

Conduct of Business Sourcebook

Chapter 20

With-profits

20.1 Application

- 20.1.1** **R** This chapter applies to a *firm* carrying on *with-profits business*, except to the extent modified in the following *rules*.
- 20.1.2** **R**
- (1) The section on the process for *retribution* (■ COBS 20.2.42 R to ■ COBS 20.2.52 G):
 - (a) applies to a *firm* that is proposing to make a *retribution* of its *inherited estate*;
 - (b) but not if, and to the extent that, it would require the *firm* to breach, or would prevent the *firm* from complying with, an order made by a court of competent jurisdiction.
 - (2) If a *firm* proposes to seek an order from a court of competent jurisdiction that would allow or require it to act in a way that is contrary to the *rules* on *retribution* (■ COBS 20.2.42 R to ■ COBS 20.2.52 G) (through, or because of, the exception in (1)(b)), the *firm* must:
 - (a) tell the *appropriate regulator* that that is what it proposes to do;
 - (b) seek the order at the earliest opportunity; and
 - (c) if it wishes to take a step that would be contrary to those *rules* in anticipation of such an order, secure a *waiver* before it does so.
- 20.1.3** **R** [deleted]
- 20.1.3A** **R**
- 20.1.4** **R** The following do not apply to a *non-directive friendly society*:
- (1) ■ COBS 20.3 (Principles and Practices of Financial Management);
 - (2) ■ COBS 20.4 (Communications with with-profits policyholders); and
 - (3) ■ COBS 20.5 (With-profits governance).
- 20.1.5** **R** This chapter does not apply to *with-profits business* that consists of effecting or carrying out *Holloway sickness policies*.

20.1A The with-profits fund

'Other liabilities' in the with-profits fund

20.1A.1 **R** For the purposes of calculating any *with-profits funds surplus* and the *rules and guidance* in ■ COBS 20, including ■ COBS 20.1A.5 R, ■ COBS 20.1A.6 R and ■ COBS 20.2.17C R, a *firm* must include the following non-exhaustive list as 'other liabilities':

- (1) liabilities arising from its regulatory duty to treat *customers* fairly (where not already included in *technical provisions*); and
- (2) the value of any prospective future transfers out of the *with-profits fund* properly attributable to shareholders in accordance with ■ COBS 20.

Sub-funds

20.1A.2 **R** (1) Where the *firm*:

- (a) identifies particular assets as forming a distinct part of its *with-profits fund*; and
- (b) restricts participation in the profits or other experience of that distinct part of the fund to a particular category of *with-profits policies*;

then, provided that:

- (c) such identification and restriction is consistent with the considerations in (3), and
- (d) the *firm* treats each affected category of *with-profits policyholder* fairly, having regard to those considerations;

each such part constitutes a separate *with-profits fund*.

(2) Notwithstanding (1), each different part of its *with-profits fund* constitutes a separate *with-profits fund* if that is necessary in order to treat each affected category of *with-profits policyholder* fairly, having regard to the considerations in (3).

(3) The considerations referred to in (1) and (2) are the terms of the relevant *with-profits policies*; the *firm's* established practice; its *PPFM* and/or other relevant communications to affected *with-profits policyholders*, and the terms of any arrangement formally approved by a court of competent jurisdiction, *appropriate regulator* or *previous regulator*.

20.1A.3 **R**

- (1) For a *Solvency II firm* operating a with-profits fund prior to 1 January 2016:
- (a) assets in the with-profits fund held in accordance with *INSPRU* on 31 December 2015 are deemed to be items in a *with-profits fund* for the purposes of ■ COBS 20 from 1 January 2016, provided that any transfers out of, and any outgoings from, the fund up to 31 December 2015 were made in accordance with, and/or do not as at 31 December 2015, constitute, or continue to constitute, a breach of ■ *INSPRU* 1.5.21 R and ■ *INSPRU* 1.5.27 R;
 - (b) any assets transferred out of the fund in breach of ■ *INSPRU* 1.5.21 R and ■ *INSPRU* 1.5.27 R are deemed not to have been transferred out of the fund and remain part of the *with-profits fund*;
 - (c) to the extent that the assets in (b) have also been transferred out of the *firm* then, before (a) can apply to the *firm*, the *firm* must transfer into the *with-profits fund* assets equal to the value of the assets referred to in (b), and of a similar quality, having regard to the PRA Rulebook: Solvency II Firms: Investments.
- (2) *Firms* to which (1)(a) applies must, in any event, comply with ■ COBS 20.1A.2 R. Paragraph (1)(a) does not apply to the extent that it would be inconsistent with the operation of ■ COBS 20.1A.2 R where the effect is to require a *firm* to create or make changes to sub-funds amounting to separate *with-profits funds*.

Governance arrangements for the with-profits fund

20.1A.4 **R**

A *Solvency II firm* effecting or carrying out *with-profits insurance business* must identify the assets relating to all the business written in, or transferred into, each *with-profits fund* which it is required to hold under ■ COBS 20.1A.5 R or PRA Rulebook: Solvency II firms: With Profits rule 2.1.

20.1A.5 **R**

A *Solvency II firm* must ensure that it holds assets in each of its *with-profits funds* of a value at least sufficient to cover the "with-profits policy liabilities" defined in the PRA Rulebook: Glossary and as required by PRA Rulebook: Solvency II firms: With Profits rule 2.1, and any other liabilities in respect of all of the business written in, or transferred into, that *with-profits fund*.

20.1A.6 **R**

A *Solvency II firm* must maintain separate accounting records for each of its *with-profits funds*. The accounting records must identify:

- (1) all of the assets of that *with-profits fund*;
- (2) the best estimate component of *technical provisions* for the *with-profits policies* written in, or transferred into, that *with-profits fund*;
- (3) the best estimate component of *technical provisions* for the *non-profit insurance contracts* written in, or transferred into, that *with-profits fund*;
- (4) any other liabilities of the *with-profits fund* not covered by (2) or (3), and their value calculated in accordance with PRA Rulebook: Solvency II Firms: Valuation and applicable parts of the *Solvency II Regulation* (EU) 2015/35 of 10 October 2014.

