

# Commission on Dormant Assets

## Tackling dormant assets

Recommendations to benefit  
investors and society

March 2017



# Foreword by the Chair of the Commission on Dormant Assets



**Dormant assets should not exist, but they do. Individuals should never lose track of their assets, but they do.** Companies should not have out-of-date contact details for their customers, but they do. As a result, there is a significant amount of money in our economy which is unclaimed or lost. Public interest dictates that money ordinarily due to customers should not unduly benefit companies. We should all do whatever we can to minimise dormancy occurring in the first place, but if it does occur, the owners should be found and, if that is not possible, society should benefit.

The Government first began to address this issue in 2008 with the Dormant Bank and Building Society Accounts Act. This has led to significantly enhanced reunification of dormant assets by our banking institutions.

In December 2015, I was pleased to be asked by the Minister for Civil Society, Rob Wilson, to chair the new independent Commission on Dormant Assets. The Commission's remit was to look beyond simple bank and building society accounts and consider the full spectrum of potentially dormant financial and non-financial assets. Its ambition was to encourage steps that could minimise existing and future dormancy, reunite assets with their beneficial owners and, where that was not possible, recommend a mechanism to recycle dormant funds to be used to address key social issues throughout the UK.

This report contains the principal findings and recommendations of the Commission. It concludes that there is a broad range of financial assets where significant levels of dormancy may exist. It also concludes that much more should be done to reduce these through substantially greater reunification efforts. However, even after this, there is still likely to be over £1bn that, over time, can be channelled to good causes.

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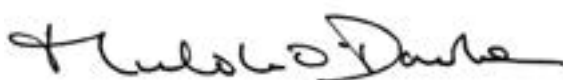
*"We should all do whatever we can to minimise dormancy occurring"*

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*“Likely to be over £1bn  
that, over time, can  
be channelled to  
good causes”*

The work of the Commission required the support of a significant number of individuals and institutions. Firstly, my nine fellow Commissioners who brought their expertise and commitment to what was often a difficult, technical and complex discussion. Their experience, particularly of the financial services sector, was invaluable and I would like to thank them enormously for their unstinting support. Secondly, thanks are also due to the many stakeholders who spent considerable time working with the Commission. These included representatives of Government departments and regulatory agencies, trade associations, the Co-operative Group and Reclaim Fund Ltd, and the many individual companies and organisations that took the time to respond to our call for evidence. Last, but by no means least, I am very grateful to the hard-working and dedicated Secretariat at the Department for Culture, Media and Sport, without whom none of this would have been possible.

The report of the Commission marks the beginning, not the end, of a process. Much additional work needs to be undertaken by the Government, industry bodies and firms if we are to achieve our two objectives of minimising dormancy and utilising any surplus for the good of society.



**Nick O'Donohoe**

*Chair of the Commission on Dormant Assets*

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# Executive summary

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*“Where it is not possible to reunite dormant assets with their rightful owners, there is a strong argument that these assets should be used for good causes and public benefit”*

**A dormant asset is one that a firm is unable to reunite with a beneficial owner.**

In a perfect world, assets would never become dormant, but in reality, firms can lose contact with their customers for a variety of reasons. Sometimes customers move house or change their name and forget to pass on their new details; sometimes they buy new financial products and forget about those they already have; and sometimes, unfortunately, they die without leaving a will or beneficiaries.

While firms try to reunite such assets with their customers, the efforts made vary greatly in their extent and effectiveness, and there consequently remains within the UK a pool of dormant assets which exists across multiple financial services and non-financial services products.

From a public-interest perspective, it does not seem right that dormant assets should reside indefinitely with firms. Where it is not possible to reunite dormant assets with their rightful owners, there is a strong argument that these assets should be used for good causes and public benefit.

**The current dormant assets scheme**

The Government recognised the need to address the challenges and opportunities presented by dormancy and began the process of addressing the issue by passing the Dormant Bank and Building Society Accounts Act in 2008 (the Act).

The Act’s objective was to encourage banks and building societies to identify dormant assets and to make reasonable efforts to reunite those assets with their beneficial owners. If those efforts failed, the Act provided a mechanism whereby dormant accounts could be transferred to an independent body, currently Reclaim Fund Ltd (RFL), formed specifically to fund future customer reclaims, which can be made in perpetuity, and to distribute any surplus for the benefit of good causes throughout the UK.

### Building on the success of the current scheme

The Government believes the current scheme has been a significant success. It has encouraged banks to work harder to reunite dormant assets with their owners, while at the same time it has identified and freed up a substantial sum of money for good causes. In addition, although created as a scheme with voluntary participation, it has been adopted by the major UK high street banks and building societies.

These participating financial institutions benefit reputationally from being seen to embrace a scheme which has protected their customers' property rights, with any future reclaims being borne by the scheme, and which also facilitates significant additional funding for good causes. Participants also benefit, from an operational perspective, by being able to transfer dormant accounts that are otherwise administratively burdensome.

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*“The Government believes the current scheme has been a significant success”*

The first assets were transferred to RFL in 2011, and the total value of assets transferred is now close to £1bn. Of that, £362m has so far been distributed for the benefit of good causes, while reclaim rates have been 5% of the total asset value transferred.

### The Commission's remit and objectives

Given the positive industry participation to date, the Government announced in late 2015 its intention to appoint a new independent commission to consider the most effective way of broadening the range of assets that could be included in the scheme. In December 2015, the Minister for Civil Society, Rob Wilson, appointed Nick O'Donohoe, former CEO of Big Society Capital, to chair the Commission on Dormant Assets, and in March 2016 announced the names of nine Commissioners.

The purpose of the Commission, as laid down in its terms of reference, was to *“identify new pools of dormant assets and work with industry to encourage the contribution of these assets to good causes”*. Specifically, the Commission was asked to provide expert, independent, impartial advice and evidence in four areas:

- What additional classes of dormant assets could be brought into an expanded scheme;
- How much these assets could produce for good causes;

- Whether the current system for managing dormant assets would cope with a larger and potentially more complex group of assets; and
- Whether firms should be more transparent about the level of dormant assets within their industry sectors.

The Commission was not specifically tasked with considering whether sufficient efforts are being made by firms to reunite customers with dormant assets. However, in the course of its work, it became increasingly apparent that this is a significant issue and needs to be addressed. Accordingly, in addition to making recommendations to expand the current scheme, the Commission also makes recommendations on this front.

Finally, the Commission was not asked to suggest any principles or make any recommendations about which organisations or specific good causes should benefit from the expanded scheme. Decisions on the most appropriate use of additional dormant assets transferred through an expanded scheme will continue to be taken by the Government.

### **Determining which additional assets should be included**

The Commission's first task was to consider the additional types of dormant asset that might be included in an expanded scheme. It looked at the banking, insurance and pensions, and investment and wealth management industries, as well as a range of assets from non-financial services sectors.

Having reviewed these, the Commission decided to concentrate on the financial services sector, because it believed this to hold the greatest value and most readily accessible pool of potentially dormant assets. Given the time frame within which the Commission was asked to report, and the resources at its disposal, it was not feasible to consider non-financial products in detail. Some potential non-financial areas where dormancy may exist, and where additional analysis might be considered in the future, are outlined in Annex C.

### **Engagement with industry**

The Commission recognised that consulting broadly with the financial services sector would be essential to understanding where potential dormancy might arise, and the practical challenges of identifying and reuniting these assets with customers.

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*“The Commission decided to concentrate on the financial services sector, because it believed this to hold the greatest value and most readily accessible pool of potentially dormant assets”*



During the summer of 2016, the Commission contacted around 200 organisations, including trade associations, regulators and market participants, to seek their views on expanding the current scheme. A summary of the main response themes is in Annex E.

The Commission also convened a number of industry working groups to provide additional insight into industry-specific issues. More information on the Commission's working methodology is in Annex A.

### **The challenges of expanding the scheme**

The wide range of assets under consideration meant the Commission had to think carefully about what should be prioritised for inclusion in an expanded scheme. In making decisions, a number of different factors were involved. These included the potential dormant proportion for a given asset type; the legal vehicle in which assets are held; the current arrangement, if any, for dealing with dormancy; and the challenges of ensuring that a reclaim fund could provide restitution in the event of a reclaim.

The Commission further recognised that it would be inappropriate to seek to apply one definition of dormancy across multiple different assets. Most bank and building society accounts necessarily involve regular contact between the institution and the customer. However, many of the assets considered for inclusion in the expanded scheme come from long-term savings products where it would not be unusual for there to be no ongoing contact with customers, sometimes for decades. The Commission has therefore proposed different definitions for different asset types.

### **Participation costs**

It was important for the Commission to consider the impact that participating in an expanded scheme might have on firms. The Commission considered the costs and benefits to the firm of participating, and recognised the need to ensure that the net costs to firms, both in terms of transferring assets and attempting to reunite customers with lost assets, are proportionate to the value of the assets themselves.

### **Key conclusions and recommendations**

The Commission's view is that the current scheme should be expanded to include a much wider range of financial assets. It estimates that their inclusion could lead to an extra £1-2bn of funding being transferred for the eventual benefit of good causes.

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*“The wide range of assets under consideration meant the Commission had to think carefully as to what should be prioritised for inclusion in an expanded scheme”*

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*“In dealing with any asset, the first priority of the firm should be to seek to reunite it with its beneficial owner”*

The Commission believes the expanded scheme should retain the core principles of the current scheme, but the way the scheme is managed should be revised to enable it to cope with the wider range of assets envisaged. New and / or amended legislation will be required to assist the implementation of the expanded scheme.

In addition to the detailed recommendations which can be found in the sector chapters, and which are collated in Annex B, the Commission makes four overarching recommendations, as set out below:

**1. The key principles of the current scheme should be reaffirmed**

The Commission considered the key principles of the current scheme and how these should be applied to an expanded scheme.

It concluded that, in dealing with any asset, the first priority of the firm should be to seek to reunite it with its beneficial owner. Within this context, firms should be encouraged to do more and only when reunification efforts are unsuccessful, should assets be re-directed for the benefit of good causes. Likewise, customers should be encouraged to ensure that firms holding their assets have their current contact details.

As with the current scheme, the right for customers to reclaim assets transferred to an expanded scheme should continue to exist in perpetuity.

Participation by firms in an expanded scheme should continue to be voluntary as this has proven successful with the current scheme. However, the Commission recognises that the expanded scheme will deal with a much more diverse range of firms, and therefore the effectiveness of the expanded scheme should be monitored. To facilitate this monitoring, and achieve a greater degree of transparency, firms should specifically disclose and explain their approach regarding dormant assets and the extent of their participation in the scheme.

The Commission is aware that a voluntary scheme risks relatively low levels of participation in some product areas. If overall participation levels in the expanded scheme are low, the Government should consider the reasons behind this and whether moving to mandatory participation in the future would be appropriate.

## ***2. The current scheme should be expanded to include a much wider range of financial assets***

All UK-domiciled assets, irrespective of the nationality of the customer or beneficial owner, have been considered for inclusion in the scheme.

The Commission's assessment of asset suitability was driven by a number of criteria, including the volume of dormant assets within a specific product class, how operationally straightforward it would be to transfer the assets to a reclaim fund, and the liquidity of the assets. More information on the Commission's methodology is in Annex A.

The Commission recommends that a broad range of UK-domiciled financial products are suitable, for inclusion, including: additional bank accounts, unclaimed proceeds from life insurance and pensions products, and non-cash assets such as dormant holdings in investment funds, shares and bonds.

The Commission further recognises that certain assets recommended for inclusion are held through trust structures, and that legislative change may be required to facilitate trustees transferring assets to the scheme.

Certain financial products do not lend themselves to inclusion at this stage, although the Commission recommends some of these should be revisited in the future. More detail on which specific assets are included or excluded can be found in the relevant industry chapters.

There is already an existing definition of dormancy used in the current scheme for bank and building society accounts. However, the Commission believes this cannot be universally applied and that the identification of dormancy will not be standard across all asset and product types. Instead, dormancy should be defined by some or all of: customer inactivity over time, lack of proactive action at a trigger date (e.g. maturity date), and loss of contact with customers over an extended time frame despite a reasonable level of attempted reunification activity by a firm.

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*“The identification of dormancy will not be standard across all asset and product types”*

### ***3. The process of administering the dormant asset scheme should be revised to facilitate larger flows and more complex assets***

RFL was established as a company with restricted objects, as required by the Dormant Bank and Building Society Accounts Act 2008. It is wholly owned by an entity within the Co-operative Group.

The Commission recognises that the Co-operative Group played an important role in initially setting up and running RFL. However, the private ownership structure presents challenges of brand risk, both for RFL and the Co-operative Group, and introduces the possibility of a reclaim fund's objectives being influenced by the policies of a parent group. In particular, the existence of a corporate parent may encourage a more conservative approach to reserving for potential future reclaims, resulting in lower distributions for the benefit of good causes, than might otherwise be the case if a reclaim fund were not part of a corporate group.

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*“The Co-operative Group played an important role in initially setting up and running RFL”*

To address these challenges, the Commission recommends that, alongside operational changes concerning reserving policy and governance, RFL should be reconstituted. The directors of the reconstituted reclaim fund should be responsible for ensuring there is an appropriate balance between the two roles of reserving for future reclaims and making distributions for the benefit of good causes.

Providing the changes recommended by the Commission are made to RFL, the Commission would be supportive of it remaining the only reclaim fund for the expanded scheme – in particular because having a single reclaim fund is helpful for monitoring the scheme's effectiveness and reporting of it to the Government – a function that would be complicated if the formation of multiple reclaim fund entities remained possible.

Currently, all assets are transferred to RFL in cash form and any claimant is entitled to reclaim the transferred value, plus interest, in perpetuity. In an expanded scheme, it is anticipated that the vast majority of additional assets from the banking, and insurance and pensions industries will also be in cash form, and that the same principles regarding reclaim value will apply.

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*“The right to reclaim any assets transferred to the reclaim fund should be preserved in perpetuity”*

In the case of non-cash assets (e.g. Unit Trusts), that are eligible for transfer to the fund, the Commission considered three possible methods of assessing reclaim values. These were: restitution of the asset in its original form, reflecting any market changes in value between transfer and the point of reclaim; restitution of the cash equivalent value of the asset at the point of reclaim, reflecting any market changes in value between transfer and the point of reclaim; or restitution of the cash equivalent value of the asset at the point of transfer to the fund plus an appropriate level of interest.

The Commission considered restitution of the original asset to be impractical and felt that from the beneficial owner’s perspective, the fairest and most protected option is full monetary restitution – the second option described above. However, the Commission recognises that this option is complex and may present significant challenges. A final decision will require the Government to undertake more work to understand the potentially substantial operational and risk management issues involved and assess those against the risk of fewer firms participating in a voluntary scheme that does not provide full monetary restitution. A decision can then be taken regarding the best option for an expanded scheme, balancing all benefit, risk and cost factors. Irrespective of which valuation option is chosen for future reclaims, the Commission considered that the right to reclaim any assets transferred to the reclaim fund should be preserved in perpetuity.

#### **4. New legislation**

Most of the recommendations made by the Commission will require either amendments to existing legislation, or new legislation. In particular, while firms’ participation in an expanded scheme should remain voluntary, standardised disclosure regarding approaches to reuniting dormant assets, levels of potentially dormant balances and degree of participation in the expanded scheme, should be implemented fully. The Commission also makes recommendations in respect of assets held in trust that require a change in the responsibilities of trustees, and thus trust law.

Changes may also need to be made to existing industry and taxation regulations, although these are not expected to be insurmountable. Chapter 6 sets out the changes in legislation and regulations that the Commission has identified as being required to implement its recommendations.

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*“Publishing this report will not in itself cause the expanded scheme to happen”*

### **Next steps**

The Commission has now stood down to allow the Government to consider the recommendations made and determine the next steps. The Commission expects that the Government will provide a formal response to this report. It is likely that a legislative framework will not be introduced before 2018 and that it will take a period of time thereafter, which may extend to years, before new dormant assets start to flow into an expanded scheme.

Publishing this report will not in itself cause the expanded scheme to happen. Instead, this report is the starting point for an ambitious, long-term programme of work. A range of parties, including the Government, trade and regulatory bodies, and the financial services sector, all need to play their part to ensure a smooth and successful transition to an expanded dormant assets scheme.

# Guide to key terms

**To assist the understanding of the reader, this guide sets out a number of key terms and how they have been used in the report.**

## **Dormant assets**

Unless specifically explained otherwise in the body of the report, a dormant asset is an identifiable and attributable item, valued as a monetary amount or able to be valued as such, which is held by a party other than the beneficial owner of that asset. The beneficial owner is the person entitled to the proceeds of an asset.

For the purpose of this report and the work of the Commission, a dormant asset could be, and the reader may ordinarily understand it as being:

- an unclaimed asset (an asset which has matured and could be returned by a firm but is yet to be redeemed by the beneficial owner);
- a gone-away (a term used by some firms in relation to assets if communications are unable to be delivered and are returned to the firm);
- an uncashed payment;
- assets which have generated gone-aways, uncashed payments or other forms of dormant asset; or
- lost, or where the beneficial owner cannot be identified.

The current dormancy period for bank and building society accounts, as set out in the Dormant Bank and Building Society Accounts Act 2008, is 15 years of no customer-initiated contact. The precise definition of dormancy to be used for different assets in an expanded scheme is discussed in the relevant chapters of the report.

## **Sector and industry**

A sector refers to a large segment of the economy. In this report, the UK economy has been divided into financial service and non-financial service sectors. The term 'industry' describes a much more specific group of firms (i.e. the banking industry), insurance and pensions industry, or the investment and wealth management industry, which come together to comprise a sector.

## **Asset and product**

Each firm in an industry may contain a range of potentially dormant assets (e.g. a share, bond, cash deposit, insurance policy, etc.). Each class of asset may then ultimately incorporate a number of separate products (e.g. life insurance, motor insurance, etc.).

## Chapter 1

# Banks and building societies



## SUMMARY

### CURRENT SCHEME

Under the current scheme, governed by the Dormant Bank and Building Society Accounts Act 2008 (the Act), banks and building societies are able to transfer dormant assets to Reclaim Fund Ltd (RFL). Participation is voluntary for firms and covers most of the retail banking market. Almost £1bn has been transferred to RFL since its inception in 2011.

The Act also provided an alternative scheme for smaller banks and building societies, of which there has been no take up, and the Commission recommends it be abolished.

### TRACING AND REUNITING

From the outset, the first principle of the scheme was for firms to reunite customers with their assets wherever possible, and considerable progress has been made with firms now actively re-contacting customers and working with the specially-created website 'mylostaccount.org.uk'.

### SCHEME EXPANSION

The Commission looked at a range of banking assets for immediate inclusion in the current scheme and for inclusion in an expanded dormant assets scheme.

#### *Assets included in the current scheme: current and savings accounts, Cash ISAs, TESSAs, suspense balance accounts*

- As participation in the scheme is voluntary, firms can and do exercise discretion as to whether they include and transfer to RFL a range of assets. The Commission recommends to firms that all assets currently in scope should be transferred.

#### *Assets recommended to be included in an expanded scheme*

- Foreign currency cash balances: these present a currency risk, though the Commission believes it to be manageable, and the total asset size to be finite and relatively small.

#### *Assets recommended to be excluded from an expanded scheme*

- Financial sanctions and proceeds of financial crime: unfeasible due to difficulties in distinguishing legitimate from illegitimate assets.
- Overpaid lending and credit cards: balances are commonly small and successfully repaid.
- Safe custody items: by nature a long-term service for items, often of no intrinsic value (e.g. wills).
- Credit unions: already have specialised definitions and rules for dormancy in place.

#### *Assets to be reviewed or reconsidered*

- Child Trust Funds: introduced in 2002; to be reviewed in 2020 when they start to mature.
- National Savings & Investments (NS&I): previously exempted under the current scheme.

The Commission calculates that implementing these recommendations may make around £140m available for transfer to RFL.

### CHALLENGES AND OPPORTUNITIES

The Commission noted that, given the scheme's voluntary nature, there is inconsistency among firms regarding reuniting efforts, inclusion of assets currently in scope, and participation (with smaller firms not opting in). There is opportunity for improvement on all three fronts.

The operational cost of an expanded scheme is a potential challenge, though the Commission feels this should not restrict firms, and the cost impact should be limited given the level of systems already in place.

Significantly, the current scheme was broadly felt to be a success, and thus to provide a strong base for now including a wider range of banking assets.

## OVERVIEW OF THE UK BANKING INDUSTRY

### Banks and building societies

- 1.1 This chapter focuses on retail banks and building societies. This includes the UK retail banking businesses of the large UK banking groups and building societies, as well as banking businesses owned by retail groups, independent specialist or local subsidiaries of overseas banks, and National Savings and Investments (NS&I), a Government-run savings bank.
- 1.2 Together, this report refers to the activities of banks and building societies as the banking industry.
- 1.3 According to end November 2016 data provided by the British Bankers' Association (BBA), for all banks in the UK, UK residents' deposits were £2tn, of which UK households' deposits were £1.3tn.<sup>1</sup>
- 1.4 Building societies offer banking and related financial services, especially savings accounts and mortgage lending. In the UK today, building societies actively compete with banks for most consumer banking services, especially mortgage lending and savings accounts.
- 1.5 According to the Building Societies Association (BSA), the building societies' trade association, building societies had total retail balances worth £238bn in 2015 / 16.<sup>2</sup>
- 1.6 The Nationwide Building Society, with £195bn in total assets and retail balances of £132.4bn, has close to five times the volume of assets as the next largest building society, Yorkshire, with retail assets of £27.4bn followed by Coventry and Skipton Building Societies.<sup>3</sup>

### Dormancy: a definition and the reason for dormancy in the industry

- 1.7 The definition of dormancy as set out in the Dormant Bank and Building Society Act (the Act) is 15 years of no customer-initiated contact. The primary reason for dormancy is the organisation losing touch when a customer fails to inform their bank or building society of a change in contact details when moving property or changing their email address or telephone number.
- 1.8 Other dormancy triggers include when a customer is deceased, customer inertia (usually because of a small amount of money being held in accounts) or customers forgetting about an account.

## HOW THE CURRENT SCHEME WORKS

- 1.9 In the current dormant assets scheme, which came into operation in March 2011, banks and building societies may transfer money from dormant accounts to Reclaim Fund Limited (RFL). There is more information on the current scheme in Annex F.
- 1.10 The assets included under the Act are:
  - current and savings accounts;
  - Cash ISAs;
  - Tax Exempt Special Savings Accounts (TESSAs); and
  - certain types of suspense account balances.

### Current participation

- 1.11 The main dormant assets scheme allows any bank or building society regardless of size, to opt into the scheme. The main scheme currently has 12 participants, comprising most of the retail banking sector.
- 1.12 In addition to the main scheme, the Act also provides for an alternative scheme. This scheme allows smaller banks or building societies to transfer a proportion of their dormant account money to RFL. The remaining proportion can be transferred to one or more charities that the bank or building society chooses to support.
- 1.13 A 2014 HM Treasury review<sup>4</sup> of the current scheme named a number of technical reasons why the alternative scheme has not had any take up. These include:
  - the proportion of dormant account money that needs to be passed to RFL to meet reclaims, which limits the money available for local causes;
  - the set up cost for joining the alternative scheme, such as legal and system updates, has proven unattractive for small banks and building societies; and
  - the requirements of the Act which mean that money can only be transferred to RFL (and eventually on to the Big Lottery Fund), without a mechanism to allow money to be passed back to smaller banks and building societies (retrospectively) to be sent directly to local causes chosen by that institution.
- 1.14 However, even if RFL distributed a greater proportion of transferred funds to good causes, there is no guarantee that smaller banks and building societies would participate in the alternative scheme - which raises a question as to whether the alternative scheme should be continued. This is particularly relevant when considering expanding the scheme to other asset types where no such alternative scheme is envisaged. The Commission's view is that the alternative scheme does not serve a practical purpose and should be abolished.

<sup>1</sup> Data provided by BBA, based on end November 2016 data

<sup>2</sup> Data provided by BSA, based on latest annual accounts' data for years ending up to end February 2016

<sup>3</sup> Building Societies Association, Extract from BSA Yearbook 2015 / 16, 2016

<sup>4</sup> [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/298366/review\\_of\\_dormant\\_accounts\\_act\\_2008.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/298366/review_of_dormant_accounts_act_2008.pdf)

**Recommendation 1.1**

The alternative dormant accounts scheme should be abolished, given the lack of take up to date and that there will be no equivalent alternative schemes proposed for other asset types.

- 1.15 Figure 1.1 shows the amount of money transferred to RFL by participating banks for 2015 and the total until the end of 2015 since the scheme's inception in 2011. The figure also shows the levels of reclaim for the same period.

**Figure 1.1<sup>5</sup> – Monies transferred to, and reclaimed from, RFL inception versus 2015**

	Dormant account monies received from participants		Reclaims paid to participants	
	2015 £'000	Since inception £'000	2015 £'000	Since inception £'000
Barclays Bank PLC	24,292	155,394	1,651	5,782
Commonwealth Bank of Australia – London branch	-	4	-	-
Clydesdale Bank PLC	22,239	22,239	-	-
The Co-operative Bank plc	1,419	11,066	214	601
Danske Bank	233	4,989	37	172
HSBC Bank plc	5,457	47,288	1,243	1,446
Lloyds Banking Group				
Lloyds Bank plc	6,249	176,628	2,247	4,364
Bank of Scotland plc	19,152	97,415	2,994	4,405
Nationwide Building Society	4,878	51,317	144	406
Royal Bank of Scotland				
Adam and Company plc	2	14	-	-
Coutts & Co	5	1,363	-	-
National Westminster Bank plc	21,316	83,073	163	863
The Royal Bank of Scotland plc	7,043	21,953	1	1
Ulster Bank Limited	1,527	6,054	105	105
Santander UK plc	12,299	150,126	3,193	13,992
TSB Bank plc	-	12,354	1,240	3,408
Virgin Money plc	5,199	14,277	462	1,312
<b>Totals</b>	<b>131,310</b>	<b>855,554</b>	<b>13,694</b>	<b>36,857</b>

- 1.16 Chapter 5 discusses in more detail the operation of the dormant assets scheme and the role of RFL.

## TRACING AND REUNIFICATION

### History of tracing in this industry and current approach to reuniting customers with their assets

- 1.17 Firms, where possible, should reunite customers with their lost assets. Cross-industry tracing activity was undertaken prior to the Act being passed in 2008, and firms undertake such activity on an ongoing basis as part of their commitment to treating customers fairly.

### Customer protection and right to reclaim

- 1.18 The Act ensures the customer is protected. The beneficial owner has the legal right to reclaim their money in perpetuity. Equally important is the agency agreement by firms to retain customer records and to validate and process reclaims subsequent to transfer.

### Pre-dormant assets scheme reunification efforts

- 1.19 To help lay the groundwork for the scheme, HBOS, Nationwide, Lloyds TSB and HSBC undertook reunification exercises in advance of the first transfer of money under the dormant assets scheme.<sup>6</sup> Other organisations followed suit in the latter part of 2008, in some cases working with third-party tracing agents in respect of high value accounts (e.g. above £1,000) and undertaking further mailings, based on available data for other accounts of more than £100.
- 1.20 In 2008 the BBA, BSA and NS&I set up 'mylostaccount.org.uk', a central tracing scheme spanning bank, building society and NS&I personal accounts. The BBA indicated that in the past 12 months to May 2016, there were 416,000 visits to the website and only 71,000 requests for information.
- 1.21 Typically after three years, if there has been no customer-initiated contact, a firm will write to the most recent address it holds to ask if the customer wants to keep their account open. If contact is not established, most firms may take additional steps to attempt to re-contact customers. This could be by using internal systems or, if appropriate, a third-party tracing supplier. Feedback from the industry working group, and through the call for evidence, shows there is no systematic approach across the industry to tracing and reuniting customers with their assets.
- 1.22 A small number of firms have told the Commission that they plan to start using a third-party tracing supplier to carry out electronic traces against the electoral roll and death registers before instigating a more forensic search, if deemed appropriate.
- 1.23 Where tracing agents have been used, firms have reported a range of results. The cost-benefits clearly need to be carefully considered in relation to the value of balance and unit costs of the tracing service, whether in-house or commissioned through a third party.

<sup>5</sup> Reclaim Fund Ltd, Annual Report and Accounts 2015

<sup>6</sup> Subsequently, Lloyds TSB acquired HBOS in 2008 and then completely divested TSB in 2015

1.24 Historically, banks have not utilised group-wide customer contact details from non-banking entities. However, an expanded scheme will include non-banking entities, for example those offering insurance, pension or investment management products. To improve reunification success rates, the Commission is recommending that reunification efforts are on a group basis. This is discussed in more detail in Chapter 5.

## ASSETS IN SCOPE OF THE CURRENT AND AN EXPANDED SCHEME

### Engagement with the industry

- 1.25 Since being formed, the Commission has worked closely with the industry. As part of its call for evidence, the Commission wrote to 34 banking organisations to seek their views on an expanded dormant assets scheme, receiving more than 20 responses. The Commission then wrote to a smaller subset asking for further information on the value of potential dormant assets and tracing efforts.
- 1.26 The Commission also established an industry working group, led by a commissioner and supported by both the BBA and BSA. The group convened twice to discuss the operation of the current scheme, potential new assets for inclusion in an expanded scheme, and to provide views on the emerging recommendations. The Commission would like to thank the BBA and the BSA for facilitating the working group and supporting engagement across the industry.

### Assets included in the current scheme

- 1.27 As participation in the scheme is voluntary, firms can choose which of their dormant assets are suitable for inclusion. There are several dormant asset classes within the industry that are currently within scope of the current scheme where participating firms have taken the view that they should not be included, or that have been included by only a small number of firms.

### Cash ISAs

- 1.28 Cash ISAs were introduced in 1999. This product is therefore only now becoming eligible for transfer under the 15-year dormancy period. There are opposing views by firms as to whether including Cash ISAs is appropriate, given their purpose as long-term savings, with customers often happy to leave an ISA untouched for many years – although banks still have a duty to maintain contact with the customer.
- 1.29 A number of respondents to the call for evidence cited lack of certainty over breaking the tax wrapper as the primary barrier to transferring Cash ISAs to the scheme.

1.30 HM Revenue and Customs (HMRC) issued guidance that covered the tax treatment of Cash ISAs when the scheme commenced in 2011.<sup>7</sup> This makes provision for the waiver of Cash ISA subscription limits upon reclaim. This means that the tax treatment of Cash ISAs is unaffected by transfer and reclaim.

1.31 Junior Cash ISAs, which were introduced in 2011, are for under-18s and convert to an adult Cash ISA at age 18. The Commission believes these should be treated in the same way as all Cash ISAs.

### Tax-Exempt Special Savings Accounts

- 1.32 Pre-dating ISAs, from 1990 the tax-free savings base was broadened with the introduction of TESSAs for the investment of cash into TESSA-designated deposit or share accounts with a bank or building society.
- 1.33 To coincide with the launch of ISAs, no new TESSAs (or follow-on TESSAs) could be opened after 5 April 1999.
- 1.34 Given that RFL is already handling TESSAs and some participating firms are soon to start transferring Cash ISAs, the Commission recommends that all participating firms include Cash ISAs and TESSAs in assets transferred to RFL.

### Suspense accounts

- 1.35 A suspense account is a bank account used to keep money in until it can be paid into the right account. Each firm treats its suspense accounts differently. Assets that might sit within a suspense account include:
- unidentified / unapplied credits and funds to support uncashed banker's drafts / blank cheques; and
  - legacy funds that have been held in central suspense accounts because of the length of time they have been dormant or because of lack of up-to-date customer records.
- 1.36 Suspense account balances can be transferred to the current scheme under the Act. Some firms transfer suspense account balances; others do not.

### Assets to be included in an expanded scheme

- 1.37 There are several categories of assets, as well as individual firms, that are not part of the current dormant assets scheme which the Commission has considered for inclusion in an expanded scheme. The following sections describe assets that the Commission believes should be part of an expanded scheme and those that should remain exempt.

<sup>7</sup> HM Revenue and Customs, The Dormant Bank and Building Society Accounts (Tax) Regulations 2011, 2011

### Foreign currency account balances

- 1.38 Many banks participating in the current scheme have excluded balances held in accounts denominated in foreign currencies, largely due to the fluctuating value of the asset; the difficulty of managing the associated market risk; a lack of clarity over who would bear the cost of any movement in the exchange rate in the customer's favour in the period between transfer and the date of any subsequent reclaim; and reputational risk to individual banks and to the scheme itself if the currency risk lies with the customer.
- 1.39 The Commission notes the concerns of banks; it also notes that this is likely to be a finite dormant asset involving a relatively small number of accounts and that the first transfer would be the largest, with small amounts to follow.
- 1.40 The treatment of assets subject to market movement, including those denominated in a non-sterling currency, is discussed further in Chapter 5.

#### Recommendation 1.2

Cash ISAs, TESSAs and the full range of suspense accounts should be transferred to the current scheme.

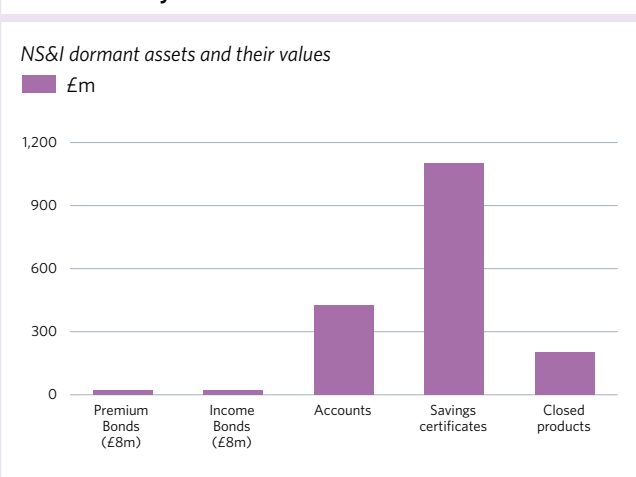
#### Recommendation 1.3

Foreign currency account balances should be included in an expanded scheme.

### Bringing National Savings and Investments (NS&I) into an expanded scheme

- 1.41 NS&I, an executive agency of the Chancellor of the Exchequer since 1996, is one of the largest savings organisations in the UK, with more than 25 million customers and more than £135bn invested.<sup>8</sup>
- 1.42 All funds raised by NS&I go to the National Loans Fund (NLF) and are used by the Government to help finance expenditure on public services and investment for the general good of the public. Based on information provided by NS&I, total unclaimed balances amount to £2.2bn, but these reduce to £1.8bn when applying a dormancy definition of 15 years with no activity or customer contact.
- 1.43 The breakdown of the £1.8bn by product type with number of customer holdings is shown in Figure 1.2.

**Figure 1.2 – Total unclaimed assets where no customer contact for 15 years or more**



### Rationale for exclusion from the existing scheme

- 1.44 The Government exempted NS&I from participation in the current scheme, despite a call for it to be included by the Treasury Committee which stated:

*“If the Government considers that specific use for identified good causes is the best use for the dormant accounts held by others, the Government should apply the same principle to accounts held by NS&I. On the grounds of equity between financial institutions, we recommend that NS&I be brought into the scope of the Unclaimed Asset Scheme. If that scheme is to be voluntary, we recommend that the Government volunteer NS&I’s participation.”<sup>9</sup>*

- 1.45 The Government’s response at the time was that NS&I “does not hold any of the money invested in its products on its own balance sheet. Instead, the monies are passed directly to the Exchequer where they are used to fund public services. This means that money in NS&I accounts is already benefiting the community”. Therefore, NS&I was exempted from the current scheme.<sup>10</sup>

### Rationale for inclusion in an expanded scheme

- 1.46 The Commission recognises NS&I’s exemption from the current scheme, and that any dormant assets are already used to support national funding, and therefore the public good and society at large. It also recognises that, as NS&I does not hold any of the money invested in its products, any transfers to the dormant accounts scheme will have to be funded by the Exchequer.

<sup>9</sup> House of Commons Treasury Committee, Unclaimed assets within the financial system: Government Response to the Committee’s Eleventh Report of Session 2006-07, Eighth Special Report of Session 2006-07, 2007

<sup>10</sup> House of Commons Treasury Committee, Unclaimed assets within the financial system: Government Response to the Committee’s Eleventh Report of Session 2006-07, Eighth Special Report of Session 2006-07, 2007

- 1.47 The Commission notes too that NS&I is an active member of 'mylostaccount.org.uk', operates its own tracing service for customers and regularly encourages customers to see if they have unclaimed Premium Bond prizes. In 2015-16, £36m was reunited with customers. This brings the total amount that has been reunited with customers to £656m through 'mylostaccount.org.uk' and its own tracing activities.
- 1.48 However, the Commission believes that the Government could demonstrate important leadership by contributing NS&I assets to an expanded scheme.
- 1.49 One exception to this is Premium Bond prizes. A Premium Bond could be assessed as dormant but then win a large sum of money, causing significant reclaim reserving issues for RFL. Premium Bond balances should therefore be excluded from any expansion of the current scheme - however, unclaimed prizes could be included.

#### Recommendation 1.4

The Commission recognises the Government position is that dormant NS&I assets are used for public benefit but recommends that the Government reconsiders whether these, excluding Premium Bonds, are included in an expanded dormant assets scheme.

