independence of fund managers outside of the FPA. And few firms

provide any public reassurance of the independence of their fund managers.

We know of at least two trusts that invest in properties owned by the plan providers. This brings the independence of their fund managers into question.

Although investing in property as part of a balanced portfolio isn't an unreasonable decision, it is improbable that an independent fund manager would choose to satisfy this investment decision by investing in any asset connected to the business.

The FPA Rules[22] state that "assets in the trust fund [must not be] the assets of the Registered Provider." But this is not a part of the rulebook that has been enforced strongly up till now as at least one of its members contravenes this rule.

What happens if there's a shortfall?

The FPA Rules[23] set out that providers must make sure that administrators can't use trust funds for any purpose except the delivery of clients' funerals. This is achieved through the wording of the trust deed.

The Rules also require firms to report to the FPA within 14 days if an actuarial valuation reports a shortfall of assets versus liabilities. Firms have another 14 days from the date of that report to inform the FPA on how it intends to deal with the shortfall.

However, there aren't any timeframes set out for the deficit itself to be put right.

22 FPA Rules 4.3.1.1

23 FPA Rules 8

The deed must make provisions for cases where a firm, or its trust, fails. It must ensure that customers still get the funerals that they pay for. This poses a practical difficulty. Trustees must arrange the delivery of funerals without the direction of the PFP firm.

The FPA's 'Pledge to Customers'[24] is relevant here. It states that if one registered provider becomes insolvent, the rest should "examine ways in which the Authority might assist in arranging delivery of the [necessary] funerals… the extent of this cooperation will be at the discretion of the individual Registered Providers."

There are no details on how the delivery of funerals would actually be achieved in practice. It seems that providers have also been given a 'get out' clause which means they could opt out of helping entirely.

Even within a voluntary regulation framework, it would be possible to build a more concrete process for the delivery of funerals in these circumstances. Providers should be forced to co-operate as a condition of their membership.

The FPA has had discussion with members about the possibility of establishing a formal FPA-led compensation scheme – which would greatly enhance the equity of the FPA brand and by extension the value of being an FPA member. The chances of this becoming a reality in a voluntary regulatory environment remain slim.

Firms who run their businesses responsibly are understandably reluctant to stand by the firms whose conduct and financial management is poor. This is an argument that the FSCS is familiar with – but FSCS members do not have a choice as to whether they participate.

24 www.funeralplanningauthority.co.uk/regulations/code-of-practice/

An additional complexity in the funeral plan market is that those who offer insurance-backed plans feel there is no need for them to be part of a compensation scheme. Customer assets are already backed by the FSCS in the event the life insurer was to become insolvent.

But providing an opt out for insurance-backed plans would greatly increase the cost for trust-backed businesses.

We believe there is an urgent need for a universal compensation scheme to sit behind funeral plans. We see this as one of the main reasons why statutory regulation is required. Such a scheme is arguably impossible to set up in a voluntary regime – and even if such a fund could be established, protection for customers of non-FPA registered firms would remain absent.

Even if membership to a compensation scheme were mandated, there are challenges around how to handle the two different models. Given different risk profiles, should companies who run trust-based models be charged more or vice versa? Would a new category need to be created for funeral plans, or could it be rolled in with insurance intermediation?

The FSCS does not currently operate a risk-based levy in insurance markets. Its levies are based on turnover and the risk of insolvency in the sector as a whole. However, regulators continue to look at the possibility of introducing a risk-based levy.

Would a single-model system be better?

The RAO allows firms to choose between putting client money into a trust or whole of life insurance plan.

A well-managed trust does not pose a major risk. One provider told us that during the 2007/8 financial crisis, the value of its trust didn't fall below the prudent 'cushion' it had built up in surplus. A responsible outlook can produce fair and reasonable outcomes for consumers who hold trust-backed plans.

But we aren't convinced that all trusts are being managed responsibly or have been managed responsibly in the past.

Whole of life policies are issued by FCA-regulated firms, so there are already tighter controls in place around this option - though we've identified potential shortcomings here too.

Crucially, a market with two different ways of managing client money creates significant complexity for consumers.

Mandating that client money is invested only in trusts – or only in life funds – would make the market much easier for consumers to understand and would remove some of the complexity of regulation.

A transition to a market where only one model was permitted would be complex. There would need to be an indefinite transitional period to allow one of these routes to 'unwind' over time.

Such a transition could place undue strain on smaller providers who were currently using the model which was being phased out. Nevertheless, we recommend that if the government introduces statutory regulation of this sector, it considers the costs and benefits of simplifying the way in which client money is managed.

CHAPTER FOUR

Improving conduct in the prepaid funeral planning market

Most of the UK financial services market is regulated by the Financial Conduct Authority. The FCA combines a detailed conduct rulebook with a set of overarching principles[25]. It has an explicit rule that firms it regulates must communicate with customers in a way that is 'clear, fair, and not misleading'[26].

Although FPA members are bound by its Rules and Code of Practice, these are relatively broad, and do not include some of the key elements of the FCA regime.

At the simplest level, the regulator does not have a broad set of principles, equivalent to Treating Customers Fairly – although some similar themes are included in its Code of Practice.

Many PFP firms we spoke to, and the FPA itself, were supportive of moving towards a principles-based approach. This could help to make the regulator's objectives, and the spirit of individual rules, more apparent.

The FCA principles in PRIN[27] inform the more prescriptive rules set out by the rest of its Handbook. There's an opportunity for the FPA to apply a similar regulatory approach. This would drive home key messages about the fair treatment of customers.