- 20.1A.7** **G** A *Solvency II firm* must ensure that the assets in its *with-profits funds* are separately identified and allocated to the relevant *with-profits fund* at all times. Assets in external accounts (e.g. with banks, custodians, or brokers) should be segregated in the *firm's* books and records into separate accounts for *with-profits insurance business* and other business. Where a *firm* has more than one *with-profits fund*, separate accounting records must be maintained for each fund. Accounting records should clearly document the allocation.
- 20.1A.8** **R** A *Solvency II firm* must not transfer assets out of a *with-profits fund* unless:
- (1) the assets represent any part of a *with-profits fund surplus*, or represent assets held in accordance with **■ COBS 20.1A.5 R** in relation to the part of a distribution that has been made which is properly attributable to shareholders, in accordance with **■ COBS 20**; and
 - (2) no more than three months have passed since the *actuarial investigation* determining that surplus.
- 20.1A.9** **G** For the purposes of **■ COBS 20.1A.8 R**, an *actuarial investigation* is required to determine any *with-profits fund surplus* for the requirements in **■ COBS 20** and remains in-date for three months from the date when the determination of the surplus was made. However, even where the investigation is still in-date, the *firm* should not make the transfer unless there is sufficient surplus at the time of the transfer to cover the value of the assets being transferred. The *actuarial investigation* carried out may rely, in part, on any relevant and sufficiently up-to-date valuation exercise carried out for the purposes of calculating *technical provisions* under the PRA Rulebook: *Solvency II Firms: Technical Provisions* and applicable parts of the *Solvency II Regulation (EU) 2015/35* of 10 October 2014, provided that the person carrying out the *actuarial investigation* considers it appropriate to do so.
- 20.1A.10** **R**
- (1) A *Solvency II firm* must use or apply an asset in a *with-profits fund* only for the purpose of the business in the *with-profits fund*.
 - (2) For the purpose of (1), applying or using an asset includes any obligation (even if only contingent) to apply or use that asset.
- 20.1A.11** **R** A *Solvency II firm* must not agree to, or allow, any mortgage or charge on the assets in any of its *with-profits funds*, other than in respect of, and for the purposes of, the business in the *with-profits fund*.
- 20.1A.12** **G** References in **■ COBS 20.1A.10 R** and **■ COBS 20.1A.11 R** to 'the purposes of the business' in the *with-profits fund* include the payment of claims, expenses and liabilities arising from that business, the acquisition of lawful access to fixed assets to be used in that business and the investment of assets. The payment of liabilities may include repaying a loan but only where that loan was incurred for the purpose of the business written into the *with-profits fund*. The purchase or investment of assets may include an exchange at fair market value of assets (including cash) between the *with-profits fund* and other assets of the *firm*. A *Solvency II firm* may also lend securities held in a *with-profits fund* under a stock lending transaction, or transfer assets as collateral for a stock lending transaction, where the *firm* is the borrower and

where such lending or transfer is for the benefit of the business written into the *with-profits fund*.

Management of the with-profits fund

20.1A.13 **R**

A *firm*, other than a *non-directive friendly society*, which is subject to contractual terms providing for payments under a capital instrument included in that *insurer's* own funds, must:

- (1) manage any *with-profits fund* so that discretionary benefits under a *with-profits policy* are calculated and paid, disregarding, insofar as is necessary for its *customers* to be treated fairly, any requirements in such contractual terms whether or not they are absolute, contingent or at the discretion of the *firm*; and
- (2) disclose its intention to manage the *with-profits fund* on the basis set out in (1) in the *firm's PPFM*.

20.1A.14 **G**

- (1) A *firm*, other than a *non-directive friendly society*, is expected to manage its *with-profits fund* so that amounts (whether interest, principal, or other outgoings) payable by the *firm* under a capital instrument included in that *insurer's* own funds (as determined in accordance with the PRA Rulebook: Solvency II Firms: Own Funds or Non-Solvency II firms: Insurance Company – Capital Resources) do not impact on the *with-profits fund's* assets or on the *firm's* ability to declare and pay under a *with-profits policy* discretionary benefits that are consistent with the *firm's* obligations under *Principle 6* (Customers' interests).
- (2) A *firm*, other than a *mutual*, should not regard any asset held in the *with-profits fund* as necessarily available to cover payments or other obligations arising under a subordinated loan.

20.1A.15 **R**

A *Solvency II firm* must ensure that it has adequate arrangements in place for ensuring that transactions affecting the assets of the *firm* operate fairly between *with-profits policyholders* and other persons interested in the other assets of the *insurer* and, where the *firm* has more than one *with-profits fund*, those transactions operate fairly between the *with-profits policyholders* in each of those funds.

20.2 Treating with-profits policyholders fairly

Introduction

- 20.2.1** **G** (1) *With-profits business*, by virtue of its nature and the extent of discretion applied by *firms* in its operation, involves numerous potential conflicts of interest that might give rise to the unfair treatment of *policyholders*. Potential conflicts of interest may arise between shareholders and *with-profits policyholders*, between *with-profits policyholders* and non-profit *policyholders* within the same fund, between *with-profits policyholders* and the members of mutually-owned *firms*, between *with-profits policyholders* and management, and between different classes of with-profits policyholders, for example those with and without guarantees. The *rules* in this section address specific situations where the risk may be particularly acute.
- (2) *With-profits policyholders* have an interest in the whole and in every part of the *with-profits fund* into which their *policies* are written and from which the amounts payable in connection with their *policies* are to be paid. Those amounts include those required to satisfy their contractual rights and such other amounts as the *firm* is required to pay in order to treat them fairly (including but not limited to the amounts required to satisfy their reasonable expectations).
- (3) The fair treatment of *with-profits policyholders* requires the *firm's* pay-outs on individual *with-profits policies* to be fair (see **COBS 20.2.3 R** et seq.) and, if the *firm* makes a distribution from the *with-profits fund* into which their *policies* are written, the receipt by the *with-profits policyholders* of at least the *required percentage* (see **COBS 20.2.17 R**).
- 20.2.1A** **R** A *firm* must take reasonable care to ensure that all aspects of its operating practice are fair to the interests of its *with-profits policyholders* and do not lead to an undisclosed, or otherwise unfair, benefit to shareholders or to other *persons* with an interest in the *with-profits fund*.
- 20.2.1B** **G** (1) Notwithstanding that there may not be a *rule* in the remainder of this section addressing a particular aspect of a *firm's* operating practices, *firms* will need to ensure that they take reasonable care to ensure that all aspects of their operating practice comply with **COBS 20.2.1A R**.

(2) For the avoidance of doubt ■ COBS 20.2.1A R does not exhaust or restrict the scope of *Principle 6*. *Firms* will in any event need to ensure that their operating practices are consistent with *Principle 6*.

20.2.1C **G** When considering the provisions in this chapter a *firm* will need to ensure that, if applicable, it complies with the with-profits governance requirements in ■ COBS 20.5.

20.2.1D **G** For the purposes of ■ COBS 20.2.1A R the *FCA* expects a *firm* to be able to demonstrate that it has taken reasonable care to ensure its operating practices are fair, including being able to produce appropriate evidence to show that it has followed relevant governance procedures.

20.2.2 **R** Neither *Principle 6* (Customers' interests) nor the *rules* on treating *with-profits policyholders* fairly (■ COBS 20.2) relieve a *firm* of its obligation to deliver each *policyholder's* contractual entitlement.

Amounts payable under with-profits policies

20.2.3 **R** A *firm* must have good reason to believe that its pay-outs on individual *with-profits policies* are fair.

Amounts payable under with-profits policies: Maturity payments

20.2.4 **G** In this section, maturity payments include payments made when a *with-profits policy* provides for a minimum guaranteed amount to be paid.

20.2.5 **R**

(1) Unless a *firm* cannot reasonably compare a maturity payment with a calculated asset share, it must:

- (a) set a target range for the maturity payments that it will make on:
 - (i) all of its *with-profits policies*; or
 - (ii) each group of its *with-profits policies*;
- (b) ensure that each target range:
 - (i) is expressed as a percentage of unsmoothed asset share; and
 - (ii) includes 100% of unsmoothed asset share; and
- (c) manage its *with-profits business*, and the business of each *with-profit fund*, with the aim of making on each *with-profit policy* a maturity payment that falls within the relevant target range.