## ASSETS THAT ARE NOT IN SCOPE OF AN EXPANDED SCHEME

- 1.50 As part of its scoping work, the Commission considered a number of potential assets, as well as firms exempted from the current scheme, for inclusion in an expanded dormant assets scheme. After careful thought and through both the call for evidence and the industry focus group, the Commission recommends that the following assets and firms remain exempt from the expanded scheme at this stage, although they should be reviewed by the Government in 2020 for inclusion.

### Other sterling cash balances

#### Financial sanctions and proceeds of financial crime

- 1.51 Financial sanctions are restrictions put in place by the Government or the multilateral organisations that limit the provision of certain financial services or restrict access to financial markets, funds and economic resources in order to achieve a specific foreign policy or national security objective.<sup>11</sup>

Financial sanctions come in many forms. The most common types of financial sanctions currently in use or used in recent years are set out below:

- Targeted asset freezes, which are usually applied to named individuals, entities and bodies, restricting access to funds and economic resources.

- Restrictions on a wide variety of financial markets and services. These can apply to named individuals, entities and bodies, to specified groups or to entire sectors. To date these have taken the form of investment bans; restrictions on access to capital markets; directions to cease banking relationships and activities; requirements to notify or seek authorisation prior to certain payments being made or received; and restrictions on provision of financial, insurance, brokering, advisory services or other financial assistance.

- 1.52 Proceeds of financial crime are funds that are the product of fraudulent or financial crime activity, or other balances which are excluded from the current scheme because such funds need to be managed in compliance with the Proceeds of Crime Act 2002, the Terrorism Act 2000 and/ or the Money Laundering Regulations 2007. There is no central fund where unreturnable funds can be transferred to support, for example, victims of crime. This means that any unreturnable funds sit within the firm indefinitely.
- 1.53 The Commission is of the view that given the complexity of differentiating between assets acquired legitimately and those acquired through criminal means, the operational, administrative and reserving difficulties are so great as to not warrant their inclusion in an expanded scheme.

### Overpaid lending and credit cards

- 1.54 Under current common reporting standards, the Financial Services Compensation Scheme and Foreign Account Tax Compliant Act, if there is a credit balance held on either a personal loan or credit card, the credit balance is returned to the customer within 60 days and is therefore not available to the scheme.
- 1.55 There are many instances where following the closure of an account or the withdrawal of all funds by a client, a small positive balance subsequently accrues on the account. Most commonly, this is as a result of an interest posting and in many instances banks are able to repay these monies to their client.

### Non-cash assets

#### Safe custody items

- 1.56 Safe deposit boxes (SDBs) or other open or sealed packages are often held at banking firms, but may also be held by specialist SDB companies and may consist of both cash and non-cash assets. The Commission has noted that most high street firms are withdrawing or have already withdrawn this service and are requesting that customers remove these items, driven by a combination of reduction in customer demand, anti-money-laundering concerns, and the economics of the service.

<sup>11</sup> Office of Financial Sanctions Implementation, HM Treasury, Financial Sanctions: Guidance December 2016

- 1.57 The Commission has heard from the industry focus group and the call for evidence that safe custody items should not be included in an expanded dormant assets scheme. They argued that some safe custody items hold no intrinsic value, such as wills, and would generate no value for an expanded scheme.

### Child Trust Funds

- 1.58 Child Trust Funds (CTFs) is a Government scheme that offered long-term tax-free savings accounts for children born between 2002 and 2011. Parents in receipt of child benefit could receive either £50 or £250 from the Government depending on when the child became entitled to an account. The scheme closed in 2011.
- 1.59 CTF balances will not be eligible for an expanded scheme until at least 2020 when children born in September 2002 turn 18 years old. Issues of lost contact are likely to arise in CTFs as the issuing firm may not have the contact details of the child and tracing efforts may be required.
- 1.60 The true level of dormancy is therefore hard to ascertain as there is no requirement to interact with the firm until that point.
- 1.61 The Commission recommends that the Government reviews whether CTFs are included in an expanded scheme from 2020, particularly focusing on whether tracing and reunification efforts in relation to CTFs are sufficient.

#### Recommendation 1.5

The Government should review whether Child Trust Fund balances are included in an expanded scheme from 2020.

### Credit unions

- 1.62 Credit unions are not-for-profit, financial cooperatives owned and controlled by their members and therefore are considered here as having a very similar model to building societies. The majority provide savings and affordable loans to their members, but some offer more sophisticated products, such as current accounts, Cash ISAs and mortgages.
- 1.63 At December 2015, credit unions were providing financial services to 1.27m people. The industry held around £1.3bn in assets, with more than £769m out on loan to members and £1.2bn in deposits.<sup>12</sup>
- 1.64 While credit unions are exempted in the Act from the current scheme, they have their own definitions and rules for dealing with dormant accounts. Credit unions' own definition of dormancy stems from the Association of British Credit Unions Limited's (ABCUL) Credit Union Model Rules 2012, which define dormancy as a period of 12 months without any transactions on an account held by the member.

- 1.65 The credit union industry has restricted returns on assets and operates on tight margins due to their social goals of financial inclusion, an interest rate cap on lending and their small size compared to other deposit takers. Therefore, whether or not credit unions would voluntarily participate in an expanded dormant assets scheme is heavily dependent on the overall costs of transferring to the fund compared to how credit unions currently manage dormant accounts.
- 1.66 The relatively small amounts of potentially dormant funds mean that the benefit of inclusion in the scheme is likely to be immaterial to an expanded scheme.

#### Recommendation 1.6

Credit unions should continue to be exempt from joining an expanded scheme.

## POTENTIAL VALUE OF DORMANT ASSETS

- 1.67 In its call for evidence, the Commission asked respondents to value the level of dormant assets within their control. The responses received by the Commission provided an initial indication of the potential volume of dormant assets but the Commission recognises that the call for evidence responses do not provide anything more than an indication because:
- the Commission had not finalised its recommendations at that stage; and
  - the time available for firms to provide quantum information was limited, and accordingly, some firms were only able to provide an estimation.
- 1.68 Despite these constraints, firms that responded to the first call for evidence and the supplementary questionnaire indicated that there might be as much as £140m available within banking assets already eligible for transfer to the current scheme or as part of an expanded scheme.

### Valuation calculation

- 1.69 Not every firm that responded to the call for evidence submitted values for each individual dormant asset considered within scope of an expanded scheme. Those respondents who did submit values used the current 15-year period of dormancy applied to identify dormant assets for inclusion in the current scheme.
- 1.70 In an attempt to estimate the level of dormant assets that might potentially be available across the banking industry the Commission conducted its own extrapolation.
- 1.71 Some firms provided values for dormant assets, in three asset classes, in their response to the call for evidence. Using market share data, the Commission extrapolated these to generate an estimate of the value of total potentially dormant assets in these classes.

<sup>12</sup> ABCUL response to the call for evidence: figures from unaudited quarterly returns provided to the Prudential Regulation Authority

- 1.72 The Commission's discussions with specialist tracing agents indicate that between 50-95% of potentially dormant assets may be reunited with their beneficial owners. For the purposes of extrapolation, the Commission has assumed that the reuniting success rate will be 75%, therefore 25% of the potential industry dormant assets will be available to be transferred to the reclaim fund.
- 1.73 The results of this extrapolation are set out in Figure 1.3.

**Figure 1.3 – Commission estimate of the dormant assets potentially available in the banking industry**

Asset	Values provided in the call for evidence	Potential total industry dormant assets	Industry assets, available for transfer to a reclaim fund, following reunification efforts
Suspense accounts	£164m	£275m	£69m
Cash ISAs	£142m	£249m	£62m
Foreign exchange currency	£26m	£44m	£11m
<b>Total</b>		<b>£568m</b>	<b>£142m</b>

## CHALLENGES AND OPPORTUNITIES

### Challenges

#### *Consistent approach to treatment of assets within the current scheme*

- 1.74 The Commission is aware that at the moment there are inconsistencies across participating firms as to the treatment of assets within scope of the current scheme. The fact that firms have discretion to decide which dormant assets to transfer to RFL can mean that more complex assets are not transferred. An example is that of Cash ISAs, as discussed in paragraphs 1.28-1.31.

#### *Improving extent of participation within the current scheme*

- 1.75 Banks have said that they are doing their utmost to participate in the current scheme, as evidenced by the 2014 HM Treasury report.<sup>13</sup> As discussed in Chapter 5, the scope of the HM Treasury report was constrained and although there was evidence of participation by the main banks and the main building society there could clearly be greater participation in the scheme by smaller banks and building societies. The Commission would therefore like to see greater levels of engagement from such firms.

- 1.76 Although the majority of major high street banks are participating in the current scheme, participation by building societies is to date limited to the Nationwide Building Society. This is disappointing. The Commission would like to see more building societies participating in the current main scheme.

#### *Cost implications of an expanded scheme*

- 1.77 It is important to be able to understand what impact an expanded scheme could have on participating firms, be this direct impact on profits or more indirect costs, such as setting in place the systems required to ensure successful transfer of additional assets, such as IT, using third-party tracing agents or an increased administrative burden.
- 1.78 A consistent theme emerged from the call for evidence that it was difficult for a firm to assess the impact that an expanded scheme might have without first knowing the type of balances to be included and equally important, the parameters for transfer and reclaim.
- 1.79 The Commission notes this, but believes that cost implications should not restrict firms from transferring additional assets, as recommended earlier in this chapter, in an expanded scheme.

### Opportunities

#### *Increased scope of balances covered by the scheme*

- 1.80 Respondents to the call for evidence felt that the current scheme has been broadly successful in terms of identifying dormant accounts and transferring these to RFL and that this provides a strong base on which the banking industry can build to include additional dormant assets.
- 1.81 While participating firms are already transferring a range of dormant assets to the current scheme, there are opportunities for a more consistent approach and a wider range of bank and building society assets to be included.

<sup>13</sup> HM Treasury, Review of the Dormant Bank and Building Society Accounts Act 2008, March 2014



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## Chapter 2

# Insurance and pensions

## SUMMARY

The insurance and pensions market is large, totalling some £2tn of assets under management, and comprises myriad product types, many of a long-term nature and some of which are complex.

Dormancy in insurance and pension policies occurs because customers move house or die without the insurer being notified, or otherwise forget about their policies.

## ASSETS IN SCOPE OF AN EXPANDED SCHEME

There is considerable scope for insurance and pensions products to be included within an expanded scheme, though first a robust, industry-specific definition of dormancy is required. For policies with a fixed term, the Commission settled on a period of seven years after the end of the policy term. For policies with no fixed term the point at which the 'lost' customer is notionally over 120 years old was chosen (details given in Figures 2.1 and 2.2). Both scenarios would also be accompanied by a period of tracing activity to try to re-establish contact with the relevant owner.

Thus equipped, the Commission recommends that the following assets either be included or excluded from an expanded scheme:

### *Included*

- Savings endowments;
- Term insurance;
- Pensions;
- Annuities;
- Whole-of-life assurance;
- Income drawdown; and
- Investment bonds.

### *Excluded*

- With-profit funds;
- Mutual funds;
- Industrial branch policies;
- Policies held under group trusts; and
- Most general insurance.

Using its proposed definition of dormancy, the Commission estimates there to be £400-500m of dormant insurance and pensions assets that have accrued and may be available now, with a further £40-50m becoming dormant on an annual basis thereafter.

## TRACING AND REUNIFICATION

Industry consensus was that efforts to trace lost customers currently vary; that there was no agreed best method, nor a framework from the Financial Conduct Authority; and that generally more could be done.

To better facilitate tracing, firms would like to see greater linking and sharing of data (e.g. from HM Revenue & Customs, DVLA, the TV Licensing authority), the collection of National Insurance numbers in death notifications and consideration of whether the 'pensions dashboard' could be leveraged for tracing and reunification purposes.

## CHALLENGES AND OPPORTUNITIES

Bringing insurance and pensions assets into an expanded scheme may introduce a degree of market risk for some customers of equity-backed policies, though the incidence of this is anticipated to be very small. A much more significant challenge for firms stems from the potential costs arising from dealing with these assets more actively than they do currently. Until the specifics of the expanded scheme are settled, such costs are hard to quantify, and there is further work to be done here to establish the anticipated impact.

On the opportunity side, the key benefit of the scheme would be the improved reunification of customers with their lost assets. Firms also welcomed potential publicity benefits, as well as seeing an upside to being relieved of the problem of what to do with the assets. Their use, when untraceable, for societal benefit was felt to be a positive outcome.

## OVERVIEW OF THE UK INSURANCE AND PENSIONS INDUSTRY

- 2.1 The UK's insurance and long-term savings industry is the third largest in the world and manages investments worth £1.9tn.<sup>1</sup>
- 2.2 According to figures provided to the Commission by the Association of British Insurers (ABI), in 2014 there were over 57 million life and long-term saving policies in force, generating premium income of £132.8bn per year and paying out benefits worth £149.4bn.<sup>2</sup>
- 2.3 The Commission sought to engage with the insurance and pensions industry to inform its thinking and help shape its recommendations. It wrote to 38 insurance and pension firms as part of its call for evidence and received 28 responses.
- 2.4 The Commission would like to thank the ABI and all those firms who provided information to the Commission, either via responses to its call for evidence or through the Insurance and Pensions Working Group (IPWG) which was established with the assistance of the ABI. Further detail around the Commission's engagement with the various industries can be found in Annex A.

### Description of insurance and pensions products

- 2.5 The UK's insurance and pensions industry is mature and the products that are sold and managed are very varied and, in some cases, technically complex.
- 2.6 To aid the reader's understanding of how certain assets may become dormant, a brief description of the products and funds referred to throughout this chapter is included below.

### Life insurance products

#### Term insurance

- 2.7 Term insurance is fixed-term life insurance which pays out a sum assured following the death of the insured person during the policy term. Policies are usually taken out for between 10 and 25 years, with premiums typically paid monthly and cover expiring if premiums are not maintained. If the insured dies after the end of the policy term, no sum assured is payable.

#### Whole-of-life assurance

- 2.8 Whole-of-life assurance is life insurance that is designed to continue for the remainder of the life of the insured person. The policy pays out a sum assured following the death of the insured person, regardless of when the death occurs. Policies may be taken out at any age, subject to minimum and maximum limits. Premiums can either be paid monthly, annually or by an initial lump sum. If premiums are not maintained, the policy will eventually lapse and no amounts will be payable.

### Savings endowment

- 2.9 A savings endowment is a fixed-term combined investment and life insurance policy, usually used in conjunction with a mortgage. The policy is designed to pay out either a lump sum at the end of the policy term, known as maturity, or a sum assured on the death of the insured person if that takes place during the policy term. Only one amount is paid out, so if the insured person dies before the policy ends there is no maturity payment. Premiums are typically paid monthly and, if not maintained, the policy may be converted into a 'paid up' policy, whereupon the sum assured or maturity payment will be lower than that which was originally intended.

### Investment bonds

- 2.10 An investment bond is a form of life insurance contract that does not have a fixed term and which allows policyholders to invest in a range of investment funds. Investments are typically made via an initial lump sum and policyholders are generally free to make further investments into their policy at any time. Withdrawals can also be made and the policy can be surrendered at any time, although there may be surrender penalties for doing so in the early years of a contract. Policyholders are therefore usually advised only to invest if they can do so for a period of at least five years. The life cover element of the policy typically pays out 101% of the current investment value of the bond upon the policyholder's death.

### Pensions products

#### Annuity (both deferred and guaranteed)

- 2.11 An annuity is a lump-sum investment which typically guarantees to pay a certain level of income for the remainder of the policyholder's life. Unless the annuity was purchased with income guarantees (see below), annuity payments cease on the death of the policyholder. Annuities can be purchased at any point during an investor's life, although they are typically purchased at retirement with the lump sum payments available from pension policies. Annuities can be set up so that annuity payments are deferred for a certain period of time following purchase and can also be purchased with guarantees that mean annuity payments are made for a specified minimum period of time following commencement, typically between five and 10 years, regardless of whether the policyholder dies during that period or not.

#### Defined contribution personal pension

- 2.12 A defined contribution personal pension is a retirement savings vehicle that allows monthly or lump sum contributions, subject to various contribution limits. Tax relief is provided on contributions at source and it is designed to allow policyholders to accumulate funds to enable them to provide an income for themselves in retirement. The pension will typically pay out a lump sum on the death of the policyholder prior to them either taking an annuity or an income drawdown policy.

1 UK Insurance and Long Term Savings Key Facts 2015, ABI

2 Data provided by ABI, October 2016

- 2.13 Prior to April 2015, defined contribution personal pension policyholders were obliged to purchase an annuity or an income drawdown policy by age 75. However, as a result of changes made by Government in April 2015, known within the industry as the ‘pensions freedoms changes’, policyholders are no longer compelled to do so. Instead, once policyholders reach age 55, they can either leave the pension pot untouched; purchase an annuity at any time; take an adjustable income (flexi-access drawdown); take cash in lump sums (non-crystallised funds pension lump sum); cash in the entire fund value in one go; or take a mixture of any of the above options.<sup>3</sup>
- 2.14 The pensions freedom changes are permissive rather than mandatory, so firms can decide whether to apply them or not. Accordingly, some firms allow the changes to apply in respect of policies sold before and after April 2015, whereas others only allow them to apply to contracts sold after April 2015.

### Income drawdown

- 2.15 An income drawdown contract is a type of defined contribution personal pension policy which allows the policyholder to take regular income withdrawals. The fund remains invested, so any income withdrawals reduce the amount of the pension pot that is available for future investment. If income withdrawals are higher than the investment returns of the policy, it is possible for a policyholder to exhaust the pension fund. As is the case for a defined contribution personal pension policy, an income drawdown contract will typically pay out a lump sum on the death of the policyholder prior to an annuity being purchased.

### General insurance

- 2.16 General insurance contracts are typically annually renewable contracts that provide cover against a specified set of risks in exchange for an annual premium. The premium can either be paid in one lump sum or via a series of monthly instalments. If premiums are not paid, cover ceases. If a specified event against which the policy provides insurance occurs, for example damage to a motor car or theft from a residential property, it is up to the policyholder to submit a claim to their insurer. The insurer will then assess the claim and, provided the terms of the policy have been adhered to, pay out the pre-agreed sum in respect of the insured event. If the policyholder does not submit a claim, or an insured event occurs after the policy has expired, the insurer will not be liable.

## DORMANT ASSETS IN THE INDUSTRY

- 2.17 Before considering why dormant assets occur in the insurance and pensions industry two factors must be understood: first, what is meant by the term dormant asset; and second, who owns these dormant assets? The combination of these factors enables the reader to understand how and why assets become dormant.

## Dormancy

- 2.18 In its call for evidence, the Commission asked firms to explain what they understood the term dormancy to mean, and what the rules for defining dormancy should be, in an expanded scheme. In response to these questions, and almost without exception, insurance and pensions respondents consistently expressed the view that dormancy was an unhelpful term when trying to decide which assets might be available for inclusion in an expanded scheme.
- 2.19 Many long-term insurance and pensions contracts are designed to provide for events that are likely to occur many years in the future. For example, a whole-of-life contract taken out at the age of 30 may run for another 50 years before it leads to a claim. Similarly, pension savings contracts taken out at the age of 30 can be expected to run for at least 30 years before the contract is required to provide benefits.
- 2.20 As a result of the long-term nature of many insurance and pensions contracts, it is not unusual for an owner to have little, if any, regular contact with the firm providing the contract. In some cases, for example, policies that are set up with an initial lump sum do not even require ongoing premium payments.
- 2.21 To that extent, a long-term insurance contract might be considered dormant for many years, by virtue of there being no customer-initiated contact, but only because there is no need for the customer to contact the firm. The fact that a contract is dormant in this sense does not act as a good guide as to whether the contract has been forgotten about or is no longer required.
- 2.22 Additionally, many long-term insurance contracts do not acquire a value until after a specified policy event. For example, in the case of a term insurance contract, the policy does not obtain any value unless there is an insured death during the term of the policy. Unless that happens, there is no asset that can be classed as dormant because the policy merely provides the expectation of a future amount potentially being payable.
- 2.23 Similarly, in the case of an endowment savings policy, the contract acquires a realisable value either on the death of the policyholder, at maturity or on the earlier surrender of the policy. As an endowment savings policy has to be actively surrendered by its owner, dormancy is only likely to occur where instances of death or policy maturity occur.
- 2.24 Accordingly, respondents from the insurance and pensions industry consistently suggested that the term ‘unclaimed asset’ rather than ‘dormant asset’ would be more appropriate when considering which assets might be available for inclusion in an expanded scheme. The Commission decided to continue to use the term ‘dormant asset’ to maintain consistency with the existing Dormant Bank and Building Society Accounts Act 2008, but acknowledges that for the purposes of this chapter, when referring to a dormant asset, what is actually meant is assets that the industry has, up to now, referred to as ‘unclaimed’.

<sup>3</sup> The Pensions Advisory Service: <http://www.pensionsadvisoryservice.org.uk/about-pensions/pension-reform/freedom-and-choice>

- 2.25 The Commission sets out proposed definitions of dormancy for the insurance and pensions industry in Figures 2.1 and 2.2.

### Ownership

- 2.26 Assets that might become dormant in the insurance and pensions industry are typically owned either by one or more individuals or, in the case of group personal pensions or policies otherwise written under trust, by trustees.
- 2.27 Where policies are written under trust these may be for the benefit of one specific individual. In these circumstances it may be appropriate to class such assets as dormant if the trustees lose contact with the single beneficiary.
- 2.28 In other trusts there may be more than one beneficiary, so it may not be possible to identify which assets within the trust can be specifically apportioned to individual beneficiaries. In these circumstances, it may not be appropriate to class such assets as dormant because if the trustees lose contact with one beneficiary there are still others who rightly should benefit from the assets held by the trust.

### Why do policies become dormant / why are they not claimed?

- 2.29 In the case of policies owned by individuals, the primary reason identified in response to the Commission's call for evidence was that owners simply move house and neglect to tell the insurance or pension firm. Firms are therefore often unaware that the owner has moved house, and accordingly they continue to write to the old address. Firms would generally only become aware of the change of address if communications they send to the owner are returned as gone-away or the owner contacts them subsequently to inform them of their new address.
- 2.30 The other main reason for policies becoming dormant surrounds the circumstances following the death of an owner. As things currently stand, insurance and pensions firms rely on third parties to inform them of the death of an owner. This is usually either a family member or a legally appointed personal representative. The system relies on papers being left behind by the owner which identify the policy, or on the owner drawing the attention of those who will administer their estate to the existence of such policies prior to their death. If there is no such evidence, it is possible for the administrator of the estate to be unaware of certain policies. Accordingly, they are not then able to notify insurance or pension firms of the death of the individual whose estate they are administering and the proceeds remain unclaimed.
- 2.31 There are also other circumstances in which individuals can become separated from their policies. If policy records are either lost, destroyed or stolen; if there is a company merger or brand change; or if an owner simply forgets that they have a policy with a certain insurance or pension firm, policies can become dormant and assets unclaimed.
- 2.32 On the face of it, the payment or otherwise of policy premiums might appear to be a good indicator of whether a policy is dormant or not. However, this is not necessarily a reliable guide. If premiums stop being paid in respect of a particular policy, insurers will typically try to establish why that is, although this relies on them having up-to-date contact details for the customer. Premiums may cease to be paid if a customer closes a premium paying account and fails to set up a new payment method. Conversely, premiums may continue to be paid by Direct Debit after a policyholder has died if no one is administering the estate and there are sufficient funds in the relevant premium-paying bank account.
- 2.33 The Commission understands that the ABI is considering developing, in conjunction with the industry, a free database portal that would enable customers to see which company is now managing legacy policies. The Commission considers that development of such a facility can only help increase the chances of customers staying in touch with their assets.
- 2.34 Where policies are held in trust by trustees, policies typically become dormant in circumstances where a trustee loses contact with a beneficiary. This can happen for any number of reasons, but the most common reason in the context of pensions is again to do with changes of address. When an employee leaves the employment of their sponsoring employer, who is providing the trust-based pension scheme, it is easy for them to forget to inform their now-former employer of subsequent house moves.
- 2.35 There is clearly a responsibility on customers to inform firms when they move house, and it may be possible to incorporate prompts into existing literature which will serve to remind customers periodically of this responsibility.

### ASSETS IN SCOPE OF AN EXPANDED SCHEME

- 2.36 In simple terms, the Commission considered that any insurance and pensions asset that was not deemed to be out of scope should be considered as in scope for the industry. However, this is an oversimplification of the position and does not take account of the complexities of the definition of what constitutes a dormant asset within the insurance and pensions industry.
- 2.37 The definition of dormancy is key to determining what insurance and pensions assets can be considered as within scope of an expanded scheme because getting that right should reduce the number of reclaim events in future years.
- 2.38 The Commission's call for evidence and feedback from the IPWG quickly identified that the definition of dormancy that exists within the current scheme is too simplistic to be utilised in the insurance and pensions industry.
- 2.39 With that in mind, the Commission settled on a three-pronged approach to defining dormancy for long-term insurance contracts, the three prongs being:

- A policy event such as maturity or actual or anticipated death;
- A passage of time thereafter; and
- Attempts to trace the whereabouts of owners or beneficial owners and reunite them with their assets.

2.40 The Commission then settled on the following approaches for the various products in scope:

**Figure 2.1 – Definitions of dormancy for insurance and pensions policies with a contractual end date**

Asset type	Contractual end date or trigger point for crystallisation of benefits	Minimum period following trigger point after which asset can be considered dormant	Actions to be taken during minimum period and prior to transfer of dormant asset to reclaim vehicle
Savings endowment	End of contractual policy term	Seven years after end of contractual term	Undertake specified tracing activities using financial and residential data retained by the firm, as well as that which is publically available, to try to trace the customer and, where appropriate, next of kin or estate executors / administrators and re-establish contact
Savings endowment	Death or illness claim accepted*	Identification that the customer has no next of kin or, where later, seven years after a death or illness claim is accepted and there has been no ongoing contact with those managing the estate	
Term insurance			
Defined contribution personal pension with requirement to purchase annuity or income drawdown at age 75	75 years of age	Seven years after end of contractual term	
	Death claim accepted*	Identification that the customer has no next of kin or, where later, seven years after a death or illness claim is accepted and there has been no ongoing contact with those managing the estate	
Annuity with guaranteed payment period	Death claim accepted*	Identification that the customer has no next of kin or, where later, seven years after a death or illness claim is accepted and there has been no ongoing contact with those managing the estate	

\* Evidence of death provided by death certificate or mortality screening provided by an expert supplier using official death registry data.

**Figure 2.2 – Definitions of dormancy for insurance and pensions policies with no contractual end date**

Asset type	Contractual end date or trigger point for crystallisation of benefits	Minimum period following trigger point after which asset can be considered dormant	Actions to be taken during minimum period and prior to transfer of dormant asset to reclaim vehicle
Whole-of-life	Very old age	Customer's age (date of birth to current date) is notionally over 120 years old	Undertake specified tracing activities using financial and residential data retained by the firm, as well as that which is publically available, to try to trace the customer and, where appropriate, next of kin or estate executors / administrators and re-establish contact
Investment bonds			
Defined contribution personal pension with <b>no</b> requirement to purchase annuity or income drawdown at age 75			
Income drawdown			
Deferred annuity			
Whole-of-life	Death claim accepted*	Identification that the customer has no next of kin or, where later, seven years after a death or illness claim is accepted and there has been no ongoing contact with those managing the estate or the customer is now notionally over 120 years old	
Investment bonds			
Defined contribution personal pension with <b>no</b> requirement to purchase annuity or income drawdown at age 75			
Income drawdown			
Deferred annuity			

\* Evidence of death provided by death certificate or mortality screening provided by an expert supplier using official death registry data.

- 2.41 The broad outline of Figures 2.1 and 2.2 was put forward by the IPWG as its suggestion for how to define dormancy in the insurance and pensions industry, and ultimately adopted by the Commission.
- 2.42 The suggestion to wait seven years after a policy event, such as maturity or death, before classing the policy as dormant came from the experience of insurers at the IPWG, which suggested that most customers come forward within five years to claim their policy proceeds. The Commission decided it was prudent to extend this time to give greater opportunities for firms to trace and reunite customers with lost proceeds and for customers to conduct their own investigations. The Commission thus settled on a period of seven years.
- 2.43 The suggestion of using the age 120 as the cut-off point for determining dormancy for whole-of-life contracts comes from considerations of likely total life expectancy for individuals in the UK, with anecdotal evidence suggesting that very few individuals are likely to live beyond 115 years of age. The IPWG originally suggested using the current age of the UK's oldest living resident plus two years. However, rather than having the dormancy definition being subject to change as the current oldest resident either passes another birthday or dies, and is replaced by a new oldest UK resident, the Commission felt that it was preferable to fix an age.
- 2.44 The Commission recognises that it may be necessary to amend this age of 120 as general life expectancy in the UK changes.

#### **Recommendation 2.1**

The assets comprised in the endowment, term insurance, pension, annuity, whole-of-life, drawdown and investment bond products set out in Figures 2.1 and 2.2 should be included within an expanded dormant assets scheme and that any transfer of assets to the reclaim fund is made in a cash form.

## **ASSETS THAT ARE NOT IN SCOPE OF AN EXPANDED SCHEME**

- 2.45 In seeking to identify which assets should be considered for inclusion in an expanded scheme the Commission also sought to identify those asset classes that would be unsuitable for inclusion at this stage (although they may be considered for inclusion at a later date). These include assets that present very complex issues that could not easily be solved at this stage, or where the value of potentially dormant assets is immaterial or uncertain.
- 2.46 After considering all the issues, the Commission concluded the following asset types should be out of scope at this stage:
- With-profits funds;
  - Mutual funds;
  - Industrial branch policies;
  - Policies held under group trusts; and
  - General insurance policies.
- The reasons why are as follows.
- ### **With-profits funds**
- 2.47 With-profits funds are pooled investments where the assets of the fund are owned by the fund itself. Investors in with-profits funds generally have a contingent interest in the asset share of the fund, but do not generally own a specifically identifiable portion of the asset share within the fund until a policy event, such as a surrender or maturity occurs, and the individual policyholder's contingent interest in the with-profits fund is crystallised.
- 2.48 If assets are unclaimed at maturity, they are usually left within the relevant with-profits fund so that they can either be reclaimed by the relevant owner or they can be used by the fund for the benefit of the remaining with-profits investors. Any change to this basis, which formed part of the terms upon which the original contract was formed, would potentially be unfair, as defined by the Financial Conduct Authority's (FCA) treating customers fairly requirements, and possibly open to legal challenge whether or not policies were ultimately deemed to be dormant.
- 2.49 This pooled nature of with-profits funds and the fact that the assets belong to the funds themselves make with-profits funds unsuitable for inclusion in an expanded scheme at the present time, except in the circumstances described below.
- 2.50 A number of firms crystallise any with-profits funds where an amount due to customers arises. On death or policy maturity, the policy proceeds are removed from the with-profits fund and held separately on account for future reclaim by the owner.
- 2.51 In circumstances where these monies remain unclaimed by the original owner, they would be available for inclusion in an expanded scheme because the relevant amount had been removed from the with-profits fund it was originally invested in.
- 2.52 Respondents to the Commission's call for evidence were also of the view that any product partly invested in with-profits funds should also be excluded from the expanded scheme. This is because it would be difficult to disinvest that part of a dormant policy which was not invested in with-profits while leaving the with-profits element invested. Respondents did not see how they could justify transferring one part of the policy but not the other.
- 2.53 It is worth noting that while the Commission has decided to exclude with-profits funds from inclusion in an expanded scheme at this stage, it may be appropriate to revisit this decision as the treatment of closed with-profits funds (i.e. those that are not open to new business) develops.



As these funds get older, and the number of customers decreases, the fund must eventually be wound down and there is the possibility of a 'tontine effect' occurring – a situation where a large windfall payment goes to the last surviving member of a fund. This could happen in a with-profits fund if a surplus of assets over and above those needed to pay customers is allowed to build up over time and not dissipated by regular additional bonus payments to customers.

- 2.54 This may arise where the actuarial reserving for the relevant fund has been more conservative than was necessary, so that if the remaining assets were divided equally among remaining customers, they would receive returns far above those that they could reasonably have expected to receive when they originally took out the policy. There is a potential argument that these customers should not be entitled to these inflated returns if this sort of scenario were to play out, and the Commission therefore suggests that the inclusion of with-profits policies and funds be reconsidered at a later date if and when such funds start to run off (i.e. be wound down), and particularly if they appear to be experiencing a tontine effect.
- 2.55 The Commission believes that this assessment is best performed by the industry body, the ABI, in conjunction with industry firms.

#### **Recommendation 2.2**

The eligibility of non-crystallised with-profits policies and funds should be reviewed regularly by industry participants, to reconsider them for inclusion in an expanded scheme as and when closed funds experience a 'tontine effect'. The Commission considers that the Government has a role to play in triggering such reviews and that the ABI may be best placed to help facilitate these, in conjunction with industry, potentially at five-yearly intervals.

### **Mutual funds**

- 2.56 Mutual funds operate in a similar way to with-profits funds, in that assets are owned by the fund and are managed on a pooled basis for the benefit of the policyholders within them. As is the case for with-profits funds, potentially dormant assets held in the fund are used for the benefit of remaining policyholders. Any change to this would alter the basis on which the original contract was entered into and could potentially be unfair and / or unenforceable.
- 2.57 Mutual fund firms who responded to the Commission's call for evidence were unanimous in their support for the exclusion of mutual funds from an expanded scheme, with some even questioning whether the industry would be able to continue in its present form if dormant mutual funds were removed from existing funds and transferred to an expanded scheme.
- 2.58 This is because the capital position of mutual societies is such that they often rely heavily on the availability of dormant assets to underwrite new business in these funds.

Unlike public limited companies, mutual insurers cannot go to the market to raise new capital and so the availability of dormant assets within these mutual funds is, to some mutual firms at least, crucial to the ongoing viability of their business model.

#### **Recommendation 2.3**

All mutual insurance funds should be excluded from an expanded dormant assets scheme.

### **Industrial branch policies**

- 2.59 Firms with industrial branch policies who responded to the Commission's call for evidence were unanimously of the view that these policies should be excluded from the scope of an expanded scheme. This was not because of any conviction that dormant assets do not arise within industrial branch policies but because it is very difficult, if not impossible, to identify when industrial branch policies have become dormant and to quantify their value.
- 2.60 Industrial branch policies were typically sold door to door by sales agents at a time before centralised computer records were in common use. Records of policies were typically held in paper form, by the agent who sold the policy. These physical paper records have very often been lost over the years for various reasons.
- 2.61 Additional factors that reduce the quality of record keeping are also at play. Many firms who originally sold these policies have subsequently merged with, or been taken over by, other firms. This introduces the possibility of records being lost or corrupted at the point of data transfer between the companies. Some firms have also undertaken various exercises to manually transfer data from paper records to computerised records, which introduces the opportunity for further errors as it is possible for operators to mistype data into the new system.
- 2.62 The combination of these various factors means that the records held by firms for these policies are generally of a poor quality. In some instances, firms are uncertain as to the precise volume of policies that are still in existence and what level of liability they are carrying as a consequence. Firms typically pay out on claims if a policyholder or beneficiary can prove ownership of a policy by production of the original cover note, even though the firm itself may not have a copy of the cover note or of the policy itself.
- 2.63 To provide for this uncertain liability, many firms have put aside reserves to pay claims as and when they arise. That being the case dormant assets are unlikely to arise in respect of industrial branch policies because firms do not have a complete picture of what policies they are providing cover for.
- 2.64 If claims experience is lower than anticipated, any excess in reserves will ultimately flow back into company funds. In the reverse scenario, where claims experience is higher than anticipated, the firm will have to find additional reserves of money to pay claims.

**Recommendation 2.4**

All industrial branch insurance policies should be excluded from an expanded dormant assets scheme.

**Policies held under trust**

- 2.65 Many policies in the insurance and pensions industry are held under either individual or group trusts.
- 2.66 An individual trust occurs when a policy owner places his or her policy into trust. This is often done at the start of the policy, but it can also be done later on during the lifetime of the policy.
- 2.67 Policies are put into trust often for tax reasons, but can also be put into trust for the primary reason of ensuring that the owner's wishes are carried out at a later date or after death.
- 2.68 Group trusts typically exist in respect of pensions where group pension schemes are established for a group of beneficiaries, typically a group of employees.
- 2.69 The issue with policies placed in trust is that the trustees have a fiduciary duty that personally obliges them to deal with any policy proceeds for the benefit of beneficiaries. Any failure to discharge those duties for anything other than the benefit of beneficiaries potentially leaves trustees open to legal action.
- 2.70 At present any attempt by trustees to divert monies to an expanded scheme would not discharge their fiduciary duty (unless the terms of the trust specifically provided for dormant assets to be passed to an expanded scheme) because it would not be for the sole benefit of nominated beneficiaries. Without a change in this aspect of trust law individual or group trusts cannot be considered for inclusion in an expanded scheme.
- 2.71 Accordingly, the Commission makes recommendations to change existing trust law in Chapter 6.
- 2.72 These changes will mean that where within a particular trust it is possible to identify a sole individual who should ordinarily benefit from specific assets within the trust – for example where there is only one trust beneficiary – those assets should be considered as within scope of an expanded dormant assets scheme.
- 2.73 Where within a trust structure it is not possible to identify sole specific individuals who would ordinarily be expected to benefit from specific assets, for example group trusts, those assets will be exempt from inclusion within an expanded scheme

**General insurance**

- 2.74 The general insurance market in the UK is very large, with the motor and household insurance markets alone being worth approximately £2bn in premium income per year.<sup>4</sup> Despite this, the levels of dormant assets that arise are expected to be very small.