25 www.fca.org.uk/firms/fair-treatment-customers

26 www.handbook.fca.org.uk/handbook/COBS/4/2.html

27 www.handbook.fca.org.uk/handbook/PRIN/2/?view=chapter

It's also worth noting that the insurance sector will soon be bound to the terms of the Insurance Distribution Directive[28]. This introduces the principle that insurance firms will "always act honestly, fairly and professionally in accordance with the best interests of their customers."

This goes far beyond the current requirement to treat customers 'fairly'. We'd like to see a similar rule built into regulation for the PFP sector.

How could current FPA rules be improved?

The next three sub-sections look at existing conduct, marketing and disclosure requirements set out by the current FPA rulebook. We discuss the ways in which they could be improved.

1. Conduct rules

The FPA's Code of Practice sets out conduct rules for providers:

> *Plan Providers:*
>
> *1.1 must act in a courteous, sensitive, dignified and professional manner and, in particular, must not pressurise potential customers to buy funeral plans;*
>
> *1.2 must not make unsolicited visits or unsolicited telephone calls to potential customers and, in particular, to residents of nursing homes, residential care homes or other similar establishments;*
>
> *1.3 must respect the confidential nature of information given to them and only use that information for its proper purpose;*

28 eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32016L0097&from=en

1.4 in recommending another business, must disclose any interest they may have in that business;

1.5 must not make misleading comments about the quality or appropriateness of any funeral plan which a customer has already purchased or is thinking of purchasing.

Research for our first report found that it was not uncommon for sales representatives to place undue pressure on customers to push them towards a decision. There were examples of this behaviour among both FPA-registered and non-registered firms (or from their sales partners). Though it was far more prevalent among non-registered providers.

FPA Rule 1.1 forbids pressurising customers, so this isn't necessarily an issue with the rulebook, but about its enforcement – particularly relating to third party sales firms. Considering the potentially

vulnerable customer base in this market, we believe that stronger oversight in this area is needed.

The FCA's 11 Principles for Business set out overarching conduct rules that go beyond professionalism and courtesy. The FPA could draw on these principles to improve its conduct standards rules.

The FCA principles we draw specific attention to in relation to conduct risks are:

1 Integrity	A firm must conduct its business with integrity
2 Skill, care and diligence	A firm must conduct its business with due skill, care and diligence
6 Customers' interests	A firm must pay due regard to the interests of its customers and treat them fairly.
5 Market conduct	A firm must observe proper standards of market conduct.
7 Communications with clients	A firm must pay due regard to the information needs of its clients and communicate information to them in a way which is clear, fair and not misleading.

Source: PRIN 2.1

2. Marketing rules

The FPA Rules include marketing rules for materials supplied to consumers:

> *2.1 must ensure that any marketing or advertising which they undertake does not bring the funeral planning industry into disrepute and that their marketing and advertising:*
>
> - *is always in good taste;*

• is legal, decent, honest and truthful and complies with all the other requirements of the British Code of Advertising Practice or other relevant Code of Practice;

• only contains third party endorsements or sponsorship which have been specifically approved by that third party;

• makes no unsubstantiated claims about funeral plans or services provided by others;

2.2 must provide their employees, agents and representatives with training and written guidance on sales practices which ensures that potential customers are given sufficient information to make informed decisions about buying a funeral plan.

‘Legal, decent, honest and truthful’ communication isn’t necessarily clear communication. The need for clear communications could be added to these requirements.

Funeral directors and third-party sale firms

Rule 2.2 covers ‘agents and representatives’ as well as employees. The FPA doesn’t directly regulate funeral directors and third-party sales firms.

It’s important to say that we wouldn’t want to see smaller businesses put into a position where they were overly burdened with compliance rules.

However, it’s clear to us that there are issues when third parties are selling plans. This is of particular concern when these are large call centre operations.

A recent undercover operation for a national newspaper[29] found that third party sales staff selling plans for an FPA-registered firm were “flouting a series of industry rules.”

For example, if customers complained about the calls, some members of staff would call them back at five-minute intervals to provoke a reaction. The undercover reporter was also seemingly encouraged to use underhand tactics to get customers to reveal personal information.

This demonstrates the need for a much tighter grip on third party sales operations. We’d like to see the FPA rules making provider obligations much clearer around management of third parties.

Most PFP firms were keen to talk to us about the negative aspects of what one referred to as ‘warehouse call centres’, particularly in relation to aggressive outbound telephone sales. Another said that telephony-based sales were driving some of the worst outcomes in the sector. Too often, high-commission, high-volume sales practices are driving these models. And at a senior level, blind eyes are being turned to poor sales practices to maintain volume.

The industry agrees that better oversight of third party sales firms is necessary. Some firms suggested that anyone selling a funeral plan (including funeral directors) should have to undergo training and pass basic knowledge and competence testing before selling PFPs to consumers. Testing staff’s knowledge and competence would go beyond the current ‘training’ requirement in Rule 2.2.

The FPA could formalise and set standards for testing. Firms could then report results from their partners to the FPA as part of their registration or as an ongoing monitoring processes.

29 www.dailymail.co.uk/news/article-5096715/Funeral-firm-backed-using-illegal-tactics.html

Many firms already have good protocols in place to vet and train potential partners. These include routine training, and the ability to strike off third parties who didn't live up to internal standards. FPA-monitored training and testing would help to create a comprehensive feedback loop.

This would make it easier for the FPA to track third party performance. And to see how firms were dealing with third parties who weren't up to scratch.

Incentives

There is nothing in the FPA Code of Practice or rules about sales incentives. There is a long history of poor practice in financial services markets being driven by high sales incentives. In the case of payment protection insurance, commissions were so attractive that sales staff were selling policies to their own family members.