(2) Unsmoothed asset share means:

- (a) the unsmoothed asset share of the relevant *with-profits policy*; or
- (b) an estimate of the unsmoothed asset share of the relevant *with-profits policy* derived from the unsmoothed asset share of one or more specimen *with-profits policies*, which a *firm* has selected to represent a group, or all, of the *with-profits policies* effected in the same *with-profits fund*.

- (3) A *firm* must calculate unsmoothed asset share by:
- (a) (i) for a *firm* which is not a *Solvency II firm*, applying the methods in ■ INSPRU 1.3.119 R to ■ INSPRU 1.3.123 R;
 - (ii) for a *firm* which is a *Solvency II firm*, applying the methods in PRA Rulebook: Solvency II Firms Valuation, Technical Provisions and Surplus Funds and applicable parts of the *Solvency II Regulation (EU) 2015/35* of 10 October 2014;
 - (b) including any amounts that have been added to the *policy* as the result of a distribution from an *inherited estate*; and
 - (c) subject to (d), and where the terms of the *policy* so provide, adding or subtracting an amount that reflects the experience of the *insurance business* in the relevant *with-profits fund*; but
 - (d) if a *with-profits fund* has suffered adverse experience, which results from a *firm's* failure to comply with the *rules and guidance* on treating *with-profits policyholders* fairly (■ COBS 20.2.1 G to ■ COBS 20.2.41 G and ■ COBS 20.2.53 R to ■ COBS 20.2.60 G), that adverse experience may only be taken into account if, and to the extent that, in the reasonable opinion of the *firm's governing body*, the amount referred to in (c) cannot be met from:
 - (i) the *firm's inherited estate* (if any); or
 - (ii) any assets attributable to shareholders, whether or not they are held in the relevant *with-profits fund*.

20.2.6 **R** Notwithstanding that a *firm* must aim to make maturity payments that fall within the relevant target range, a *firm* may make a maturity payment that falls outside the target range if it has a good reason to believe that at least 90% of maturity payments on *with-profits policies* in that group have fallen, or will fall, within the relevant target range.

20.2.7 **G** If it is not fair or reasonable to calculate or assess a maturity payment using the *prescribed asset share methodology*, a *firm* may use another methodology to set bonus rates, if that methodology properly reflects its representations to *with-profits policyholders* and it applies that methodology consistently.

20.2.8 **R** A *firm* may make deductions from asset share to meet the cost of guarantees, or the cost of capital, only under a plan approved by its *governing body* and described in its *PPFM*. A *firm* must ensure that any deductions are proportionate to the costs they are intended to offset.

20.2.9 **R** If a *firm* has approved a plan to make deductions from asset share, it must ensure that its planned deductions do not change unless justified by changes in the business or economic environment, or changes in the nature of the *firm's* liabilities as a result of *policyholders* exercising options in their *policies*.

20.2.10 **R** If a *firm* calculates maturity payments using the *prescribed asset share methodology*, it must manage its *with-profits business*, and each *with-profits*

fund, with the longer term aim that it will make aggregate maturity payments of 100% of unsmoothed asset share.

Amounts payable under with-profits policies: Surrender payments

- 20.2.11** **G** A *firm* may use its own methodology to calculate surrender payments, but it should have good reason to believe that its methodology produces a result which, in aggregate across all similar policies, is not less than the result of the *prescribed asset share methodology*. A *firm* might, for example, test the surrender payments on a suitable range of specimen *with-profits policies*.
- 20.2.12** **R** If a *firm* calculates surrender payments using the *prescribed asset share methodology*, it must first calculate what the surrender payment would be if it was a maturity payment calculated by that methodology.
- 20.2.13** **R** A *firm* may then make a deduction from unsmoothed asset share if necessary, in the reasonable opinion of the *firm's governing body*, to protect the interests of the *firm's* remaining *with-profits policyholders*.
- 20.2.14** **G** Amounts that might be deducted include:
- (1) the *firm's* unrecovered costs, including any financing costs incurred in effecting or carrying out the surrendered *with-profits policy* to the date of surrender, including the costs that might have been recovered if the *policy* had remained in force;
 - (2) costs that would fall on the *with-profits fund*, if the surrender value is calculated by reference to an assumed *market value* of assets which exceeds the true *market value* of those assets;
 - (3) the *firm's* costs incurred in administering the surrender; and
 - (4) a fair contribution towards the cost of any contractual benefits due on the whole, or an appropriate part, of the continuing policies in the *with-profits fund* which would otherwise result in higher costs falling on the continuing *with-profits policies*.
- 20.2.15** **G** The provisions dealing with the calculation of surrender payments (■ COBS 20.2.11 G to ■ COBS 20.2.12 R) do not prevent a *firm* from setting a target range for surrender payments where the top-end of the range is lower than the top-end of the relevant range for maturity payments.
- 20.2.16** **R** A *firm* must not, in so far as is reasonably practicable, make a market value reduction to the face value of the units of an accumulating *with-profits policy* unless:
- (1) the *market value* of the *with-profits assets* in the relevant *with-profits fund* is, or is expected to be, less than the assumed value of the assets on which the face value of the units of the *policy* has been based; and

- (2) the market value reduction is no greater than is necessary to reflect the impact of the difference in value referred to in (1) on the relevant payment out to the *policyholder*.

20.2.16A **G** If a *firm* is able to satisfy ■ COBS 20.2.16R (1), then the volume of surrenders, transfers, or other exits from the *with-profits fund* that there has been, or is expected to be, is a factor that a *firm* may take into account when it is considering whether to make a market value reduction, and if so, its amount, subject to the limit in ■ COBS 20.2.16R (2).

Conditions relevant to distributions

20.2.16B **G** References to distributions in ■ COBS 20 includes distributions of distributable profits arising, namely any permanent addition to *policy* benefits made at the *firm's* discretion based on the investment or other experience in the fund or more generally. Distributions include those relating to expected payments for which allowance has been made in the *technical provisions* or to a *firm's* other liabilities arising from its regulatory duty to treat *customers* fairly, and not just distributions of any *with-profits fund surplus*.

20.2.16C **G** Examples of distributions include any payment of a cash bonus (including a final bonus on exit or a reduction in *premium*), or a declaration of a reversionary bonus in the form of a permanent addition to the benefits guaranteed to be payable at death or on maturity. In ■ COBS 20.2.21 R and ■ COBS 20.2.22 E (distributions from excess surplus) distributions also include any other amounts that are added to asset shares or to any other measure that is used to determine pay-outs under *policies*.

20.2.17 **R** A firm must ensure that the amount distributed to *policyholders* from a *with-profits fund*, taking into account any adjustments required by ■ COBS 20.2.17A R, is not less than the *required percentage* of the total amount distributed.