- 2.75 The nature of general insurance is that a specific risk is insured against, such as the risk of accidental damage to the policyholder's car, or the risk of burglary from the policyholder's house.
- 2.76 Unless the policyholder informs the insurance company that an event against which the insurance has been taken out occurs, the insurer would be unaware of circumstances in which a claim has arisen. As claims are usually for specific events that policyholders wish to be reimbursed for, such as damage to or theft of property, it is very unusual for policyholders to notify insurers of a claim and then not follow it through to the point where they are reimbursed by their insurer. The annual renewal of general insurance policies also makes it much less likely that insurers and policyholders will lose contact with each other.
- 2.77 Respondents to the Commission's call for evidence were virtually unanimous in their view that dormant assets do not generally arise in the context of general insurance, and respondents were accordingly unable to identify any amounts of money that they would currently consider dormant from a general insurance point of view.
- 2.78 There was one exception to this general rule and that was for insurance brokers who act as an intermediary between the insurance firm and the policyholder. In certain circumstances it is possible for the insurance broker to accumulate dormant assets where they deal with claims, or amendments to, or refunds from, client premiums on behalf of customers. In circumstances where insurance brokers remit money to customers via cheque it is possible for the broker to accumulate dormant assets if those cheques are not cashed. Although respondents were not able to quantify the amounts that might be at stake, they are expected to be small. Nevertheless they would potentially be suitable for inclusion in an expanded scheme.

**Recommendation 2.5**

General insurance should be excluded from an expanded dormant assets scheme, with the exception of uncashed cheque payments due to clients that sit either with insurers or brokers.

**TRACING AND REUNIFICATION**

- 2.79 In the insurance and pensions industry, there is no single agreed best method of tracing and reunifying customers with lost assets, and existing efforts vary in nature and effectiveness.
- 2.80 The general consensus across the industry is that more could be done to improve the success rates here. It is generally anticipated that this will occur as firms get better at utilising all the data currently available to them in the digital age, and begin to obtain new sources of data from social media or third parties.

<sup>4</sup> UK Insurance and Long Term Savings Key Facts 2015, ABI

## Effectiveness of tracing and reunification

- 2.81 A number of firms also highlighted anecdotal evidence that suggested that the actual act of locating lost customers was not necessarily too problematic. Indeed, one firm reported that they were able to establish the whereabouts of 95% of their lost customers through the employment of professional tracing agents.
- 2.82 The real problem in reuniting customers with their assets was that, once they had managed to trace a lost customer, it was often difficult to get that customer to respond. The firm concerned explained that they typically tried to re-establish contact by writing to the customer on a number of occasions, but that it was not unusual to receive responses from customers in only 50% of cases. It was speculated that this might be explained by customers thinking that they were being subject to some form of scam.
- 2.83 There was general consensus that firms may achieve greater success if they were given access to more linked sources of data for the purposes of tracing. For example, firms felt that, if they were given access to data held by HM Revenue & Customs, DVLA and the TV Licensing authority, they would be better at tracing lost customers.
- 2.84 In the IPWG, the suggestion of collecting the National Insurance number of a customer as part of the process for recording a death was tabled. This is discussed in more detail in Chapter 5.
- 2.85 The Commission also makes recommendations in Chapter 5, which outline the ways in which current tracing and reunification efforts might be improved.

## Pensions dashboard

- 2.86 In March 2015, the FCA announced that it would take forward its December 2014 proposal to create a 'pensions dashboard'.
- 2.87 The pensions dashboard is envisaged as a 'one stop shop' point of reference for an individual's pension provision. In effect, it is intended to be akin to an aggregator website where individuals can obtain details in one place of all their pension provisions with different firms, be they defined benefit, defined contribution or state provision.
- 2.88 The ABI is currently working with the insurance industry to develop a prototype of the pensions dashboard and the Commission anticipates that there will be a degree of data sharing required to facilitate the functionality of the dashboard. If data is shared or consolidated to facilitate the pensions dashboard, it may be that this presents an opportunity to use this data for the purposes of reuniting policyholders with lost or dormant assets.
- 2.89 The Commission considers that it would be helpful if the tracing and reunification possibilities presented by the pensions dashboard were considered as part of its development, so that appropriate functionality can be designed in from the outset.

### Recommendation 2.6

The ABI and pension firms should develop the functionality of the proposed pensions dashboard to also facilitate efforts by firms to trace and reunite lost assets with customers.

## FCA long-standing customer review

- 2.90 In March 2016, the FCA published its feedback on the thematic review of fair treatment of long-standing customers in the life insurance industry.<sup>5</sup>
- 2.91 The insurance industry had been hoping that, in the publication of this report, the FCA would provide detailed guidance on the tracing activity it would expect firms to undertake, thus providing firms with a degree of certainty as to the level of tracing that the FCA would deem acceptable.
- 2.92 However, industry consensus appears to be that the feedback paper, while providing helpful high-level guidelines as to the type and frequency of tracing that firms might carry out, did not provide a detailed predetermined framework that firms could follow.
- 2.93 The Commission makes recommendations about FCA recognition of industry-created tracing and reunification guidance in Chapter 5.

## POTENTIAL VALUE OF DORMANT ASSETS

### Value of assets

- 2.94 In its call for evidence, the Commission asked firms to value the level of dormant assets within their control. The responses provided an initial indication of the potential volume of dormant assets, but no more than that because:
- the Commission had not finalised its recommendations at that stage;
  - firms were asked to use their own varying definitions of dormancy to quantify their potentially dormant assets;
  - some firms did not engage with the Commission and so accordingly have not provided quantum information; and
  - the time available for firms to provide quantum information was limited, and accordingly, some firms were only able to provide an estimate.
- 2.95 Despite these constraints, insurance and pensions firms that responded to the Commission's call for evidence indicated that there might be as much as £1.4bn of unclaimed money from their own policy records, with further amounts of up to £70m being added to this annually thereafter.

<sup>5</sup> Financial Conduct Authority, TR16/2: Fair treatment of long-standing customers in the life insurance sector, March 2016

2.96 The IPWG performed its own valuation exercise, linking the valuation of potentially dormant assets to the definitions of dormancy that the working group developed. This led to estimates of £360m being available now, with further amounts of £32m becoming available annually thereafter.

### Assumptions behind valuation

- 2.97 The difference in the figures quoted between the Commission's call for evidence and the IPWG is explained by a difference in the question asked. For the purposes of the Commission's call for evidence, firms were asked to quantify the likely value of assets based on their own internal definition of dormancy. Inevitably, firms used different definitions of what dormancy was and so the quantum associated with these submissions was not necessarily consistent.
- 2.98 For the IPWG quantum piece, firms were asked to use the definition of dormancy that was arrived at by the IPWG. This typically led to lower estimations of quantum than had been the case when firms used their own definition.
- 2.99 In addition, the group of respondents to the IPWG request for quantum information was different to the group that responded to the Commission's call for evidence, as not all insurance and pensions firms are members of the ABI.

### Estimated calculation – dormant assets market size

- 2.100 In an attempt to estimate the volume of dormant assets that might potentially be available across the insurance and pensions industry, the Commission conducted its own extrapolation exercise.
- 2.101 For this exercise, the Commission used data provided by one of the industry respondents. The firm concerned, which for the purposes of this section is referred to as Life Co Ltd, represents a good proxy for the insurance and pensions industry as it sells a broad range of products and has a significant and varied legacy portfolio.
- 2.102 The Commission used data it received from Life Co Ltd, together with publically available information from two leading industry analysts, Cazalet Consulting<sup>6</sup> and Bernstein Research,<sup>7</sup> to calculate potential industry totals for dormant assets, the results of which can be found in Figures 2.3 and 2.4.
- 2.103 One of the key pieces of information that Life Co Ltd shared with the Commission was that the total number of assets that it reported in response to the call for evidence as being available now for dormancy reduced by 78% when the IPWG definitions of dormancy were applied, and the figure for ongoing annual releases reduced by 52%. These figures have been instrumental in allowing the Commission to conduct its own estimate of the dormant assets potentially available across the industry. Figures 2.3 and 2.4 set out the Commission's calculations.

**Figure 2.3 – Commission estimate of the dormant assets potentially available now in the insurance and pensions industry as a whole**

Ref	Calculation	Industry size estimate using Life Co Ltd data	Industry size estimate using Life Co Ltd and Bernstein Research data	Industry size estimate using Life Co Ltd and Cazalet Consulting data
A	Value of Life Co Ltd assets under management	£490bn*	£272bn	£182bn
B	Value of Life Co Ltd dormant assets	£360m*	£360m*	£360m*
C	% of Life Co Ltd assets under management determined as dormant	0.07%	0.13%	0.2%
D	Total insurance and pensions industry market asset size	£3tn*	£1.6tn	£1tn
E	Total market dormant assets using figure C	£2.2bn	£2.1bn	£2bn
F	Reduction factor	78%*	78%*	78%*
<b>G</b>	<b>Potential total insurance and pensions industry dormant assets</b>	<b>£485m</b>	<b>£466m</b>	<b>£435m</b>

\* Data estimate provided by Life Co Ltd.

NB: figures in the tables are rounded for presentation purposes and will not recalculate exactly.

6 Cazalet Consulting, Life & Platforms 2015-16, March 2016

7 Bernstein Research, Bernstein Industry Primer, June 2015

**Figure 2.4 – Commission estimate of the dormant assets potentially available on an annual basis in the insurance and pensions industry as a whole**

Ref	Calculation	Industry size estimate using Life Co Ltd data	Industry size estimate using Life Co Ltd and Bernstein Research data	Industry size estimate using Life Co Ltd and Cazalet Consulting data
A	Value of Life Co Ltd assets under management	£490bn*	£272bn	£182bn
B	Estimated value of Life Co Ltd annual dormant assets*	£36m*	£36m*	£36m*
C	% of Life Co Ltd assets under management becoming dormant annually	0.007%	0.013%	0.02%
D	Market asset size	£3tn*	£1.6tn	£1tn
E	Market assets becoming dormant annually using figure C	£220m	£212m	£198m
F	Reduction factor	78%*	78%*	78%*
<b>G</b>	<b>Potential total insurance and pensions industry dormant assets</b>	<b>£48m</b>	<b>£47m</b>	<b>£44m</b>

\* Data estimate provided by Life Co Ltd.

NB: figures in the tables are rounded for presentation purposes and will not recalculate exactly.

### Conclusions regarding value

- 2.104 It appears reasonable to the Commission to assume that a conservative estimate as to total dormant assets available now, before any reduction for consistent dormancy definitions is applied, is in the region of £2bn, as per row E, Figure 2.3. The figure produced by the Commission's call for evidence of £1.4bn is clearly lower than this as there were firms of significant volume who were either not included in the call for evidence request or who did not respond to it.
- 2.105 The Commission therefore considers that a conservative estimate of the value of dormant assets available now, once a reduction has been applied to reflect a consistent definition of dormancy, is in the region of £400-500m across the industry, as per row G, Figure 2.3.

2.106 For ongoing releases, there is perhaps a greater degree of uncertainty as to the long-term sustainability of the Commission's estimate. This is because as tranches of business run off, and new ones become potentially available, the profile of ongoing dormancy releases will change. For example, in the case of Life Co Ltd, 70% of dormant assets are generated by mortgage endowment policy maturities that have not been claimed. However, given that mortgage endowments are generally not being actively marketed, and have not been for approximately 10 years, there will inevitably come a time when such maturities cease to be a significant source of potentially dormant assets. Therefore, while the estimate of ongoing annual releases may be relevant now, it is likely to change over the course of the next decade.

2.107 At the present time, the Commission estimates that between £40m and £50m may become dormant on an annual basis after commencement of an expanded scheme, as per row G, Figure 2.4.

## CHALLENGES AND OPPORTUNITIES

### Challenges

- 2.108 At present, firms do not generally deal with the issue of dormant assets, preferring to leave such assets invested so they are in a position to meet any reclaim liabilities that may arise. Accordingly, dormant assets currently present little, if any, risk for firms.
- 2.109 There are a number of risks to customers and firms if firms were to participate in an expanded scheme.

### Customer risk

- 2.110 The main risk to customers is of losing money if the value of a policy reclaimed from the scheme was less than it would have been had it not been transferred. This could happen where a policy which was originally equity-backed, or dependent on the occurrence of a specific policy event to determine its value, is converted into cash, having been determined as dormant in accordance with Figure 2.2.
- 2.111 This potentially applies to whole-of-life policies, investment bonds, deferred annuities and pensions products, where there is no contractual end date.
- 2.112 However, the Commission considers that its proposals in respect of the dormancy definition for insurance and pensions products should limit the occurrence of instances where the risk of customers being worse off presents itself. Additionally, the Commission prefers reclaim values based on full monetary restitution, see Recommendation 5.29, which, if implemented, would eliminate this risk.

## Costs

- 2.113 Insurance and pensions firms were not in a position to provide analysis of the costs and benefits of participating in an expanded scheme as the likely composition and qualifying criteria of such a scheme were not sufficiently clear at the time they responded to the call for evidence.
- 2.114 In responses to the Commission's call for evidence, and in the discussions held as part of the IPWVG, insurance and pensions firms expressed concerns about the potential costs that might be involved, highlighting that if there were significant costs to participating in an expanded scheme, it could act as a disincentive to voluntary participation.
- 2.115 Firms pointed out however, that the costs of participating may be as much a symptom of internal constraints, such as issues with legacy IT systems, as external factors that are driven by the scheme itself, and highlighted that more work will have to be done in this area to quantify the likely cost to firms of participating in an expanded scheme.

## Opportunities

### Tracing

- 2.116 Respondents to the call for evidence generally felt that the key benefits of an expanded scheme could be to help improve tracing of customers, promote greater engagement with customers, and promote higher levels of reunification of customers with previously 'lost' assets, although it is not possible to quantify the extent of these benefits at this stage.

### Industry reputation

- 2.117 Respondents to the call for evidence also felt that participating in an expanded scheme might generate positive publicity and solve a problem for firms, in that it would provide clarity as to what to do with dormant assets.
- 2.118 Firms also generally felt that using dormant assets for wider societal benefit was a positive outcome where it was not possible to reunite customers with 'lost' assets.

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Annexes

## Chapter 3

# Investment and Wealth Management



## SUMMARY

The investment and wealth management industry is highly complex and diversified, with a large number of products, underlying assets and providers involved. Dormancy certainly occurs and is concentrated among individual retail (as opposed to institutional) investors. The Commission therefore focused on the products most readily available to such 'retail clients', these being regulated investment schemes such as Open-Ended Investment Companies and Unit Trusts.

## DORMANT ASSETS IN THE INDUSTRY

The Commission noted that the concept of dormancy is not generally recognised, with firms often regarding long periods without client contact as normal. In addition, in terms of industry guidance or frameworks, there is little to incentivise identifying dormancy or reuniting dormant assets with their owners. The Financial Conduct Authority's Client Assets sourcebook (CASS) contains provision for liquidating unclaimed assets, however the process leaves firms with perpetual reclaim liability and consequently it is little used. The Commission does not believe this general state of affairs is good for customers, and supports enhanced requirements for firms to maintain client interaction.

More familiar than dormancy is the concept of a gone-away customer, as identified by post being returned and payments remaining uncashed. With distributing schemes, where payments (e.g. dividends) are sent out regularly, these act as clear trigger points to flag potential dormancy, as well as creating an unclaimed cash asset. They are absent however for accumulating schemes, where returns are reinvested.

Drawing on the CASS definitions for unclaimed status, the Commission settled on dormancy being defined differently for different assets with a combination of some or all of cash balances being unclaimed for a period, no customer-initiated activity, and the owner not being found.

## ASSETS IN SCOPE OF EXPANDED SCHEME

The Commission recommends for inclusion in an expanded scheme both cash and non-cash investment assets. For the former this would be relatively straightforward.

The latter will require appropriate enabling legislation and possible changes to CASS and Collective Investment Schemes sourcebook (COLL) rules.

## TRACING AND REUNIFICATION

Here there is wide inconsistency of practice. Firms have expressed concern over the potential costs of greater efforts to reunite customers with their lost assets, but the Commission does not believe cost should be a blanket excuse for a light-touch approach. The Commission recommends the industry collectively develops an industry standard for tracing and reunification procedures.

## OPPORTUNITIES AND CHALLENGES

There are a number of challenges to an expanded scheme:

- Tax wrappers: retail investors often invest under these, adding a further, but by no means unfeasible, level of complexity to inclusion and requiring HM Revenue and Customs support;
- Trust structures: trustees of Unit Trusts have fiduciary duties that may make them reluctant to transfer dormant assets to a reclaim fund. The Commission recommends amendments to trust law to absolve trustees of liability here;
- Fees: firms may draw management fees from retaining dormant assets, which provides a disincentive to transferring them to a reclaim fund. In reality such fees are relatively immaterial, but the motivational conflict poses a major challenge to getting firms to participate; and
- Fragmentation: the sheer number of industry players makes establishing consensus hard. The Commission encourages firms to engage with their representative body to work towards this.

Alongside these challenges, participation in an expanded scheme does offer firms substantial opportunities, including: improved relationships with customers through reunification; reduced administrative burden through transfer; enhanced reputation through creating societal benefits; and, most of all perhaps, the opportunity to draw a line in the sand and move forward to address dormancy in the industry.

## OVERVIEW OF THE UK INVESTMENT AND WEALTH MANAGEMENT INDUSTRY

- 3.1 The UK investment and wealth management industry covers many types of participant including fund managers, brokers, financial advisers, banks and private banks, and platforms. Most insurance firms are also active participants in the UK's investment management sector.
- 3.2 Investment managers focus on the management of money on behalf of investors. Invested money can be placed in pooled vehicles, which may be regulated or unregulated schemes, or can be managed on a bespoke basis. Bespoke management is more prevalent for institutional mandates (i.e. investing on behalf of fellow corporate vehicles), rather than for individual retail clients.
- 3.3 Wealth managers, as referred to in this report, are characterised as firms who generally have the direct client relationship with retail investors and act as intermediaries to channel those investors' funds. These include platforms, brokers, independent financial advisers, banks and insurers. The wealth manager invests the investor's funds in accordance with the contractual terms of the relationship with the investor. This relationship may include the provision of investment advice or be execution-only.
- 3.4 Together, this report refers to the activities of investment managers and wealth managers as the 'investment and wealth management industry'.
- 3.5 Investment and wealth management products and services are also offered by firms in other industries. For example, many banking groups have investment or wealth management divisions and actively distribute investment management products, and many insurers often distribute similar products. There are also a wide range of additional participants in parts of the industry chain, including trustees, custodians, depositories and registrars.

### The Commission's engagement with the industry

- 3.6 As with all industries considered by this report, engagement with the participants throughout the process, from commencement of the Commission's work to implementation, is important to ensure that issues are understood and possible solutions supported. Accordingly the Commission sent a call for evidence, explained in greater detail in Annex E, to a broad range of industry participants.
- 3.7 Additionally, with the assistance of a number of industry trade associations led by the Investment Association (IA), a working group was convened with representation from a broad spectrum of the industry. This working group provided a forum for the Commission to explore industry issues with participants and to start to raise greater industry awareness of the Commission's direction of travel regarding dormant assets in the financial services sector. The Commission would like to thank the IA for facilitating the working group and supporting engagement across the industry.

## Product types in the investment and wealth management industry

- 3.8 The main product types relevant to an expanded scheme in the investment and wealth management industry are investments in regulated and unregulated collective investment schemes.
- 3.9 Holdings in securities (i.e. shares and bonds), are also appropriate for consideration but are discussed further in Chapter 4.
- 3.10 Collective investment schemes are vehicles that pool the monies of a number of investors and invest these with a specified investment strategy to create returns for the investors. The aims and objectives of the scheme are set out in the scheme prospectus. The pooled monies from investors create a fund and are invested accordingly in certain underlying assets (e.g. property, listed shares or even other collective investments). The scheme owns the assets for the benefit of all investors, while investors themselves do not own the underlying assets, but own units or shares in the scheme according to their proportion of the total pool of invested monies.

### Regulated collective investment schemes

- 3.11 In the UK, regulated collective investment schemes are established as Investment Companies with Variable Capital (ICVCs) – also known as Open-Ended Investment Companies (OEICs) – and Authorised Unit Trusts (Unit Trusts). These vary in their legal form, which creates different complexities for including them in an expanded scheme. The Commission has focused on OEICs and Unit Trusts as the most readily available schemes to retail investors, while recognising that it is also possible for dormancy to occur in other regulated, unregulated, open-ended and closed-ended scheme types.
- 3.12 Both OEICs and Unit Trusts are collective investment structures that are open-ended, and therefore accept new monies from investors without limit. Both are regulated funds that target the UK investor market and are generally domiciled in the UK. Many are also subject to the EU's Undertakings for Collective Investment in Transferable Securities (UCITS)<sup>1</sup> directive and related regulations, or the Financial Conduct Authority (FCA) rules that apply to Non-UCITS Retail Schemes or Qualified Investor Schemes.<sup>2</sup>

### OEICs

- 3.13 An OEIC is a corporate structure, and structurally similar to any other corporate entity. Generally, if an OEIC complies with its instrument of incorporation and other contractual terms set out in its prospectus and agreed to by individual investors at the point of investment, it has more freedom to deal with dormant assets than other schemes.

1 EU directive 2009 / 65 / EC

2 FCA, Handbook

However, all OEICs are also subject to the Open-Ended Investment Company Regulations 2001<sup>3</sup> and the FCA's Collective Investment Schemes sourcebook (COLL) rules.<sup>4</sup>

### Unit Trusts

- 3.14 Unit Trusts are established with a trust structure and, as such, have trustees. The trustees are subject to very high standards of fiduciary obligation to the Unit Trust unitholders. In addition, Unit Trusts are also subject to the COLL and FCA Client Assets sourcebook (CASS)<sup>5</sup> rules. The key difference from OEICs is that the trustees have an overarching duty to protect the interests of all unitholders as a collective. Transferring dormant assets to an expanded scheme may potentially contravene this duty. The trustees' duty may therefore make it more difficult for Unit Trusts to transfer dormant assets to an expanded scheme than it is for OEIC managers.

### Other factors

- 3.15 Many OEICs and Unit Trusts are additionally held within tax wrapper structures such as Stocks and Shares Individual Savings Accounts (Stocks & Shares ISAs) or Self Invested Personal Pensions (SIPPs). This potentially adds a further layer of complexity to the process of transfer, distribution and reclaim of such assets, but should not represent a barrier to their inclusion in an expanded scheme – providing HM Revenue & Customs (HMRC) deals with these assets with the same principles as applied to assets included in the current scheme. This is described in more detail in paragraphs 3.85-3.88.
- 3.16 Authorised Contractual Schemes (ACS) are a relatively new legal structure and open to investment from institutions or individuals investing more than £1m. The Commission has focused on OEICs and Unit Trusts as the most readily available to retail investors, while recognising that it is also possible for dormancy to occur for retail investors in ACS.

### Unregulated collective investment schemes

- 3.17 In terms of legal formation, unregulated collective investment schemes are generally open-ended companies or limited partnerships but may also be unregulated unit trusts. Holdings in these types of schemes are generally less liquid because they are not as readily tradable. The Commission understands that these do not make up a significant portion of the UK market, but nevertheless, voluntary participation in an expanded scheme should be possible for such schemes.

### Regulatory landscape

- 3.18 The investment and wealth management industry is highly regulated by the FCA and, where the firm is systemically important to the safety and soundness of the UK's financial system, the Prudential Regulation Authority.

- 3.19 All firms supervised by the FCA are subject to the rules and guidance set out in its handbook.

### FCA Collective Investment Schemes sourcebook

- 3.20 Managers of regulated collective investment schemes are subject to the rules and guidance contained in the COLL module that applies specifically to the operators of regulated OEICs, Unit Trusts and ACS.<sup>6</sup> It is notable however that COLL guidance does not include provisions regarding the treatment of dormant or potentially dormant assets, save in respect of unpaid dividends.

### FCA Client Assets sourcebook

- 3.21 Where firms hold or control client money or client assets as part of their business activities, the CASS module provides additional rules for firms.<sup>7</sup> Included within this sourcebook there is guidance regarding the treatment of potentially dormant assets, which firms may follow on a voluntary basis.
- 3.22 Of particular relevance to the Commission is a notable exclusion at CASS 1.2.3 that excludes ICVCs, in other words OEICs, from having to adhere to CASS rules.
- 3.23 CASS 6.1.16BA also deems managers of investment funds to be excluded from the activity of safeguarding and administering investments under the Financial Services and Markets Act 2000<sup>8</sup> and its associated statutory instruments. As such, trustees and managers (except where they intermediate subscriptions and redemptions) do not need to apply the custody rules set out in CASS 6, but custodians or depositaries would.
- 3.24 CASS 6 specifically contains rules relating to the holding of client assets, and CASS 7 specifically contains rules relating to the holding of client money.
- 3.25 For relevant parties, CASS 6 allows a firm to divest itself of a client's unclaimed client assets. For the purposes of CASS, this means assets in non-cash form. The module allows a firm to:
- “either (i) liquidate an unclaimed safe custody asset it holds for a client, at market value, and pay away the proceeds or (ii) pay away an unclaimed safe custody asset it holds for a client, in either case, to a registered charity of its choice.”*<sup>9</sup>
- 3.26 The CASS 6 rules stipulate that such action can only be taken where permitted by law, and where there have been no client-initiated instructions for a continuous period of at least 12 years, and the firm can demonstrate that it has taken reasonable steps to trace and reunite the investor with their assets.
- 3.27 Should a firm undertake the action per paragraphs 3.25 and 3.26, it must also continue to carry the perpetual liability for reclaim by the underlying investor or their beneficiaries.

3 Open-Ended Investment Company Regulations 2001

4 FCA, Handbook: Collective Investment Schemes

5 FCA, Client Assets sourcebook

6 FCA, Handbook: Collective Investment Schemes

7 FCA, Client Assets sourcebook

8 Financial Services and Markets Act 2000

9 FCA, Client Assets sourcebook

The specific inclusion of this requirement in the CASS rules therefore means the major advantage for addressing potentially dormant holdings, being the relief for the firm from holding reclaim liability, does not currently exist. An expanded scheme should transfer liability for reclaim to the reclaim fund, partly to encourage greater participation levels than under the CASS rules.

- 3.28 CASS 7 relating to client money (i.e. assets in cash form), has similar provisions as for client assets described in paragraphs 3.25-3.27. However, in the case of client money, the applicable period is only six continuous years without customer-initiated instructions. There is also a *de minimis* provision whereby lesser procedures apply for unclaimed retail client money values of less than £25.

## DORMANT ASSETS IN THE INDUSTRY

### Dormancy in the industry

- 3.29 The concept of dormancy is not generally recognised in the investment and wealth management industry. The long-term nature of many investment products and, in the case of most collective investments, the lack of a maturity date, means that firms tend to consider products as perpetual. In the eyes of a number of industry participants, the lack of maturity means that dormancy is impossible. This view of impossibility is not shared by the Commission, which does not accept that no maturity automatically implies no dormancy. A similar situation is seen with bank and building society accounts, which also do not have product maturity, but can still be identified as dormant in the current scheme.
- 3.30 A more widely recognised industry concept than dormancy, mentioned by a number of those who responded to the call for evidence, is that of a gone-away. A gone-away exists where a firm has had a number of items of post returned from the last known address of the recorded beneficial owner of an asset. Gone-away also captures instances where payments have not been cashed, or have been returned in the case of electronic transfers.
- 3.31 Investment and wealth management assets have very different structures, features and characteristics to assets in the current scheme. It is currently entirely possible that investors will purchase a product and not interact with the product provider at all until the point at which the beneficial owner seeks to dispose of the asset. This may be decades from the initial date of product purchase or investment, particularly in the case of investments made for the purposes of retirement planning.

### Reasons for dormancy

- 3.32 Dormant assets in collective investment schemes typically arise because either the original investor dies without providing their estate with details of their asset ownership, or the beneficial owner changes their address details without notifying the firm. As recognised by the FCA, customers need to be responsible for their own finances, one aspect of which is for customers to notify firms of changes in contact details.

- 3.33 Dormant assets are likely to be highest in firms with lower levels of ongoing customer contact due to the nature of their services, and / or with a greater number of older products where the provision of customer data was often very limited making it harder for firms to trace and reunite customers. In recent years, a higher level of personal information has been required from investors prior to purchasing an investment product, which makes tracing and reunification efforts more efficient.

### Forms of potentially dormant assets

- 3.34 Collective investment schemes typically hold up to five types of asset that have the potential to become dormant over time. These are:
- unclaimed dividends;
  - uncashed redemption cheques;
  - unclaimed distributions from the winding-up of a scheme;
  - other cash balances that cannot be allocated to individual investors; and
  - the shares or units in the scheme, where the customer has lost contact.
- 3.35 In the list above, items (a-d) are cash items. In other words, these assets have a crystallised value and are in highly liquid form prior to any efforts to reunite them with beneficial owners. Item (e) is considered to be a non-cash item, the value of which may fluctuate according to external influences. Prior to valuation and liquidation, non-cash items do not have crystallised values. Non-cash items are also less liquid than cash items as a result of the need for a process of liquidation.

### Defining dormant assets

- 3.36 The Commission does not consider the fact that there can be a lack of contact between industry firms and customers to be necessarily in customers' best, long-term interests. Contact details may change in that time, or customers' investment needs may change between purchase and disposal. More frequent contact between firm and customer may more readily identify these situations and allow for alterations to be made. Although the primary responsibility for providing up-to-date contact details should remain with the customer, enhanced requirements for firms to attempt to maintain customer contact seems to align with possible remedies to a number of the issues raised in the FCA's November 2016 Asset Management Market Study Interim Report.<sup>10</sup>
- 3.37 Collective investments may also have differing share classes within the same scheme. For example, schemes can have both accumulating shares and distributing shares. For the former, income generated by the scheme's underlying investments is added to the scheme's pool of assets. For the latter, income is periodically paid out to investors as a dividend.

<sup>10</sup> FCA, Asset Management Market Study Interim Report, November 2016

- 3.38 For the purposes of the Commission's work, this affects the point at which an asset, the shares or units in the scheme, may be identified as potentially dormant. Where shares are accumulating, the automatic investing of income can occur without the need for any action by an asset owner. Accumulating shares therefore do not have a frequent trigger point at which dormancy may be identified. Distributing shares may be flagged as potentially dormant earlier – for example when one or more dividend payments are not encashed by the beneficial owner.
- 3.39 As individuals are not required to interact with firms, in particular with accumulating shares, customer inactivity in, and of itself, does not indicate that the beneficial owner does not intend to ultimately realise the asset in question or make it available to his or her heirs. Given this, it is unsurprising that respondents to the call for evidence generally explained that a definition of dormancy based simply on elapsed time since the last investor-initiated transaction is inappropriate.
- 3.40 The Commission agrees with this stance and has therefore needed to consider a definition of dormancy incorporating more aspects than are utilised under the existing scheme for bank and building society accounts.
- 3.41 Such a composite definition would relate to an industry asset where contact has been lost, cannot be re-established through appropriate tracing efforts, and accordingly the asset is unable to be reunited with the beneficial owner. The precise point at which an industry asset becomes dormant, and therefore the appropriate definition, will vary on an asset-by-asset basis.
- 3.42 Figure 3.1 displays the Commission's recommendations regarding composite definitions of dormancy for different assets. Assuming that contact with a beneficial owner has been lost, there is a time aspect and reuniting aspect to the definition.
- 3.43 It is intended that until the time period has elapsed, a given asset cannot be defined as dormant or transferred to an expanded scheme. In addition to the elapse of this time, an asset cannot be defined as dormant unless the firm is unable to reunite the beneficial owner with the asset in question. The specific considerations governing efforts to reunite beneficial owners with their assets are covered in Chapter 5.
- 3.44 Figure 3.1 includes two time period options for use in the definition. The most appropriate option will depend upon which restitution option is implemented in the expanded scheme, discussed in further detail in Chapter 5. If full monetary restitution is ultimately implemented, column B should form the time element of the definition. If anything other than full restitution is ultimately implemented, column C should form the time element of the definition. The Commission has focused on OEICs and Unit Trusts as the most readily available schemes to retail investors, while recognising that it is also possible for dormancy to occur in other regulated, unregulated, open-ended and closed-ended scheme types. For these, it anticipates a similar dormancy definition structure.

**Figure 3.1 – Definitions of dormancy for assets in the investment and wealth management industry (elapsed time periods are inclusive of unsuccessful reunification efforts)**

		B	C
	Asset type	Minimum period after which an asset can be considered dormant	Minimum period after which an asset can be considered dormant
CASH	Dividends	Unclaimed for six years	Unclaimed for six years
	Redemptions	Unclaimed for six years	Unclaimed for six years
	Fund closures / winding-up / other cash balances	Unclaimed for six years	Unclaimed for six years
NON-CASH	Units	Twelve consecutive years following last client-initiated activity	Twenty consecutive years following last client-initiated activity (and at least 25 years since original investment date)
	OEIC Shares	Twelve consecutive years following last client-initiated activity	Twenty consecutive years following last client-initiated activity (and at least 25 years since original investment date)

## ASSETS IN SCOPE OF AN EXPANDED SCHEME

- 3.45 The Commission considers that assets that are available to individual, rather than institutional, investors defined as 'retail clients' in the FCA handbook<sup>11</sup> and the EU's Market in Financial Instruments Directive (MiFID),<sup>12</sup> should be within the scope of an expanded scheme. Such assets are thought to represent the majority of potentially dormant assets in the industry and relate to: "a client who is not a professional client or an eligible counterparty"<sup>13</sup> and "a client who is not a professional client"<sup>14</sup> respectively.
- 3.46 While relatively illiquid assets should form part of an expanded scheme, this should be subject to the reclaim fund being able to refuse to accept the transfer of such assets. In practice, this will likely only impact assets that may be too onerous to receive and administer.

11 FCA, Handbook: Glossary Terms

12 Markets in Financial Instruments Directive 2004 / 39 / EC

13 FCA, Handbook: Glossary Terms

14 Markets in Financial Instruments Directive 2004 / 39 / EC

## Cash assets

3.47 There was general consensus from respondents to the call for evidence that the unclaimed or uncashed element of cash assets in the industry should be included in an expanded scheme, as valuation and transfer is likely to be relatively straightforward. The Commission agrees with this general consensus relating to cash assets.

## Non-cash assets

3.48 Non-cash assets are inherently more difficult to deal with than cash assets, and include funds under management. The responses to the call for evidence regarding the inclusion of these assets in an expanded scheme had no consensus, with some respondents highlighting their likely reluctance to transfer shares or units in collective investment schemes to an expanded scheme unless the firm could be fully relieved of the liability for future reclaims. This includes reclaimants not being able to pursue transferors for any perceived value differential. In this instance, the Commission is of the same mind as the industry and supports transferors being relieved of all liability for future reclaims.

3.49 Existing regulation, in CASS and COLL rules particularly, may conflict with the Commission's implemented recommendations if current rules are retained without modification. The Commission discusses this and other legislative matters in more detail in Chapter 6.

3.50 Additionally, some unregulated schemes may need to include authority for the manager to instruct the custodian / depository to release dormant assets in their constitutional documents.

### Recommendation 3.1

Cash and non-cash investment and wealth management assets, with both currently crystallised and not currently crystallised values, should be included in an expanded scheme.

### Recommendation 3.2

Enabling legislation covering an expanded scheme should take precedence over existing CASS and COLL rules, which should be modified if necessary to align with the enabling legislation.

## TRACING AND REUNIFICATION

3.51 The industry call for evidence responses highlighted that efforts to attempt to trace beneficial owners and return assets to them are undertaken by some industry firms but that the levels of effort expended, and the consequent success rates achieved, vary widely. That there are inconsistent tracing and reuniting practices across the industry as a whole is a strong message, and one which the Commission does not feel to be the right outcome for a customer-focused industry.

In Chapter 5 the Commission therefore proposes a way for industries to be able to standardise reuniting efforts.

3.52 The tracing and reuniting activity currently undertaken by the industry also appears to focus on cash assets. Identifying, tracing and reuniting the larger, potentially dormant non-cash funds under management seems not to be a focus for either the regulator, industry as a whole, or most industry firms.

3.53 Respondents to the call for evidence raised concerns about the cost of trying to reunite customers with their assets compared with the benefits, especially for small balances. The Commission recognised a desire for the cost of reuniting to be proportionate to the value of the asset. However, it does not believe that the cost of reuniting should be used as a blanket excuse for firms to undertake only light-touch efforts, especially where it is clear that some industry participants already implement extensive tracing and reuniting programmes, potentially to their competitive disadvantage.