With commissions of up to £900 a plan being paid to sellers of funeral plans, there is a heightened risk of poor sales practices. One plan provider told us that until recently, up to 70% of staff's remuneration had been coming from commission, although they were in the process of phasing this to a maximum of 30%. Even at 30%, sales operatives are in a position where they can increase their salary by over 40% based on their sales performance.

We would like to see the FPA code of practice laying out rules as to how sales staff are remunerated and performance managed. And there is a case to be made that commissions should be disclosed. However, this issue should be considered carefully to ensure it doesn't negatively impact competition.

If the FCA was to take responsibility, the treatment of commission disclosure would be uncertain. In the protection market,

commissions are disclosed. But in the general insurance market they are not.

Printed materials

Many providers supply printed brochures to customers. But there's confusion centred around plan 'guarantees'. Consumers interviewed by Matter for our previous report felt that most 'guarantees' were confusing. When researchers explained what the different costs were, one consumer commented that a guarantee had "no value" because it only covered funeral director's costs.

It's easy to see how this becomes a source of confusion. We have particular concerns around the use of word 'guarantee' – most 'guarantees' are only guaranteeing funeral director's costs, not disbursements.

Firms shouldn't use the word 'guarantee' to describe plans which guarantee funeral director costs but not disbursements. Even when used with the best of intentions, there's a high chance of the word 'guarantee' causing confusion among consumers over what is and what isn't covered.

3. Disclosure requirements

The current FPA Code of Practice sets out certain pre-contractual written disclosure requirements:

> *3.1 the type and cost of funerals and other services which can be provided under the funeral plan;*
>
> *3.2 any costs which may not be met by the funeral plan;*
>
> *3.3 any administration charges which the customer will need to pay;*

3.4 if the plan is paid for by instalments, what happens if someone dies before all payments have been made;

3.5 the customer's right to a full refund if the plan is cancelled within 14 days of its commencement and any rights to a refund which the customer has if the plan is cancelled by the customer after that time;

3.6 what happens if the Plan Provider cannot meet its obligations under the plan;

3.7 how a customer may complain about the Plan Provider or any plan provided and how such complaints will be handled;

3.8 the other terms and conditions which apply to the plan.

This is a decent starting point. However, it does not tell firms to set out significant benefits, exclusions, and limitations in a summary document.

Summaries can be very helpful for consumers. A good summary sets out the key features and limitations without containing an overwhelming amount of information. Summary documents are a mandatory feature of many FCA-regulated insurance products[30].

Oral sales

Many PFPs are sold over the phone, or in a face-to-face setting. The FPA rulebook lacks information on how oral communications should be conducted.

Customers should still receive a pack containing all the details of the provider's plans after this.

30 FCA Handbook ICOBS 6.4.4 R & ICOBS 6 Annex 2

The FCA's Insurance Conduct of Business Sourcebook (ICOBS) sets out clear requirements for oral sales[31]. This avoids doubt over which information firms should supply to customers during oral sales. ICOBS describes the appropriate way to supply it:

> *(1) If a firm provides information orally during a sales dialogue with a customer on a main characteristic of a policy, it must do so for all the policy's main characteristics.*
>
> *(2) A firm must take reasonable steps to ensure that the information provided orally is sufficient to enable the customer to take an informed decision on the basis of that information, without overloading the customer or obscuring other parts of the information.*

The FPA could build similar requirements into its own rulebook.

Cancellation fees

Some firms in the market charge cancellation fees of up to 20% of the plan value. This can amount to many hundreds of pounds. Some others charged fixed fees of around £400 or more. We would like to see the FPA introduce rules which make it clear that any fees should be proportionate. We believe Age UK's cancellation fee of £95 is reasonable.

31 ICOBS 6.4.2 R

4. The fit and proper persons test

The FPA Rules use a wide wording to explain how assessments of fitness and propriety are carried out on applicants and trustees:

> *An Applicant must satisfy the Authority that:*
>
> *2.2.1 The Applicant, and*
>
> *2.2.2 Any Trustee,*
>
> *are fit and proper persons who will comply with the Rules. In assessing the fitness and propriety of any person the matters which the Authority will take into account include but are not limited to the Applicant's continuing obligation to meet the requirements of the RAO so far as they relate to the provision of funeral plan contracts.*

The wideness of the clause is beneficial in the sense that it allows for it to take into account anything it is legally allowed to, which could mean close scrutiny. However, in doing this it sets no minimum bar and allows for a great deal of subjectivity in its assessment.

The FCA's FIT test is designed to ensure that anyone who is being considered for a senior managerial position in a regulated firm is assessed as fit and proper, and that ongoing assessment of their fitness and propriety is taking place.

FIT 1.2 contains a number of variables the FCA may consider, including qualification, training, competence and personal characteristics[32]. Its guidance states more generally that firms should only employ people who have the necessary skills, knowledge and expertise to perform their duties effectively.

32 FIT 1.2.1B G

It is notable that the entirety of FIT is designated as guidance, not regulation. This allows the FCA to change and extend the scope of who it is willing to consider as a fit and proper person over time. As with the FPA, this is beneficial.

But it would be useful for the FPA – and firms who are applying for registration – to explain the criteria it's likely to hold firms (and staff) up against when considering their suitability and competence.

Intervention from the Information Commissioner's Office

There are many websites which pose as funeral plan comparison sites. They are actually lead generators.

They often claim to offer a 'free quote'. But when you click the button to get a quote on these sites, you won't receive one online as you'd expect. Your data is sold to a third-party sales firm who will use the information provided to contact you. This is often only disclosed in small, non-prominent, text.

It's unfair to 'trick' consumers into handing over their data in this way. A new FPA rule could prevent firms from using any data which obtained through this misleading practice.