20.2.17A **R**

(1) Where a *firm* adjusts the amounts distributed to *policyholders*, either by market value reduction or otherwise, in a way that would result in a distribution to *policyholders* of less than the *required percentage*, taking both the relevant distributions and the adjustment into account, then the *firm* must apply a proportionate adjustment to amounts distributed to shareholders so that the distribution to *policyholders* will not be less than the *required percentage*.

(2) The adjustments referred to in (1) include but are not limited to a situation where such an adjustment has the effect of retrospectively reducing past *policyholder* distributions.

20.2.17B **G** An example of the application of ■ COBS 20.2.17A R, without limitation to its scope generally, is where a *firm* reduces, for any reason, the amounts of a bonus or of bonus units added to *policies* in force. The *firm* should treat this as effectively a 'negative distribution', calculated by making the same assumptions regarding discount rates and other relevant factors as would be used for positive bonus additions. The amount so calculated should then be taken into account in ensuring that the amount distributed to *policyholders*

from a *with-profits fund* is not less than the *required percentage* for the purposes of ■ COBS 20.2.17 R.

- 20.2.17C** **R** A *firm* must not make a distribution from a *with-profits fund*, unless:
- (1) if it is not a *Solvency II firm*, the whole of the cost of that distribution can be met without eliminating the *regulatory surplus* in that *with-profits fund*; and
 - (2) if it is a *Solvency II firm*:
 - (a) the whole of the cost of that distribution can be met without eliminating the *with-profits fund surplus* in that *with-profits fund*; and
 - (b) following any distribution that is made to meet a liability for which allowance has been made in *technical provisions* or other liabilities the *firm* is able to demonstrate that it reasonably expects to be able to continue to comply with the requirements in ■ COBS 20.1A.5 R (Governance arrangements for the with-profits fund).

- 20.2.18** **R** A *firm* which is not a *Solvency II firm* must not make a distribution from a *with-profits fund* to any *person* who is not a *with-profits policyholder*, unless the whole of the cost of that distribution (including the cost of any obligations that will or may arise from the decision to make a distribution) can be met from the excess, if any, of the assets over the liabilities in that *with-profits fund*.

- 20.2.19** **R** A distribution to a *person* who is not a *with-profits policyholder* includes a transfer of assets out of a *with-profits fund* that is not made to satisfy a liability of that fund.

Notification and other requirements in relation to certain distributions

- 20.2.19A** **R** If a *firm* which is a *Solvency II firm* proposes to make a distribution from a *with-profits fund* to any *person* who is not a *with-profits policyholder*, where:
- (1) the distribution to *with-profits policyholders* is smaller than the 'pre-notification to *policyholder* minimum' calculated in accordance with ■ COBS 20.2.19BR (1) then the *firm* must:
 - (a) provide the *FCA* with written details of the proposed distribution at least two months prior to the proposed distribution, together with copies of draft notifications it proposes to send to *with-profits policyholders* to satisfy (b); and
 - (b) give affected *with-profits policyholders* in the fund at least one month prior written notice stating:
 - (i) that it proposes to make no distribution to them; or
 - (ii) that it proposes to make a distribution of an amount which is smaller than the 'pre-notification to *policyholder* minimum',

and setting out the amount and how the distribution is calculated; and

the reasons for (i) or (ii) as relevant; or

- (2) the distribution to *with-profits policyholders* does not meet the test in (1) but is smaller than the 'after the event notification to *policyholder* minimum' calculated in accordance with ■ COBS 20.2.19BR (2) then the firm must:
- provide the *FCA* with written details of the proposed distribution at least one month prior to the proposed distribution together with copies of draft notifications it proposes to send to *with-profits policyholders* to satisfy (b); and
 - give affected *with-profits policyholders* in the fund, notice of the distribution within a reasonable period from the date of the distribution, setting out the amount of the distribution, how it was calculated and the reasons for the change compared to the last previous distribution.

20.2.19B **R**

- (1) The 'pre-notification to *policyholder* minimum' referred to in ■ COBS 20.2.19A R is as follows:

$$\frac{b \times c}{a} - \frac{c}{50}$$

where

a is the total amount available for with-profits distribution in the *with-profits fund* in question at the time of the most recent previous distribution;

b is the amount of the most recent previous distribution to *with-profits policyholders*; and

c is the total amount available for with-profits distribution in relation to the proposed distribution.

- (2) The 'after the event notification to *policyholder* minimum' referred to in ■ COBS 20.2.19A R is as follows:

$$\frac{b \times c}{a} - \frac{c}{200}$$

where *a*, *b* and *c* have the same meaning as in (1).

- (3) The calculations in (1) and (2) must be determined by *actuarial investigation*.

20.2.19C **G**

- (1) If the circumstances in ■ COBS 20.2.19AR (1) or ■ (2) arise, the *firm* should also consider whether any reduction(s) in the proposed distribution and any previous distributions to *with-profits policyholders* over a period of at least the last five years are consistent with treating *with-profits policyholders* fairly and any other obligations of the *firm* under ■ COBS 20.

- (2) When calculating the amounts distributed in ■ COBS 20.2.19A R and ■ COBS 20.2.19B R:
- (a) any amount allocated to *with-profits policyholders* in anticipation of a distribution is treated as included in the next distribution;
 - (b) the amount of any available distributable profits is treated as reduced by any part of it which the *firm* has decided to carry forward unappropriated; and
 - (c) risk margin associated with *technical provisions* should be excluded.
- (3) A *firm* which is not a *Solvency II firm* is required to comply with *IPRU(INS) 3.3*.

- 20.2.20 **R** If, on a distribution, a *firm* incurs a tax liability on a transfer to shareholders, it must not attribute that tax liability to a *with-profits fund*, unless:
- (1) the *firm* can show that attributing the tax liability to that *with-profits fund* is consistent with its established practice;
 - (2) that established practice is explained in the *firm's PPFM*; and
 - (3) that liability is not charged to asset shares.

Requirement relating to distribution of an excess surplus

- 20.2.21 **R** At least once a year (or, in the case of a *non-directive friendly society*, at least once in every three years) and whenever a *firm* is seeking to make a *retribution* of its *inherited estate*, a *firm's governing body* must determine whether the *firm's with-profits fund*, or any of the *firm's with-profits fund*, has an *excess surplus*.

- 20.2.22 **E**
- (1) If a *with-profits fund* has an *excess surplus*, and to retain that surplus would be a breach of *Principle 6 (Customers' interests)*, the *firm* should make a distribution from that *with-profits fund*.
 - (2) Compliance with (1) may be relied on as tending to establish compliance with *Principle 6 (Customers' interests)*.
 - (3) Contravention of (1) may be relied on as tending to establish a contravention of *Principle 6 (Customers' interests)*.

Charges to a with-profits fund

- 20.2.23 **R** A *firm* must only charge costs to a *with-profits fund* which have been, or will be, incurred in operating the *with-profits fund*. This may include a fair proportion of overheads.
- 20.2.24 **R** Subject to ■ COBS 20.2.25 R, ■ COBS 20.2.25A R and ■ COBS 20.2.25B R, a *firm* must not pay compensation or redress from a *with-profits fund*.