## Existing frameworks for tracing procedures

3.54 The Commission is aware of two broad voluntary frameworks which detail ways in which the industry could currently attempt to reunite beneficial owners with their assets: CASS,<sup>15</sup> and the BSI Standards Publication: Specification for the maintenance of financial services customer data.<sup>16</sup>

## CASS rules

3.55 CASS rules suggest up to three steps of repeated contact via different forms (e.g. written letter, email, public advertisement), before the asset can be transferred to a registered charity. In the Commission's discussions with the industry, it was made clear that firms feel the level of effort and associated cost required before an asset can be considered to be potentially dormant is disproportionate to the value of some assets.

3.56 The CASS rules relating to tracing, reunification and transfers to charities are voluntary. They also stop some way short of being a best-practice procedure, and a level of latitude remains that potentially leaves firms open to future challenge of their efforts. Partially as a consequence of the lack of clarity of the CASS rules, and partially due to the requirement that firms continue to retain the liability after transfer to good causes, the amount of tracing or reuniting activity and the consequent value of monies passed to charities under CASS rules is currently low.

## BSI Standard

3.57 One industry association, the Tax Incentivised Savings Association, sponsored the creation of the BSI Standards Publication.<sup>17</sup>

<sup>15</sup> Financial Conduct Authority, Client Assets Sourcebook

<sup>16</sup> BSI Standards Limited, Specification for the maintenance of financial services customer data, 2015

<sup>17</sup> BSI Standards Limited, Specification for the maintenance of financial services customer data, 2015

The driver for this was the same issue of unclaimed and potentially dormant industry balances as is under consideration by the Commission. The publication's objective was the creation of a governance process for improving the accuracy of customer data held by firms, including the accompanying tracing practices, which would result in a greater level of reunited beneficial owners.

- 3.58 Specifically related to firms attempting to reunite beneficial owners with their assets, Section 7 of the publication lays out the minimum steps that a firm should undertake, irrespective of any de minimis value. Fundamentally, these are stated to be the firm attempting to use either internal or external sources to verify the beneficial owner and their current contact details.
- 3.59 Where the value of the asset exceeds a de minimis limit of £25, and if an owner is flagged as gone-away, within 12 months the firm should additionally attempt to verify contact details using at least one of: the electoral roll; national change of address database; and BT OSIS – a database of telephone numbers, names and addresses. The firm may engage an external tracing agency to assist with this.
- 3.60 Where it is believed that the current recorded owner of an asset held by a firm may be deceased, the firm should additionally attempt to verify this status against the disclosure of death registration information scheme. The standard suggests that only where the value of the asset exceeds £500 should estate executors or beneficial owners be sought.
- 3.61 In the Commission's view, this standard represents a good approach to a best practice for tracing and reuniting beneficial owners with their assets. It is therefore disappointing that current adoption of the standard by industry firms has been exceedingly low. Recommendation 5.14 addresses the development of a standardised industry procedure to reunite potentially dormant assets.
- 3.62 In the course of the Commission's work, the IA has informed the Commission that it intends to work jointly with firms to encourage an exercise to find the industry's gone-away clients. The IA will also request that firms undertake regular checks of gone-away clients, and create and implement processes to address this across the industry on an ongoing basis. The Commission is encouraged by this support for the Commission's aim to minimise dormancy in the industry. The IA expects the exercise to find the industry's gone-away clients to take 12-18 months.

## MiFID II

- 3.63 The Commission is also aware that from January 2018 a revision to the EU Legislation Markets in Financial Instruments Directive<sup>18</sup>, known as MiFID II, will take effect. This contains aspects that investment and wealth managers will need to address for the first time.

Specifically, MiFID II includes regulations that will require industry firms to verify that their products continue to match the risk profiles and investment needs of individual investors. This will therefore need investment and wealth managers to be able to demonstrate that they have up-to-date information about their customers. The impact of this legislation may result in industry firms increasing their rates of reunification in advance of the implementation of the recommendations in this report.

## POTENTIAL VALUE OF DORMANT ASSETS

- 3.64 Total funds under management in UK-domiciled funds are £978bn.<sup>19</sup> Retail investors will directly or ultimately own many of these non-cash assets and there will also be cash balances, such as uncashed redemption proceeds or dividends, associated with these funds. Some of these assets will be dormant, and if not able to be reunited with their owners, could be transferred to an expanded scheme.

### Extrapolation methodology

- 3.65 The Commission's attempt to survey the industry to produce a dormant assets value estimate via the call for evidence was a complex process due to the wide-ranging nature of the investment and wealth management industry in terms of activity, types of product and the large number of industry participants. The process was further complicated by the lack of industry agreement on a definition of dormancy, or standardised data available to the Commission. It was only possible to sample a subset of the industry for the purposes of estimating a value.
- 3.66 The Commission used the call for evidence to ask for information relating to cash and non-cash balances, as they pertain to UK retail clients. Some industry participants also provided supplementary data. These two sources of data were used as a basis to extrapolate an industry-wide estimate of the value of potential dormant assets.
- 3.67 Dormant cash asset data, in terms of both value and number of clients, was available from many respondents and generally represented firms' gone-aways.
- 3.68 However, few respondents provided quantum regarding the underlying, non-cash dormant funds under management, which give rise to the gone-away cash elements. Firms are not currently required to report on dormant funds under management, although some could choose to do so under CASS rules in their monthly Client Money and Assets Return (CMAR). Through supplementary data enquiries, the Commission was able to gather limited data on dormant funds under management, but the definition of dormancy used tended to be inconsistent. As the best data available, the Commission has extrapolated an industry estimate from this.

18 EU directive 2014/65/EU

19 Investment Association, Monthly Statistics, September 2016

- 3.69 Both the cash and non-cash asset extrapolations have been based on a number of assumptions, not least of which is that sample data provided via the call for evidence and supplementary submissions is representative of the levels and values of dormancy within the industry.
- 3.70 With no clear split of the funds under management balances between types of industry participant, the Commission has had to use retail fund sales data to estimate the split of assets by type of industry participant. This flow, rather than balance, breakdown of industry structure has been used as the best available basis for extrapolation. The extrapolation methodology must therefore be caveated as a result of using sales flow data across a period to estimate the structure of the industry at a point in time.

### Potentially dormant assets, prior to attempted reuniting

- 3.71 Based on the data collected via the call for evidence and extrapolated across the industry, the Commission estimates that a value of approximately £2.9bn of potentially dormant assets might currently exist in the industry. This comprises both cash and non-cash elements as follows.

#### Cash

- 3.72 The majority of call for evidence respondents provided data on dormant cash as it may already be reported to the FCA. Dormant cash levels provided by respondents ranged from 0.001-0.2% of respondents' UK retail funds under management. By extrapolating this to the industry, the Commission estimates that dormant cash assets in the industry may be valued at approximately £15m.

#### Non-cash

- 3.73 Data on dormant funds under management was less readily available than for cash elements. It is important to reiterate that there is currently no standard industry practice for defining dormancy. The Commission therefore asked firms to provide the value of funds under management associated with clients who had dormant cash balances. A number of firms cooperated in providing this estimate.

#### Direct sales to retail clients by fund managers

- 3.74 The highest rates of dormant funds under management appear to be in the relatively small segment of funds sold directly to retail clients by fund managers. This typically represents legacy business dating from when fund managers used direct sales as a major channel to market, often via newspaper advertisements. The data received by the Commission suggests that an average of 3.1% of funds under management in this segment might be dormant. Extrapolating this percentage provides a figure of approximately £670m of potentially dormant funds under management at fund managers.

This figure must be treated with caution as the range was wide, from 1.3-4.5% of funds under management, and some key industry participants did not provide data.

#### Intermediaries and other direct sales

- 3.75 Other parts of the industry appear to have significantly lower rates of dormant assets, perhaps as a result of either a higher degree of product-dependent ongoing customer contact, newer books of business with more accurate customer contact information, or operating platforms with more modern technological capabilities. These other channels include platform firms, banks selling Individual Savings Accounts (ISAs), and other financial intermediaries such as Independent Financial Advisers, wealth managers and private banks.
- 3.76 The Commission received very limited data from these other industry participants, making the task of extrapolation less accurate. However, using the responses received, the Commission estimates that approximately 0.2% of funds under management could be dormant in the remainder of the industry. As this represents the bulk of the industry, even modest rates of dormancy would produce a high aggregate value of potentially dormant assets. The overall industry calculation regarding the value of potentially dormant assets is therefore particularly sensitive to assumptions around dormancy rates at these other industry participants. The Commission's extrapolation results in an estimate of £2.2bn of further potentially dormant funds under management from other industry participants. The data limitation means that this figure must be treated with even more caution than the extrapolation arising from the fund managers' data.
- 3.77 Recognising the limitations of the extrapolation methodology, the Commission estimates that there could be approximately £2.9bn of potentially dormant assets in the investment and wealth management industry. This highlights the need for further industry efforts to reunify dormant assets with beneficial owners.

### Effect of reuniting efforts on the value of potentially dormant assets

- 3.78 It is critical to recognise that firms currently employ a widely varying range of processes to reunite potentially dormant assets with beneficial owners and that the Commission is seeking to standardise these efforts.
- 3.79 The actual value of truly dormant assets which could be transferred to an expanded scheme is therefore ultimately dependent upon not only the size of the pool of potentially dormant assets per paragraph 3.77, but also on firms' effectiveness in tracing beneficial owners and reuniting them with their assets prior to any transfer. An increase in expended efforts to reunite should be a clear future priority for the industry.
- 3.80 The Commission's discussions with specialist tracing agents indicate that as many as 95% of gone-away beneficial owners could be traced.



However, the rate for successfully reuniting beneficial owners with gone-away assets could be significantly lower, at close to 50%. Perhaps counter-intuitively, it is significantly more difficult to reunite beneficial owners with assets than it is to find the beneficial owner in the first place.

- 3.81 For the sake of prudence, given the likely publicity around a surge in efforts to reunite beneficial owners as part of an expanded scheme, the Commission has assumed that the success rate in reuniting is 75%. If this assumption proves correct, over £700m of the value in paragraph 3.77 could potentially be available for transfer to an expanded scheme, as illustrated in Figure 3.2.

**Figure 3.2 – Estimated dormant assets for transfer to an expanded scheme, investment and wealth management industry**

	Direct via fund managers	All intermediaries and other direct sales	Total value / blended rate
Estimated value of industry Funds under Management (FuM)	£21bn	£957bn	£978bn
Estimated industry split	2%	98%	100%
Potentially dormant cash assets as % of FuM	0.08%	0.004%	<b>0.006%</b>
Potentially dormant non-cash assets as % of FuM	3.1%	0.22%	<b>0.29%</b>
Total potentially dormant assets, pre reuniting activity	£671m	£2,188m	<b>£2,859m</b>
Assumed pre-transfer reuniting success rate	75%		
Total estimated dormant industry assets potentially available to an expanded scheme	<b>£715m</b>		

NB: figures in the table are rounded for presentation purposes and will not recalculate exactly.

- 3.82 Further possible restrictions on the value of dormant assets potentially available for transfer to an expanded scheme may come from the effect of tax and trust structures. This is further explained in paragraphs 3.85-3.91.
- 3.83 In advance of the Commission making this value estimation for the industry, pre-existing sources of an industry dormant assets estimate were sought. As alluded to in paragraph 3.68, the Commission is aware that some firms report figures regarding potentially dormant cash assets that they hold to the FCA in their monthly CMAR. Firms are also able to use their CMAR to report non-cash dormant balances on a free-text basis. However, the FCA has not shared any of this data with the Commission, even on an aggregated and non-attributable basis, and it has therefore proven difficult to benchmark the Commission's estimate.

## CHALLENGES AND OPPORTUNITIES

- 3.84 As with all such proposals, the Commission's recommendations regarding ongoing practice and an expanded scheme present challenges, but also opportunities, for firms. This section illustrates some of these.

### Challenges

#### Tax efficient structures

- 3.85 When considering both the valuation of assets within the industry and their potential transfer to an expanded scheme, it is important to recognise that a further layer of complexity may exist due to the existence of tax wrappers. Collective investments are often held within tax wrappers, and the retail clients contemplated by the Commission often invest via a tax wrapper such as an ISA or SIPP. This results in the wrapper provider maintaining the investor-facing relationship and introducing a further level in the relationship chain that may need to be unwound to identify dormancy.
- 3.86 The proportion of directly held UK-domiciled funds held within tax wrappers was not available from industry participants via the call for evidence. However, trade association estimates are that the proportion is significant, with approximately two-thirds of such funds held within tax wrappers, of which 15% is estimated to consist of ISAs.
- 3.87 The Commission believes that the tax-wrapped status of such assets is not sufficiently challenging that they should not be part of an expanded scheme. However, their ultimate inclusion in an expanded scheme will depend upon the tax treatment by HMRC, in the event of reclaim, reflecting similar principles to those adopted by HMRC in respect of bank and building society accounts. This is discussed further in Chapter 5. If treatment is more punitive than tax neutral, and applied by HMRC to Stocks & Shares ISAs, SIPPs, or any other tax-wrapped product, the Commission could not recommend that such wrapped products be in scope, because transferred beneficial owners would be placed in a less favourable position than would be the case had voluntary transfer into the expanded scheme not occurred.
- 3.88 HMRC has indicatively noted that, as for the Cash ISAs included within the existing scheme, their preference would be for the benefit of a tax wrapper to survive a transfer and potential subsequent reclaim. If this preference survives implementation, beneficial owners would not be disadvantaged by virtue of their tax-wrapped products being transferred to the scheme. However, it should be stressed that this view was not confirmed to the Commission by HMRC.

### *Trust structures and law*

- 3.89 Particular challenges are associated with including Unit Trusts in an expanded scheme. The Commission is aware that Unit Trust trustees currently have a fiduciary duty and legal obligation to administer the assets within their respective Unit Trusts solely for the purposes specified in the respective trust deeds. Without the ability to modify these deeds centrally, and without agreement from beneficial owners who are by definition unable to be contacted, the trustees might be unwilling or unable to voluntarily transfer assets to an expanded scheme. To address this, the Commission recommends that trustees be discharged from their fiduciary responsibility where they participate in the expanded scheme. This is discussed in further detail in Chapter 6.
- 3.90 Like Unit Trusts, SIPPs have a similar challenge in the form of the SIPP trustee. Ownership of SIPP assets may sit with the customer in an individual trust, although in practice, most SIPPs have the provider as the SIPP trustee.
- 3.91 The participation of such trust structures in the expanded scheme would likely see greater uptake had the Commission recommended a mandatory approach to participation. However, it is hoped all industry parties will see the societal and administrative benefits of the expanded scheme, and that trustees can see past the challenges posed by voluntary participation.

### *Product management fees*

- 3.92 A number of products within the industry are structured such that firms are paid a monthly or periodic management fee in exchange for their management function. This fee is funded on an asset-by-asset basis from the value of each holding but, it should be noted, will have been consented to by the investor when they originally purchased the product. A fee structure of this type brings two challenges.
- 3.93 First, the ability for firms to continue to draw fees in perpetuity could be a disincentive to undertake tracing and reuniting activity as on being reunited with their asset the beneficial owner might withdraw it, thereby depriving the firm of the future revenue stream. Having said that, there is no solid evidence that the relatively low levels of reuniting activity in the industry are caused by the existence of the management fee structure.
- 3.94 Second, this fee structure could be a disincentive for firms to voluntarily participate in an expanded scheme. Again it would result in the loss of fees as the asset that generated the fees will have been transferred to the scheme.
- 3.95 Overcoming such potential disincentives represents a major challenge for those implementing the Commission's recommendations over the coming years.
- 3.96 Despite the preceding paragraphs, it has been represented to the Commission in the course of its work that in reality the aggregate revenue stream for firms from potentially dormant assets that accrue management fees, is relatively immaterial to most of those firms.

Notwithstanding such immateriality, the Commission considers that current conflicting motivations resulting from fee structures may present a challenge to voluntary participation levels in an expanded scheme.

### *The fragmented nature of the industry*

- 3.97 As described above, the investment and wealth management industry is highly complicated, with a large number of diverse products and participants. Not only has it therefore been impossible for the Commission to engage with all parties via the call for evidence and the industry working group, but it will also be difficult to fully accommodate all parties' opinions in the lead up to the implementation of the Commission's recommendations.
- 3.98 The Commission has engaged with a large number of the industry's representative bodies and encourages all firms to maintain contact with their representative body, so that their views may be reflected during implementation over the coming years.
- 3.99 As discussed in the valuation section of this chapter, the disparate nature of the industry also presented the Commission with methodological difficulties in extrapolating data to arrive at an industry valuation. The estimates of dormancy in the industry should be viewed with this caveat in mind. The industry may be accordingly minded to work towards some standardisation of data to facilitate a more accurate future estimate of dormant asset value in order to prioritise efforts to address product dormancy.

## **Opportunities**

### *Improving knowledge of customers*

- 3.100 The creation of an expanded scheme would present firms with an opportunity to catalyse their efforts at finding lost customers. A high proportion of these customers may be found through tracing and reunification efforts. Balances may be transferred away from the firm if they are unable to reignite contact but crucially, those beneficial owners have a right to reclaim in perpetuity, thereby potentially retaining an ongoing customer relationship.
- 3.101 Such efforts will increase firms' knowledge of their customer base, particularly with regard to older products. This is very much in line with the spirit of the industry's and regulator's principles around 'knowing your customer'.
- 3.102 Reuniting beneficial owners with lost assets by re-establishing contact may also provide firms with the opportunity to discuss the appropriateness of a product for its beneficial owner. This has the potential to improve investment product appropriateness on an individual customer basis, as well as facilitating firms to deliver better services to those customers, and ultimately drive a greater degree of customer loyalty.

### *Enhancing the industry's reputation*

- 3.103 The Commission's report is likely to highlight to the general public that there are potentially significant sums of money within financial services firms which those firms are unable to return to their proper beneficial owners. On its own, this could be a negative story for the affected industries and individual firms, which may be amplified following the recent FCA study<sup>20</sup> that identified a lack of awareness on the part of customers regarding levied management fees.
- 3.104 The banks involved in the current scheme positively publicised their participation, and the Commission hopes that the wider financial services sector grasp this chance to enhance their reputation with customers. With dormancy identified as a widespread issue, industry parties now have the opportunity to proactively address matters and advocate for the adoption of an expanded scheme.

### *Reducing the burden of legacy business*

- 3.105 Potential dormancy may be more likely to occur in legacy products or those which are no longer core to a firm's ongoing business model. This creates a potential difficulty for firms as they cannot necessarily transition away from books of business if they contain customers or beneficial owners whom they cannot contact.
- 3.106 One of the reasons firms may seek to participate in an expanded scheme is that legacy or non-core business regularly imposes a disproportionately large administrative burden. In combination with efforts to reunite beneficial owners, by participating in the expanded scheme, firms may therefore be able to reduce the drag on their internal administrative functions. As well as being an opportunity for the firm in terms of their cost base, it may also facilitate any cost benefit being passed to customers.

### *Improving outcomes*

- 3.107 Within the current industry frameworks, there is little incentive to improve procedures to minimise the number of customers who, in the fullness of time, may become dormant or unable to be reunited with their assets. The marginal impact of an extra dormant customer for firms is very low.
- 3.108 However, the introduction of the expanded scheme provides firms with an opportunity to draw a line in the sand regarding dormancy levels, and may facilitate the introduction of more efficient procedures to produce less operational drag on firms as a result of reduced aggregate levels of dormant beneficial owners.

<sup>20</sup> FCA, Asset Management Market Study: interim report, November 2016

# Chapter 4

# Securities

## SUMMARY

The securities market can be broadly categorised into debt securities (e.g. bonds), equity securities (e.g. shares) and derivatives contracts (e.g. futures). While government bonds and derivatives are held almost exclusively by corporate and institutional investors, individual investors account for some 12% of holdings of UK-listed shares (held via registrars or nominee accounts), as well as a proportion of corporate bonds (mostly held via pooled investment vehicles). Where individuals lose contact with firms holding their assets, a proportion of these assets, as well as the returns on them – the dividends and proceeds on the shares, and the coupons on the bonds – will become dormant.

While the securities industry lacks a standard definition for dormancy, there are various processes, according to asset type, for dealing with dormancy at present:

- Dividends: if left unclaimed for 12 years, typically flow back into the funds of the issuing company;
- Proceeds from corporate actions (e.g. takeovers): if shareholders do not respond for 12 years, unclaimed shares are sold and the proceeds paid to the Supreme Court (though the right to reclaim is retained);
- Shares: here there is no process, the underlying shares remain with the registrar in the name of the investor, and the funds with the relevant company; and
- Bonds: unpaid interest payments and repayments to lenders at maturity often sit on the company's accounts as pending payments until, after six years, typically the payment obligations are cancelled.

The result of this is that at present, in the bulk of cases, where individuals fail to keep up with their securities, it is the issuing companies who benefit, either through reversing debt, reabsorbing dividends, or locking up share capital. It is the belief of the Commission however that this money, where it cannot be reunited with individuals, should be used instead for the benefit of good causes.

## DEFINITION OF DORMANCY

A robust definition of dormancy will be required so that firms can identify dormant assets, and transfer them accordingly to an expanded scheme or to alternative charitable causes. This definition requires further work, and should be determined in the light of the decision regarding restitution values (see Chapter 5), and with the input of firms, registrars and the Financial Reporting Council.

For unclaimed dividends and proceeds, which have clear cash values, the Commission believes the currently accepted 12-year period may be appropriate. For the more complex assets; shareholdings; bondholdings; and coupon payments, the Commission considers that adopting 12 years, within a universal understanding of dormancy, can serve as a sensible starting point, although further work to define dormancy may result in a longer period being adopted.

## TRACING AND REUNIFICATION

There is currently no consistent approach. In line with the principle of ensuring assets are reunited with their owners where possible, the Commission recommends that industry participants work together to develop standardised procedures for tracing and reunification that can be applied equally to all securities.

## CONCLUSIONS

The Commission recognises that further work is necessary in this area but believes that all unclaimed securities, dividend payments, proceeds from corporate actions and coupon payments could be included in an expanded scheme.

For firms, participation in the scheme is essentially an opportunity to enhance their corporate reputation by ensuring that dormant assets should be used for the benefit of good causes rather than flowing back into company funds.

## OVERVIEW OF THE UK SECURITIES INDUSTRY

- 4.1 The Office for National Statistics estimates that 12% (£206bn by value) of UK-listed shares are held by individual shareholders, the remaining 88% being held by institutions, either for their own purposes or on behalf of individual shareholders.<sup>1</sup>
- 4.2 Of that £206bn, approximately 73% (£150bn) is held in the name of individual shareholders, while the remaining 27% (£56bn) is held on behalf of individuals via nominee accounts.
- 4.3 Data for bondholdings does not seem to be readily available, and the Commission was not able to ascertain what proportion of bonds in issue are held in the name of individual investors.
- 4.4 Outstanding bond issues in the UK bond markets are generally almost as high as equity issuance. The Bank of England estimated for the year ended 2010 that UK corporate bond issuance stood at £338bn.<sup>2</sup> However, most listed corporate bonds are held in pooled vehicles and the level of directly held listed bonds is expected to be low. The Commission has not received any indication of the value of unlisted bonds that may be directly held, and it is anticipated that the overall value of unlisted bonds will be significantly less than that for publicly listed bonds, although this segment is likely to have a higher level of direct holdings. As such, the Commission has not considered bondholdings any further.
- 4.5 However, the Commission considers that a proportion of the shares and dividends that are either held directly by, or on behalf of, individuals are likely to be dormant, and that these assets should be included within the scope of an expanded scheme.

## WHY ARE THERE DORMANT ASSETS IN THE SECTOR?

- 4.6 When an individual wants to hold listed shares in a company directly, they do so via a share registrar. There are three main share registrars in the UK: Capita, ComputerShare and Equiniti. Listed bonds are held in a similar manner, but with central securities depositories. Unlisted securities are typically held by the company itself on a register – an obligation that is imposed by statute.
- 4.7 These share registrars maintain records of the individuals for whom they hold shares and the firms in which the individuals have invested. Therefore, as is the case for the other industries, potentially dormant shareholder assets arise principally because the share registrars are not informed when an individual either moves address or dies.
- 4.8 When an individual holds shares in a company via a stockbroker or bank, they typically do so via a nominee account.

In this case, the intermediary maintains the records of the individual shareholdings and cash entitlements.

- 4.9 When an individual holds bonds, this is typically via a pooled investment structure such as a Unit Trust or an Open-Ended Investment Company (see Chapter 3 for more details on these products). In more limited cases, individuals may have direct bondholdings, particularly in unlisted or mini-bonds, which are retail-focused investment bonds. Potentially dormant bond assets will only arise in respect of direct individual bondholdings and in these cases this will be principally because the company is not informed when an individual either moves address or dies.

## ASSETS IN SCOPE OF AN EXPANDED DORMANT ASSETS SCHEME

- 4.10 In respect of shareholdings held directly by individuals and via nominee accounts there are two forms of potentially dormant assets:
- Unclaimed dividends and proceeds from corporate actions related to shareholdings (e.g. demutualisation, merger, acquisition, etc); and
  - The shares themselves.
- Unclaimed dividends and proceeds from corporate actions are typically held in cash form while any dormant shares are typically held in their original non-cash form.
- 4.11 In respect of bondholdings held directly by individuals, there are two forms of potentially dormant assets:
- Unclaimed coupon payments; and
  - The bonds themselves.
- Unclaimed coupon payments and bonds that have reached maturity are typically held in cash form.

## CURRENT TREATMENT OF DORMANT AMOUNTS

### Dividends

- 4.12 Unclaimed dividends are retained for a period of time by the company that declared them. The strict legal position is that, as per the Limitation Act 1980, individual shareholders have six years to claim any dividends due to them. However, the Model Articles in the Companies Act 2006, which many firms use as a template for their own Articles of Association (Articles), provide for the retention by firms of dividends that remain unclaimed for 12 years.
- 4.13 Firms that follow these Model Articles are thus free to use unclaimed dividends in the manner set out in their Articles after a period of 12 years. Firms typically release unclaimed dividends back to themselves for use by the company.

<sup>1</sup> <https://www.ons.gov.uk/economy/investmentspensionsandtrusts/bulletins/ownershipofukquotedshares/2015-09-02>

<sup>2</sup> Bank of England, Quarterly Bulletin 2011 Q4, Volume 51 No. 4

- 4.14 There has recently been a movement by some firms to use unclaimed dividends for charitable purposes, although this is not a widespread practice at present.

### Corporate actions

- 4.15 Following a corporate action, the details of shareholders who do not agree to the relevant corporate action are held on a special register. In the case of a takeover, the shares of the company that has been acquired must be exchanged for shares of the purchasing company. However, this cannot be done without the consent of the relevant shareholders.
- 4.16 A company's Articles will set out the period within which this exchange should occur. Again, the Model Articles suggest a time period of 12 years, and most firms therefore use this period. After the expiration of the relevant period, any unclaimed shares are sold and the proceeds paid to the Accountant General of the Supreme Court.
- 4.17 Individuals who subsequently re-engage with the firms concerned can reclaim their shareholding at any point, although the right to reclaim dividends, from either the company or the Court, will typically be lost after 12 years.

### Shares

- 4.18 Where contact is lost with a shareholder, either through an unnotified change of address or death, their shares cannot be sold without their instruction. There is no industry definition of dormancy in respect of shareholdings, and no accepted process for dealing with shareholdings where firms believe that dormancy has arisen because a shareholder has either moved or died.
- 4.19 Registrars typically identify that they have lost contact with a shareholder when postal communications are returned as gone-away or dividends are repeatedly uncashed over a period of time. The shares remain registered in the name of the investor until the registrar is advised otherwise.
- 4.20 One way of dealing with the issue of dormant shareholdings would be for the registrars to transfer the title to the shares to the reclaim fund. The reclaim fund could then either sell the shares or retain them and receive what would otherwise be dormant dividend payments.

### Bonds

- 4.21 The Commission is not aware of any systematic attempts to address dormancy in the bond markets. This is likely to be due to the fact that unpaid interest payments or repayments to lenders on maturity will simply sit on the relevant company's accounts pending payment. After six years, these pending payments are typically reversed and the payment obligations cancelled.

## FINDING A COMMON DEFINITION OF DORMANCY

- 4.22 The Commission considers that unclaimed dividends, coupon payments, corporate action proceeds, shares and bonds, should be considered as within scope of an expanded scheme.
- 4.23 The Commission considers that these dormant assets should be transferred to an expanded dormant assets scheme, or to an alternative charitable cause rather than to the funds of the issuing company.
- 4.24 To facilitate this, it is vital that a robust definition of dormancy for unclaimed dividends, coupon payments, corporate action proceeds, shares and bonds is developed so that firms have a consistent basis against which to assess dormancy. The final definition of dormancy, and of any applicable time periods, will be determined in light of the decision taken in respect of applicable reclaim values (see Recommendation 5.29), and the Commission considers that it would be helpful for firms to work with the Financial Reporting Council and registrars to produce standard definitions of dormancy.
- 4.25 For unclaimed dividends and proceeds from corporate actions, the currently accepted period of 12 years before assets are transferred to company funds could be used as a starting point to determine a definition of dormancy.
- 4.26 In respect of shareholdings, bondholdings and coupon payments, there is no currently accepted period from which to work and the non-cash nature of the assets makes the question more complex. The Commission considers that adopting the current 12-year period within a universal definition of dormancy is a sensible starting point, while recognising that the decision in respect of reclaim values may justify a longer period being adopted.

#### Recommendation 4.1

Registrars and depositaries should work with firms to provide an estimate of the value of unclaimed dividends, proceeds from corporate actions, dormant shareholdings, coupon payments and bondholdings that are held either directly by, or on behalf of, investors in their own name.

## TRACING AND REUNIFICATION

- 4.27 There does not appear to be a consistent effort or approach to tracing dormant securities holdings, dividend and coupon payments, and reuniting people with these. The Commission's recommendations 5.13-5.15 on tracing apply equally to securities holdings, dividend and coupon payments.
- 4.28 The objective in seeking to ensure a consistent approach to tracing and reunification is to align with the Commission's principle of first trying to ensure that beneficial owners are reunited with their assets. Thereafter, if assets remain dormant, the aim is to ensure that they are used for the benefit of society via an expanded scheme.

## POTENTIAL VALUE OF DORMANT ASSETS

- 4.29 The Commission was not able to accurately estimate the potential value of unclaimed dividends in the industry due to the limited amount of data that it was possible to obtain. However, an estimate may be possible if data regarding the level of unclaimed dividends can be obtained from registrars, and from the Accountant General of the Supreme Court on the level of unclaimed corporate action payments.
- 4.30 The level of dormant shareholdings is considerably more difficult to estimate as there is no recognised definition of dormancy. Once a definition of dormancy has been agreed, it should be possible to establish more accurately what level of unclaimed dividends, unclaimed corporate action payments and dormant shareholdings potentially exists.
- 4.31 In the meantime, the Commission has conducted a simple estimate of the potential level of dormant shares and therefore dividend payments that might be available, based on preliminary data it has received from the Registrar Group of the Institute of Chartered Secretaries and Administrators, as set out below. The Commission caveats this estimate by pointing out the extremely small size of the sample and the wide range of the data provided, meaning that it is not possible to make robust estimates for the industry.
- 4.32 Following discussions with the registrars, the Commission believes that it may be reasonable to assume that 0.1-0.3% of the £150bn of shares registered in the name of individual shareholders may be dormant. The value of these dormant shareholdings would thus be in the range of £150-450m. There are also likely to be dormant shareholdings in nominee accounts. Assuming that the dormant shareholdings registered in the names of individuals had an average dividend yield of 3.5% and a 12-year accumulation period, there would be approximately a further £60-190m of dormant dividends, plus an additional element of other dormant cash balances. Assuming that 75% of the £210-640m (dividends plus shareholdings) could be traced and reunited, as per the assumptions in Chapter 3 paragraph 3.81, this would result in approximately £50-150m being potentially available for transfer to an expanded scheme.
- 4.33 The Commission expects that there are dormant bondholdings but, given that it is likely that individuals who hold bonds will have a professional financial adviser to help them manage their investments, the Commission anticipates that the value of dormant bonds held directly by individuals is likely to be very small.

## WHY FIRMS SHOULD JOIN AN EXPANDED SCHEME

- 4.34 At present, firms are in effect able to benefit from a failure by investors to keep the share registrars informed of any change in their circumstances because unclaimed dividends can ultimately flow back to the issuing company for their own use.

- 4.35 As the behaviour of business comes under increasingly close scrutiny, there is an opportunity for firms who chose to participate in the expanded scheme to enhance their corporate reputation.
- 4.36 The question of whether firms should participate in the scheme is essentially one of business ethics. The Commission believes that dormant assets that would otherwise have flowed to individuals should be used for the benefit of good causes rather than flowing back into company funds.
- 4.37 Dividends are declared from the profits of a firm as the return on capital provided by investors, and it does not seem appropriate to the Commission that these funds should flow back to the company purely because they have not been able to maintain contact with the registered shareholder.
- 4.38 Equally, it does not seem appropriate to the Commission to allow capital in the form of dormant shareholdings to be locked up indefinitely in company funds.

## CONCLUSION

- 4.39 The Commission believes that unclaimed securities, dividend payments, proceeds from corporate actions and coupon payments should all be used for good causes rather than either being redirected into company funds or being left unused.
- 4.40 The Commission considers that firms should be free to decide whether to direct such dormant assets to the reclaim fund, in which case the liability for reclaim of the transferred asset would also transfer to the reclaim fund, or to direct such dormant assets directly to good causes, in which case any liability for reclaim would remain with the transferor firm.

### Recommendation 4.2

The Government should conduct further work to ascertain whether obstacles exist to the inclusion of unclaimed dividends, proceeds from corporate actions, dormant shareholdings, coupon payments and bondholdings within an expanded dormant assets scheme, how these might be overcome, and thus whether such assets should be included within the scope of an expanded scheme.

### Recommendation 4.3

Firms should amend their Articles where necessary to facilitate the provision of unclaimed dividend payments and dormant shareholdings to good causes after 12 years, be that via the reclaim fund or otherwise.



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Annexes

# Chapter 5

# Process of administering the dormant assets scheme

**PART A: RECOMMENDATIONS TO IMPROVE  
THE CURRENT RECLAIM FUND MODEL**

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**PART B: ADDITIONAL RECOMMENDATIONS  
TO ENABLE THE RECLAIM FUND MODEL TO  
COPE WITH AN EXPANDED SCHEME**

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## SUMMARY: CHAPTER 5, PART A: RECOMMENDATIONS TO IMPROVE THE CURRENT RECLAIM FUND MODEL

Reclaim Fund Ltd (RFL) was established in 2011 to administer the mechanism of receiving dormant assets, investing them and ultimately distributing value that is not reclaimed for the benefit of good causes.

A reclaim fund must reserve for future reclaims and pay the costs of its activities out of the dormant assets it receives. It is unable to trade for profit, nor to make any distributions to shareholders.

It was initially estimated that approximately £400m of dormant balances would be transferred by banks and building societies to RFL. In fact, since inception in 2011, a total of £980m (unaudited) has been transferred to RFL until the end of December 2016. Of that, £50m (unaudited) has been paid to reclaimants, and £362m (unaudited) has been distributed to Big Lottery Fund (BLF) for onward distribution to good causes.

RFL was first established with the support of the Co-operative Group, and has deliberately become increasingly operationally independent. The Commission would like to thank the Co-operative Group for its work in forming the reclaim fund and for its support to RFL, particularly in the early years.

RFL is governed by its Board. It is important that the Board of RFL is able to make the difficult judgement calls around such matters as risk appetite and the balancing of reserving for reclaims against the desire to distribute surplus funds to good causes.

The existence of influence from any parent entity could potentially represent a conflict of interest and the Commission recommends that the time is right for RFL to be reconstituted and that the Government should undertake a review of the most appropriate future structure, bearing in mind the preliminary work done by the Commission.

The Commission stresses it finds RFL's governance, both from its Board and the Co-operative Group, to be appropriate for the years of initial operation.

## OPERATIONS

As dormant assets are transferred into the fund, RFL's key decisions concern how much to reserve for possible future reclaims and how much to distribute to BLF for onwards distribution to good causes. This is a difficult balance to strike.

When RFL was created, dormancy was being tackled for the first time in the UK, and there was no history on which to model reclaim levels. Bearing 100% of the risk, RFL sensibly took a very prudent approach. Five years on, and now with some data in hand, while 40% of incoming transfers are reserved for reclaim, reclaim levels to date have only been approximately 5% of the value of transfers. Broadly, the balance of 55% is distributed over a number of years and this means that the delayed amounts effectively act as additional reclaim reserves.

RFL has been very prudent in its reserving policy. While this was understandable at RFL's outset because there was no experience of reclaim, the Commission supports RFL's current updating of its reclaim models and would expect a significant amount which has not yet been released to be distributed in 2017. The Commission recommends RFL review its modelling and reserving policy every two years, with a mind to achieving the best balance of reserving and distribution.

## IMPROVED TRANSPARENCY IN THE SECTOR

To understand how successful the current scheme is, there are two critical questions: are firms undertaking best efforts to reunite dormant assets with their owners; and, given voluntary participation, what proportion of the dormant assets held by firms are transferred to the scheme? On both counts, the current opacity of information makes it difficult to reach a conclusion.

The Commission believes that increased transparency will benefit society, and accordingly recommends that the concept of 'participate and explain' be applied. This means that all firms with potentially dormant assets falling within scope of an expanded scheme should be required to issue a statement within their annual reports explaining, for each asset category:

- the aggregate value of dormant assets held;
- the number of individuals affected; and
- the extent of the firm's participation in the scheme or the reasons for not participating.