Under current data protection law, this practice is a grey area. The General Data Protection Regulation (GDPR) comes into force on May 25th 2018. Under GDPR, businesses must provide customers with a clear opt-in for the use and sharing of their data. Ways in which data will be used must be clearly disclosed.

As it stands, most of these sites will be in breach of these rules. We call on the Information Commissioner's Office (ICO) to play a much larger role in tackling these websites from that point.

Many firms in the PFP industry have voiced their frustration about these sites. Firms have also reported that the sites are often using

their logos without permission. Their staff are wasting significant amounts of time in order to have these removed. And new sites pop up frequently, meaning even more time wasted for firms.

We understand how exasperating this cycle must be. Post-GDPR, the ICO can use its enforcement powers to clamp down on these practices. It should be sending a strong message that collecting and selling consumer data without clear and valid consent will not be tolerated.

The lead generation sites in the PFP market would be a good place to start.

Transparency around complaints handling

The existing dispute resolution service provided by the FPA hasn't seen a lot of use.

The FPA Code of Practice contains rules to ensure customers are aware of the right to complain to their provider. But they may be less aware of the possibility of escalating the complaint the FPA.

Firms must distribute the Code of Practice on request to consumers, but it is unlikely this is happening on a wide scale. Many firms include details of how to escalate a complaint to the FPA in their Ts & Cs and on their websites. But this isn't an FPA rule. Firms are only obliged to detail their own complaint procedures[33].

As a starting point to making the existing system better, the right to complain about a PFP should be better publicised. Websites, and post-sale information for customers should also contain prominent information on how to make a complaint. It should also be formally extended to the customer's next of kin.

33 FPA Code of Practice 3.7

The funeral director who carries out a customer's funeral could distribute information on making a complaint to the next of kin. They could also give them information about the services covered by the plan. This would allow next of kin to compare what was paid for with what's delivered.

We'd also like to see better reporting on complaints. The FPA should publish annual numbers and breakdowns of complaints by type and provider on its website.

Making FPA registration a 'must' for all firms

In the short term, we would like to see all PFP firms meeting the FPA's standards and becoming registered firms.

While FPA registration isn't mandatory, it would be possible to make FPA registration a 'must have' for firms. This would help to drive and maintain higher standards across the industry.

Looking at changes to the equity release market of the 1990s will be helpful.

A series of scandals in that market during the late 1980s led to the development of a trade association known as Safe Home Income Plans (SHIP). To be a member of SHIP, firms had to abide by several key pillars, set out in its code of conduct.

These included the right for customers to remain in their homes for life, and perhaps most importantly, the No Negative Equity Guarantee. This guaranteed that customers with a SHIP plan would never owe more than the value of their homes to the equity release firm.

Equity release firms and the media publicised the benefits of SHIP widely, making consumers aware of the reasons why they should

only choose a SHIP member when buying an equity release product.

Many firms we interviewed felt that the FPA was currently lacking the profile and credibility it needed to achieve similar outcomes to SHIP.

Given that its own modernisation has started recently, there is work to be done in showing its effectiveness to external stakeholders.

We believe the FPA needs to build a clearer external narrative around why consumers should only use its providers. It could do this by creating pledges similar to those created by SHIP.

These could include, for example, a pledge that customers will never pay more for their agreed funeral services even if they move home (within the UK). Or a promise that families will never have to ‘top up’ the plan after the plan holder dies.

The one that would be most potent with consumers is some form of guarantee for consumers. As discussed in the previous chapter, while it may prove difficult to build a compensation scheme in a voluntary environment, the FPA could look at mandating providers to have adequate insurance coverage in place to protect against insolvency.

Another alternative would be to create some kind of additional pot of funds which could provide some limited compensation in the event that of an insolvency. This could be funded by lifting the cap on fees and diverting a significant proportion of the additional revenues into a ringfenced pot.

The FPA also needs to spend time and effort on raising its profile with external stakeholders. We believe that it will be very difficult to do this within its existing budgets.

The funeral industry could also provide support by more publicly stating its commitment to only dealing with FCA firms. Both the National Association of Funeral Directors and the National Society of Allied and Independent Funeral Directors (SAIF) have issued guidance to their members encouraging them to only sell funeral plans from FPA members. However, they stop short of mandating this as a condition of membership, citing legal advice that this would be anti-competitive.

We believe this an overly conservative interpretation of the law. In practice, if these bodies were to mandate that their members only sold FPA plans, and were subsequently sued by non-FPA members, the FPA could ask members to share the costs of the suit.

If statutory regulation becomes a reality in the sector, the natural evolution for the FPA would be to become the industry trade body. The FPA has at times been resistant to evolution and change around its remit and role. We'd like to see the existing team driving towards a goal of statutory regulation, given that it is an outcome that all its members support. This does not have to mean working to put themselves out of a job. It is working towards a new remit and position for the body once statutory regulation has been achieved.

CHAPTER FIVE

Approaches to regulation in other countries

Law and regulation surrounding the PFP sector in other countries varies widely – and it can also vary within countries which are comprised of multiple states.

Money handling rules are generally similar – funeral directors, in most cases, may not hold customer money themselves but must instead invest it in a trust (or similar arrangement) or life insurance policy.

Some of these systems are more stringent than the UK's current model, and potentially offer better protection for consumers. We are not saying that any other model is perfect, but various aspects of these systems have been highlighted below as useful blueprints for potential change.

Countries in this section are ordered alphabetically, not in any order of preference. The details give simplified overviews – there are various legal caveats and exceptions sitting around some of the regulations listed, and many of these are not listed here for the sake of brevity.