20.2.25 **R** A proprietary *firm* may pay compensation or redress due to a *policyholder*, or former *policyholder*, from assets attributable to shareholders, whether or not they are held within a *long-term insurance fund* or *with-profits fund*, as relevant.

20.2.25A **R** A *mutual* may pay compensation or redress due to a *policyholder*, or former *policyholder*, from a *with-profits fund*, but may only pay from assets that would otherwise be attributable to asset shares if, in the reasonable opinion of the *firm's governing body*, the compensation or redress cannot be paid from any other assets in the *with-profits fund*.

20.2.25B **R** A payment or transfer of liabilities made to correct an error and which has the effect of restoring a *policyholder*, or former *policyholder*, and the *with-profits fund* to the position they would have been in if the error had not occurred (a "rectification payment"), is not a payment of compensation or redress for the purposes of **COBS 20.2.24 R**.

20.2.25C **G** Rectification payments may include, for example, a payment to a *policyholder* or former *policyholder* to correct an erroneous underpayment of policy proceeds, or a reimbursement of premiums overpaid. The effect of **COBS 20.2.25B R** is that a *firm* may make rectification payments using assets in a *with-profits fund*.

20.2.25D **G** **COBS TP 2.14 R** has the effect that payments of compensation and redress arising out of events which took place before 31 July 2009 are subject to **COBS 20.2.23 R** to **COBS 20.2.25 R** as in force at 30 July 2009.

20.2.26 **R** A proprietary *firm* must not charge to a *with-profits fund* any amounts paid or payable to a skilled person in connection with a report under section 166 of the *Act* (Reports by skilled persons) if the report indicates that the *firm* has, or may have, materially failed to satisfy its obligations under the *regulatory system*.

20.2.26A **R** A proprietary *firm* must not charge to a *with-profits fund* any financial penalty imposed on the *firm* by the *appropriate regulator*.

Tax charge to a with-profits fund

20.2.27 **R** A *firm* must not charge a contribution to corporation tax to a *with-profits fund*, if that contribution exceeds the notional corporation tax liability that would be charged to that *with-profits fund* if it were assessed to tax as a separate *body corporate*.

New business

20.2.28 **R** A *firm* must not effect new *contracts of insurance* in an existing *with-profits fund* unless:

- (1) the *firm's governing body* is satisfied, so far as it reasonably can be, and can demonstrate, having regard to the analysis in (2), that the terms on which each type of contract is to be effected are likely to

have no adverse effect on the interests of the *with-profits policyholders* whose *policies* are written into that fund; and

- (2) the *firm* has:
- (a) carried out or obtained appropriate analysis, based on relevant evidence and proportionate to the risks involved, as to the likely impact on *with-profits policyholders*, having regard to relevant factors including:
 - (i) the volumes of each type of contract that the *firm* expects to be effected; and
 - (ii) the periods over which the contracts are expected to remain in force; and
 - (b) provided the analysis referred to in (a) to its *with-profits committee* or, if applicable, its *with-profits advisory arrangement* and to its *governing body* for the purposes of (1).

20.2.28A G

- (1) Writing new *insurance business* into a *with-profits fund* is not, of itself, automatically adverse to the interests of *with-profits policyholders*. For example, new *insurance business* which defers the emergence or distribution of surplus to a limited extent for a number of *policyholders*, or which leads to a marginal change in the equity backing ratio, may, subject to satisfying the guidance in ■ COBS 20.2.60 G and ■ COBS 20.2.29 G, reasonably be considered not to have an adverse effect on the *with-profits policyholders* in a *with-profits fund*, if the *firm's governing body* is satisfied (and can demonstrate based on appropriate analysis) that each new line of *insurance business* is likely to be financially self-supporting over the periods during which the contracts are expected to remain in force and is likely to add sufficient value to the *with-profits fund* to offset the cost of acquiring the business.
- (2) Conversely, if the particular line of new *insurance business* is priced on loss-making terms or the terms are such that the new *insurance business* is not likely to generate sufficient value after covering all the costs associated with it (in either case when considered in aggregate over the periods over which the contracts are expected to remain in force), then in the *FCA's* view, the terms of that *insurance business* are likely to have an adverse impact on *with-profits policyholders* interests in the relevant fund.
- (3) *Firms* will need to ensure that they comply with ■ COBS 20.2.28 R at all times, but in practice *firms* will be expected to pay particular attention when they are designing and pricing or re-pricing products, when they are preparing their financial plans that take into account their expected costs and levels of new business, and, in particular, when reviewing their financial performance, if that reveals that costs or levels of new business have varied significantly from those expected previously.
- (4) New business for the purposes of ■ COBS 20.2.28 R will not, in general, include increments on existing *policies* or business written as a result of the exercise of options by an existing *policyholder*.

20.2.29 **G** In some circumstances, it may be difficult or impossible for a *firm* to mitigate the risk of an adverse effect on its existing, or new, *with-profits policyholders*, unless it establishes a new bonus series or *with-profits fund*. Circumstances that might cause a *firm* to establish a new bonus series or *with-profits fund* include:

- (1) where the *firm* has a high level of guarantees or options in its existing *with-profits policies*, which might place an excessive burden on new *with-profits policies*, or vice versa; and
- (2) where the potential risks are likely to be so great that a single *with-profits fund* cannot provide adequately for the interests of new and existing *policyholders*, even after allowing for any beneficial effects of diversification. Such potential risks are likely to arise from significant differences in the terms and conditions of the new and existing *with-profits policies*, including the basis on which charges are levied and reviewed.

20.2.30 **G** (1) When a *firm* prices the new *insurance business* that it proposes to effect in an existing *with-profits fund*, it should estimate the volume of new *insurance business* that it is likely to effect and then build in adequate margins that will allow it to recover any acquisition costs to be charged to the *with-profits fund*.

- (2) ■ COBS 20.2.28 R requires *firms* to obtain appropriate analysis and evidence and this should include at least a profitability analysis on a marginal cost basis.

20.2.31 **G** When a *firm* sets a target volume for new *insurance business* in an existing *with-profits fund*, it should pay particular attention to the risk of disadvantage to existing *with-profits policyholders*. Those *policyholders* might be disadvantaged, for example, by the need to retain additional capital to support a rapid growth in new business, when that capital might have been distributed in the ordinary course of the *firm's* existing business.

Relationship of a with-profits fund with the firm and any connected persons

20.2.32 **R** Unless ■ COBS 20.2.32A R applies, a *firm* carrying on *with-profits business* must not:

- (1) make a loan to a *connected person* using assets in a *with-profits fund*; or
- (2) give a guarantee to, or for the benefit of, a *connected person*, where the guarantee will be backed using assets in a *with-profits fund*;

unless that loan or guarantee:

- (3) will be on commercial terms;
- (4) will, in the reasonable opinion of the *firm's* senior management, be beneficial to the *with-profits policyholders* in the relevant *with-profits fund*; and

- (5) will not, in the reasonable opinion of the *firm's* senior management, expose those *policyholders* to undue *credit* or *group* risk.

20.2.32A **R** ■ COBS 20.2.32R (1) does not apply to a *Solvency II firm*.