The Commission appreciates this may require significant changes within firms, and so recommends adoption be achieved within three years from the date of this report.

The Commission has consulted with key parties. Fundamental to this have been RFL and the Co-operative Group. The Commission would like to thank both RFL and the Co-operative Group, and their staff, for their time and effort spent responding to the Commission's queries.

## STRUCTURE

5.1 Under the Dormant Bank and Building Society Accounts Act 2008 (the Act), a reclaim fund has a number of key objectives, which are added to by further principles which arose from the relevant HM Treasury consultation papers and Parliamentary debates at the time of forming the first reclaim fund. From these key objectives and principles, a reclaim fund has two headline roles: ensuring that future reclaims can be paid; and distributing money for the benefit of good causes. The manner in which a reclaim fund is structured and owned is critical as it can influence these two headline roles.

### Current structure

5.2 Following the introduction of the Act, Reclaim Fund Ltd (RFL) was set up by the Co-operative Banking Group Limited (CBG), a 100% owned subsidiary of the Co-operative Group,<sup>1</sup> to administer the process of the dormant assets scheme. For the sake of clarity, CBG also houses the Co-operative Group's 20% shareholding in Co-operative Bank plc, having disposed of 80% of the shares in 2013.

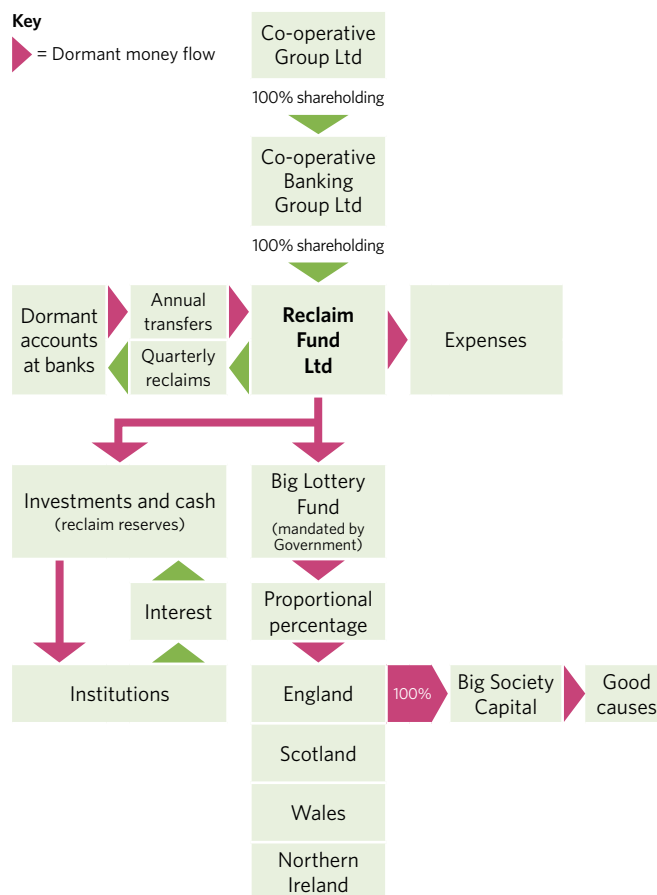
5.3 The design and establishment of RFL involved consultation with a number of stakeholders including HM Treasury, the Financial Services Authority (FSA), the British Bankers' Association, and the Building Societies Association dormant accounts working group. RFL was established with restricted objectives under the Act and is authorised and regulated by the Financial Conduct Authority (FCA), formerly the FSA.

5.4 The Commission believes the Co-operative Group should be commended and thanked for establishing RFL in 2011, which they originally undertook using their own financial resources and people. The Commission recognises that the initial support and backing provided by the Co-operative Group was critical to RFL making a successful start to the process of establishing the mechanism and commencing the flow of funds to good causes.

5.5 On its inception, RFL was heavily dependent upon support from its parent to enable it to carry out its day-to-day operations. This support included financial and HR services and shared premises. Over the past few years, as part of an agreed strategy, RFL has increasingly become operationally independent from its parent group, and today there are no significant operational dependencies.

5.6 RFL's position within the Co-operative Group and RFL's current operational flows, are illustrated in Figure 5.1.

Figure 5.1 – Operational flows relating to RFL



### Corporate ownership

5.7 As set out in the Act, RFL has specific provisions in its Articles of Association (Articles)<sup>2</sup>, governing and limiting its activities. These do not include the duty to maximise value for its shareholder and indeed it is not possible under these Articles for RFL to confer any benefit to its shareholder. The directors of RFL have a statutory duty to implement these provisions and to act in the interests of RFL. However, it is arguable that the directors of RFL also have responsibilities towards its sole shareholder.

5.8 In practice, the sole shareholder does have influence over RFL. In RFL's early years, this influence arose from the desire to ensure there was good commercial oversight of the establishment and ongoing operations of RFL, and influence continues to be exercised in multiple ways, including the ability of the sole shareholder to appoint the chair, be consulted on director appointments to the Board, and regular reporting requirements. The Commission acknowledges that this influence was appropriate, particularly in the reclaim fund's early years, but nevertheless today, and in the future, the sole shareholder influences the risk appetite and distribution policy of RFL.

<sup>1</sup> Co-operative Group Limited and Co-operative Banking Group Limited, Subsidiary List, 7 December 2016

<sup>2</sup> RFL, Articles of Association, 10 March 2014

The Commission believes that given the restricted nature of the activities of RFL, its structure going forwards should reinforce the position of the directors as being the ultimate governors of RFL's activities. For the avoidance of doubt, the Commission wishes to confirm that it believes the Co-operative Group and the directors of RFL have acted entirely properly in relation to RFL.

- 5.9 In practice, the Commission does not believe the influence of the parent group has negatively impacted the decisions of the RFL Board or the outcomes achieved by RFL in the current scheme. However, it is currently possible for further parental influence to be exerted, especially with regard to the composition of the RFL Board, and the Commission believes this potential risk should be reduced. Board composition is discussed in more detail in paragraphs 5.23–5.29. In an expanded scheme, as discussed in Part B of this chapter, broadening the range of experiences of reclaim fund directors may be especially relevant when considering a greatly diversified range of assets and the future reclaim fund distribution policy.
- 5.10 The Commission has three principal concerns regarding the current structure of RFL, all of which stem from the fact that it is owned by a commercial entity.
- 5.11 The first concern is that there may be additional commercial prudence which could constitute a conflict of objectives between the Boards of the parent and of RFL. The former is tasked with maximising the return to its members and would want a continuation of minimal risk to arise from RFL. The RFL Board, however, is tasked with making a balanced judgement regarding the need to meet all future reclaims while also distributing surplus funds for the benefit of good causes.
- 5.12 The second concern is that, because of the line of ownership, there is potentially an association risk to the brand of RFL. The wider public perception of the Co-operative Group may have an impact on the levels of participation in the current scheme, irrespective of the level of esteem in which RFL is held by participants. The reverse may also be true, and there is also a potential brand risk to the Co-operative Group if RFL was to fail.
- 5.13 The third concern is that while RFL was originally formed when the Co-operative Group had a major banking and broader financial services operation, Co-operative Group has since disposed of 80% of it and is thus only a 20% shareholder in Co-operative Bank plc. Therefore, part of the original nexus as to why the Co-operative Group represented a good home for RFL, with the bank's product and systems knowledge, has been broken.
- 5.14 When RFL was launched there were multiple advantages to being part of the Co-operative Group. However RFL is now operationally independent from its parent and no longer requires the support that CBG initially offered. The Commission does not believe that continuing to be part of the Co-operative Group, or indeed of any other corporate structure, is necessarily in the interests of RFL, participants, potential reclaimants or good causes.

From initial discussions, the Co-operative Group and CBG recognise this operational separation, and have expressed that they do not consider RFL to be core to their business.

### Reconstituting RFL

- 5.15 The Commission considered a number of alternative structures for RFL that do not involve private ownership, including a Community Interest Company (CIC), a charity, a company limited by guarantee, an operating company with trust oversight and a public body.

### Community Interest Company

- 5.16 In the circumstances, the Commission believes that a CIC would have no advantages over the current structure.

### Charity

- 5.17 The Commission carefully considered whether it would be appropriate for RFL to register as a charity because there may be some tax advantages to such a structure, which would mean a higher proportion of transferred assets could be released more rapidly for the benefit of good causes. However, the Commission did not consider this to be the best course of action for the following reasons:

- Charitable status would mean the distribution of dormant surpluses could only be used by Big Lottery Fund (BLF), and in England, by Big Society Capital, for charitable purposes. This is not the case today, as not all disbursements by these bodies are made to registered charities; and
- Charitable status would complicate the governance of RFL, introducing an additional regulatory layer and a requirement for the directors of RFL to be unpaid. Given the extent of the governance requirements, both in terms of the expertise needed and the volume of work inherent in managing RFL, it is highly unlikely that the RFL Board could sustainably be staffed by appropriate volunteers in the long term.

### Company limited by guarantee

- 5.18 The Commission assessed whether a company limited by guarantee would be a suitable structure as it may address the challenge presented by the potential influence of the reclaim fund having a corporate parent. Under this structure, ownership is by a member, or cadre of members, and the company need not distribute profits to members if that is disallowed in its Articles. Identifying the appropriate members for a reclaim fund would be challenging. In the view of the Commission, the transferring entities should not be members and the most appropriate member would be a Government entity, therefore enabling the Government to have some influence. However, in this structure, a strong commercially led Board would be important to balance the potential for Government control.

### Operating company with trust oversight

- 5.19 Another alternative structure considered involves the reclaim fund being constituted as an operating company, overseen by a trust. A limited number of trustees may be appointed to this role. However, in the same way as for a company limited by guarantee, the selection of the right trustees is critical and should enable the Government to have some influence. Again, a strong commercially oriented Board would be important.

### Public body

- 5.20 The term 'public body' captures an array of differing entity types, each featuring different characteristics including: funding source; establishment; duration; governance; staffing and reporting. Typically, such structures allow for core influence to come from the Government, for example regarding nominations to the Board. The Commission sees that there are a number of advantages to this structure. However, in order for it to work for a reclaim fund, day-to-day control of the public body must not rest with the Government. Additionally, for this structure to be preferred, it must provide for all commercial oversight to come from its directors who should have a balance of skillsets.
- 5.21 Following the publication of this report, and in consultation with various parties including the existing reclaim fund and its parent, the Government will need to undertake further work, considering a range of factors, to determine the best future reclaim fund structure. Given the unique characteristics of reclaim funds, the Commission would strongly advocate a structure which has considerable commercial expertise and freedom, with minimal external influences, but ultimate Government control.

#### Recommendation 5.1

The existing reclaim fund should become structurally separate from the Co-operative Group and be reconstituted, retaining a strong commercial focus. The Government, in consultation with various parties including the existing reclaim fund and its parent, should undertake a process to determine the best future structure.

## GOVERNANCE

- 5.22 Underpinning the structure of the reclaim fund is its Board, governance processes and internal hierarchy of responsibilities. Achieving the correct governance structure is important because the Board is responsible for taking operational decisions, including the levels of provisions held to meet future reclaims and the level of distribution for the benefit of good causes. While the Board is collectively responsible for promoting the key principles of RFL, it is also tasked with minimising risk exposure, within an agreed risk appetite, to the owners of the reclaim fund.

### The constitution of the current RFL Board

- 5.23 The RFL Board consists of the Chair, the CEO, a senior independent director and five other non-executive directors.
- 5.24 The directors are responsible for appointing new individuals to the Board, with the provisos that there must be at least five directors at any one time, and the majority of the directors on the board are to be independent non-executive directors. However, the RFL Articles<sup>3</sup> also state that the majority shareholder, CBG, should be consulted prior to the appointment of new directors. In addition, the position of Chair is to be selected for the role from the body of non-executive directors – independent at their initial appointment to the Board – by the majority shareholder of RFL.
- 5.25 A previous version of the RFL Articles allowed the majority shareholder to appoint up to two executive directors and four non-executive directors. As a legacy of this, one of the current non-executive directors on the RFL Board is a CBG nominee appointed by the Board and two of the current non-executive directors, including the CBG nominee, have simultaneous positions with another entity within the Co-operative Group.
- 5.26 In the Commission's discussions, it has been made clear by RFL that they consider the Co-operative Group's influence on the decision-making of RFL to have focused on ensuring that RFL decisions do not result in the addition of risk to the Co-operative Group in excess of the risk appetite agreed by the RFL Board and accepted by the Co-operative Group.
- 5.27 However, in the Commission's view, the Co-operative Group has influence on the governance of RFL and, in extremis, potentially significant influence. They select the director that they wish to be Chair and a new director can only be appointed by the Board following reasonable efforts to consult with the shareholder. The Co-operative Group can also remove a director in a process outlined in the RFL Articles.
- 5.28 The change in ownership structure per paragraph 5.21 would also bring changes to the current reporting and accountability lines for RFL, although regulation by the FCA will remain. The Commission foresees that such accountability would be to the new shareholder of RFL, although the identity of this shareholder will depend on the specifics of the reconstituted form of the reclaim fund.
- 5.29 Furthermore, the Commission is of the view that in the new structure, ultimately the Government should be responsible for appointing the chair and non-executive directors. It would be appropriate for there to be some level of continuity with the current director group to ensure a smooth transition of corporate memory to the reconstituted reclaim fund.

<sup>3</sup> RFL, Articles of Association, 10 March 2014

**Recommendation 5.2**

The governance of the reclaim fund should provide for the Chair and other directors to be appointed by Government through a process which appropriately reflects the reclaim fund's structure.

**OPERATIONS**

This section addresses a number of aspects which directly impact the ongoing operation of the current scheme.

**Funding and costs**

- 5.30 RFL is entirely self-funded. To this end, the Act ensures that one of the three activities that a reclaim fund may undertake is to pay its expenses from transferred dormant assets, including any investment income earned from the reserves of those transferred dormant assets.
- 5.31 2014 saw RFL physically remove itself from being located within Co-operative Group space. In the same period, RFL enlarged its back-office team to provide its own administrative, financial and HR functions. While this may have changed RFL's administrative costs, it has more importantly also increased its operational independence from its parent group.
- 5.32 In absolute terms, RFL operating costs have risen from an annualised c£1.3m (actual cost incurred in 2011 totalled a little over £1m which only included operations from March) to £2.3m in 2015. These costs include the cost of staffing and directors, shared services and professional fees, and overheads such as regulator and trade association fees and levies, and premises costs.
- 5.33 The major component of the cost base in each of the five years of operation to date has been the cost of personnel. In the past three years (figures only available for this period), personnel costs totalled between 35% and 42% of RFL's annual cost. In addition to the CEO, RFL currently engages eight people in the following roles:
- Head of operations and finance
  - Chief risk officer
  - Finance manager
  - Enterprise risk and compliance manager
  - Business analyst
  - Operations and finance analyst
  - Apprentice
  - Executive PA
- 5.34 The Commission notes that operating costs are a mean of 0.45% of the balance of total provisions across each of the first five years of operation. This may therefore provide some indication of the potential cost of expanding the range of transferred dormant assets should RFL, in its current form, be the preferred mechanism for an expanded scheme.

**Investment**

- 5.35 RFL invests the transferred monies which are provisioned in anticipation of future reclaims. The audited accounts for the year ended 31 December 2015<sup>4</sup> showed that RFL invested both the provision for reclaims and provision for future distributions.
- 5.36 The returns on investments are added to the asset value held by RFL and are therefore used by RFL to pay expenses, meet reclaims, and distribute any surplus for the benefit of good causes. Over the five years of reported operation to date, only in the first year was the level of net investment income (interest income on investments and cash deposits, less interest expense) lower than the level of operating expense, and RFL's total investment income to date has exceeded total operating and set-up costs.

**Current investment strategy**

- 5.37 As at the end of the 2016 financial reporting period, RFL generated an interest return, before interest expenses, of £1.6m from invested capital of £297m. In addition, RFL held investment securities of £272m. This was invested in listed Government, Government agency and corporate securities. In 2016, these securities earned interest of £2.3m.
- 5.38 If it is assumed that the balance of RFL's three reserves (see Figure 5.3 for more detail) accrue linearly during the year, the mean reserve total in 2015 was £520m. This generated a gross interest income of £3.6m, equating to a return of approximately 0.7%. RFL notes in its annual report that it pursues a "strict and cautious investment mandate".<sup>5</sup> This consists of the capital reserve of £74m being invested in fixed income investments, and the other two provisions being held predominantly at the Bank of England in cash deposits.
- 5.39 The Commission believes that, in terms of taking minimum investment risk, the investment policy adopted by RFL until 2016, has been appropriate in the reclaim fund's formative years. Since its inception, the RFL directors have been clear that as custodians of potential reclaimants' money, the investment strategy should seek to minimise the risk of losses. The policy has been agreed by RFL directors and determined and reviewed in line with RFL's requirement to have an appropriate internal capital adequacy assessment process (ICAAP), and with regulatory expectations and other industry investment policy standards.

<sup>4</sup> RFL, Annual Report & Accounts, 2015

<sup>5</sup> RFL, Annual Report & Accounts, 2015

- 5.40 This policy allows RFL's reserves to be held at low risk and in a liquid form. It also allows RFL to react rapidly to pay any spikes in reclaims if they occur, which was particularly useful in the period of uncertainty during which RFL's pattern of operation was becoming established.
- 5.41 Figure 5.2 shows indicative annual RFL interest income returns, in comparison to the respective annual average base rates.<sup>6</sup>

**Figure 5.2 – RFL's achieved annual investment returns**

	RFL investment return*	Average Bank of England base rate <sup>7</sup>
2011**	0.44%	0.5%
2012	0.47%	0.5%
2013	0.72%	0.5%
2014	0.70%	0.5%
2015	0.69%	0.5%

\*It has been assumed that the balance of RFL's three reserves accrue linearly during the year. Therefore, despite the three reserves being fully invested to earn greater than base rate, the figure shows some periods achieving less than this level.

\*\*2011 return does not represent a full calendar year as RFL commenced operation mid-year.

- 5.42 It is clear that RFL's highly prudent strategy has resulted in investment returns generally out-performing the rate for interbank lending. However, this outperformance is not significant and likely to be less than may have been achieved with a less risk-averse investment strategy.

### Future investment strategy

- 5.43 The current scheme has now been in operation for five years. As such, the Commission considers that there is sufficient experience of reclaim activity to modify the investment strategy in order that funds may be invested in instruments that match the likely future flow patterns of reclaim liabilities. This phasing may facilitate higher returns being achieved while ensuring adequate access to liquidity from regular maturities. The Commission understands that this process was started by RFL during 2016, and an element of investments are now held with a mixed maturity duration to match RFL's anticipated need for future liquidity.
- 5.44 At the present time, with low interest rates, it is unlikely that this strategy modification will have a material impact on RFL's income. However, if interest rates increase, this policy could see a significant positive impact on RFL's income stream and, ultimately, the amount potentially available for distribution for the benefit of good causes.

### Recommendation 5.3

While retaining the security of invested funds, the reclaim fund investment strategy should continue to provide for the matching, in length of term, between the maturity dates of investments and the likely forecast levels of future reclaims.

### Reserving

- 5.45 RFL's activities are limited to three broad areas: the payment of reclaims; provision for the payment of reclaims in perpetuity; and distribution of sums, in excess of the provision for reclaims and payment of RFL expenses, for the benefit of good causes. However, there is a level of judgement which may be applied to these activities.
- 5.46 Of particular interest to the Commission is the interplay between the Act's requirement for RFL to provide for future reclaims in perpetuity, and the requirement to distribute any surplus to BLF. It is clear that RFL must provide for reclaims in perpetuity and any surplus follows from the provisioning level. The question that has been, and continues to be, a judgement call for the RFL Board is the degree of prudence required in setting the level of provision for future reclaims, particularly in view of either no, or limited, reclaims history depending on the year concerned.
- 5.47 RFL currently holds three provisions, as shown within the RFL 2015 Annual Report:<sup>8</sup>

**Figure 5.3 – Value and description of RFL provisions**

	Year end 2015 balance <sup>9</sup>	Unaudited year end 2016 balance	Description
Capital reserve	£74m	£74m	Amount reserved for future run-off costs and incorporating RFL's capital adequacy amount
Provision for reclaims	£305m	£342m	Amount provided for potential future reclaims in perpetuity, based upon the present level of transferred dormant account balances
Provision for future distributions but not yet paid	£181m	£153m	Amount provided for future distributions to BLF

6 Bank of England, Official Bank Rate History

7 Bank of England, Official Bank Rate History

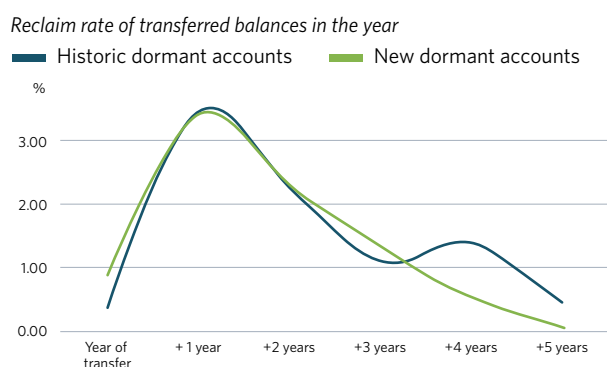
8 RFL, Annual Report & Accounts, 2015

9 RFL, Annual Report & Accounts, 2015



- 5.48 As at the end of 2015, the aggregate value of the provision for future reclaims and provision for future distributions equated to 35 years of reclaims at the 2015 reclaim level (66 years of reclaims at the average level of reclaims from 2011–2015). These figures disregard any further inward transfers of future dormant balances, which may alter the underlying extrapolation.
- 5.49 The percentage of reclaimed transfers in any of the five years of operation to date has not exceeded 3% of the aggregate of the year-end balances of the provision for future reclaims and the provision for future distributions. However, it can be seen that the rate of reclaims changes as time advances from the initial date of transfer. This is set out in Figure 5.4. As might be expected, there is a relatively high rate of reclaim of transferred balances in the first year, however this trend reduces in subsequent periods.
- 5.50 Interestingly, there is little difference in the rates at which historic (being accounts with a period of no customer-initiated transactions that exceeds 15 consecutive years) and new (being accounts that have just triggered the 15-year dormancy definition for bank and building society accounts) balances are reclaimed, despite the historic balances having a greater elapsed time since the last customer-initiated transaction. One might also expect newer balances to be more easily linked with beneficial owners, and therefore subject to a higher reclaim rate, however this does not seem to be the case.

**Figure 5.4 – Differing average annual reclaim rates of historic and new accounts**



- 5.51 The Act states that a reclaim fund is expected to “[manage] dormant account funds in such a way as to enable the company to meet whatever repayment claims it is prudent to anticipate”. There is no restriction placed upon this expectation, including in terms of time limit or de minimis value of individual assets.
- 5.52 RFL has taken a very prudent view of the possible level of future reclaims for a number of reasons including, but not limited to, there being no similar organisations in the UK with which reclaim experiences can be compared. Even now, RFL only has five years of historical reclaim activity.

- 5.53 The Commission considers it to be the responsibility of the RFL Board to determine the most appropriate degree of reserving prudence, and accordingly the most appropriate distributions. However, there is public interest both in ensuring that surplus dormant assets are distributed for the benefit of good causes, and ensuring that customers do not lose out by ceasing to be able to reclaim their assets. However, the Commission does have concerns that the approach taken to date by RFL is very prudent, bearing in mind the balance of public interest between distribution for the benefit of good causes and protecting customers.
- 5.54 The Commission fully appreciates that there is solid reasoning behind why a reclaim fund would wish to reserve prudently. In this manner, a reclaim fund can guard against any future uplift or spike in the rate of reclaims, can provide a sufficient safety net to meet reclaims in perpetuity, and can hold significant funding which may be invested to contribute to, or cover, operating costs. The Commission accepts that RFL has necessarily adopted a cautious approach in its formative years, especially given the lack of experience of reclaims in the UK. While a very prudent reserving policy was appropriate at the inception of the reclaim fund, the Commission is of the view that this policy should have been modified as reclaim experience grew. The policy has led to lower distributions to date than the Commission would have expected given the total value of transfers and the level of reclaim activity.

### Capital reserve

- 5.55 The Commission understands from RFL that, in addition to containing RFL’s ICAAP amount, the capital reserve is intended to be a provision against future run-off costs should, for whatever reason, RFL receive no further dormant asset transfers. In these circumstances, RFL would have ongoing responsibilities to pay out dormant asset reclaims, and so would need some level of ongoing operational capability.
- 5.56 While the Commission understands and agrees that RFL should hold a reserve to fund the cost of the operational mechanism to meet reclaims should there be a cessation of transfers, even allowing for the inclusion of the ICAAP amount, the current reserve balance seems excessive.

### Current capital reserve value

- 5.57 In its first year of operation, RFL used 20% of all dormant account transfers to establish the capital reserve of £74m, incorporating the appropriate ICAAP amount.

5.58 The capital reserve amount was consolidated for accounting purposes into the 2011 accounts of RFL's ultimate parent company, and was recognised via the Co-operative Group income statement as 'Other income' and separately disclosed as a 'Significant item'. It can be seen as an 'Other reserve' in the current Co-operative Group consolidated balance sheet.<sup>10</sup> This reserve is not distributable to RFL's shareholder or to Co-operative Group members.

5.59 In addition, all RFL's assets and liabilities are consolidated for accounting purposes into the Co-operative Group balance sheet, and signed off by the Group's auditors. A note explains:

*"The Group is required to consolidate Reclaim Fund Limited ('RFL') as it is a 100% owned subsidiary of the Group and the Group is 100% liable for funding RFL. However, the Fund is a not-for-profit organisation whose surplus is held entirely for the benefit of Big Lottery Fund ('BLF'). The Group derives no financial benefit from RFL nor can it access RFL's reserves. For this reason, RFL's balance sheet has not been consolidated on a line-by-line basis but instead it is separately disclosed within the Group balance sheet. The note provides an analysis of Reclaim Fund's assets and liabilities."<sup>11</sup>*

The Commission has discussed the level of the capital reserve with RFL. RFL has noted that at its inception, the reserving policy implemented was agreed with the then FSA (predecessor to the FCA). Specifically in relation to the capital reserve, RFL commented that it was set in order that the reclaim fund could continue "under a severe stress scenario for an estimated lifespan of 75 years". Despite containing the regulatory ICAAP amount, the Commission has been informed that the capital reserve was calculated to be 20% of transferred year one balances. Rather than this basis, the Commission would have expected the reserve value to contain two separately calculated elements: one for the ICAAP figure and one for modelled potential future run-off costs.

#### Capital reserve function

5.60 The Commission's view is that the right level of capital reserve should continue to contain the ICAAP and run-off cost elements. The latter should be the net present value of a sum that would enable RFL to continue to operate to meet reclaims into the future, given an assumption that no further dormant asset balances are transferred to RFL.

5.61 The Commission considers that such an approach would deliver a more accurately valued capital reserve, and is likely to derive a lower value capital reserve, thereby causing a one-off increase in the assets potentially available for distribution for the benefit of good causes.

5.62 The Commission understands that it will be necessary for RFL to agree any revised capital reserving approach with the FCA as their regulator. The Commission understands that preliminary conversations are underway.

#### Recommendation 5.4

The value of the capital reserve should be reduced to an amount that incorporates two separately calculated elements: RFL's ICAAP plus a reasonable amount to reflect the capital risk appetite of RFL, and the amount that is sufficient to fund a future reclaim run-off situation when there are no further incoming transferred assets.

#### Provisions for future reclaims and future distributions

##### Provision for future reclaims

5.63 The provision for future reclaims is intended to hold dormant assets for use to meet future reclaims of assets that have been transferred up until the date of the provision. The provision currently seems to contain a value significantly in excess of the level of reclaims that experience, in the five years since inception, suggests may happen. In turn, this negatively impacts the rate of distributions for the benefit of good causes, although potentially not the ultimate level in the fullness of time.

5.64 The provision for future reclaims has been set by RFL at a rate of 40% of transferred balances. Half of the 40% has been described to the Commission as being a core provision for future reclaims. The other half has been described as a stress provision, to be used should the flow of reclaims become stressed and significantly increase.

##### Provision for future distributions

5.65 The remaining 60% of transferred balances (40% in 2011 because of the additional 20% used to create the capital reserve) is intended by RFL to be distributed to BLF in future years and is therefore allocated to the provision for future distributions as part of a reserving policy that is very prudent. This is released over a period of time. In effect therefore, the provision acts as a secondary provision for future reclaims, as this provision is not made immediately available for distribution.

5.66 Utilising the provision for future distributions creates a smoothing approach to disbursements to BLF from RFL. The timing of release of the provision to BLF depends on the year of transfer and whether the transferred asset is historic or new as defined in paragraph 5.50. However, once an asset is determined as being provided for future distribution to BLF, the release of that asset is spread across a number of years.

5.67 In 2011, the first partial year of RFL's operation, the 2011 provision for future distributions was distributed to BLF in tranches over four years.

5.68 From 2012, the release model was adjusted to reflect that banks were transferring a mixture of new and historic assets as defined in paragraph 5.50.

<sup>10</sup> The Co-operative Group, Annual Report, 2015

<sup>11</sup> The Co-operative Group, Annual Report, 2015

- 5.69 The release of the provision for future distributions was historically determined by RFL as being for distribution in a given year, but may only have been fully distributed to BLF over a period of up to 12 years. A further adjustment to the model was made in 2015. The different release profiles are all shown in Figure 5.5.
- 5.70 Going forwards, the Commission believes that the current history of reclaims would indicate that there is very limited rationale to have a provision which is not for reclaims. While the Commission understands that this may result in an irregular flow of funds to BLF, this should not be an issue of concern for RFL.

**Figure 5.5 - Profile of release to BLF of £100 transferred to RFL**

Year of transfer to RFL	New dormant accounts			Historic dormant accounts
	2011	2012-2014	2015+	2012+
	Release to BLF	Release to BLF	Release to BLF	Release to BLF
Year 1	£20.00	£5.00	£10.00	£20.00
Year 2	£7.50	£5.00	£10.00	£27.50
Year 3	£7.50	£5.00	£10.00	£7.50
Year 4	£5.00	£5.00	£10.00	£5.00
Years 5 - 6	n/a	£5.00 p.a.	£10.00 p.a.	n/a
Years 7 - 12	n/a	£5.00 p.a.	n/a	n/a
<b>Total</b>	<b>£40.00</b>	<b>£60.00</b>	<b>£60.00</b>	<b>£60.00</b>

### Reserve review and modelling

- 5.71 Given RFL now has five years of reclaim experience, the Commission is supportive of the work RFL started in the second half of 2016 to update the modelling of reclaims and reserving based on its experience since inception. Although this updating work is at an early stage, the Commission understands that it is likely that the existing RFL reserving policy will be modified.
- 5.72 The review has been structured so that RFL can decide the level of risk it is happy to take that future reclaims will not be able to be met from the provisions. On the basis that RFL would bear a less than 100% risk of the exhaustion of the provisions, the Commission understands that a substantial reduction in the provision for reclaims might be possible, enabling an accelerated distribution for the benefit of good causes.

- 5.73 The modelling exercise has not unreasonably indicated that RFL's reserving policies may change as data continues to be inputted to the model following successive years of operation. Indeed, Figure 5.5 illustrates that RFL's reserving policy, and therefore distribution policy, has historically altered with experience. However, the Commission recommends that a review of modelling should be undertaken at least every two years, with a view to the RFL Board continually updating its reserving policy.
- 5.74 As a part of the modelling exercise, and in collaboration with the Commission, RFL considered whether additional value could be released from the reserves if the requirement to pay out reclaims in perpetuity were to be softened.
- 5.75 The Commission is aware that public and regulator support for the current and expanded scheme is essential, and an important component of that support is the public understanding that there is no time limit on reclaims being made.
- 5.76 However, from its existing data, the Commission asked RFL to model an alternative reserving position that if amounts of £100 or less have not been reclaimed in the five years after transfer to RFL, the beneficial owner's right to reclaim is lost with any excess being immediately distributed for the benefit of good causes.
- 5.77 Following analysis, it became clear that the vast majority of such low individual value balances in the current scheme are already modelled as not being reclaimed and are therefore transferred to BLF. Were there to be the release of amounts of less than £100 contemplated in paragraph 5.76, as at August 2016 this would result in the acceleration of just £3.4m being distributed by RFL for the benefit of good causes. This upside benefit is insufficient to warrant the impingement on the right to reclaim in perpetuity for all value accounts, and therefore the Commission cannot support a de minimis stance. Accordingly this should be taken no further at this point.

#### Recommendation 5.5

During 2017, either the provision for future distributions should be distributed for the benefit of good causes or, if work has been completed under the ongoing modelling exercise assuming a reasonable risk appetite, the amount this exercise determines should be distributed for the benefit of good causes.

#### Recommendation 5.6

The reserving model should continue to be reviewed and updated at least every two years.

## IMPROVING SCHEME TRANSPARENCY WITH BETTER DATA AND REPORTING

- 5.78 The question of whether firms are undertaking best efforts to reunite dormant assets with beneficial owners, and then to transfer any surplus to an expanded scheme, is critical. However, this question is very difficult to independently report on, based on currently available information.
- 5.79 It is also difficult to assess the effectiveness of reunification efforts made by firms in advance of transfers to RFL, in light of the voluntarily initiated programmes they undertake and the abbreviated disclosure from all parties involved in the current scheme.
- 5.80 The current scheme is very clear that participation by banks and building societies should be voluntary in terms of both the level of dormant assets transferred, and the range of each firm's products that are considered for transfer.
- 5.81 However, the Commission notes that it is extremely difficult for an opinion to be formed regarding the extent of participation by banks and building societies by any metric, other than the absolute value transferred to RFL.

### Current reporting does not address the effectiveness or efficiency of the existing scheme

- 5.82 By design of the Act, RFL is almost completely independent of Government involvement. However, the Act did stipulate a requirement for HM Treasury to report within three years of the commencement of the current scheme. This report<sup>12</sup> focused on three areas:
- How many banks and building societies have transferred balances;
  - How much money has been transferred; and
  - How effective have the arrangements for meeting reclaims been.
- 5.83 The report was specifically prohibited by the Act from reviewing the Financial Services and Markets Act 2000<sup>13</sup> regulated activities of RFL, including the investment of transferred monies and distribution of monies to BLF.
- 5.84 In addition, the Act requires that the reclaim fund discloses, after each financial year, the name of each firm that transferred money in that year, the amount transferred, and the amount reclaimed against each firm's transferred accounts.

- 5.85 The report concludes that, "*institutions holding over 90 per cent of personal deposits in the UK are voluntarily utilising the legislation to make dormant account money available to good causes in local communities*".<sup>14</sup> The report focus was on the simple binary question of participation or not by firms, and did not address the questions of effectiveness or efficiency.
- 5.86 Although not stipulated in the Act, HM Treasury has made the decision to undertake a further review in 2017. The 2014 report implies that the 2017 review is limited to the operation of the current, alternative scheme, which is explained in more detail in Annex F.
- 5.87 The Commission makes recommendations concerning the review of the operation of the expanded scheme and the reclaim fund in paragraphs 5.213–5.219.

### Transparency to help reduce the hidden nature of dormant assets

- 5.88 To increase the degree of transparency regarding the key questions about the scheme in paragraphs 5.78–5.79, the Commission recommends the adoption of a concept of 'participate and explain'. This would require each firm that holds a balance of potentially dormant assets within the scope of an expanded scheme to issue a statement on an annual basis, explaining either its reasons for not participating in the scheme or, alternatively, the extent to which they do participate.
- 5.89 It is envisaged by the Commission that such disclosure should be made in the annual reports of firms and be accompanied by information concerning the aggregate value of non-reunited assets held, and the number of accounts or individuals affected, on an asset-by-asset basis. The aim of this disclosure is to increase the level of transparency from industries and individual firms regarding the extent of value they hold without knowing the beneficial owner of the assets. The Commission appreciates that this will potentially require a major change to reporting systems within affected firms, and therefore firms should have an extended period of three years to update systems so that suitable disclosure may be achieved.
- 5.90 Improved and more consistent approaches to reunification will also assist in reducing levels of dormant assets. The Commission has recommended that guidance on best practice for reuniting products in each asset class be developed by industry and recognised by the regulator. This is discussed in further detail in Part B of this chapter.

<sup>12</sup> HM Treasury, Review of the Dormant Bank and Building Society Accounts Act 2008, 27 March 2014

<sup>13</sup> Financial Services and Markets Act 2000, 14 June 2000

<sup>14</sup> HM Treasury, Review of the Dormant Bank and Building Society Accounts Act 2008, 27 March 2014

**Recommendation 5.7**

RFL should continue to publish an annual report detailing which firms are participating in the scheme. However, to increase transparency, this information should be appropriately publicised, made more prominent and more readily accessible.

**Recommendation 5.8**

All firms that have potentially dormant assets should produce an annual assessment of the levels of assets held within the firm which cannot be reunified with beneficial owners. This assessment should include the aggregate value and number of affected beneficial owners on an asset-by-asset basis, and be included in annual reports. Adoption of this disclosure should be in place within three years of the date of this report.