Australia – Victoria

The state of Victoria has implemented legislation[34] to ensure customers are given certain pre-contractual information about their PFP, as well as rules surrounding how money must be handled.

34 goo.gl/xHSDPa

Money handling

Money must be invested within a funeral benefit fund established under its friendly society codes, or in certain policies or investments offered by life insurance companies.

Disclosure

Customers must also be told about any administration and brokerage fees that they are paying for their plan. As we discussed in the second chapter of this report, publishing administration fees may not be suitable for the UK market.

A ban on asking for more money

Victoria has forbidden firms which sell PFPs from asking customer for further pre-payments or other amounts not set out in their contract[35].

Canada – Ontario

The Canadian state of Ontario also has detailed legislation which specifically relates to the PFP market.

Money handling

Money is held in similar fashion to the UK market – either on trust or in a life insurance policy.

There is a statutory body, the Bereavement Authority of Ontario (BAO), which regulates the funeral market under the Funeral, Burial and Cremation Services Act, 2002[36]. This includes oversight of the PFP market.

35 www.consumer.vic.gov.au/licensing-and-registration/funeral-providers/running-your-business/pre-paid-funerals

36 www.ontario.ca/laws/statute/02f33

Licences and discipline

PFP firms must be appropriately licensed by the BAO to carry out business and must pass examinations to achieve the relevant licence.

The BAO has significant disciplinary and enforcement powers, including the power to suspend or revoke licences. It publishes details of major disciplinary decisions on its website[37]. Customers may also ask the BAO if disciplinary action has ever been taken against a licensee to check the reputation of potential providers before they choose their plan.

Consumer rights and protection

Consumers have rights[38] relating to their PFP enshrined in law. For example, a customer with a trust-based plan who cancels their PFP within 30 days is legally entitled to all of their money back.

If the customer cancels after 30 days, the provider may retain 10% of the plan cost or up to 350 CAD – whichever is lower. However, insurance-backed plans don't guarantee their customer the same rights. Customers with insurance-backed plans sign one contract with the PFP provider, and a second contract with the insurance firm, to whom they may have to pay cancellation fees.

Compensation fund

The BAO administers the Prepaid Funeral Services Compensation Fund.

This fund will reimburse customers if prepaid money is not available when needed. It is funded by licensees, who pay 250 CAD into the fund when they apply for a licence. The fund is

37 thebao.ca/news/suspension-revocation/

38 thebao.ca/for-consumers/647-2/

designed to hold a minimum of 1,000,000 CAD at all times. If its value is less than this, or if it is anticipated to be less, participants may be required to fund an amount to bring the level back above 1,000,000 CAD.

We question whether this model would offer sufficient protection in a crisis situation. The average overall cost of a funeral in Canada has been reported to be around 8,500 CAD[39]. Though this isn't necessarily the amount each funeral would cost in reality, a run on the pot could quickly drain it.

The model is interesting as it doesn't require ongoing payments from the industry, but any shock could result in significant and sudden demands for money, which would mean firms have to hold large capital amounts – 'just in case' – rather than paying into a sustainable compensation fund over time.

Guaranteed plans

As of July 1, 2012, PFP providers in Ontario must supply everything agreed upon in the contract without additional charges, even if the costs of supplying those services rise. This would definitely make PFPs easier for customers to understand, as the division between funeral director's fees and disbursements is often misunderstood.

It also prevents firms from asking customers or their families to 'top up' the plan at a later date. However, it could also have the negative effect of pushing PFP prices up across the board, as firms look to protect themselves against the risk of rising costs in the future.

39 www.lowestrates.ca/blog/burial-plots-funeral-services-and-more-how-much-it-costs-die-canada

United States of America

Funeral plans in the USA are bought directly from individual funeral directors.

Laws and regulation in the USA are very different depending on which state you're in. New York State and Florida have some of the more stringent laws and regulations surrounding PFPs.

New York State

Money handling

All money must be deposited within 10 days of receipt into an interest-bearing, government-backed investment such as US Treasury bills. All interest will be paid out at the time of need along with the initial capital[40].

No fee may be levied by a funeral director for prearranging a funeral, but as they're essentially booking in future business for themselves, this isn't a significant restriction.

Only a fee of 0.0075% of the principal sum paid[41] may be taken to pay for the management fees levied by the financial institution which administers the account.

Customers must be informed where their money is deposited and can ask to be told the total value of their account at any time. The customer remains in control of the funds, so even if the funeral home closes, the customer isn't left out of pocket. They can transfer the money to another funeral home – or in some circumstances withdraw the money and interest.

40 www.health.ny.gov/publications/0703/

41 nysfda.org/index.php/funerals-memorialization-4/94-the-security-of-preneed-funeral-funds-in-new-york-state

Florida

Florida has a number of regulations[42] designed to protect PFP customers, which makes sense in the context of the state having the second-highest population of senior citizens[43]. There are 3.3 million people living in Florida who are aged 65 or over.

Licences and discipline

To sell a PFP in Florida, firms must have a valid licence, which they gain via paying fees and providing various details to the state's Division of Funeral, Cemetery, and Consumer Services (DFCCS) – for instance, accounts to demonstrate their own solvency and the way customer money is being managed[44].

The DFCCS has statutory powers to discipline licensees, including the ability to issue fines, restrict a firm's scope of practice, and suspend or revoke licences. It can also investigate cases where unlicensed firms have sold PFPs and take action against those firms too.

Its orders up to July 1st 2015 in disciplinary matters are archived on its website[45], and after that date on the Division of Administrative Hearing's website[46].

Money handling

Firms must secure customer money in a trust account, individual insurance policy, or letter of credit. A letter of credit commits a bank to paying the agreed amount to the funeral director at the time of need.