20.2.32B **G** Loans to a *connected person* using assets in a *with-profits fund* should be considered as investments of assets within the *with-profits fund*. As such, a *Solvency II firm* will need to ensure that:

- (1) such loans comply with the PRA Rulebook: Solvency II Firms: Investments having regard to ■ COBS 20.2.35B G; and
- (2) where there is a conflict of interests, in the reasonable opinion of the *firm's* senior management, they are in the best interests of the *with-profits policyholders* in the relevant *with-profits fund*.

Contingent loans and other forms of support for the with-profits fund

20.2.33 **G** (1) If a *firm*, or a *connected person*, provides support to a *with-profits fund* (for example, by a contingent loan), no reliance should be placed on that support when the *firm* assesses the *with-profits fund's* financial position unless there are clear and unambiguous criteria governing any repayment obligations to the support provider.

- (2) The degree of reliance placed on that support should depend on the subordination of the support to the fair treatment of *with-profits policyholders* and clarification of what fair treatment means in various circumstances. For a *realistic basis life firm* this would normally be evidenced by the liability for such support being capable, under stress, of a progressively lower valuation in the *future policy-related liabilities*.

20.2.34 **G** Where assets from outside a *with-profits fund* are made available to support that fund (and there is no ambiguity in the criteria governing any repayment obligations to the support provider), a *firm* should manage the fund disregarding the liability to repay those assets, at least in so far as that is necessary for its *policyholders* to be treated fairly.

Support arrangements

20.2.34A **R** (1) A *Solvency II firm* must ensure that, in relation to any arrangements where assets outside a *with-profits fund* provide or may provide support to it, both the following requirements are met:

- (a) the precise terms and conditions on which those support asset arrangements operate and assets may become available, including whether and when they are repayable:
 - (i) are adequately documented in the *firm's* records; and
 - (ii) if the *firm* is required to produce a *PPFM*, are set out clearly and unambiguously in its *PPFM*.

- (b) the operation of those support asset arrangements is consistent with terms and conditions in communications to *with-profits policyholders*, including any *PPFM*.

Other rules and guidance on the conduct of with-profits business

- 20.2.35** **G** When a *firm*, other than a *Solvency II firm*, determines its investment strategy, and the acceptable level of risk within that strategy, it should take into account:
- (1) the extent of the guarantee in its *with-profits policies*;
 - (2) any representation that it has made to its *with-profits policyholders*;
 - (3) its established practice; and
 - (4) the amount of capital support available.
- 20.2.35A** **G**
- 20.2.35B** **G**
- (1) A *Solvency II firm* is required to consider its investment strategy in relation to the assets in a *with-profits fund*, including any *strategic investments*, in accordance with the PRA Rulebook: Solvency II Firms: Investments. *Firms* are expected, in applying the PRA Rulebook: Solvency II Firms: Investments, to take into account the particular circumstances and requirements of the liabilities in the *with-profits fund* to which those assets relate. For example, a *Solvency II firm* will need to consider:
 - (a) whether a *strategic investment* meets the criteria in the PRA Rulebook: Solvency II Firms: Investments; and
 - (b) that the investment will ensure the quality, security, liquidity of the portfolio of assets of the *firm* as a whole and that the investment(s) are localised to ensure their availability.
 - (2) Where there is a conflict of interest (e.g. between the *with-profits policyholders* and the *firm*) the *firm* must ensure that the *strategic investment* is made in the best interests of *policyholders*. It is expected that a *Solvency II firm* applying the provisions in PRA Rulebook Solvency II Firms Investments in this manner will lead to *with-profits policyholders* being treated no less fairly than if the *firm* was not a *Solvency II firm* and was subject to **COBS 20.2.35 G** and **COBS 20.2.36 R**.
- 20.2.36** **R** A *firm*, other than a *Solvency II firm*, must not:
- (1) use *with-profits assets* to finance the purchase of a *strategic investment*, directly or by or through a *connected person*; or
 - (2) retain an investment referred to in (1);
- unless its *governing body* is satisfied, so far as it reasonably can be, and can demonstrate, that the purchase or retention is likely to have no adverse

effect on the interests of its *with-profits policyholders* whose *policies* are written into the relevant fund.

20.2.36A **R** A *firm* must keep adequate records setting out the strategic purpose for which a *strategic investment* has been purchased or retained.

20.2.36B **G**

- (1) In order for a *firm* to comply with **■** COBS 20.2.36 R, a *firm's governing body* should consider:
 - (a) the size of the investment in relation to the *with-profits fund*;
 - (b) the expected rate of return on the investment;
 - (c) the risks associated with the investment, including, but not limited to, liquidity risk, the capital needs of the acquired business or investment and the difficulty of establishing fair value (if any);
 - (d) any costs that would result from divestment;
 - (e) whether the *with-profits actuary* would regard the investment as having no adverse effect on the interests of *with-profits policyholders* as a class;
 - (f) in the case of a proprietary *firm*, whether it would be more appropriate for the investment to be made using assets other than those in the *with-profits fund*; and
 - (g) any other relevant material factors.
- (2) A *firm* should consider whether making or retaining a *strategic investment* should be disclosed to *with-profits policyholders*.
- (3) Examples of *strategic investments* include, but are not limited to, a significant investment in another business or significant real estate assets used within the business of the *firm*.

20.2.37 **G** If a *firm* carries out *non-profit insurance business* in a *with-profits fund*, it should review the profitability of the *non-profit insurance business* regularly.

20.2.38 **G** If a *firm* has reinsured its *with-profits insurance business* into another *insurance undertaking*, it should take reasonable steps to discharge its responsibilities to its *with-profits policyholders*, in respect of the reinsured business. Those steps should include maintaining adequate controls.

Significant changes in with-profits funds

20.2.39 **R** A *firm* must not enter into a material transaction relating to a *with-profits fund* unless, in the reasonable opinion of the *firm's governing body*, the transaction is unlikely to have a material adverse effect on the interests of that fund's existing *with-profits policyholders*.

20.2.40 **R** A material transaction includes a series of related non-material transactions which, if taken together, are material.

20.2.41 **G** Examples of material transactions include:

- (1) a significant bulk outwards *reinsurance* contract;
- (2) inwards *reinsurance* of *with-profits business* from another *insurance undertaking*;
- (3) a financial engineering transaction that would materially change the profile of any surplus expected to emerge on the *with-profits fund's* existing *insurance business*; and
- (4) a significant restructuring of the *with-profits fund*, especially if it involves the creation of new *sub-funds*.

20.2.41A **R** A *firm* must contact the *FCA* as soon as is reasonably practicable to make arrangements to discuss what actions may be required to ensure the fair treatment of *with-profits policyholders* if, in relation to any *with-profits fund* it operates:

- (1) the *firm* reasonably expects, or if earlier, there has been, a sustained and substantial fall in either the volume of new *non-profit insurance contracts*, or in the volume of new *with-profits policies* (effected other than by *reinsurance*), or in both, effected into the *with-profits fund*; or
- (2) the *firm* cedes by way of *reinsurance* most or all of the new *with-profits policies* which it continues to effect.