## **SUMMARY: CHAPTER 5, PART B: ADDITIONAL RECOMMENDATIONS TO ENABLE THE RECLAIM FUND MODEL TO COPE WITH AN EXPANDED SCHEME**

An expanded scheme presents more of everything: industries, firms, product types, complexity, risk, and sheer volume of assets that may be available for transfer to the reclaim fund. The question was posed to the Commission: could the current reclaim fund model cope? Enhanced governance and more sophisticated mechanisms will undoubtedly be required, and the recommendations in Chapter 5, Part A should be seen as prerequisite for an expanded scheme reclaim fund model.

### **DEFINING DORMANCY**

When considering an expanded scheme, one striking issue for the industries concerned is the current inconsistency with which dormancy is being addressed. This leads, for dormant asset owners, to something of a pot-luck situation as to whether or not they will be reunited with their assets. The Commission regards this as inequitable, and recommends that each industry collaboratively develops standardised procedures for tracing and reunification, and that the FCA recognises these. Though industry-tailored, the procedures should have common underlying principles, including that the cost of tracing should be proportionate to the value of the asset, but that firms – not beneficial owners – bear this cost.

### **MANAGING TAIL RISK**

The Commission considered various issues relating to data and an expanded scheme including: the sharing of contact details within corporate groups; the inclusion of National Insurance numbers within death notifications; the type and quality of data firms provide to a reclaim fund; and the implications of electronic communication for recognising dormancy. On the separate issue of tail liability, it is notable that RFL at present bears the full risk for reclaims, and so must reserve for the most extreme scenarios, driving prudence. To unlock a greater proportion of reserves for distribution for the benefit of good causes in the future, the Commission recommends that the possibility of transferring tail risk to a third party be investigated.

### **DETERMINING RECLAIM VALUES**

The trickiest issue that arises for the reclaim fund in an expanded scheme is that of the value paid on reclaim. With newly included assets that have crystallised cash values (e.g. dividends, matured securities), processes can mimic the current scheme, and reclaim values can match the crystallised value plus an appropriate interest rate. But with assets whose value is subject to ongoing market movements (e.g. shares or units in collective investment schemes) if the reclaim fund is to reserve for them in anything other than their original form the

question arises, in the event of a reclaim, what would the appropriate reclaim value be? There are two feasible options:

One – full monetary restitution: here the owner is repaid the cash equivalent of the original asset's value as valued at the point of reclaim. This requires the reclaim fund to match any potential shifts in the asset's value between when it is transferred into the fund and when it is reclaimed, meaning reclaim fund reserves have to be managed to mirror the market movements of pre-transfer assets. Though not unfeasible, this is operationally complex and would necessitate the reclaim fund being equipped with increased levels of governance, and more finance-driven oversight and personnel, which may be relatively expensive. It also exposes the reclaim fund to higher levels of risk, translating to more prudent reserving, therefore slower distributions for the benefit of good causes. At the same time however, it is more likely to be acceptable to customers and attractive to firms, and so may lead to higher levels of voluntary scheme participation.

Two – reasonable-position monetary restitution: here the owner is repaid the cash equivalent of the original asset's value as valued at the point it was transferred into the fund, plus some reasonable form of appreciation. Regarding this appreciation, the Commission recommends LIBOR plus a small margin, thus paying beneficial owners a reclaim value based on market interest rates. Operationally, this option is relatively straightforward and therefore less expensive to operate. It also gives the reclaim fund less uncertainty regarding future reclaim values, meaning less risk. However, the potential for discrepancies between non-transferred assets and reclaim value may be used by firms as a reason not to participate and might be of concern to customers. Accordingly, this may lead to lower levels of voluntary scheme participation by firms.

In addition to these chiefly practical considerations, there is a root question of principle at stake: should owners who make reclaims be restored to an identical cash position, or to a reasonable cash position? Interestingly, dormant asset schemes in other countries tend to impose some limitations on what owners can rightfully reclaim (see Annex D) and not restore to an identical cash position.

The Commission nevertheless felt that full monetary restitution is the fairest and most protected outcome for customers, and so preferred this option. However, it is for the Government to make a decision, and further work will be required to explore both options in more detail before a final decision can be made.

The Commission considered reporting, and recommends the reclaim fund monitor and report to the Government on the effectiveness of the scheme, while the reclaim fund is also independently reviewed and reported on to Government.

## STRUCTURE

- 5.91 Widening the range of asset and product types which fall within the scope of an expanded scheme significantly increases the complexity of the scheme as a whole. It will also result in a multiplication in the number of potential transferor entities. In turn, these complexities require a greater level of sophistication from the reclaim fund, not only in operating the mechanism of transfer, investment, distribution and reclaim, but also in terms of oversight as discussed later in this chapter.
- 5.92 One of the specific terms of reference for the Commission was to consider *“whether with the potential increase of dormant assets being released by industry the current system is able to manage the burden”*.
- 5.93 Fundamentally, without changes being made to the current processes underpinning the operation, structure, and oversight of the scheme, the Commission is of the opinion that the existing system would not be the right one to cope with the burden of administering a wider range of more complex dormant assets. However, if the recommendations made in Part A of this chapter are implemented, then the system and Reclaim Fund Ltd (RFL) could be the appropriate vehicle.

## Removing possibility of multiple reclaim funds

- 5.94 The Dormant Bank and Building Society Accounts Act 2008 (the Act) allows for multiple reclaim funds. It is important from the perspective of the monitoring and reporting function discussed in paragraphs 5.215-5.219 that there is only one reclaim fund going forwards, as otherwise, Recommendation 5.33 would be logistically impossible. The Commission also believes there are likely to be operating synergies and economies of scale / scope available to a single reclaim fund.
- 5.95 However, the Commission can only recommend the continued use of RFL as the dormant asset scheme’s sole reclaim fund if it implements the recommendations in Part A of this chapter.
- 5.96 Contingent upon a single reclaim fund adopting the recommendations, the provision for multiple reclaim funds should be removed from the Act and replaced with a single fund retaining a strong commercial focus.

### Recommendation 5.9

The reclaim fund managing an expanded scheme must comply with the recommendations in Part A of Chapter 5. If these are implemented, then the reclaim fund administering the mechanism of the expanded scheme should continue to be RFL.

### Recommendation 5.10

The Act should be amended to stipulate there be only a single reclaim fund. This fund should be reconstituted and have significant ongoing private-sector expertise.

## GOVERNANCE

- 5.97 It is envisaged that the reclaim fund for an expanded scheme will continue to reserve for future reclaims, with any transferred assets not required for this reserving being distributed for the benefit of good causes. However, the range of different assets which may be transferred are sufficiently technical and potentially complex, that a reclaim fund may be unable to make reserving decisions without detailed asset knowledge.
- 5.98 In the course of its work, the Commission has been required to consider the specific features of a diverse range of asset types and individual products. It is clear that not only are these assets and products nuanced and distinct from each other, but in the main they are also each very different from the bank and building society accounts that are dealt with by the current scheme.
- 5.99 While the reclaim fund would continue to rely on the provision of data points from transferors to inform its reserving models, the Commission considers that the reclaim fund Board would benefit from the creation of a panel of industry experts to provide technical advice regarding transferred products. This product-specific knowledge will assist the Board in making reserving decisions, and is envisaged to be consulted with as the reclaim fund Board sees fit. Membership of the panel should be revised and adjusted as appropriate on a biennial basis.
- 5.100 As presently worded, the Act is silent regarding the extent to which a reclaim fund is able to outsource or sub-contract specific functions of its operation to external experts. With the complexity of an expanded range of assets, it is envisaged that the reclaim fund may be required to sub-contract specific operational elements of its functions, and to hire in professional advice. For clarity, the Act should be modified to specifically permit this.
- 5.101 Suitable and appropriate outsourcing of operations functions and obtaining of professional advice should be viewed as being part of the reclaim fund’s effective operation. The reclaim fund should also be able to recompense such outsourcing or advice from transferred assets, as reclaim funds can currently pay expenses under the Act.

### Recommendation 5.11

The Board of the reclaim fund should establish an advisory panel to provide technical subject matter expertise regarding the assets transferred under an expanded scheme. Membership of this panel should be re-evaluated on a biennial basis.

### Recommendation 5.12

The expense of obtaining advice from a technical panel and other outside expertise should be classified as a defrayed expense and therefore may be funded from the value of transferred assets. The Act should be modified, and any enabling legislation expressly permit this.

## OPERATIONS

### Reuniting

#### Current reuniting practices

- 5.102 For lost bank and building society accounts and National Savings & Investments products, beneficial owners are directed to 'mylostaccount.org.uk'. Enquiries to this service are free of charge. For shares, beneficial owners are directed to the three main share registrars who will conduct searches, also without charge. For shares bought through a nominee account, beneficial owners are advised to contact the relevant broker. For pensions, beneficial owners are directed towards the Pension Tracing Service for workplace-based pensions, and to The Pensions Advisory Service for personal pensions. Finally, for investment and life insurance policies, beneficial owners are directed to the Unclaimed Assets Register (UAR).
- 5.103 The UAR is run by Experian and levies a £25 charge for searches. In addition to levying a fee to search, it also does not provide full coverage of all potentially dormant assets arising from the financial services sector. Not all firms are registered for the UAR, so even if a beneficial owner conducts a search, they may not discover all of their lost assets.
- 5.104 The Commission has considered whether dormancy is largely a legacy issue which will decline over time if firms enhance their tracing and reuniting efforts, or whether the increasingly fragmented nature of an individual's assets and a more mobile population will result in steady-state, or even increasing rates, of dormancy. However, without consistent and aged industry data, neither position can be definitively stated at this point. A first step to achieving the ideal position of declining rates of dormancy however, is to establish processes for standardising and enhancing the tracing and reuniting efforts made by firms.
- 5.105 The key tenet of the Commission's work is that reuniting beneficial owners with their assets is preferable to the transferring of assets to an expanded scheme. Only where such reuniting cannot happen should transfer occur. Reuniting should occur where an individual assetholder has lost contact with a firm and therefore efforts are required by the firm to trace the beneficial owner and reunite them with their asset. The Commission has therefore considered how such reuniting activity could be best, and most consistently, implemented across affected industries.
- 5.106 It is clear that current tracing and reuniting efforts and methodologies vary hugely within the financial services sector: from industry to industry, from firm to firm, from asset to asset, from product to product and therefore from beneficial owner to beneficial owner. This inequity of treatment is suboptimal and means that there is an element of luck in whether two otherwise identical beneficial owners will be reunited with their potentially dormant assets.

#### Collective development of reuniting procedures

- 5.107 The Financial Conduct Authority (FCA) recognises that there is a responsibility both for firms and customers to make sure that they do not lose contact with each other. Some of the assets recommended for inclusion in an expanded scheme are specifically designed to be held with a long-term outlook, however the Commission considers that this does not mean firms can neglect to maintain contact with customers.
- 5.108 In addition to its principles and literature regarding firms treating customers fairly, the FCA also recognises that consumers need to take responsibility for their own finances. This responsibility extends to the need for customers to update firms holding their assets of changes to their contact details – a leading cause of dormant financial assets.
- 5.109 Firms and customers therefore share the burden of ensuring that, wherever possible, assets do not reach a position where they cannot be reunited with their beneficial owners and ultimately get transferred to a dormant assets scheme.
- 5.110 Given the different product features of assets within scope of an expanded scheme, it is felt that the most appropriate methodology for reuniting potentially dormant beneficial owners cannot be centrally dictated to firms.
- 5.111 The Commission believes that firms in the same industry should utilise their expertise and knowledge to co-create the most appropriate and consistent procedure for reunification efforts in their industry. This will help avoid inconsistency and inequality of treatment among otherwise similar beneficial owners.
- 5.112 It is envisaged that industries may wish to agree increasingly strenuous, and therefore costly, efforts to reunite assets as the value of a given potentially dormant asset rises. However, it is not anticipated by the Commission that the costs of attempted reunification should, at any point, exceed the value of a given potentially dormant asset.
- 5.113 It is also not the intention of the Commission that an expanded scheme should see the value of dormant assets being eroded in order to fund efforts to reunite customers with their assets. As is the case for the current scheme, the Commission believes that the costs of tracing and reuniting customers should be borne by firms and not asset owners.
- 5.114 The Commission has been made aware of the British Standards Institution publication<sup>15</sup> which aims to help firms deal with the problem of losing contact with customers and the accompanying potential for their assets to become dormant. This has been developed by financial services sector participants but has not yet been adopted widely by any industry, seemingly through lack of compulsory requirement.

<sup>15</sup> British Standards Institution, Specification for the maintenance of financial services customer data, 31 March 2013



The document may represent a useful strawman for consideration by industries while contemplating a reuniting procedure for their specific assets.

- 5.115 The regulator has a role to protect the public. How regulated firms treat their potentially dormant customers should be a part of their assessment. The Commission is also aware that without oversight of the industry-level reuniting procedures, the output may not be trusted by other stakeholders in the dormant assets process, particularly customers and beneficial owners.
- 5.116 In addition, despite this process hopefully resulting in a collection of different but tailored solutions for different types of assets, there needs to be a similar underlying philosophy across all participating industries. As the common regulator of the reclaim fund and the majority of participating financial services sector firms, the FCA is best positioned to recognise the industry-proposed procedures.
- 5.117 The FCA has an existing recognition process. The process is used in limited situations to recognise guidance created by industry and is known as FCA Confirmation.
- 5.118 Once FCA Confirmation of an industry's reuniting procedure is obtained, the procedure should be followed by firms from that industry participating in the expanded scheme.
- 5.119 Firms should evidence their adherence to the procedure which will provide protection from claims of inappropriate efforts to reunite beneficial owners with their assets. Firms should also certify to the reclaim fund upon transfer that they have adhered to the recognised industry reuniting procedure, and have not been able to reunite the asset with the correct beneficial owner.

#### **Recommendation 5.13**

Industry participants and trade associations should collaboratively develop an agreed, standardised procedure regarding the tracing and reuniting of potentially dormant assets with beneficial owners.

#### **Recommendation 5.14**

The FCA should recognise the agreed, standardised tracing and reuniting procedures developed on an industry-by-industry basis. Once recognised, transferors should adhere to this procedure as a component of their responsibilities to customers and irrespective of participating in the expanded scheme.

#### **Recommendation 5.15**

The agreed procedure to reunite beneficial owners with their assets should be proportional to the value of potentially dormant assets. A stepped procedure may result. The financial cost of reuniting efforts for a corporate group should not exceed the total value of the beneficial owner's potentially dormant assets within that corporate group, and this cost should be borne by the corporate group and not the beneficial owner.

### *Corporate groups*

- 5.120 Individual firms participating in an expanded scheme may also be members of a wider group structure incorporating a range of potential products which are in scope for an expanded scheme. For the purposes of developing standard industry procedures, firms will be best served by participating at an individual entity, rather than group, level.
- 5.121 However, there are instances where a group approach may be appropriate. Paragraph 5.108 states that customers must hold some responsibility for their own finances, including the updating of contact details with firms should these details change. It is also possible, indeed often likely, that individual investors will hold a number of assets with different entities within the same corporate group. For example, an individual may have a Brand X bank account with one entity, a Brand X Stocks and Shares Individual Savings Account (ISA) with another entity, and a Brand X life insurance policy with a third entity. Each of these three entities could be owned by the same ultimate parent and be in the same corporate group.
- 5.122 If contact details change, customers may presume that if they notify one entity in the corporate group, this notification will be passed to other group entities (i.e. if a customer notified the Brand X bank account entity of their address change, they may assume that this change would then automatically be applied to the Brand X Stocks and Shares ISA and the Brand X life insurance policy). This is often not the case, and the change in information is disseminated no further than the initially notified entity for a number of reasons, including data sharing permissions, differing and inefficient IT systems, and legacy entity acquisitions.
- 5.123 The seemingly commonplace practice of not sharing address change notifications within groups appears to the Commission to be unduly inequitable for beneficial owners and unnecessarily confusing given, in the example of Paragraph 5.121, the similar 'Brand X' branding. Facilitating the notification of all group entities by the initially contacted corporate group entity would seem to be a relatively low-effort means for corporate groups to increase their rates of reuniting potentially dormant assets with beneficial owners.

- 5.124 In due course, technological, informational and systems advances, such as blockchain, may present a solution to the issue of data existing in silos in the individual firms within groups, and result in the sharing of contact data points becoming automatic. However, this is not presently a workable solution across the majority of the financial services sector.
- 5.125 It is stated in Paragraph 5.111 that firms should engage in the process of co-creation of a reuniting procedure alongside other firms who hold similar assets. The Commission suggests that firms should consider the requirement to seek alternative contact information from their own corporate group as an early step within the procedure to reunite. This might assist in sweeping up a legacy of beneficial owners not captured by the forward-looking effect of Paragraph 5.123.

#### **Recommendation 5.16**

For new customers, firms should obtain consent from those customers to share their personal contact data with other firms in the same group, to be used for the express purpose of facilitating possible future tracing and reunification.

#### **Recommendation 5.17**

For existing potentially dormant customers, firms should seek alternative personal contact data from other firms in the same group to the extent allowed by current data permissions. If such permission does not exist, group firms should consider obtaining retrospective consent to allow contact data to be shared.

### *Linking deceased persons to products*

- 5.126 As a consequence of its work looking at how an expanded scheme may better seek to reunite beneficial owners with their assets, the Commission has considered how to more efficiently link the assets of deceased individuals with their beneficiaries.
- 5.127 One way in which this may happen is for the amount of data submitted as part of recording a death to be increased. For example, a death notification does not presently capture an individual's National Insurance number.
- 5.128 There is presently a disconnect between HM Revenue and Customs (HMRC) and the General Register Office, caretaker of the nation's register of deaths. Accordingly, it is challenging for firms to link deaths with the existence of certain, typically tax-wrapped, financial products.
- 5.129 If data protection concerns could be overcome, recording an individual's unique National Insurance number at death may assist some firms, who hold potentially dormant tax-wrapped products such as ISAs, with verifying whether the recorded customers are deceased.

#### **Recommendation 5.18**

The practicalities of including National Insurance numbers as part of a death notification, to facilitate better reuniting of beneficial owners with dormant assets, should be explored.

### *Electronic communications*

- 5.130 The Commission is aware that, to date, contact between firms and beneficial owners of assets has hinged on paper-based communications in the financial services sector. Any returns-to-sender of such hard copy communications provide firms with a very clear flag of possible changes in beneficial owner circumstances, gone-away status, and the potential dormancy of an asset.
- 5.131 However, the Commission is also aware of the increasing move towards paperless communication with customers, especially with newer types of business such as investment platform firms. Some firms have indicated to the Commission that the increased electronification of customer contact means that traditional flags of potential dormancy are not being raised, and therefore a lower level of potential dormancy is being shown, even if the true level remains unchanged. This is of interest to the Commission in view of its ultimate desire that assets should never become dormant.
- 5.132 To counter the general shift in communications towards electronic means some firms are experimenting with new ways of noting dormancy, for example by requiring periodic password changes, so that the firm still obtains an early alert of potentially dormant assets. This facilitates flags of customer inactivity being raised in a timely manner. If a scheduled password change is not acted upon, the firm can instigate attempts to trace the beneficial owner.
- 5.133 The Commission is cognisant of the need for any procedures implemented as a result of its report to be sufficiently flexible to account for future changes in industry working practices. While the Commission would support measures such as password-change flags, specific industries are best placed to collectively agree the appropriate triggers applying to changes in contact media as part of a wider reuniting procedure, as discussed in Paragraphs 5.111-5.114.

#### **Recommendation 5.19**

The process to reach an agreed, standardised procedure regarding the tracing and reuniting of potentially dormant assets with beneficial owners should consider electronic communications. The agreed procedure should also cater for beneficial owners who have previously elected to receive solely electronic communications.

## Data supporting transfer, reserving and reclaim

### Data provided by transferors

- 5.134 The quality of data supplied to RFL by the firms participating in the current scheme is variable and, although it has improved over time, may be better if it could take a more standard form.
- 5.135 An expanded scheme will involve a considerably greater number of participating firms with diverse information systems. In order for the Board of the reclaim fund in an expanded scheme to make accurate reserving decisions, they must be provided with consistent and informative data. The complexity caused by more diverse assets and a greater number of participating firms, places an even greater importance on the provision of good data than is the case under the current scheme.
- 5.136 As a minimum, and to inform the reclaim fund's reserving decisions, a transferor should provide the reclaim fund with five required standard data points to accompany the transfer of each dormant asset, where these are available.
- 5.137 From Commission discussions with RFL and their modelling advisers, these five data points should be:
- asset type;
  - individual asset value;
  - transferor type;
  - age of asset; and
  - age of beneficial owner, where available.
- 5.138 It is not intended that these points be sufficient for a transferor to validate a reclaim, or indeed for the reclaim fund to validate a transfer. These data points are solely intended for the reclaim fund to be able to identify the characteristics, and therefore inform the reserving model and decisions regarding the distribution of transferred assets.
- 5.139 The Act underpinning the current scheme already caters for data being passed to a reclaim fund. Clause 12 of the Act states that *"No obligation as to secrecy or other restriction on disclosure"* shall prevent banks or building societies from passing data to the reclaim fund in order for it to deal with reclaims. Wording having the same effect should equally apply to an expanded scheme, and will therefore facilitate the reclaim fund in efforts to continue developing and evolving its reserving model as it applies to the wide range of assets which may be transferred.
- 5.140 The robustness with which a firm could defend a view that they should not retain data regarding transferred assets as this might contravene the fifth principle of the Data Protection Act (1998), which is that data *"shall not be kept for longer than is necessary for [its original] purpose"*, is somewhat unclear. However, the Commission's view is that the necessity of the transferor validating reclaim requests as they arise as the expert agent of the reclaim fund, or third-party reinsurer, requires the transferor to retain transferred asset data as it stood at the date of transfer.

If it is felt that existing legislation does not adequately provide for this, it should be addressed in the legislation enabling the expanded scheme.

### Transferors should verify reclaims

- 5.141 As with the current scheme, where the facility of firms retaining data and verifying reclaims has worked very well, it is intended that transferors to an expanded scheme act as the first port of call for a reclaiming beneficial owner. This has the benefit of the transferor retaining the client relationship with reunited beneficial owners.
- 5.142 Respondents to the call for evidence raised concerns regarding the level of data that must be retained by firms participating in an expanded scheme in order to undertake this verification. While the Commission has some sympathy for this view, it is important to note that, were an expanded scheme not to proceed, firms would be required to retain sufficient data to reunite beneficial owners with their assets in any event.
- 5.143 Transferor firms also often have bespoke data management systems and are therefore best placed to retain the majority of data regarding an asset. This allows accurate validation of reclaims as they arise but also prevents firms from having to conform their entire data landscape to the requirements of a single, central dormant assets data management system.
- 5.144 Where a firm validates a reclaim, again mirroring the success of the current system, it is intended that the firm will act as an agent of the reclaim fund under an agency agreement. Under the terms of the agreement, the firm will repay the customer in the first instance.
- 5.145 The firm will then submit a periodic statement to the reclaim fund, seeking reimbursement for the reclaimed balances verified and restored in the period since the previous statement.

#### Recommendation 5.20

Data supplied to the reclaim fund by participating firms should be in a standard form to include: asset type; individual asset value; transferor type; age of asset; and, where available, age of beneficial owner.

#### Recommendation 5.21

Should further clarification be required, enabling legislation should include provision that a transferor retaining data to validate the reclaim of transferred assets does not contravene data protection legislation.

#### Recommendation 5.22

Responsibility for the retention of the customer relationship with the beneficial owner, the management of data and records, and the verification of the validity of reclaims, should remain with the transferor.

**Recommendation 5.23**

When validating reclaims in an expanded scheme, transferors or their corporate successors should act as agents of the reclaim fund in the same manner as is the case in the current scheme.

**Reserving: tail risk**

- 5.146 One of the foremost drivers for a reclaim fund's reserving policy is that reserving is currently undertaken with the view that the reclaim fund bears the full risk of reclaims, made against the value of transferred assets, in perpetuity. However, it may be beneficial for an element of the risk of reclaim to be borne by another party provided that party can confirm they have sufficient ability to meet reclaims if they are called upon to do so.
- 5.147 This altered reserving model may be thought of as a reclaim fund being relieved of the need to consider all situations where the level of reclaims might exceed the value reserved for in the most extreme of reserving scenarios. The model may be that cover for the final 1 / 2 / 5 / 10% of reclaim risk (the tail risk) is purchased from another party, with the reclaim fund remaining fully liable in the more likely 99 / 98 / 95 / 90% of all reclaim scenarios. Further work is required to quantify the benefit of this reserving strategy, however the Commission is not recommending that a beneficial owner's right to reclaim is removed with any external coverage of the tail risk.
- 5.148 One option to be explored is for the reclaim fund to purchase commercial reinsurance coverage for the tail risk. This would potentially add further expense drag on the pool of transferred assets available for either reclaim or distribution for the benefit of good causes. However, it may also be that if the pricing of the risk by the reinsurer was more aggressive than that contemplated by the Board of the reclaim fund, more assets could be distributed for the benefit of good causes at an accelerated rate.
- 5.149 Given the Commission's Recommendation 5.1 around the restructuring of the reclaim fund for an expanded scheme, an alternative tail risk option may be for this risk to be underwritten by the Government. Given the recurring modelling of reclaim and reserving profiles recommended in Part A of this chapter, there is likely to be a low risk that such tail risk coverage will ever be called upon. This Government option would therefore provide an element of coverage and reserving certainty to increase the speed of reserve distribution for the benefit of good causes, while potentially not imposing the same cost burden as an equivalent commercial solution.
- 5.150 With external coverage of the reclaim tail, it is still envisaged that the transferor will act in reclaim situations as the agent of the holder of the ultimate liability. In this scenario, that holder would likely be either a commercial reinsurer or the Government, who would therefore be subject to a contract with the reclaim fund.

**Recommendation 5.24**

The reclaim fund should investigate whether the reclaim tail could be economically underwritten by an external party, for example by a commercial reinsurer.

**Recommendation 5.25**

Where the reclaim tail risk passes to a third party, the transferor should continue to act as agent for the party who holds the ultimate financial liability for reclaim.

**Reclaim**

- 5.151 It is important to recognise that the need to reclaim will only affect beneficial owners who have neglected their assets. Provided that customers adhere to their responsibilities regarding maintenance of contact data, and firms implement appropriate programmes to reunite potentially dormant assets, customers whose assets are not truly dormant will be unaffected by transfers to a reclaim fund and the consequential issues caused by reclaim.
- 5.152 However, even in such a low number of instances - 5% of transfers in the current scheme - it is important to consider and explain how an expanded scheme will cater for reclaims.
- 5.153 The current scheme is clear that the right for beneficial owners to reclaim exists in perpetuity, and that the value which may be reclaimed is tied to the original terms and conditions of the bank or building society account. With these accounts being a relatively straightforward asset, this approach means that no beneficial owner will be in a position whereby they are financially disadvantaged by their asset being transferred into the current scheme.
- 5.154 However, with a range of more complex assets being considered for inclusion within an expanded scheme, the need for a reclaim fund to be able to operate and reserve for future reclaims in an effective manner is inextricably linked with the time period and value for which beneficial owners are entitled to reclaim.
- 5.155 From the analysis of other international dormant asset schemes with more complex assets than the current UK scheme as described in Annex D, the reclaim mechanisms of those schemes tend to either limit the length of time within which a beneficial owner may make a reclaim, or they stipulate restrictions on the value which a beneficial owner might reclaim.
- 5.156 Additionally, to guard against any asset causing far-reaching issues for the reclaim fund in an expanded scheme, the reclaim fund would need to be constituted to have the option to decline to accept the transfer of assets. In practice, this special ability would likely only be used in respect of assets that are impossible for the reclaim fund to value, liquidate or reserve against at anything other than the 100% level.

- 5.157 The Commission is of the opinion that a right to reclaim for beneficial owners should continue to exist in perpetuity. However, with this principal fixed, the question remains open regarding the value to which a beneficial owner is entitled to reclaim in the few instances where this is required.
- 5.158 In the course of its work, the Commission has been increasingly aware of the tension between two goals for the expanded scheme:
- for the reclaim fund to be operationally effective and ensure that potential reclaimants can always reclaim their assets; and
  - for the reclaim fund to be able to distribute any surplus for the benefit of good causes.
- 5.159 In practice, balancing these two goals is a matter for the Board of the reclaim fund and the degree of risk that they consider reasonable in terms of not being able to pay out on a reclaim. This is drawn into even sharper focus than under the current scheme when an expanded range of dormant assets is capable of being transferred.
- 5.160 The Commission's stance in this regard is explained in the following sections.

### **Assets where value movements are only interest-rate related**

- 5.161 Crystallisation of an asset's value occurs when the base value of an asset is fixed at a point in time. In the context of the current scheme, the value of a bank account at the date of transfer to the reclaim fund may be considered as crystallised as the only factor impacting this after transfer may be interest rates. The crystallised value of a transferred bank account therefore forms the base for a beneficial owner's reclaim.
- 5.162 In the current scheme the reclaim treatment of transferred assets, which are in cash form and with crystallised values, is relatively simple. £1 of value reserved against a transfer of product A can equally be used to fund reclaims made by beneficial owners of products A, B or C, as illustrated in Figure 5.6, irrespective of the precise underlying terms and conditions of the different products. For assets whose value is able to be crystallised, an expanded scheme should therefore mimic the treatment of bank and building society accounts in the current scheme.

### **Agreement of value at transfer**

- 5.163 In the current scheme, at the date of the transfer, the transferor informs the reclaim fund of the crystallised value of a transferred asset. At the same time, the transferor and the reclaim fund also agree an interest rate that should apply to each transferred asset. Typically, this rate will be that stated in the terms and conditions of the product in question. Liability for future reclaim passes to the reclaim fund, and consists of the crystallised value of the transferred asset plus an interest rate uplift, at the applicable rate, for the period between transfer and reclaim.

- 5.164 For assets within the scope of an expanded scheme, where the crystallisation of the asset's value does not involve possible lost value movements by anything other than a simple interest-rate linked movement, the expanded mechanism should work similarly to that of the current scheme. The transferor and reclaim fund should agree the crystallised value and applicable interest rate to each transferred asset at the date of transfer.
- 5.165 Within the current scheme, and upon reclaim, should a reclaiming beneficial owner be able to prove that their account was the subject of a different interest rate to that agreed by the transferor with the reclaim fund, it is the transferor that bears the cost of that difference. This places the financial risk of poor product record maintenance on the transferor who ordinarily has the responsibility for retaining accurate customer data. Again, the expanded scheme should mimic this structure for assets with crystallised values as it works well in the current scheme.

#### **Recommendation 5.26**

For assets where transferring the value does not involve the loss of possible value movements by anything other than a simple interest-rate linked movement, such assets should be transferred to the reclaim fund at the crystallised value and in cash form.

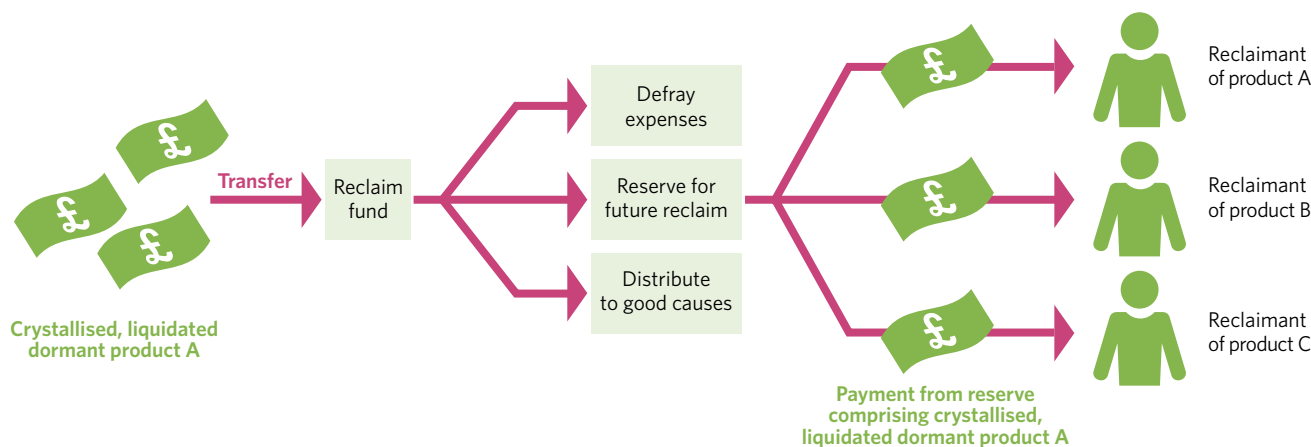
#### **Recommendation 5.27**

For assets where transferring the value does not involve the loss of possible value movements by anything other than a simple interest-rate linked movement, the transferor and reclaim fund should agree, at the point of transfer, the crystallised value of the asset and the rate of interest to apply to the value between the dates of transfer and any possible future reclaim.

#### **Recommendation 5.28**

For assets where transferring the value does not involve the loss of possible value movements by anything other than a simple interest-rate linked movement, should the reclaimant be able to prove they are due a different rate of interest to that agreed between transferor and reclaim fund, the cost of any uplift should be borne by the transferor.

Figure 5.6 - Illustration of aggregate reserve being reclaimed by beneficial owners of different products



### Asset values subject to market movements

5.166 In the expanded scheme, there will be some assets which fall within scope of the scheme whose future reclaim value is affected by dynamics other than just an applicable interest rate. This may be due to a range of factors including the value of the asset being driven by open market trading, currency fluctuation or because the underlying components of the asset's value are themselves subject to movements. The two most likely market influencers on value are foreign currency fluctuations and market-tradable assets (e.g. stock market valuations).

5.167 Such effects did not require contemplation when establishing the current scheme given the characteristics of bank and building society accounts. The expanded scheme includes such assets, and the Commission has considered the amount to which the beneficial owners of such assets should be entitled to reclaim.

5.168 For an expanded scheme, the Commission has considered three possible options for what can be reclaimed by the beneficial owners of assets susceptible to market movements:

- Option A The asset in its original form, reflecting any market changes in value since transfer;
- Option B The cash equivalent value of the asset at the point of reclaim, reflecting any market changes in value since transfer; and
- Option C The cash equivalent value of the asset at the point of transfer, plus an interest uplift between transfer and the point of reclaim.

5.169 The Commission does not consider Option A to be a viable option. If implemented, this would mean that the majority of transferred assets would need to continue to be held in their original form. Any reclaim fund would thus be unlikely to ever distribute significant values of assets for the benefit of good causes as, by and large, transferred assets could not be realised.

5.170 The most appropriate remaining option for the reclaim of assets susceptible to market movements in an expanded scheme will depend upon which restitution outcome is preferred by Government. The key question is:

- should reclaimants be restored to an identical cash equivalent position to that had transfer not occurred (Option B); or
- should reclaimants be restored to a reasonable cash position (Option C).

5.171 The Commission cannot decide for the Government which of these outcomes is most desirable. While the Commission has initially explored this issue with the Government, these discussions did not reach a conclusion. This report provides alternative options to address each desired restitution outcome, and will therefore help inform the Government's decision-making process.

5.172 The two separate options are explained in the following paragraphs.

	Pros	Cons
<b>Option B</b>	<ul style="list-style-type: none"> <li>Facilitates full monetary restitution for beneficial owners</li> <li>More likely to attract participation from the investment and wealth management industry</li> <li>Beneficial owners will not be disadvantaged by having assets transferred</li> </ul>	<ul style="list-style-type: none"> <li>Has an inherently higher level of risk attached to reclaim amounts, which will require more prudent reserving and therefore a lower value of funds distributed for the benefit of good causes</li> <li>Potentially complex to administer and more costly</li> <li>Requires more skilled operations and oversight</li> </ul>
<b>Option C</b>	<ul style="list-style-type: none"> <li>Operationally more straightforward so less costly to operate</li> <li>Risk inherent in reclaim reserving is lower so funds can be distributed for the benefit of good causes at a potentially faster rate</li> <li>Transferred assets are protected from fluctuations in market values so beneficial owners cannot ultimately reclaim less than the transferred value</li> </ul>	<ul style="list-style-type: none"> <li>Beneficial owners may be disadvantaged by having assets transferred, if market performance exceeds the interest uplift</li> <li>Without full monetary restitution to customers, firms' voluntary participation levels may be lower, particularly in respect of assets currently held in trust</li> </ul>

### Option B

5.173 If the central policy decision is that a valid claimant is restored to an identical cash-equivalent position as they would have had in the event that a historical transfer to the reclaim fund had not occurred, the only practical way in which the reclaim fund can operate to allow for both reserving for future claims and making some distributions for the benefit of good causes, is to construct the mechanism so that the reclaim fund can actively manage the risk of market movements on transferred assets. It should be noted that as no customer can ever be disadvantaged under this scheme option, compared to them continuing to hold the asset, it may have the effect of absolving customers from taking responsibility for their finances by updating their contact details with firms.

5.174 For the reclaim fund to make distributions for the benefit of good causes, it has to be able to identify the surplus of transferred assets that will likely not be reclaimed. The reclaim fund does this by reserving for the amount that may be reclaimed in the future. With a requirement for full monetary restitution, reclaim reserving would need to cater for the transferred asset value, future market movements, and a potential additional overlay for exchange-rate movements in respect of non-sterling assets, where asset values are subject to both non-foreign exchange and foreign exchange market movements.