42 goo.gl/Jyn59M

43 www.mypalmbeachpost.com/interactive/aging-population/

44 goo.gl/YF7cjE

45 finalorders.fldfs.com/ExternalWebAccess.aspx

46 www.doah.state.fl.us/FLAIO/

The DFCCS conducts regular examinations of these arrangements to ensure the regulatory requirements are being fully met[47].

Oversight of contracts

Firms must also submit contracts to the licensing authority for approval before use[48]. The authority may refuse the use of contracts which contain illegible material, small print, are misleading, unfair, and don't contain sufficient detail.

Compensation fund

There is a compensation fund in Florida on which consumers can make a claim if their PFP provider goes out of business[49]. It's called the Preneed Funeral Contract Consumer Protection Trust Fund.

Firms are explicitly forbidden from using the existence of the trust fund as a sales and marketing tool in any form.

Firms make payments at the end of each calendar quarter towards the fund; 2.50 USD for each PFP contract sold during the quarter for 1,500 USD or less, and 5 USD for each PFP contract sold during the quarter for more than 1,500 USD. The required payments may be lowered if the trust fund balance exceeds 1,000,000 USD.

However, the fund will never pay out more than the amount paid in the first place for a plan, and often will pay out less.

47 www.myfloridacfo.com/division/funeralcemetery/Consumers/ConsumerFAQ.htm#pncontracts

48 goo.gl/ezwd23

49 www.myfloridacfo.com/division/funeralcemetery/Consumers/PreneedClaims.htm

CHAPTER SIX

Routes to statutory regulation in the UK

There are two ways to move the PFP market into statutory regulation:

1. Create a statutory funeral planning regulator.
2. Bring the PFP market under FCA regulation.

This chapter looks at how each of these would be set up and examines the benefits and drawbacks of each option.

Option 1: Creating a statutory funeral regulator

When we say 'statutory funeral planning regulator' (SFPR), we mean any organisation with statutory powers which regulates this market but is independent from the FCA. This could be the FPA or a successor organisation, for example.

The Treasury maintains that the creation of a new SFPR would require primary legislation. This means it would need to be included in a new Bill that would need to pass through the Houses of Parliament.

If there was political will to back a new SFPR, the Treasury told us that it was unlikely that the necessary primary legislation would be tabled before the end of the current parliament in 2022 – as the current legislative agenda is backed up with Brexit related legislation. We estimate that it would likely be at least a further two years at the earliest until the legislation was in place.

The SFPR would need a tight set of rules to set out exactly how firms must act, keep records, handle money, and communicate with

customers. The benchmarks set by the existing FPA Rules and FCA Handbook could inform these.

An SFPR would need adequate funding supplied from industry fees. These may need to increase above current FPA levels to cover the cost of resources to enforce the rules.

An SFPR would not necessarily be any less effective than FCA regulation. In fact, we've heard a lot of evidence which suggests that the level of interaction FPA-registered firms have with the FPA is well above the level of interaction on FCA-regulated firm might expect.

The ability to bring materials to the regulator for its opinion, for example, can help firms make sensible proactive decisions, rather than relying on reactive regulatory enforcement.

But the creation of an SFPR seems unlikely in practice. It would be against the direction of travel in which financial services regulation has headed over the past couple of decades.

The FSA took over from the self-regulating Securities and Investment Board (SIB) in 2001, becoming the statutory regulator for markets the SIB had previously overseen. It then grew to encompass further markets.

As we've mentioned, the equity release market came under FSA regulation in 2004, and the mortgages market became FSA-regulated in the same year. Retail insurance markets were then brought under FSA regulation in 2005.

The FSA was succeeded by the FCA in 2013 and took over regulation of the consumer credit market from the Office of Fair Trading (OFT) in 2014. The FCA now regulates the vast majority of

UK financial services, many of which are also regulated by the Prudential Regulation Authority (PRA).

In this context, setting up a new statutory regulator – especially given the relatively small size of the PFP market – goes against the grain of regulatory consolidation. The current political administration has been looking to rationalise regulators and quasi-governmental bodies.

Costs of a statutory funeral planning regulator

An SFPR might use the existing FPA fees model as a guide. Removing the fees cap would bring the funding model into closer alignment with existing regulatory models.

This would result in larger firms paying higher annual fees and bearing a larger proportion of the cost of PFP regulation. This may not affect the fees of firms which already fall underneath the cap. However, the regulator might also need to increase base fees to cover the cost of further resourcing.

Statutory regulation of the market would also mean bringing several non-regulated firms into the regulatory structure, as well as firms which sell plans backed by others. This would result in some level of further funding – unless compliance costs drove the smaller firms out of business. This is a risk worth bearing in mind, as it could be detrimental to competition.

We wouldn't expect major increases in recurring internal costs for firms, as most are well-resourced to deal with existing compliance needs. A more stringent environment might result in one-off costs to develop new systems. For example, this might be to cope with new reporting needs for the FPA.

Option 2: Bringing the market under FCA regulation

An amendment to the RAO is necessary to remove the regulatory exemption for the PFP market.

The Treasury could amend the RAO using secondary legislation. This would mean creation of a statutory instrument (SI) to amend article 60 of the RAO, and any references to it elsewhere.

Politically, the passing of an SI is much simpler than primary legislation. Nevertheless, there needs to be political will at ministerial level to introduce such a change.

If the Treasury wished to amend the RAO, there would need to be an initial consultation before any decision was taken. If the Treasury proceeded to amend the RAO after consultation, there would likely be a period of transition while the FCA began consultation on the introduction of a new set of rules for the PFP market.