20.2.41B **G**

- (1) The aim of the discussions in **■ COBS 20.2.41A R** is to:
 - (a) allow the *FCA* to comment on the adequacy of the *firm's* planning; and
 - (b) seek agreement with the *firm* on any other appropriate actions to ensure *with-profits policyholders* are treated fairly.
- (2) If the *firm* is no longer effecting a material volume of new *with-profits policies* (other than by *reinsurance*) into a *with-profits fund*; or if it is ceding by way of *reinsurance* most or all of the new *with-profits policies* which it continues to effect, then it may also be appropriate to consider whether, in the particular circumstances of the *firm*, it should be regarded as ceasing to effect new *contracts of insurance* for the purposes of **■ COBS 20.2.54R (3)**.
- (3) In the discussions the *FCA* will have with regard to **■ COBS 20.2.28 R** (New business), if the volumes of new business are expected to be profitable and, in relation to *non-profit insurance business*, it is demonstrated that a fair distribution to *with-profits policyholders* out of the fund can be achieved and the economic value of any expected future profits is likely to be available for distribution during the lifetime of the *with-profits business* for the purposes of **■ COBS 20.2.60 G**, then, in the *FCA's* view, it is likely to be reasonable for a *firm* to be satisfied that there will be no adverse effect for *with-profits policyholders*, and accordingly that such business may continue to be written.

Process for reattribution of inherited estates: Policyholder advocate: appointment and role

20.2.42

R

A *firm* that is seeking to make a *reattribution* of its *inherited estate* must:

- (1) first discuss with the *FCA* (as part of its determination under **COBS 20.2.21 R**):
 - (a) its projections for capital required to support existing business, which must include an assessment of:
 - (i) the *firm's* future risk appetite for the *with-profits fund* and other relevant business; and
 - (ii) how much of the margin for prudence can be identified as excessive and removed from the projected capital requirements; and
 - (b) its projections for capital required to support future new business, which must include an assessment of:
 - (i) new business volumes;
 - (ii) product terms; and
 - (iii) pricing margins;
- (2) following the discussions referred to in (1), identify at the earliest appropriate point a *policyholder advocate*, who is free from any conflicts of interest that may be, or may appear to be, detrimental to the interests of *policyholders*, to negotiate with the *firm* on behalf of relevant *with-profits policyholders* and seek the approval of the *FCA* for the appointment of the *policyholder advocate* as soon as he is identified, or appoint a *policyholder advocate* nominated by the *FCA* if its approval is not granted; and
- (3) involve the *policyholder advocate* designate at the earliest possible opportunity to enable him to participate effectively in the negotiations about the proposals for the *reattribution*.

20.2.42A

R

20.2.43

G

The *firm* should include an independent element in the *policyholder advocate* selection process, which may include consulting representative groups of *policyholders* or using the services of a recruitment consultant. When considering an application for approval of a nominee to perform the *policyholder advocate* role, the *FCA* will have regard to the extent to which the *firm* has involved others in the selection process.

20.2.44

G

The precise role of the *policyholder advocate* in any particular case will depend on the nature of the *firm* and the *reattribution* proposed. A *firm* will need to discuss, with a view to agreeing, with the *FCA* the precise role of the *policyholder advocate* in a particular case (**COBS 20.2.45 R**). However, the role of the *policyholder advocate* should include:

- (1) negotiating with the *firm*, on behalf of the relevant *with-profits policyholders*, the benefits to be offered to them in exchange for the rights or interests they will be asked to give up;

- (2) commenting to *with-profits policyholders*, on:
 - (a) the methodology used for the allocation of benefits amongst the relevant (or groups of) *with-profits policyholders* and the form of those benefits;
 - (b) the criteria used for determining the eligibility of the various *with-profits policyholders*;
 - (c) the terms and conditions of the proposals (to the extent that they materially affect the benefits to be offered, or the bonuses that may be added to *with-profits policies*); and
 - (d) the views expressed by the *independent expert* or the *retribution expert* (as the case may be), and the *firm's with-profits actuary* on the allocation of any benefits amongst the relevant *with-profits policyholders*; and
- (3) telling *with-profits policyholders*, or each group of *with-profits policyholders*, with reasons, whether the *firm's* proposals are in their interests.

Process for reattribution of inherited estates: Policyholder advocate: terms of appointment

20.2.45

R

A *firm* must:

- (1) notify the *FCA* of the terms on which it proposes to appoint a *policyholder advocate* (whether or not the candidate was nominated by the *FCA*); and
- (2) ensure that the terms of appointment for the *policyholder advocate*:
 - (a) include a description of the role of the *policyholder advocate* as agreed with the *FCA* under ■ COBS 20.2.44 G;
 - (aA) stress the independent nature of the *policyholder advocate's* appointment and function, and are consistent with it;
 - (b) define the relationship of the *policyholder advocate* to the *firm* and its *policyholders*;
 - (c) set out arrangements for communications between the *policyholder advocate* and *policyholders*;
 - (d) make provision for the resolution of any disputes between the *firm* and the *policyholder advocate*;
 - (e) specify when and how the *policyholder advocate's* appointment may be terminated;
 - (f) allow the *policyholder advocate* to communicate freely and in confidence with the *FCA*;
 - (g) require the *policyholder advocate* to communicate with *policyholders*:
 - (i) as soon as is practicable after his appointment, having regard to (h)(i) and (iii); and
 - (ii) thereafter no less frequently than every six *months* for the duration of the *policyholder advocate's* appointment; and
 - (h) require the *policyholder advocate*:

- (i) to make reasonable endeavours to agree with the *firm* the contents of any proposed *policyholder* communications;
- (ii) to allow sufficient time for the process in (i) in order to meet any timescales in (g); and
- (iii) to provide copies of the final draft of the intended *policyholder* communications, whether or not agreement has been reached in accordance with (i) above, both to the *firm* and to the *FCA* at least seven *days* in advance of the date on which the *policyholder advocate* intends to make the communications.

20.2.46 G A *firm* may include, within the *policyholder advocate's* terms of appointment, arrangements for the *policyholder advocate* to be indemnified in respect of certain claims that may be made against him in connection with the performance of his functions. If such indemnity is included, it should not include protection against any liability arising from acts of bad faith.

Process for reattribution of inherited estates: Reattribution expert

20.2.47 R Where a *firm* is not otherwise required to appoint an *independent expert*, it must:

- (1) appoint a reattribution expert to undertake an objective assessment of its *reattribution* proposals, who must be:
 - (a) nominated or approved by the *appropriate regulator* before he is appointed; and
 - (b) free from any conflicts of interest that may, or may appear to, undermine his independence or the quality of his report;
- (2) ensure that the *reattribution expert's* terms of appointment allow him to communicate freely and in confidence with the *appropriate regulator*; and
- (3) require the *reattribution expert* to prepare a report which must be available to the *appropriate regulator*, the *policyholder advocate* and the court (if it is relevant to any court proceedings).