5.175 The goal is thus for the reclaim fund's portfolio of transferred assets to mirror the performance of the original, pre-transfer assets that are reclaimed in the future.

### Process

5.176 To achieve this mirroring, the reclaim fund could use the received cash equivalent values of transferred assets susceptible to market movements and reinvest these values. Alternatively, the reclaim fund could receive some or all transfers of potentially dormant assets in their original form. This 'in specie transfer' would allow the reclaim fund to actively manage the entire portfolio of transferred assets to match the performance of dormant, transferred assets with equivalent non-transferred assets for the benefit of future claimants.

5.177 Any in specie assets transferred, but not retained in order to meet future claims could be liquidated, and if necessary reinvested, and the surplus distributed for the benefit of good causes.

### Costs of the option

5.178 Requiring the reclaim fund to meet future claims that are based on market and / or currency fluctuations will increase the risk margin that needs to be included within the reclaim fund's reserves. The risk margin may be characterised as an amount over and above that which may be reclaimed under a normalised scenario. This additional margin would act as a safety net should the normalised scenario for reserving prove to be insufficient. This option may also result in the incurring of increased costs in the running of the reclaim fund as a result of increased complexity of operations and oversight.

5.179 The reclaim fund risk margin would need to be greater than in other options due to the greater uncertainty of value of future claims, based on both a set level of claims and on a defined level of risk. Under this option, the Commission would recommend that the reclaim fund Board should set risk parameters based on their responsibilities and in accordance with the expanded scheme enabling legislation. These parameters should then be implemented in terms of an asset-matching and reserving strategy, which would be applied leaving the resultant levels of surplus to be distributed for the benefit of good causes.

5.180 Without wishing to diminish the increased complexity of managing multiple assets and lines of stock, many of these tasks could be outsourced, potentially at modest cost. The additional complexity for the reclaim fund is therefore reduced to the need for long-term retention, and matching, of assets against their potential future claim liabilities. Therefore under this option, the Commission does not believe this would be unworkable.

5.181 Given the increased complexity of the reclaim fund and the requirement, under this option, for it to effectively act as an asset manager, there will need to be a more involved governance structure than under other options. Accordingly, the individuals overseeing the governance would need to be more skilled, which in turn may both increase costs and decrease the pool of potential individuals able and available to fill such roles.

#### *Benefits of the option*

5.182 The Commission has given consideration to the appropriate degree of customer protection that should apply to all aspects of an expanded scheme. This has partly resulted in the Commission's recommendation to maintain the right for a beneficial owner to reclaim transferred assets in perpetuity. Additionally however, the most protected reclaim outcome for customers and beneficial owners is to ensure that no individual is in a worse position as a result of a transfer to the scheme than they had been had transfer not occurred. This option would ensure this.

5.183 The Commission is aware that a number of assets recommended for inclusion in an expanded scheme have structures which bring an overarching duty of care to customers, such as trusts. Without an undertaking to mirror market movements into the future for the benefit of a possible claimant, voluntary participation in an expanded scheme by firms holding such assets may be low. Therefore this option may see greater levels of participation, and therefore value of transferred assets, than the alternatives.

#### **Option C**

5.184 Should the decision regarding the restitution goal be that it is desirable to return beneficial owners to a reasonable, but not identical, position to that had the transfer not occurred, the reclaim fund mechanism may be simplified in comparison to Option B.

5.185 The reclaim value would be based on the transferred value plus some form of value appreciation uplift between the dates of transfer and any reclaim, and would not be tied to market or currency movements.

#### *Process*

5.186 An asset identified for transfer would be realised into cash, and denominated in sterling if it is originally in a foreign currency, at the point of transfer to the reclaim fund. The record of this value would need to be retained by the transferor.

5.187 The disassociation of value from market movement raises the question concerning what form of value appreciation the beneficial owners of transferred assets of this type should be entitled to reclaim. It would clearly be unreasonable for the reclaim value to be fixed in perpetuity at the transferred value without possibility of appreciation: however there is a range of possibilities for calculating the uplift.

5.188 The Commission's view is that with a crystallised, liquidated asset value, the most equitable form of appreciation that should be applied is in the form of an interest rate. At the most basic level, the applicable interest rate could be pegged as being equal to that of inflation. This would cater for changes in the time value of money, but not for any real increase in value between the dates of transfer and reclaim.

5.189 Another alternative would be for a flat rate of interest to be applied to all transfers of assets. While simple to calculate and administer for the reclaim fund, this may leave beneficial owners exposed to the risk of large future movements in interest rates. While that may be to the benefit of a claimant if interest rates fall, it may also act as a source of discontent if interest rates rise above that of the agreed flat rate. A further alternative would be for the interest rate to be pegged to an interest rate structure that attempts to provide a market rate of return for transferred values over the period between transfer and reclaim.

5.190 However, on balance, the Commission's view is that the fairest and most acceptable appreciation calculation to be applied is for interest between the dates of transfer and reclaim to be LIBOR plus a small margin. This would allow the reclaim fund a level of certainty in their reserving calculations, but would also provide claimants with value appreciation on their asset based on market rates of interest between transfer and reclaim, perhaps equivalent to what they would have received had they themselves liquidated the asset at the point of transfer to the fund and then invested the result.

#### *Costs of the option*

5.191 Without restoration of claimants to an identical cash-equivalent position as had transfer not occurred, some beneficial owners of transferred assets could be disadvantaged under this option. This may occur if the value of the original asset at the date of reclaim is higher than the cash equivalent value of the asset at the date of transfer plus interest thereon between the dates of transfer and reclaim. However, it is important to note that for such a disadvantage to happen, all of the following events would need to occur:

- The beneficial owner would need to have disregarded their FCA – and potentially product – responsibilities to maintain current contact details with the transferor;
- The robust reuniting process would have to have been unsuccessful in reuniting the asset with the beneficial owner. This means that, in accordance with the Commission's discussions with specialist tracing agents which indicate that as many as 95% of gone-away beneficial owners could be traced, they are either in the 5% of people who are untraceable, or they have not acted upon a firm's efforts to reunite them with their assets; and
- The interest appreciation earned by the transferred asset would still need to be less than the market return earned by an identical asset that had not been transferred.



5.192 The possibility that a small number of customers or beneficial owners may, to some extent, be disadvantaged does however present a risk that potential transferor firms will use this as a reason not to voluntarily participate in an expanded scheme. In turn, while the reserving risk margin may be lower than under alternative options, the aggregate value of transferred assets may also be lower.

5.193 It must also be highlighted that market and currency performance can be negative as well as positive, and therefore this option may actually be to the advantage of dormant asset holders if the transfer of their asset results in a crystallisation of the asset's value at a higher point in the market than that which an identical asset obtains at the date of reclaim.

#### *Benefits of the option*

5.194 This option is more operationally straightforward than a structure to ensure full monetary restitution. Accordingly, the governance requirements are less onerous and the cost burden associated with all aspects of this option are reduced, leading to a lesser degree of cost drag on the total value of transferred assets potentially available for reclaim by beneficial owners or distribution for the benefit of good causes.

5.195 Greater reserving certainty is possible under Option C, by virtue of there being greater reclaim value certainty than under Option B, assuming an identical level of reclaims and a defined risk appetite. Interest rate appreciation on a dormant asset would not be directly driven by market movements, and therefore reserving for future reclaims need carry a lesser risk margin than when reserving must cater for wider fluctuations in market performance. The combination of these factors may result in an accelerated rate of distribution of transferred assets for the benefit of good causes than under alternative options.

5.196 This option also fixes a reclaim value for all beneficial owners which cannot be eroded by either fees potentially levied on assets that are not transferred, or negative market movements. Accordingly, this option will result in there being appreciating value available for reclaim by a beneficial owner in perpetuity.

#### **Conclusion**

5.197 Assuming the same level of participation in the expanded scheme between options B and C, Option C has lower risk of reclaim fund reserves being insufficient to meet future reclaims. It is also the lower cost option, and would enable a greater value of transferred dormant assets to be distributed for the benefit of good causes at an earlier stage.

5.198 However, the Commission recognises the importance of seeking to provide full restitution to claimants as it is felt that this is the fairest and most protected restitution outcome for consumers, be they customers or beneficial owners. While some beneficial owners may lose out if full monetary restitution is implemented and market values fall, this loss is in comparison to alternative restitution structures rather than to the situation had the transfer not taken place.

5.199 The Commission has analysed and discussed at length what it feels are the three broad restitution options outlined in this section. However, it recognises that the implementation of any of these options will only affect a small proportion of transferred assets. Despite this, the selection of the most appropriate option is important, and crucially, hinges on the Government's central view regarding the importance of complete customer protection in the design of an expanded scheme as discussed in paragraphs 5.170–5.171. The most appropriate option can therefore only be recommended once the Government has taken this decision. This decision was not reached by the time of the Commission's report. The Commission recognises that further work is required following its report, to explore the complexity and operational challenges presented by these options and help inform the Government's decision.

#### **Recommendation 5.29**

From the beneficial owners' perspective, the fairest and most protected option is for full monetary restitution. The Government should therefore seek to implement an expanded scheme with full monetary restitution. However the Commission recognises that this option is complex and may present significant challenges. A final decision on the restitution structure will require the Government to take a view, balancing the potentially substantial operational and risk management issues of this option, with the willingness of industries to voluntarily participate in an expanded scheme that provides an alternative to full monetary restitution but which limits risk and cost exposure.

#### **Additional considerations for assets denominated in currencies other than sterling**

5.200 Currency movements between the dates of transfer and reclaim may or may not result in a favourable outcome for the claimant, and the reclaim fund could conceptually accept transfer of an asset denominated in any currency. Should a valid reclaim be made and require repayment, the reclaim fund could also conceptually make payment in either the denominated currency of the asset, or in sterling.

5.201 If Option B is chosen, this may require the reclaim fund to hedge foreign exchange risk. Holding assets denominated in multiple currencies may also require a secondary layer of reserving. In turn, this may mean that cross-fertilisation of asset pools in the manner explained in Paragraph 5.162 to meet reclaims as they arise, would be less all-inclusive with multiple currencies of operation.

5.202 The reclaim of assets originally denominated in a currency other than sterling is more complex than their transfer and is dependent upon who bears the risk of currency market movements in the period between the dates of transfer and reclaim. Whether a claimant should receive payment of their reclaim in the currency of the original asset or whether this should be in sterling depends upon the outcome of the Government policy decision concerning their desired restitution outcome.

- 5.203 The theory underpinning the currency of reclaim payment should be consistent with the choice of restitution outcome. If the Government implements an expanded scheme with full monetary restitution, any currency market risk should be borne by the reclaim fund and reclaim repayment should therefore be in the original currency. This has further implications for any agency agreement between the transferor and reclaim fund to deal with reclaims. The specifics of this should be considered when implementing the expanded scheme, following the Government's response to this report.
- 5.204 If the Government implements an expanded scheme with anything other than full monetary restitution, the reclaim fund need not bear currency-market risk. Indeed, to ensure consistency with other forms of market movement, the reclaim fund should definitively not bear the risk of currency market movements. However, further work and consultation will be required to determine whether this risk should be wholly borne by the transferor, wholly borne by the claimant, or borne by some combination of the transferor, claimant and reclaim fund.

#### **Recommendation 5.30**

Once the Government's decision concerning the desired restitution outcome has been made, further work and consultation should be undertaken. This should determine whether the payment of reclaims should be in sterling or the original pre-transfer currency, and the impact of this upon agency agreements for transferors to meet reclaim payments before seeking subsequent reimbursement from the reclaim fund.

### **Impact of taxation**

- 5.205 Expanding the range of assets to be covered by the dormant assets scheme potentially increases the number of assets which have a tax wrapper and which are affected by the scheme's provisions. Consideration therefore needs to be given to how the favourable tax status of such products should be treated throughout the process from the point of transfer to potential reclaim or distribution for the benefit of good causes.

### **Tax neutrality**

- 5.206 Under the current scheme, the beneficial owner of a transferred Cash ISA is treated in a tax-neutral manner as on reclaim, they are restored to the position as though the transfer had not occurred, thereby continuing to benefit from the annual allowances for tax-efficient contributions made in the years until transfer of the Cash ISA into the scheme.
- 5.207 In terms of the expanded scheme, the Commission anticipates that a precedent has been established via the current scheme, and therefore any assets within a tax wrapper which are transferred into the expanded scheme should be treated in a similarly tax-neutral manner.

- 5.208 This tax neutrality would also require HMRC to be comfortable that the principles of taxation as applied to the current scheme would apply to any taxable gains for some of the assets considered within the scope of an expanded scheme.

### **Tax inefficiency**

- 5.209 Separately to the circumstances regarding tax wrappers, in the course of its work, the Commission has become aware that there may be tax inefficiency within the current scheme.
- 5.210 Had the transfer of an asset not occurred, and assuming for simplicity that the earned investment income matched the interest paid to the beneficial owner, no profit would be derived by the bank or building society and therefore no tax would be payable by them. The individual would pay their usual rate of income tax on the interest they receive in each tax year.
- 5.211 Under the current scheme, The Dormant Bank and Building Society Accounts (Tax) Regulations 2011<sup>16</sup> describe the treatment of transferred bank and building society accounts with respect to taxation and arising tax liabilities. In summary, the only point of the transfer and reclaim process at which an income tax liability arises is when the beneficial owner receives payment of a reclaim. At that point, the beneficial owner declares the accrued interest element between the dates of transfer and reclaim, as they would have done on an annual basis had they not lost contact with their asset.
- 5.212 With the addition of the reclaim fund to the process, the bank or building society intermediates between claimant and reclaim fund. Accordingly, the bank or building society would again not face a tax liability. A valid claimant will receive repayment gross of income tax and therefore still pay income tax on any interest growth arising between the dates of transfer and reclaim. Additionally, during that period however, the reclaim fund will have invested the transferred value and earned investment income. The reclaim fund is subject to corporate tax on this income, irrespective of the fact that if it perfectly matches interest paid to a claimant, the reclaim fund would not have generated a gain. It is therefore possible for the same £1 of transferred asset value to be subject to both corporate and income tax if it is subsequently reclaimed by a beneficial owner.

#### **Recommendation 5.31**

The impact of a transfer on individual customers should be tax-neutral. Distributions for the benefit of good causes from the reclaim fund should continue to be exempt from tax. The incidence of income tax should be the same as for the current scheme, which is only at the point of a successful reclaim.

**Recommendation 5.32**

The tax treatment of all assets in the current and expanded schemes should be reviewed in order that any potential risk of double taxation is removed.

## REPORTING THE EFFECTIVENESS AND EFFICIENCY OF THE EXPANDED SCHEME

- 5.213 Paragraphs 5.82–5.86 describe the HM Treasury report regarding the participation of firms in the current scheme.<sup>17</sup> However, even had sufficient data been readily available for HM Treasury to make an assessment of the effectiveness of reuniting activity or extensiveness of participation within firms, an expanded scheme will significantly complicate this review and analysis.
- 5.214 Obtaining an answer to the questions of effectiveness and extensiveness with a widely expanded range of assets will require a correspondingly wide range of industry and product technical knowledge and likely considerable data-analytics power.

### Monitoring the effectiveness of reuniting efforts and the extensiveness of voluntary participation

- 5.215 The Commission hopes that its recommendations concerning the disclosure of information by firms about the aggregate value of potentially dormant balances they hold, as discussed in Paragraphs 5.88–5.90, will help to address some of the difficulty in answering critical questions pertaining to the current scheme. The disclosure will have the additional benefit of assisting with wider awareness of the issue of dormant assets.
- 5.216 However, even with the changes to the disclosure requirements, given the complexity of the expanded scheme, the best party to review the effectiveness of reuniting efforts made by participants, and the extensiveness of voluntary participation, may be the reclaim fund. The reclaim fund sits in the centre of all processes impacted by transfer, reclaim and reserving, and may therefore be best positioned to form a view on these processes.
- 5.217 Under the current scheme, the reclaim fund has minimal need or scope to monitor the overall operation of the scheme. This empowerment should be granted with a requirement for the reclaim fund to submit periodic reports to the Government with appropriate recommendations concerning how these two critical aspects may be improved on an ongoing basis.

- 5.218 In the fullness of time, and if participation levels are lower than expected, the output of this monitoring and reporting to the Government may include a recommendation to move from a voluntary scheme to one which requires mandatory firm participation. It may also recommend the inclusion of additional types of assets within the scope of the expanded scheme.

### Monitoring the reclaim fund

- 5.219 One aspect that it would be inappropriate for the reclaim fund to report on is the efficiency and effectiveness of its own operation, and especially the balance it strikes between reserving for future reclaims and making distributions of any surplus for the benefit of good causes. This should continue to be independently reviewed.

**Recommendation 5.33**

The reclaim fund should review the expanded scheme every three years from launch and, where necessary, make recommendations for its improvement to the responsible Secretary of State. This review should hold at its core two critical questions: how effective are firms' reuniting efforts, and how extensive is voluntary participation in the expanded scheme.

**Recommendation 5.34**

The efficiency and effectiveness of the reclaim fund operation should additionally be independently reviewed every five years, with recommendations made to the responsible Secretary of State regarding any possible improvements.

<sup>17</sup> HM Treasury, Review of Dormant Bank and Building Society Accounts Act 2008, 27 March 2014

## Chapter 6

# Legislation and regulation

## SUMMARY

At the outset of its work, the Commission decided that it should not be constrained by the existing legal and regulatory status quo and that, where appropriate, it should identify potential hurdles to an expanded scheme, and suggest ways to overcome them.

The Dormant Bank and Building Society Accounts Act 2008 provided the legislative framework for the current scheme. In making recommendations to expand the current scheme and bring more industries and asset types into scope, the Commission anticipates that legislative changes will be required to enable this.

These changes will have to deal with the provisions for new definitions of dormancy, and their application to UK-domiciled assets (regardless of the residency of the beneficial owner). In addition, amendments to trust law will also be required to absolve trustees of liability, and to the Financial Conduct Authority's Collective Investment Schemes sourcebook to grant authority to investment fund managers, so that both can participate in the scheme, and transfer into it the dormant assets they currently hold.

This chapter sets out a table summarising the legal or regulatory changes that may be necessary as a result of some of the Commission's recommendations. This is followed by a further table summarising other recommendations made by the Commission that do not require immediate change to legislation or regulation.

## CURRENT POSITION

- 6.1 The Dormant Bank and Building Society Accounts Act 2008 (the Act) provides the legislative framework under which the current scheme operates. The Act was enacted on 26 November 2008 and provides for the operation of a dormant accounts scheme that includes bank accounts held by bank and building societies only.
- 6.2 The Commission's recommendations for amending the existing Act to facilitate the expansion of the existing scheme and the improved administration of the current one are set out in Chapter 5. The Commission would like to maintain the existing right, set out in section 1(2)(b) of the existing Act, of customers to reclaim any transferred amount from the reclaim vehicle at any time.
- 6.3 The existing Act provides that reclaim liability passes from the transferor to a reclaim fund with the transfer of the relevant asset (section 1(2)). The Commission considers that it is essential that this same principle is applied to any new assets that are included in the scope of an expanded scheme and subsequently transferred to a reclaim fund. To achieve this, it may be necessary to specifically extinguish liability from the transferor so that the transfer of liability to a reclaim fund is beyond doubt. The Financial Conduct Authority's Client Assets sourcebook (CASS) rules may also need to be amended to align with this, in particular CASS rules 6.2.10, 6.2.14, 7.11.50 and 7.11.54.<sup>1</sup>

## LEGAL AND REGULATORY IMPLICATIONS OF AN EXPANDED SCHEME

- 6.4 To enable an expanded dormant assets scheme to operate there will need to be some form of enabling legislation, being either amendments to the existing Act and / or a new act dealing with the provisions for an expanded scheme. Enabling legislation will deal with issues such as dormancy definition, transfer of reclaim liability from the transferring institution to a reclaim vehicle, and application of the scheme to UK-domiciled assets regardless of the residency of the owner or beneficiary.
- 6.5 In addition to enabling legislation, there will also be other consequential amendments to existing law and regulation required to facilitate the ongoing operation and expansion of the current scheme.

### Trust law

- 6.6 The Commission makes recommendations to enable trustees to transfer dormant assets out of a trust vehicle and into an expanded scheme. The main examples of where this might occur is for an authorised Unit Trust where a professional trustee oversees the vehicle, and for insurance and pensions assets held in trust.

- 6.7 To encourage participation in the scheme by investment vehicles that are managed by trustees and insurance and pensions assets that are held in trust, the Commission recommends discharging trustees from their obligations to investors where trustees choose to contribute dormant assets to the expanded scheme. This will need to be reflected in the enabling legislation and the various trusts and trustee acts that govern the operation of trusts in the UK.
- 6.8 In addition, most investment funds are managed and controlled by an independent investment manager, which means that authority for the manager to instruct the custodian / depository to release assets in circumstances where the account holder's investment is deemed to be dormant will need to be created.

#### Recommendation 6.1

Trust law should be amended to allow trustees to transfer genuinely dormant trust assets to an expanded scheme and to absolve them of any liability for making such a transfer.

#### Recommendation 6.2

For regulated funds, the Financial Conduct Authority's Collective Investment Schemes sourcebook should be amended to facilitate the transfer of dormant assets by the custodian / depository to the expanded reclaim fund. For unregulated funds, authority to make such a transfer will need to be included in the applicable fund's constitutional documents.

## TABLE OF LEGAL AND REGULATORY PROVISIONS REQUIRING INTRODUCTION OR AMENDMENT

Figure 6.1 sets out the areas of law and regulation that the Commission has identified as requiring amendment or introduction as a result of its recommendations, grouped by broad legal and regulatory themes. The table thus serves as a summary of legal and / or regulatory changes that might be necessary as a result of the Commission's recommendations. More work by Government will be required to determine the best way of implementing the necessary changes.

Figure 6.1 – Legal and regulatory provisions requiring introduction or amendment		
Theme 1: Recommendations which require changes to be made to the existing Act		
Number	Recommendation	Notes
1.1	The alternative dormant accounts scheme should be abolished, given the lack of take up to date and that there will be no equivalent alternative schemes proposed for other asset types.	The provisions of the existing Act providing for the alternative scheme should be repealed – s2 and s13.
5.10	The Act should be amended to stipulate there be only a single reclaim fund. This fund should be reconstituted and have significant ongoing private-sector expertise.	The existing Act provides for the existence of more than one reclaim vehicle – s5. New provisions will be required to limit the scheme to a single reclaim fund.
5.21	Should further clarification be required, enabling legislation should include provision that a transferor retaining data to validate the reclaim of transferred assets does not contravene data protection legislation.	
Theme 2: Additions to the existing Act (or a new act)		
Number	Recommendation	Notes
1.4	The Commission recognises the Government position is that dormant NS&I assets are used for public benefit, but recommends that the Government reconsiders whether these, excluding Premium Bonds, are included in an expanded dormant assets scheme.	
2.1	The assets comprised in the endowment, term insurance, pension, annuity, whole-of-life, drawdown and investment bond products set out in Figures 2.1 and 2.2 should be included within an expanded dormant assets scheme and that any transfer of assets to the reclaim fund is made in a cash form.	Dormancy of assets may also be defined by industry guidance.
2.5	General insurance should be excluded from an expanded dormant assets scheme, with the exception of uncashed cheque payments due to clients that sit either with insurers or brokers.	Only need to include provision to capture unclaimed cheques as general insurance is not currently in scope of the existing scheme.
3.1	Cash and non-cash investment and wealth management assets, with both currently crystallised and not currently crystallised values, should be included in an expanded scheme.	Dormancy of assets may also be defined by industry guidance. Financial Conduct Authority's Collective Investment Schemes sourcebook (COLL) 6.8.4 would also require amendment to enable transfer to an expanded scheme.
5.1	The existing reclaim fund should become structurally separate from the Co-operative Group and be reconstituted, retaining a strong commercial focus. The Government, in consultation with various parties including the existing reclaim fund and its parent, should undertake a process to determine the best future structure.	
5.2	The governance of the reclaim fund should provide for the Chair and other directors to be appointed by Government through a process which appropriately reflects the reclaim fund's structure.	
5.9	The reclaim fund managing an expanded scheme must comply with the recommendations in Part A of Chapter 5. If these are implemented, then the reclaim fund administering the mechanism of the expanded scheme should continue to be RFL.	If Reclaim Fund Ltd continues to administer the expanded scheme, this may be enshrined in legislation.
5.12	The expense of obtaining advice from a technical panel and other outside expertise should be classified as a defrayed expense and therefore may be funded from the value of transferred assets. The Act should be modified, and any enabling legislation expressly permit this.	

5.26	For assets where transferring the value does not involve the loss of possible value movements by anything other than a simple interest-rate linked movement, such assets should be transferred to the reclaim fund at the crystallised value and in cash form.	
5.28	For assets where transferring the value does not involve the loss of possible value movements by anything other than a simple interest-rate linked movement, should the claimant be able to prove they are due a different rate of interest to that agreed between transferor and reclaim fund, the cost of any uplift should be borne by the transferor.	The existing Act provides for interest to be considered, s8(1), but is not specific about how to resolve issues where it is difficult to determine what interest is due.
5.29	From the beneficial owners' perspective, the fairest and most protected option is for full monetary restitution. The Government should therefore seek to implement an expanded scheme with full monetary restitution. However the Commission recognises that this option is complex and may present significant challenges. A final decision on the restitution structure will require the Government to take a view, balancing the potentially substantial operational and risk management issues of this option, with the willingness of industries to voluntarily participate in an expanded scheme that provides an alternative to full monetary restitution but which limits risk and cost exposure.	Legislation will need to reflect whichever option the Government decides to implement.
5.30	Once the Government's decision concerning the desired restitution outcome has been made, further work and consultation should be undertaken. This should determine whether the payment of reclaims should be in sterling or the original pre-transfer currency, and the impact of this upon agency agreements for transferors to meet reclaim payments before seeking subsequent reimbursement from the reclaim fund.	
5.33	The reclaim fund should review the expanded scheme every three years from launch and, where necessary, make recommendations for its improvement to the responsible Secretary of State. This review should hold at its core two critical questions: how effective are firms' reuniting efforts, and how extensive is voluntary participation in the expanded scheme.	
5.34	The efficiency and effectiveness of the reclaim fund operation should additionally be independently reviewed every five years, with recommendations made to the responsible Secretary of State regarding any possible improvements.	
6.1	Trust law should be amended to allow trustees to transfer genuinely dormant trust assets to an expanded scheme and to absolve them of any liability for making such a transfer.	
<b>Theme 3: Regulatory changes</b>		
<b>Number</b>	<b>Recommendation</b>	<b>Notes</b>
3.2	Enabling legislation covering an expanded scheme should take precedence over existing CASS and COLL rules, which should be modified if necessary to align with the enabling legislation.	CASS and COLL rules to be amended as required.
5.8	All firms that have potentially dormant assets should produce an annual assessment of the levels of assets held within the firm which cannot be reunified with beneficial owners. This assessment should include the aggregate value and number of affected beneficial owners on an asset-by-asset basis, and be included in annual reports. Adoption of this disclosure should be in place within three years of the date of this report.	FCA rules to be amended to introduce this requirement.
5.14	The FCA should recognise the agreed, standardised tracing and reuniting procedures developed on an industry-by-industry basis. Once recognised, transferors should adhere to this procedure as a component of their responsibilities to customers and irrespective of participating in the expanded scheme.	See also Recommendation 5.13. Once tracing procedures have been developed, these may need to be incorporated into the existing Act.
5.15	The agreed procedure to reunite beneficial owners with their assets should be proportional to the value of potentially dormant assets. A stepped procedure may result. The financial cost of reuniting efforts for a corporate group should not exceed the total value of the beneficial owner's potentially dormant assets within that corporate group, and this cost should be borne by the corporate group and not the beneficial owner.	See also Recommendation 5.13. Once tracing procedures have been developed, these may need to be incorporated into the existing Act.
6.2	For regulated funds, the Financial Conduct Authority's Collective Investment Schemes sourcebook should be amended to facilitate the transfer of dormant assets by the custodian / depositary to the expanded reclaim fund. For unregulated funds, authority to make such a transfer will need to be included in the applicable fund's constitutional documents.	



Theme 4: Changes to HM Revenue and Customs tax rules		
Number	Recommendation	Notes
5.31	The impact of a transfer on individual customers should be tax-neutral. Distributions for the benefit of good causes from the reclaim fund should continue to be exempt from tax. The incidence of income tax should be the same as for the current scheme, which is only at the point of a successful reclaim.	
5.32	The tax treatment of all assets in the current and expanded schemes should be reviewed in order that any potential risk of double taxation is removed.	

For completeness, the following is a list of the recommendations that do not require any changes to legislation or regulation.

Chapter 1			
1.2	1.3	1.5	1.6
Chapter 2			
2.2	2.3	2.4	2.6
Chapter 4			
4.1	4.2	4.3	-
Chapter 5			
5.3	5.4	5.5	5.6
5.7	5.11	5.13	5.16
5.17	5.18	5.19	5.20
5.22	5.23	5.24	5.25
5.27	-	-	-
Annex C			
AC1	-	-	-

# Annexes

## **Annex A**

Membership, remit and work of the commission

## **Annex B**

Report recommendations

## **Annex C**

Non-financial services sector assets

## **Annex D**

International dormant assets scheme comparisons

## **Annex E**

Call for evidence: a summary of the key themes

## **Annex F**

Background to the dormant assets in the UK

## ANNEX A MEMBERSHIP, REMIT AND WORK OF THE COMMISSION

### Membership of the Commission

In December 2015, the Government announced the creation of the independent Commission on Dormant Assets and appointed Nick O'Donohoe, former Chief Executive of Big Society Capital, as its Chair. The commission was launched in March 2016. It had nine Commissioners from across the financial services and professional services sectors.

Chair	
Nick O'Donohoe	Former Chief Executive of Big Society Capital and Senior Advisor to the Gates Foundation
Commissioners	
Richard Collier-Keywood	Vice-Chairman, PwC Global Network
Kirsty Cooper	Office of the Chairman, Group General Counsel and Company Secretary of Aviva plc
Gurpreet Dehal	Former Global Chief Operating Officer for the Prime Services Business of Credit Suisse
Sean Donovan-Smith	Head of the Investment Management and Funds Group of K&L Gates LLP / London
Rachel Hanger	Partner and UK Head of Investment Management & Funds Tax of KPMG London
Jackie Hunt	Member of the Management Board of Allianz SE
Mark Makepeace	Chief Executive, FTSE Russell and Group Director of Information Services, London Stock Exchange Group
Susan Sternglass Noble	Senior Adviser to the Investor Forum
Martin Turner	Former Group Business Risk Director of Lloyds Banking Group
The Commission's work has been supported by a small civil service secretariat.	

### The Commission's remit

Government asked the Commission to provide expert, independent and impartial advice and evidence on:

- which dormant assets could be brought into an expanded dormant assets scheme, and how they can be identified by industry;
- the projected size of the funding pot this could produce for good causes;
- whether, with the potential increase of dormant assets being released by industry, the current system was able to manage the burden; and
- whether any new legislation should include a requirement for improved transparency from industry on disclosing the level of assets within their sector.

### Valuations overview

Before the Commission was established, very little work had been carried out, either by the Government or individual industries or firms, looking at potential types of dormant assets and their values, over and above those included in the current scheme.

Other very high valuations have been placed on the overall level of potentially dormant assets that might exist in the UK economy. However, the Commission was unable to substantiate these figures. The Commission's stance has been to carry out an objective review of the assets that could be brought into an expanded scheme and to estimate their potential value.

The Commission is grateful to the organisations and firms who have provided valuation information via the Commission's call for evidence. The call for evidence submissions, and certain assumptions, have been used to indicate the values potentially available for transfer within the banking, insurance and pensions, and investment and wealth management industries. Further details regarding this process are in Chapters 1, 2 and 3.

### Government will decide how any expanded dormant asset surplus is distributed

The Government was clear that the Commission's work should focus on identifying new sources of potentially dormant assets and how these might be brought into an expanded dormant assets scheme. The Commission did not look at where or how the spending of any new dormant asset surplus that is identified might be distributed. This decision lies solely with the Government.

### Criteria for considering assets in an expanded scheme

The Commission carried out an extensive scoping exercise assessing potential dormant assets in both the financial services and non-financial services sectors, evaluating assets against a range of criteria that included:

- how easily the asset could be accessed for transfer to a reclaim fund;
- how liquid the potential dormant asset was;
- how easily an individual beneficial owner could be identified;
- the likelihood of an asset being reclaimed by the beneficial owner following transfer; and
- whether the aggregate value of a potential dormant asset class was material to an expanded scheme.

### The Commission's work programme

#### Industry working groups

As part of the Commission's work, three industry focus groups were established, each headed up by a Commissioner, on banking, insurance and pensions, and investment and wealth management. This formation was supported by the British Bankers' Association, the Building Societies Association, the Association of British Insurers and the Investment Association.

Membership of the three groups comprised a cross-section of firms from the industries and included senior representatives from trade associations.

The working groups were used to help inform the Commission's thinking on a number of issues, including:

- which dormant assets could be brought into an expanded dormant assets scheme, and how they could be identified by industry; and
- the projected value of dormant assets that could be transferred for distribution to good causes.

In particular, discussions within the working groups were instrumental in the Commission reaching the definitions of dormancy explained in Chapters 1, 2 and 3.

The Commission is grateful for the support from the trade associations in helping to establish the focus groups and for hosting meetings, as well as for the invaluable contributions from the firms who participated in the working groups.

A fourth commissioner led the work reviewing the process for administering the current scheme. The Commission has held several discussions with both the Co-operative Group and Reclaim Fund Ltd and these have helped form the Commission's recommendations in this area.

### ***Call for evidence***

The Commission issued a call for evidence in May 2016 to around 200 key organisations, trade associations and regulatory bodies. Each was invited to supply information on a range of questions to support the Commission's work. Almost 100 responses were received.

Although the Commission was generally pleased with the level of engagement it received from the industries, there were a number of firms who did not respond to the call for evidence. Where the Commission felt that such firms were of strategic significance to the market, it followed up with the firms in question to remind them of the opportunity to respond.

Supplementary questionnaires were sent to those organisations that the Commission felt were well-placed to provide additional information on valuations. A summary of the responses to the call for evidence is in Annex E.

In addition to the work of the industry working groups, the call for evidence responses received from the industries were very helpful in shaping the Commission's proposals.

### ***Bilateral evidence***

The Commission and Secretariat have met with key stakeholders in both the financial services and non-financial services sectors, in particular the trade associations and regulatory bodies. The Commission would like to thank all those who have contributed to its work.

### ***Procurement***

A tender exercise was carried out and PricewaterhouseCoopers LLP (PwC) was recruited to work with the Commission in autumn 2016 to provide additional technical advice on certain issues. Where appropriate, PwC's findings have been incorporated into the Commission's report and recommendations.

## ANNEX B REPORT RECOMMENDATIONS

This annex details the Commission's estimates of when its recommendations might be implemented and which party is most likely to be responsible for delivery. In some instances, recommendations will likely be implemented by Government. In others, implementation will likely be led by a non-Government party and thought will have to be given to how this is overseen.

The Commission recognises the Government will have its own views on the implementation timetable and owners for delivery. Accordingly, the following table is intended as a guideline only.

### Legislation

A large number of recommendations are dependent or contingent upon appropriate legislation being in place. The current dormant assets scheme was created following the enactment of the Dormant Bank and Building Society Accounts Act 2008 (the Act). The Commission anticipates that some recommendations will either require amendments to the existing Act, or a new act, while other recommendations may be implemented via regulation or other secondary legislation.

### Sequencing

Where possible, a specific date for the commencement of work to address a recommendation, or the deadline for delivery of a recommendation, has been identified. However, a number of recommendations are predicated on events, the precise timing of which is difficult to forecast.