The market does not neatly fit into any existing product-specific part of the FCA Handbook. Given the product's similarity to insurance products, ICOBS could inform the construction of new rules for the PFP industry. But creation of a specific PFP rulebook would likely be another lengthy procedure, involving consultation with industry stakeholders.

We estimate that the time from the Treasury starting consultation on an amendment to the RAO, through to full FCA regulation of the market, would be a minimum of two years, and likely three or four years.

Costs of statutory FCA regulation

The cost of statutory FCA regulation is hard to gauge. Without knowing the exact regulatory structure, it's hard to know how many internal resources firms would need to be compliant.

Some PFP firms already have sizeable compliance departments. Many providers indicated that at least some members of their compliance teams were trained to work in, and had experience of working in, an FCA-regulated environment. It's likely that firms would need to develop new systems to meet FCA reporting standards.

There would then be the cost of regulatory fees. The FCA collects fees for itself and on behalf of other organisations such as the FOS and the FSCS. Rates are consulted on and may change each year.

The FSCS has issued a sample calculation of how fees and levies work (at 2015/16 rates, see footnote for full document)[50]. We've worked from this example to show what FCA fees could look like for the PFP industry. We aim to give a rough idea of the potential cost below.

In its example, Firm X has an annual income of £480,000. This income falls under FCA fee block A013 (Investment mediation).

Its FCA fees would total £2,419.85.

Relevant FSCS levies in the example are classes SC02 (life and pensions intermediation) and SD02 (investment mediation). These categories might apply to the PFP industry, given the available business models. However, as noted, new categories may have to be developed instead.

Firm X's income breaks down as £288,000 of eligible annual income in FSCS class SC02 and £192,000 in FSCS class SD02. In this example:

- The cost of the SC02 levy is £9,273.18.
- The cost of the SD02 levy is £5,389.82.

50 www.fca.org.uk/publication/fees-information/fscs-levy-calculation-notes-15-16-rates.pdf

- There are also base cost levies to account for.
- **The total cost of FSCS protection for Firm X is £14,725.75.**

There are also contributions to the Money Advice Service and the Pensions Guidance Service.

The total cost of regulatory fees for Firm X would be £17,228.18 for the 2015/16 financial year.

Income of £480,000, when plans cost around £3,000, would account for only 160 plans. This is very low in comparison to the real number of plans sold.

We've scaled this up to create two examples which reflect the potential costs for a mid- to large-sized firm and a very small firm.

A Mid- to large-sized provider

We scaled the costs above to reflect a mid- to large-sized provider. This provider has a share of roughly 7.5% of the market. It sells 15,750 mid-tier plans a year at £3,500 each for a total income of £55,125,000.

We'll use the same proportion of SC02 and SD02 levies as in the example above. This would give eligible income of £33,075,000 and £22,050,000 respectively.

We used the FCA calculator[51] (using 2017/18 rates) to find the following costs:

51 www.fca.org.uk/firms/calculate-your-annual-fee/fee-calculator

Total fees & levies	£1,496,122.33
Financial Conduct Authority (FCA) total	£161,842.83
Money Advice Service (MAS) total	£3,751,70
Pensions Guidance Service (PGS) total	£4,071.85
Financial Services Compensation Scheme (FSCS) total	£1,326,455.95

In comparison, a firm selling 15,750 plans a year under FPA regulation would pay £63,500. That includes the annual registration fee.

A small provider

We also scaled the costs to reflect a very small provider. It might be a new entrant to the market. This provider has a share of roughly 0.25% of the market. It sells 500 mid-tier plans a year at £3,500 each for a total income of £1,750,000.

We'll use the same proportion of SC02 and SD02 levies as in the example above. This would give eligible income of £1,050,000 and £700,000 respectively.

We used the FCA fees calculator (using 2017/18 rates) to find the following costs:

Total fees & levies	£48,289.99
Financial Conduct Authority (FCA) total	£5,915.24
Money Advice Service (MAS) total	£122.20
Pensions Guidance Service (PGS) total	£122.10
Financial Services Compensation Scheme (FSCS) total	£42,130.45

In comparison, a firm selling 500 plans a year under FPA regulation would pay £2,500. That includes the annual registration fee.

It's important to say that the PFP market, may better suit alternative FCA fee blocks or FSCS levy classes. It's also arguable that neither of these fee blocks is appropriate, and that a new fee structure would better suit this industry.

The cost of regulation in this example is higher than the cost of FPA regulation. Most of the market could probably bear this. There's a small risk that providers would find it hard to meet costs of the FCA itself, from these examples.

It's the FSCS levy which has the largest impact and could have a negative effect on this market in terms of competition and prices for consumers.

It may be the case that a different compensation scheme is more appropriate. To avoid the high cost of a levy-based system, this could come in a similar form to the existing pledge the FPA operates. Providers would sign up to make sure consumers receive the funerals they've paid for. The regulator would need to formalise a system which ensured co-operation from firms.

After all, in the context of PFPs, it's perhaps more important that consumers get the funerals they have paid for, rather than a refund – especially if this was to come after their death. This could side-step the impact of enormous FSCS levy contributions.

It's also very unlikely that in a situation where a firm collapses with major deficits against its liabilities in either its trust or life fund arrangements, that there would be nothing at all for the other providers to use as funding for funerals for customers of the firm which has collapsed.

So this arrangement could be a viable alternative to the FSCS. It would fulfil the specific needs of customers, so that they would get what they've paid for.

The appointed representative model

In an FCA-regulated environment, there would be a potential issue in that small funeral directors may have to be regulated. Small family firms could struggle with adhering to compliance rules to the point they were put out of business, and the industry has been very vocal about this risk.