**Table of recommendations**

Number	Recommendation	Earliest starting point	Latest completion point	Anticipated owner
<b>Chapter 1: Banking and building societies</b>				
1.1	The alternative dormant accounts scheme should be abolished, given the lack of take up to date and that there will be no equivalent alternative schemes proposed for other asset types.	From date of Commission report	By date of enactment of enabling legislation	Government
1.2	Cash ISAs, TESSAs and the full range of suspense accounts should be transferred to the current scheme.	From date of Commission report	Ongoing	Banks and building societies
1.3	Foreign currency account balances should be included in an expanded scheme.	From enactment of enabling legislation	Ongoing	Banks and building societies
1.4	The Commission recognises the Government position is that dormant NS&I assets are used for public benefit but recommends that the Government reconsiders whether these, excluding Premium Bonds, are included in an expanded dormant assets scheme.	From date of Commission report	By date of enactment of enabling legislation	Government
1.5	The Government should review whether Child Trust Fund balances are included in an expanded scheme from 2020.	From date of Commission report	2020	Government
1.6	Credit unions should continue to be exempt from joining an expanded scheme.	From date of Commission report	Ongoing	Government
<b>Chapter 2: Insurance and pensions</b>				
2.1	The assets comprised in the endowment, term insurance, pension, annuity, whole-of-life, drawdown and investment bond products set out in Figures 2.1 and 2.2 should be included within an expanded dormant assets scheme and that any transfer of assets to the reclaim fund is made in a cash form.	From enactment of enabling legislation	Ongoing	Insurance and pensions firms
2.2	The eligibility of non-crystallised with-profits policies and funds should be reviewed regularly by industry participants, to reconsider them for inclusion in an expanded scheme as and when closed funds experience a 'tontine effect'. The Commission considers that the Government has a role to play in triggering such reviews and that ABI may be best placed to help facilitate these, in conjunction with industry, potentially at five-yearly intervals.	From enactment of enabling legislation	Every five years following enactment of enabling legislation	Government, ABI and insurance and pensions firms

Number	Recommendation	Earliest starting point	Latest completion point	Anticipated owner
2.3	All mutual insurance funds should be excluded from an expanded dormant assets scheme.	From enactment of enabling legislation	Ongoing	Government
2.4	All industrial branch insurance policies should be excluded from an expanded dormant assets scheme.	From enactment of enabling legislation	Ongoing	Government
2.5	General insurance should be excluded from an expanded dormant assets scheme, with the exception of uncashed cheque payments due to clients that sit either with insurers or brokers.	From enactment of enabling legislation	Ongoing	Government
2.6	The ABI and pension firms should develop the functionality of the proposed pensions dashboard to also facilitate efforts by firms to trace and reunite lost assets with customers.	From date of Commission report	Ongoing	ABI and insurance and pensions providers
<b>Chapter 3: Investment and wealth management</b>				
3.1	Cash and non-cash investment and wealth management assets, with both currently crystallised and not currently crystallised values, should be included in an expanded scheme.	From enactment of enabling legislation	Ongoing	Government
3.2	Enabling legislation covering an expanded scheme should take precedence over existing CASS and COLL rules, which should be modified if necessary to align with the enabling legislation.	From date of Government response	By enactment of enabling legislation	FCA for CASS and COLL
<b>Chapter 4: Securities</b>				
4.1	Registrars and depositaries should work with firms to provide an estimate of the value of unclaimed dividends, proceeds from corporate actions, dormant shareholdings, coupon payments and bondholdings that are held either directly by, or on behalf of, investors in their own name.	From date of Commission report	Prior to legislation being drafted	Registrars, depositaries and firms
4.2	The Government should conduct further work to ascertain whether obstacles exist to the inclusion of unclaimed dividends, proceeds from corporate actions, dormant shareholdings, coupon payments and bondholdings within an expanded dormant assets scheme, how these might be overcome, and thus whether such assets should be included within the scope of an expanded scheme.	From date of Commission report and in conjunction with output from recommendation 4.1	By enactment of enabling legislation	Government
4.3	Firms should amend their Articles where necessary to facilitate the provision of unclaimed dividend payments and dormant shareholdings to good causes after 12 years, be that via the reclaim fund or otherwise.	From date of Commission report	By enactment of enabling legislation	Firms
<b>Chapter 5a: Recommendations to improve the current reclaim fund model</b>				
5.1	The existing reclaim fund should become structurally separate from the Co-operative Group and be reconstituted, retaining a strong commercial focus. The Government, in consultation with various parties including the existing reclaim fund and its parent, should undertake a process to determine the best future structure.	From date of Commission report	By amendment of current Act	Co-operative Group, Government
5.2	The governance of the reclaim fund should provide for the Chair and other directors to be appointed by Government through a process which appropriately reflects the reclaim fund's structure.	From amendment of current Act	Ongoing	Government
5.3	While retaining the security of invested funds, the reclaim fund investment strategy should continue to provide for the matching, in length of term, between the maturity dates of investments and the likely forecast levels of future reclaims.	From date of Commission report	Ongoing	Reclaim Fund Ltd
5.4	The value of the capital reserve should be reduced to an amount that incorporates two separately calculated elements: RFL's ICAAP plus a reasonable amount to reflect the capital risk appetite of RFL, and the amount that is sufficient to fund a future reclaim run-off situation when there are no further incoming transferred assets.	From date of Commission report	Ongoing	Reclaim Fund Ltd

Number	Recommendation	Earliest starting point	Latest completion point	Anticipated owner
5.5	During 2017, either the provision for future distributions should be distributed for the benefit of good causes or, if work has been completed under the ongoing modelling exercise assuming a reasonable risk appetite, the amount this exercise determines should be distributed for the benefit of good causes.	From date of Commission report	By end of 2017	Reclaim Fund Ltd
5.6	The reserving model should continue to be reviewed and updated at least every two years.	From date of Commission report	Every two years from 2017	Reclaim Fund Ltd
5.7	RFL should continue to publish an annual report detailing which firms are participating in the scheme. However, to increase transparency, this information should be appropriately publicised, made more prominent and more readily accessible.	From date of Commission report	Ongoing	Reclaim Fund Ltd
5.8	All firms that have potentially dormant assets should produce an annual assessment of the levels of assets held within the firm which cannot be reunified with beneficial owners. This assessment should include the aggregate value and number of affected beneficial owners on an asset-by-asset basis, and be included in annual reports. Adoption of this disclosure should be in place within three years of the date of this report.	From date of Commission report	Q1 2020	Firms via reporting standards

#### Chapter 5b: Additional recommendations to enable the reclaim fund model to cope with an expanded range of assets

5.9	The reclaim fund managing an expanded scheme must comply with the recommendations in Part A of Chapter 5. If these are implemented, then the reclaim fund administering the mechanism of the expanded scheme should continue to be RFL.	From date of Commission report	By amendment of current Act	RFL, Government
5.10	The Act should be amended to stipulate there be only a single reclaim fund. This fund should be reconstituted and have significant ongoing private-sector expertise.	From date of Commission report	By amendment of current Act	Government
5.11	The Board of the reclaim fund should establish an advisory panel to provide technical subject matter expertise regarding the assets transferred under an expanded scheme. Membership of this panel should be re-evaluated on a biennial basis.	From enactment of enabling legislation	Ongoing	Reclaim fund
5.12	The expense of obtaining advice from a technical panel and other outside expertise should be classified as a defrayed expense and therefore may be funded from the value of transferred assets. The Act should be modified, and any enabling legislation expressly permit this.	For inclusion in amendment to current Act and enabling legislation	Ongoing	Government
5.13	Industry participants and trade associations should collaboratively develop an agreed, standardised procedure regarding the tracing and reuniting of potentially dormant assets with beneficial owners.	From date of Commission report	By enactment of enabling legislation	Banks and building societies, insurance and pensions firms, and investment and wealth management firms, and their associated trade bodies
5.14	The FCA should recognise the agreed, standardised tracing and reuniting procedures developed on an industry-by-industry basis. Once recognised, transferors should adhere to this procedure as a component of their responsibilities to customers and irrespective of participating in the expanded scheme.	Industry development of standardised tracing and reuniting procedure	By enactment of enabling legislation	FCA
5.15	The agreed procedure to reunite beneficial owners with their assets should be proportional to the value of potentially dormant assets. A stepped procedure may result. The financial cost of reuniting efforts for a corporate group should not exceed the total value of the beneficial owner's potentially dormant assets within that corporate group, and this cost should be borne by the corporate group and not the beneficial owner.	From date of Commission report	By enactment of enabling legislation	FCA, banks and building societies, insurance and pensions firms, and investment and wealth management firms, and their associated trade bodies

Number	Recommendation	Earliest starting point	Latest completion point	Anticipated owner
5.16	For new customers, firms should obtain consent from those customers to share their personal contact data with other firms in the same group, to be used for the express purpose of facilitating possible future tracing and reunification.	From date of Commission report	Ongoing	Firms
5.17	For existing potentially dormant customers, firms should seek alternative personal contact data from other firms in the same group to the extent allowed by current data permissions. If such permission does not exist, group firms should consider obtaining retrospective consent to allow contact data to be shared.	From date of Commission report	Ongoing	Firms
5.18	The practicalities of including National Insurance numbers as part of a death notification, to facilitate better reuniting of beneficial owners with dormant assets, should be explored.	From date of Commission report	By enactment of enabling legislation	General Register Office / Government
5.19	The process to reach an agreed, standardised procedure regarding the tracing and reuniting of potentially dormant assets with beneficial owners should consider electronic communications. The agreed procedure should also cater for beneficial owners who have previously elected to receive solely electronic communications.	From date of Commission report	By enactment of enabling legislation	FCA, banks and building societies, insurance and pensions firms, and investment and wealth management firms, and their associated trade bodies
5.20	Data supplied to the reclaim fund by participating firms should be in a standard form to include: asset type; individual asset value; transferor type; age of asset; and, where available, age of beneficial owner.	From enactment of enabling legislation	For inclusion in agency agreements	Reclaim fund, transferors
5.21	Should further clarification be required, enabling legislation should include provision that a transferor retaining data to validate the reclaim of transferred assets does not contravene data protection legislation.	From date of Commission report	For inclusion in enabling legislation	Government
5.22	Responsibility for the retention of the customer relationship with the beneficial owner, the management of data and records, and the verification of the validity of reclaims, should remain with the transferor.	From enactment of enabling legislation	Ongoing	Government
5.23	When validating reclaims in an expanded scheme, transferors or their corporate successors should act as agents of the reclaim fund in the same manner as is the case in the current scheme.	From enactment of enabling legislation	Agency agreement to be established between reclaim fund and transferors	Reclaim fund, transferors
5.24	The reclaim fund should investigate whether the reclaim tail could be economically underwritten by an external party, for example by a commercial reinsurer.	From date of Commission report	By Government response to Commission report	Reclaim fund
5.25	Where the reclaim tail risk passes to a third party, the transferor should continue to act as agent for the party who holds the ultimate financial liability for reclaim.	From any passing of reclaim liability to a third party	Ongoing	Reclaim fund, transferors
5.26	For assets where transferring the value does not involve the loss of possible value movements by anything other than a simple interest-rate linked movement, such assets should be transferred to the reclaim fund at the crystallised value and in cash form.	n/a	For inclusion in enabling legislation	Government
5.27	For assets where transferring the value does not involve the loss of possible value movements by anything other than a simple interest-rate linked movement, the transferor and reclaim fund should agree, at the point of transfer, the crystallised value of the asset and the rate of interest to apply to the value between the dates of transfer and any possible future reclaim.	n/a	For inclusion in enabling legislation and agency agreements	Government for enabling legislation; reclaim fund and transferors for agency agreements
5.28	For assets where transferring the value does not involve the loss of possible value movements by anything other than a simple interest-rate linked movement, should the claimant be able to prove they are due a different rate of interest to that agreed between transferor and reclaim fund, the cost of any uplift should be borne by the transferor.	n/a	For inclusion in enabling legislation and agency agreements	Government for enabling legislation; reclaim fund and transferors for agency agreements



Number	Recommendation	Earliest starting point	Latest completion point	Anticipated owner
5.29	From the beneficial owners' perspective, the fairest and most protected option is for full monetary restitution. The Government should therefore seek to implement an expanded scheme with full monetary restitution. However the Commission recognises that this option is complex and may present significant challenges. A final decision on the restitution structure will require the Government to take a view, balancing the potentially substantial operational and risk management issues of this option, with the willingness of industries to voluntarily participate in an expanded scheme that provides an alternative to full monetary restitution but which limits risk and cost exposure.	From date of Commission report	For inclusion in enabling legislation	Government
5.30	Once the Government's decision concerning the desired restitution outcome has been made, further work and consultation should be undertaken. This should determine whether the payment of reclaims should be in sterling or the original pre-transfer currency, and the impact of this upon agency agreements for transferors to meet reclaim payments before seeking subsequent reimbursement from the reclaim fund.	From Government decision regarding restitution options	By enactment of enabling legislation	Government
5.31	The impact of a transfer on individual customers should be tax-neutral. Distributions for the benefit of good causes from the reclaim fund should continue to be exempt from tax. The incidence of income tax should be the same as for the current scheme, which is only at the point of a successful reclaim.	From date of Government response	For inclusion in enabling legislation	HM Revenue and Customs
5.32	The tax treatment of all assets in the current and expanded schemes should be reviewed in order that any potential risk of double taxation is removed.	From date of Commission report	By amendment of current Act	HM Revenue and Customs
5.33	The reclaim fund should review the expanded scheme every three years from launch and, where necessary, make recommendations for its improvement to the responsible Secretary of State. This review should hold at its core two critical questions: how effective are firms' reuniting efforts, and how extensive is voluntary participation in the expanded scheme.	From enactment of enabling legislation	Every three years from enactment of enabling legislation	Reclaim fund
5.34	The efficiency and effectiveness of the reclaim fund operation should additionally be independently reviewed every five years, with recommendations made to the responsible Secretary of State regarding any possible improvements.	From amendment of current Act to reconstitute the reclaim fund	Every five years from amendment of current Act	Government
<b>Chapter 6: Legislation</b>				
6.1	Trust law should be amended to allow trustees to transfer genuinely dormant trust assets to an expanded scheme and to absolve them of any liability for making such a transfer.	From date of Government response	By enactment of enabling legislation	Government
6.2	For regulated funds, the Financial Conduct Authority's Collective Investment Schemes sourcebook should be amended to facilitate the transfer of dormant assets by the custodian / depositary to the expanded reclaim fund. For unregulated funds, authority to make such a transfer will need to be included in the applicable fund's constitutional documents.	From date of Government response	By enactment of enabling legislation	FCA / unregulated funds
<b>Annex C: Non-financial sector assets</b>				
AC1	The inclusion of non-financial assets in an expanded scheme has been discounted by the Commission at the current time; however, the Commission recommends that Government and the reclaim fund review this stance once the expanded scheme has been in place for three years.	From enactment of enabling legislation	Three years after enactment of enabling legislation	Government, reclaim fund

## ANNEX C NON-FINANCIAL SERVICES SECTOR ASSETS

The Government asked the Commission to review potential dormant assets for inclusion in an expanded scheme. Following initial consideration of a broad range of industries, a number were reviewed in more detail.

The Commission reviewed the following potential assets:

- Refunds and compensation (rail, air and Oyster card);
- Utility refunds (energy, telecoms and water); and
- Unclaimed gambling winnings.

### Refunds and compensation

The Commission carried out a high-level review of whether there were potential dormant assets within the transport industry – namely passenger refunds for rail or air delays.

#### Rail

There are 31 train operating companies and each has a Passenger's Charter. This is a guide to the level of service a passenger can expect to receive when using the firm's stations and their train services.

If a journey is delayed, passengers may be entitled to compensation. The compensation offered depends on the operator they travelled with, ticket type and length of the delay.

Each train firm publishes the details of their compensation arrangements within their Passenger's Charter. In addition, the nature of compensation offered will depend on the type of compensatory arrangement that the train firm has in place, according to the specific terms of their franchise commitment.

All rail companies offer refunds to customers whose journeys have been delayed, usually for 30 minutes or longer. However, the reclaim rate by passengers is historically very low and it is very difficult for firms to identify or trace passengers who may be eligible for a reclaim. This results in firms making an estimate for annual compensation payments and making a financial provision for this.

In December 2015, the consumers' association, Which?, issued a super-complaint on behalf of all rail passengers. This asked the Office of Rail and Road to investigate how easy it was for passengers to claim compensation payments for rail delays. In 2015, about 80% of passengers who were eligible to claim compensation did not do so.<sup>1</sup>

As rail refunds are a provision rather than an asset, the Commission recommends that these are not included in an expanded scheme.

#### Air

The Commission also looked at what scope there might be for including air refunds in an expanded scheme. Air compensation schemes are highly complex, with widespread individuals and airlines involved in the process across multiple nations. There is also interaction with EU regulation given that this is the origin of the compensation requirement, and feedback from the industry was that if assets were transferred to an expanded dormant assets scheme, this would have a negative impact on flight prices in order to fund any transfer.

The Commission recommends that as air refunds are not currently viable as a dormant asset, they be excluded from an expanded scheme.

#### Oyster cards

Transport for London (TfL) is responsible for Oyster cards. An Oyster card is classed as dormant by TfL if unused for 12 months or longer. There are nearly 42 million dormant cards, where passengers load them with value but fail to use the full balance. The rise of contactless cards as a payment option is expected to increase the stock of dormant Oyster cards.<sup>2</sup> The average balance on a dormant card is £2 and passengers are able to reclaim an unused credit balance at any time.

While there is no suggestion that travel fares using Oyster cards are partly underpinned by dormancy, unused deposits and balances do revert to TfL and are used for network improvements. The Commission supports the continued use of dormant Oyster card balances for this purpose.

#### Utilities

The Commission considered the potential dormant assets within the energy, telecoms and water utilities industries. Of the three industries, water providers were quickly discounted because credit balances are attached to residences rather than individuals.

#### Energy providers

There are six main energy providers: British Gas, E.ON, npower, SSE, ScottishPower and EDF. Ofgem is the industry regulator.

Potentially dormant assets in the industry comprise credit balances on energy accounts. The principle reasons for dormancy occurring are:

- The customer has cancelled a Direct Debit and the provider does not have accurate bank details to refund any credit balance to the customer; or
- Where there is no direct debit, the customer has moved property without providing new contact details, so the firm cannot provide a refund.

1 Office of Rail and Road, ORR Super Complaint Analysis, 2016

2 <https://tfl.gov.uk/corporate/publications-and-reports/oyster-card>

The largest energy providers are participating in an Ofgem campaign. From 2014, if the energy provider has not been able to return credit balances to a customer for two consecutive years, the money is instead donated to good causes, charitable organisations of the individual supplier's choice or to support customers who are struggling to pay their energy bills.

The Commission therefore recommends that the dormant assets within the energy sector are not suitable for inclusion in an expanded scheme. The use of dormant credit balances to help support good causes, charitable organisations and vulnerable individuals struggling to pay their bills is a worthwhile use of an aggregate balance that is unlikely to be material to an expanded scheme.

### Telecoms

Potential dormant assets within the telecoms sector include credit balances from landlines, mobile phones, broadband and television supplies when a customer cancels their service and does not provide a change of address.

The number of products involved may make identification and valuation difficult but estimates are low, at around £10m, making it unviable for firms in terms of set-up and administrative costs, to participate in an expanded scheme.

## Unclaimed gambling winnings

### Background

For the purposes of this report, the term 'dormant accounts' only applies to online or telephone betting functions, where a customer deposits money into a betting account, and falls into two main categories:

- Unclaimed winnings, including void bets (e.g. where a horse does not run); and
- Dormant accounts, where money is deposited into a betting account. If an account is inactive for a period of time, the account is either closed or monthly maintenance fees erode the funds over time; either way the money is absorbed into the operator's profits.

When an account has remained dormant for a period of time, which varies from bookmaker to bookmaker, most betting operators will contact their customer with marketing emails and encourage them to use the money in their account.

An expanded dormant assets scheme is unlikely to gain any voluntary participation from the industry and accordingly the Commission considers that unclaimed gambling winnings should not be included in an expanded dormant assets scheme.

#### Recommendation AC1

The inclusion of non-financial assets in an expanded scheme has been discounted by the Commission at the current time; however, the Commission recommends that Government and the reclaim fund review this stance once the expanded scheme has been in place for three years.

## ANNEX D

### INTERNATIONAL DORMANT ASSETS SCHEME COMPARISONS

#### Summary

The Commission has reviewed a number of international dormant asset schemes to learn any lessons that may be available, particularly as other jurisdictions have included a wider range of dormant assets than are within the scope of the current UK scheme.

What was clear was that not only are the incentives and objectives for the dormant assets schemes in each jurisdiction different, but that this array of incentives and objectives has led to a range of differently designed and administered schemes.

There is no overseas scheme which may be considered a direct equivalent for either the current UK scheme or the potential expanded UK scheme. The seemingly unique feature of the current UK scheme is that the full liability for future reclaim in perpetuity is held by an independent body, completely without recourse to central Government. This presents a unique challenge to the Commission in seeking to expand the current scheme for a wider range of assets.

The international landscape of dormant assets schemes is continually evolving. New nations are looking to establish schemes to reunite beneficial owners with their assets and use truly dormant value for societal benefit in some way. In recent months, the Commission is aware of the launch of a new dormant assets scheme in Jersey and an upswing in interest in forming a scheme to address dormant Japanese assets.

In conclusion, the UK is unable, and would not necessarily desire, to replicate the precise construction of an overseas scheme. However, a survey of their characteristics is instructive of the type of issues that an expanded UK scheme may be challenged to address.

#### Introduction

The impetus for different nations to instigate a dormant assets scheme are many and varied. All schemes require central Government to set policies and / or legislation to underpin the scheme and it is perhaps therefore unsurprising that a number of schemes have an ultimate beneficiary that boosts national coffers. The current UK scheme is unusual, but not unique, in that it has been formed to direct any surplus to benefit UK society via good causes.

Different ultimate beneficiaries generate a different public perception of each scheme. In turn, this has a knock-on effect on: the participation levels in the scheme; whether that participation needs to be mandatory; and the degree of aggressiveness required from the supporting scheme rules.

#### Scale of international dormant asset schemes

The Commission is aware of more than 20 nations across the world that have instigated a mechanism to address dormant assets. This does not include the separate regimes that have been implemented on a regional basis, for example at the state and provincial level in the US and Canada.

This number is also increasing with further nations considering the formation of a scheme. This can be seen by recent developments in Japan, Jersey and Guernsey.

#### Features of selected international schemes

The Commission surveyed the way in which a number of international schemes have been constructed. The Commission had particular interest in the way that certain features, pertinent to the formation of an expanded scheme in the UK, had been implemented. The findings from this exercise are laid out in Figure D.1.

It is clear that the range of features of the various international schemes vary widely. It is also clear that the current UK dormant asset scheme features are more customer-favourable, and that the process to administer the scheme is more independent of central Government, than in other jurisdictions.

Of the selected international schemes surveyed by the Commission, those in Australia and Ireland are the closest in construction to the current UK scheme. These were reviewed in closer detail by the Commission to try to understand why the schemes in these three, ostensibly similar, jurisdictions have been constructed differently.

#### Australia

##### Background

The Australian Unclaimed Money scheme broadly comprises four asset types: bank accounts; matured life insurance policies; surplus company assets; and unclaimed pensions.

Australia runs a very similar bank accounts scheme to that currently existing in the UK. Following amendments to banking legislation, from 31 December 2015 bank accounts become dormant seven years after the last deposit / withdrawal. In common with bank accounts, life insurance policies also become unclaimed after seven years, although the trigger event for this timing is the policy maturing and not being claimed. Unclaimed compulsory pension (Superannuation) dormancy is determined by a range of criteria, including when beneficiaries do not claim or become uncontactable through two items of returned mail, or are inactive for more than 12 consecutive months.

Finally, company assets, which include the surplus assets of deregistered companies and security holders, are deemed dormant if the beneficial owners are uncontactable for six years.

Unclaimed money from these three areas is required to be deposited by each relevant institution with the Australian Securities and Investments Commission (ASIC) on an annual basis, and is then transferred to a central fund. Superannuation falls under the remit of the Australian Tax Office (ATO) and is held by either a Super Fund or the ATO if the dormancy threshold<sup>1</sup> has been reached.

Of further interest, the dormancy threshold for bank accounts was shortened from seven years to three years in 2012. This shortening was subsequently reversed in 2015 amid calls that three years was an inequitably brief period for individuals.

<sup>1</sup> Australian Taxation Office, Unclaimed superannuation money protocol

**Figure D.1 – Comparison of the UK current dormant assets scheme features with those of selected international schemes**

Country	In-scope assets	Degree for firms' compulsory involvement	Ability to reclaim	Post transfer interest	Ultimate reclaim guarantor	Use of unclaimed dormant assets
UK	Bank and building society accounts	Voluntary participation	Unlimited by time	Yes	Reclaim Fund Ltd	Good causes
Australia	Bank accounts; life insurance policies; shares / dividends; investments; client money; Superannuation	Mandatory participation	Unlimited by time	Only accrues post-July 2013	Australian Government	Australian Treasury
Bahamas	Bank accounts; bank drafts; manager's cheques; money orders; travellers' cheques; credit card balance	Mandatory participation	25 years (five years for balances <\$500)	Yes, except for balances <\$500	Central Bank of The Bahamas for 25 years	Projects for the general good of society
Belgium	Bank accounts; safety deposit boxes; insurance contracts	Mandatory participation	30 years	Yes	Belgian Treasury	Belgian Treasury
Canada (central and provincial schemes)	Insolvent distributions; utilities; life insurance / insurance policies; pension funds; corporate dividends; bank accounts; travellers' cheques; tax refunds	Mandatory disclosure, voluntary participation	Six years - unlimited by time depending on asset and scheme	Yes, but only for some assets and some provinces	Unknown	Federal / provincial revenues or local foundation (British Columbia only)
Ireland	Bank accounts; life assurance policies	Mandatory participation	Unlimited by time	Yes	Department of Finance	Charitable / social projects
Kenya	Bank accounts; insurance policies; utilities; cheques; and gift certificates	Mandatory participation	Unlimited by time	No	Kenyan Government	Unknown
New Zealand	Bank accounts; life insurance policies; dividends	Voluntary participation	Unlimited by time	No	New Zealand Crown	New Zealand Crown
United States (state schemes)	Various	Mandatory via escheatment laws	Generally unlimited	No	State	Treated as State funds

### Valuation

2015 transfers from bank accounts totalled AU\$145m.<sup>2</sup> Given the shorter threshold for dormancy and the mandatory nature of the scheme, the per capita value is slightly higher than that in the UK. Of note, the Australian scheme specifically excludes accounts domiciled in Australia but held in non-Australian dollar denominations.

2015 life insurance transfers were AU\$17m. Company asset transfers were AU\$47m in 2015.

As at 2015, the balance of dormant, unclaimed Superannuation funds held was AU\$16bn.<sup>3</sup> The average individual unclaimed fund equates to AU\$2,586 (£1,275).

### Reclaims and surplus distribution

Unclaimed money can be reclaimed from ASIC by the rightful owner and there is no time limit on such reclaims. However, interest only accrues and is payable from July 2013. A total of AU\$158.4m in reclaims was paid out by ASIC in 2014-15 from bank accounts, life insurance and company transfers, compared with AU\$309.6m in the prior year.<sup>4</sup>

Figures for Superannuation funds reclaimed from the ATO are not available as transfers to the scheme are reported net of reclaim activity.

2 Australian Securities & Investments Commission, Annual report, 2015

3 Australian Taxation Office, Super accounts data overview, 31 December 2015

4 Australian Securities & Investments Commission, Annual report, 2015

## Ireland

### Background

The Ireland Dormant Accounts Fund is a mandatory scheme. It requires the transfer of dormant bank, building society and An Post accounts and unclaimed life assurance policies. The fund allows reclaims and provides a mechanism for the charitable / social disbursement of funds which are not likely to be reclaimed. The fund is administered by the National Treasury Management Agency (NTMA).

Financial institutions must contact any customer where the balance exceeds €100 and there has been no customer-initiated transaction in the previous 15 years. If the institution cannot contact the customer, the money in the account will be transferred to the Dormant Accounts Fund. The rights of the original account holder are not affected by the transfer and the beneficial owner has a guaranteed right of reclaim to their property at any time in the future from the original issuer.

Central Fund (under the remit of the Government's Department of Finance) is the guarantor of last resort and holds the ultimate liability, should the Dormant Accounts Fund be insufficient to meet reclaim demand.<sup>5</sup>

### Valuation

The latest available information regarding the Dormant Accounts Fund is contained within the NTMA 2014 Annual Report.<sup>6</sup> During the calendar year, the fund received dormant assets to the value of €49m to bring the held balance at the end of 2014 to €215m. A further difference from the Australian scheme is that the Irish scheme specifically includes accounts domiciled in Ireland but denominated in non-euro currencies.

### Conclusion

The features of each international scheme are created to be bespoke to the circumstances facing each jurisdiction. The impact for the Commission therefore, is that while some lessons may be learnt from looking to overseas experience, any recommendations need to be specific to the situation that exists in the UK and the current or potentially expanded UK dormant assets schemes.

The Commission has noted that the majority of international dormant assets schemes appear to require mandatory firm participation. However, the experience of the UK's scheme is that good results have been achieved with voluntary firm participation and that, provided participation levels are significant, this is a preferable approach for an expanded scheme in the UK.

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<sup>5</sup> NTMA, Financial Statements, 31 December 2013

<sup>6</sup> NTMA, Annual Report, 31 December 2014

## ANNEX E

### CALL FOR EVIDENCE: A SUMMARY OF THE KEY THEMES

In the summer of 2016, the Commission carried out a targeted call for evidence, writing to around 200 organisations across both the financial services and non-financial services sectors, including trade and regulatory bodies and individual firms, to seek views on how an expanded dormant assets scheme might work.

Nearly 100 responses were received, and the Commission thanks all the participants who took the time to submit information. Of those responses received, a number were from non-financial services industries, including gambling, utilities, and transport. These are all industries holding potential dormant assets that the Commission wished to understand more fully.

Following the responses provided, the Commission made the decision to concentrate its efforts solely on the financial services sector. This annex summarises six themes that emerged from the responses received from the banking, insurance and pensions, and investment and wealth management industries.

#### Definition of dormancy

Given the diversity of potential new assets in an expanded scheme, there was unsurprisingly little cross-industry agreement on how best to define dormancy.

Banking respondents agreed that the current definition of 15 years of no customer-initiated contact remains the most appropriate definition of dormancy.

Insurance and pensions respondents reported that the current definition was unhelpful because the long-term nature of life insurance and pensions products means it is quite common for customers not to contact their provider for very long periods of time. Respondents also felt that 'dormancy' was not a helpful term for them to use, preferring instead 'unclaimed'. The industry reported that the best way to define dormancy was by way of a combination of a trigger event, such as policy maturity / selected retirement age / actual or expected death of policyholder; a period of time thereafter of no customer contact; and failure to successfully reunite customers or beneficiaries with their assets.

The investment and wealth management industry also felt that the current scheme's definition was inappropriate for their use, given the long-term nature of many of their products. Respondents indicated that the definition will need to differ on an asset-by-asset basis, partly according to whether the asset is in a cash or non-cash form. The definition should also incorporate a combination of a period of no contact followed by a period of unsuccessful attempted reuniting.

#### Voluntary versus mandatory firm participation in an expanded scheme

There were mixed views across the three industries on the merits of voluntary versus mandatory participation. As expected, banking industry feedback was that the current scheme is working well, and changing the scheme to feature mandatory participation would not be necessary. That said, some respondents raised the point that mandatory participation would help create a more level playing field, and greater transparency for the customer, across the industry.

The majority of insurance and pensions respondents were in favour of voluntary participation because it would provide firms with flexibility to decide when and how to take part in the scheme. Respondents also proffered the view that voluntary participation would enable them to initially opt in for some products, and then bring other products in at a later date once systems or operational complexities had been resolved. Some respondents expressed the view that voluntary participation would enable them to divert some of the unclaimed assets to their own favoured charities. Respondents were concerned that a scheme with mandatory participation might impose undue cost on providers, especially if it was 'one size fits all' in nature.

Investment and wealth management responses were similar in many ways to those of the insurance and pensions industry, preferring participation on a voluntary basis due to the complexity of creating and enforcing a scheme with mandatory participation. Voluntary participation would also provide firms with flexibility and time to deal with important operational issues, and allow for a possible phased approach to a firm's participation.

Respondents also raised a concern about the possible cost burden of mandatory participation, particularly given the large number of small firms in the industry. Despite the general preference for voluntary participation, it was noted by representatives of collective investment trustees that mandatory participation might be required in order to overcome difficulties caused by trustees' fiduciary duties to investors under trust law.

#### Legislation and regulation

There were a number of regulatory and legislative issues highlighted across the three industries in responses to the call for evidence. Banks already participating in the current scheme felt the current legislation is fit for purpose, but acknowledged that bringing any new assets into scope would require legislative change and further clarity regarding their treatment.

The key issues requiring attention as part of an expanded scheme identified by the insurance and pensions, and investment and wealth management industries were:

- concern about the fair treatment of customers if they were unable to reclaim the full transferred asset by reference to its pre-transfer form;
- statutory measures to discharge providers from liability following transfer;
- a mechanism to facilitate transfer in the first place;
- preservation of a customer's tax position on reclaim;

- data protection issues with transfer, and for providers thereafter;
- FCA rules;
- trust law; and
- compatibility with both English and Scottish law.

### Current treatment of dormant assets

In the banking industry, the majority of major retail banks are participating in the current scheme whereas in other industries, identifying and treating dormant assets is an unknown or limited concept. Generally within the investment and wealth management industry, dormant assets do not exist as a concept. Respondents to the call for evidence were far more comfortable with assets termed as 'gone-aways'. These are customers for whom communications have been returned or payments remain unbanked. Industry practice in attempting to reunite such customers is highly variable.

While FCA Client Assets Sourcebook (CASS) rules exist within the investment and wealth management industry, these are not used extensively to facilitate charitable donation. It was felt by respondents that the CASS stipulations are by turns too prescriptive (in terms of the means to recontact customers and low value of de minimis amounts) and not prescriptive enough (with an undefined concept of 'best efforts' for required efforts to reunite). It was also felt that the CASS rules have a critical limitation as the liability for reclaim does not move away from the transferor, thereby restricting the commercial benefit of using the CASS procedure.

Similarly, within the insurance and pensions industry, there was no generally agreed current definition of dormancy. Instead, respondents use factors such as gone-away status or a lack of contact from customers to drive certain internal actions to try to deal with dormant or unclaimed policies. However, dealing with did not include passing the proceeds of these policies to charity, as the vast majority of respondents continued to retain unclaimed assets.

### Cost / profit impact

A number of banks (both those participating in the current scheme and newer, smaller institutions) raised concerns that mandatory participation in a scheme could prove costly in terms of both set-up and customer notification costs (one organisation costed the notification of changes to account terms and conditions at £300k). This concern regarding expense was consistent across all three financial services industries considered by the Commission. However, without knowledge of the particulars of an expanded scheme, no respondent could accurately quantify this.

Within the investment and wealth management sector, some respondents felt that participation in the scheme could end up having a positive profit impact as firms might be able to transfer a large number of the low value balances which have a disproportionately high cost, particularly due to ongoing CASS reporting requirements. They also cited potential long-term benefits from cleaning up legacy databases, assisting them in progressively modernising their IT architecture over time.

### Reason for loss of contact

There was agreement in responses across the three industries considered by the Commission that the primary reasons for losing contact with customers were: customer failure to notify institutions of new address details when moving property; or the death of the beneficial owner.

Following the initial loss of contact, the assorted and varied efforts made by firms to reunite beneficial owners with assets have differing levels of success. Some respondents even noted that when they had managed to successfully trace a customer they were unable to re-engage with them, possibly because the customer suspected that communications were some form of scam.

### Conclusion

It must be noted, that the call for evidence was not a public consultation; rather a small-scale and carefully targeted exercise, aimed at key organisations. This annex summarises trends within the responses received to the call for evidence from the three financial services industries considered by the Commission only.

The Commission wishes to make clear that the identification of themes does not represent a consensus, or indeed necessarily a majority view, across either an industry or the financial services sector unless specifically identified as such.

Respondents drew attention to the fact that it was difficult for them to definitively respond to some questions as there was no expanded scheme framework proposal upon which they could base their thinking. For example, responses to the question concerning whether participation in a scheme should be mandatory might change depending upon the implications of expanded scheme design and asset inclusion. Likewise, providing an accurate costing of an expanded scheme for the purpose of a cost-benefit analysis proved to be very difficult for firms without an expanded scheme proposal.

While the Commission's recommendations have taken account of the views expressed by respondents, it should be noted that, as only a limited number of organisations were asked to respond to the call for evidence, further work will be required in order to provide a framework proposal, and an industry-wide consultation needed before implementation can be considered.



## ANNEX F BACKGROUND TO THE DORMANT ASSETS SCHEME IN THE UK

### The Dormant Bank and Building Society Accounts Act 2008

The Dormant Bank and Building Society Accounts Act 2008 (the Act), was passed in November 2008. The Act classifies bank and building society accounts as dormant when they have not had any customer-initiated activity for more than 15 years. The Act enables banks and building societies to transfer the money held in dormant accounts to a reclaim fund.

In March 2011 authorisation was granted by the then Financial Services Authority to establish Reclaim Fund Ltd (RFL). RFL was set up by the Co-operative Banking Group Limited (CBG), a 100% owned subsidiary of the Co-operative Group, to administer the process of the dormant assets scheme.

RFL is responsible for managing dormant account money, meeting reclaims and passing surplus money to the Big Lottery Fund (BLF) for distribution to good causes. RFL is also responsible for ensuring that enough funds are retained to meet any future reclaims so customers are always able to reclaim money held in accounts they may have forgotten about.

### The current dormant assets scheme

The dormant assets scheme is voluntary for firms to participate in, and has been successful in terms of participation and money transferred to the scheme. The majority of main high street retail banks and building societies participate. This means that institutions holding over 90% of personal deposits in the UK are voluntarily utilising the Act to make dormant account money available to good causes.

The Act also provides for an alternative scheme which enables smaller banks and building societies – as an alternative to transferring dormant account money through the main scheme – to make dormant account money available to both BLF and specific local causes of their choice. Currently there are no participants in the alternative scheme.

It was initially estimated that approximately £400m of dormant balances would eventually be transferred by banks and building societies to RFL. In fact, since inception in 2011 a total of £980m (unaudited) has been transferred to RFL until the end of December 2016. Of that, £362m (unaudited) has been distributed to BLF for onward distribution.





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