Any new regulation which produced this outcome would not be good for the sector, and it would not be good for consumers as it would reduce choice and potentially push up the price of a funeral even further.

The solution may be an 'appointed representative' (AR) model which already exists in the insurance and investment sectors[52].

ARs report to an authorised firm – their 'principal' – whose products they sell. A common example of this might be a travel firm selling travel insurance to customers at the time they buy a holiday.

The FCA published a thematic review of ARs in the general insurance sector in 2016[53]. It identified concerns relating to the oversight of AR activity, which it said at the time had "resulted in detriment to the consumer; for example, through mis-selling or failings in service provision."

It took action to share its findings with the industry and intervened to address the failings it identified. It imposed restrictions on

52 www.fca.org.uk/firms/appointed-representatives-principals

53 www.fca.org.uk/publication/thematic-reviews/tr16-06.pdf

several firms to prevent them taking on any new ARs and stopped several ARs from selling any more insurance policies.

While the AR model is not without potential pitfalls, strong regulatory oversight can correct the course of ARs acting inappropriately. It can also proportionately discipline regulated firms for failings in their duty to oversee the behaviour of the ARs they contract with.

The FPA could use the appointed representative model to hold PFP firms responsible for the behaviour of the third parties they work with. It already does this to a loose extent – but this should be built out within its current rules. This would provide even stronger motivation for firms to carefully select their partners and stamp out bad behaviour.

Expectations could be set out in a service level agreement (SLA), rather than having each smaller business report to the FPA. The FPA could demand to approve all SLAs before they are put into use.

This SLA could ensure regular reporting from the third parties, and reasonable access for the PFP firm to monitor the third party and drive good conduct.

A third option

Although it's not an option that we'd favour, there is a potential third option open to government. It could make amendments to tighten the RAO, without bringing the whole industry into statutory regulation.

It could do this by mandating membership of the FPA – although this would create a voluntary regulator with a statutory remit but no government oversight.

More effectively, it could increase reporting and disclosure requirements on the industry as a condition of remaining exempt from FCA regulation. If firms were forced to disclose the true strength of their trusts, this could potentially expose some of the weaker players and force them to repair deficits or consider exiting the market.

This would, however, still not address issues around poor conduct, and would still leave the industry without any kind of compensation scheme safety net sitting behind it.

If the government was minded to commit to secondary legislation, we believe it would be more effective to remove the exemption and push the industry under the wing of the FCA.

CHAPTER SEVEN

Conclusions and recommendations

The PFP industry believes that it needs some form of statutory regulation. We agree and believe the Treasury should act immediately to begin the process. As it will take several years to complete, we believe the FPA and industry should continue to work on raising standards in the interim.

In the short to medium term

In the short to medium term, the first goal should be the improvement of the FPA's standards, enforcement and reputation. Even if statutory regulation of the PFP market is delivered, the earliest it is likely to come into force is 2020 – and there is much that the FPA can do in the interim to improve standards.

Its structural changes have helped the FPA to assert its independence from the industry. On the 1st April 2017, the FPA became a community interest company[54]. This legal designation is reserved for social enterprises which use profits and assets for the public good. The appointment of an independent board, and the introduction of regular stakeholder meetings are also important developments.

The FPA is already working on a new rulebook which will demand higher standards of its members and is considering how a compensation scheme could be introduced.

Its goal must be to create a set of benefits and protections that strengthen the FPA brand to the point where it is very difficult for providers to succeed without being members.

54 beta.companieshouse.gov.uk/company/04314827

This task requires PFP firms and the FPA to get involved in PR and marketing efforts to drive awareness, as SHIP achieved in the equity release market during the 1990s.

It will take time to build a profile comparable to that of SHIP. But consumers need to know what the FPA is and why they should only buy FPA-regulated plans.

In the short-term, the FCA also needs to step up its work in policing the perimeter of the funeral plans market. Contrary to the FCA's assertion, we believe there are firms that are in breach of the RAO and need to be held to account for this.

From a political perspective, we would urge the government to begin the process of consulting on the introduction of statutory regulation at the earliest opportunity. We believe there are already a significant number of consumers whose money could be at risk, and it is in the interests of all parties to act before the industry is hit by the collapse of a provider.

In the long term

Although we support the continued strengthening of the FPA in the short to medium term, we don't believe adequate protection can be achieved for this market without statutory regulation.

The formation of a standalone statutory funeral plan regulator seems unlikely. Although we can see that there may be cost savings for the industry of going down this route, it will prove costlier to government and it remains improbable it will make it onto the legislative agenda before 2022 at the earliest.

We also don't believe that the higher costs associated with FCA regulation will be sufficient to significantly impact competition in this market. The largest cost will be membership of the FSCS – but

exactly how much this might be depends on a number of factors which would need to be resolved in consultation with the industry.

In light of this, we recommend that the government begins the process of bringing the market into FCA regulation as a matter of urgency.

After an initial Treasury consultation on an amendment to the RAO, the FCA would need to begin a period of consultation with the industry around the creation of a relevant, suitable, and proportionate, set of rules for the sector.

A period of transition would be required, to allow companies to raise standards to meet FCA requirements. All effort should be made to protect smaller players and competition in the market – in line with the FCA objectives.

We believe it is unlikely full FCA regulation of the market can be achieved before 2021, but the beginning of the process should start to raise standards, even amongst those outside of the FPA.

Once the process of regulating the industry is complete, the FPA could transition to become the industry trade or professional standards body, changing its name to the Funeral Planning Association.

Funeral plans are important products, with widespread appeal and utility. We want this market to thrive, but it's important that the right consumer protections are in place so that customers can have confidence that their money is safe, and their wishes will be executed once they are gone.

@fairerfinance fairerfinance.com

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