20.2.48 G A *reattribution expert's* report should comply with the applicable rules on expert evidence. The scope and content of the report should be substantially similar to that of the report required of an *independent expert* under ■ SUP 18.2 (Insurance business transfers), as if (where appropriate) a reference to:

- (1) the '*scheme report*' was a reference to the '*reattribution expert's* report';
- (2) the '*independent expert*' was a reference to the '*reattribution expert*'; and
- (3) the '*scheme*' was a reference to the proposal for a '*reattribution*'.

Process for reattribution of inherited estates: Information to policyholders

- 20.2.49 **R** A firm must ensure that every *policyholder* that may be affected by the proposed *reattribution* is sent appropriate and timely information about:
- (1) the *reattribution* process, including the role of the *policyholder advocate*, the *independent expert* or *reattribution expert*, as the case may be, and other individuals appointed to perform particular functions;
 - (2) the *reattribution* proposals and how they affect the relevant *policyholders*, including an explanation of any benefits they are likely to receive and the rights and interests that they are likely to be asked to give up;
 - (3) the *policyholder advocate's* views on the *reattribution* proposals and any benefits the relevant *policyholders* are likely to receive and the rights and interests that they are likely to be asked to give up; and
 - (4) the outcome of the negotiations between the *firm* and the *policyholder advocate* about the benefits that will be offered to relevant *with-profits policyholders*, in exchange for the rights and interests that they will be asked to give up.

- 20.2.50 **R** An adequate summary of the report by the *reattribution expert* must be made available to every *policyholder* that may be affected by the proposed *reattribution*.

Process for reattribution of inherited estates: Consent of policyholders

- 20.2.51 **R** A firm must give relevant *with-profits policyholders* the option to:
- (1) individually accept or reject the final proposals for the *reattribution*;
or
 - (2) (if the legal process to be followed allows the majority of *policyholders* to bind the minority) vote on whether the *firm* should go ahead with those proposals.

Process for reattribution of inherited estates: Costs

- 20.2.52 **G**
- (1) *Reattribution* and *insurance business transfer* costs (excluding *policyholder advocate* costs) should be met from shareholder funds. A firm may present alternative arrangements if it can show good reasons for doing so.
 - (2) Shareholders should pay a reasonable proportion of the *policyholder advocate's* costs.
 - (3) If a *reattribution* proposal is not successful, the FCA would expect the costs of the *policyholder advocate* to be met by the *person* initiating the proposal. That will usually be the shareholders of the *firm*.

Ceasing to effect new contracts of insurance in a with-profits fund

- 20.2.53** **R** A *firm* must:
- (1) inform the *appropriate regulator* and its *with-profits policyholders* within 28 days; and
 - (2) submit a run-off plan to the *appropriate regulator* as soon as reasonably practicable and, in any event, within three months;
- of first ceasing to effect new *contracts of insurance* in a *with-profits fund*.
- 20.2.54** **R** A *firm* will be taken to have ceased to effect new *contracts of insurance* in a *with-profits fund*:
- (1) when any decision by the *governing body* to cease to effect new *contracts of insurance* takes effect; or
 - (2) where no such decision is made, when the *firm* is no longer:
 - (a) actively seeking to effect new *contracts of insurance* in that fund; or
 - (b) effecting new *contracts of insurance* in that fund, except by increment; or
 - (3) if the *firm*:
 - (a) (i) is no longer effecting a material volume of *with-profits policies* (other than by *reinsurance*), into the *with-profits fund*; or
 - (ii) is ceding by way of *reinsurance* most or all of the new *with-profits policies* which it continues to effect; and
 - (b) cannot demonstrate that it will treat *with-profits policyholders* fairly if it does not cease to effect new *contracts of insurance*.
- 20.2.55** **G** For the purposes of **■ COBS 20.2.54R (3)** the *FCA* will have regard to, amongst other things, the factors set out in **■ COBS 20.2.41BG (3)**.
- 20.2.56** **R** The run-off plan required by **■ COBS 20.2.53 R** must:
- (1) include an up-to-date plan to demonstrate how the *firm* will ensure a fair distribution of the closed *with-profits fund*, and its *inherited estate* (if any); and
 - (2) be approved by the *firm's governing body*.
- 20.2.57** **G**
- (1) A *firm* should also include the information described in Appendix 2.15 (Run-off plans for closed with-profits funds) of the Supervision manual in its run-off plan.
 - (2) A *firm* should periodically review and update its run-off plan and submit updated versions to the *FCA* when requested to do so.

- 20.2.58** **G** When a *firm* tells its *with-profits policyholders* that it has ceased to effect new *contracts of insurance* in a *with-profits fund*, it should also explain:
- (1) why it has done so;
 - (2) what changes it has made, or proposes to make, to the fund's investment strategy (if any);
 - (3) how closure may affect *with-profits policyholders* (including any reasonably foreseeable effect on future bonus prospects);
 - (4) the options available to *with-profits policyholders* and an indication of the potential costs associated with the exercise of each of those options; and
 - (5) any other material factors that a *policyholder* may reasonably need to be aware of before deciding how to respond to this information.
- 20.2.59** **G** A *firm* may not be able to provide its *with-profits policyholders* with all of the information described above until it has prepared the run-off plan. In those circumstances, the *firm* should:
- (1) tell its *with-profits policyholders* that that is the case;
 - (2) explain what is missing and give a time estimate for its supply; and
 - (3) provide the missing information as soon as possible, and within the time estimate given.
- 20.2.60** **G**
- (1) If *non-profit insurance business* is written in a *with-profits fund*, a *firm* should take reasonable steps to ensure that the economic value of any future profits expected to emerge on the *non-profit insurance business* is available for distribution during the lifetime of the *with-profits business*.
 - (1A) Where a *with-profits fund* contains assets which may not be readily realisable, the *firm* should take reasonable steps to ensure that the economic value of those assets is made available as part of a fair distribution to *with-profits policyholders*.
 - (2) Where it is agreed by its *with-profits policyholders*, and subject to meeting the requirements for effecting new *contracts of insurance* in an existing *with-profits fund* (■ COBS 20.2.28 R), a *mutual* may make alternative arrangements for continuing to carry on *non-profit insurance business*, and a *non-directive friendly society* may make alternative arrangements for continuing to carry on non-insurance related business. Where a *mutual* has been granted a *waiver* in accordance with ■ COBS 20.2.61 G, the agreement of its *with-profits policyholders* to alternative arrangements for continuing to carry on *non-profit insurance business* may not be needed.
- 20.2.61** **G**
- (1) A *mutual* operating a common fund may seek to undertake an exercise to identify that part of the fund to which the *mutual* considers it would be fair for relevant provisions in ■ COBS 20 not to apply.

- (2) To give regulatory effect to the identification exercise, the *FCA* expects that a *mutual* will need to apply to the *FCA* to modify the relevant provisions in ■ COBS 20 and elsewhere which are dependent on the definition of the *with-profits fund*.
- (3) A *mutual* will need to demonstrate that the appropriate statutory tests in section 138A of the *Act* are met. The *FCA* expects that *mutuals* will need to do at least the following to allow the *FCA* to consider whether granting the modification would adversely affect the advancement of the *FCA*'s consumer protection objective:
- (a) demonstrate that the exercise does not amount to a *retribution*;
 - (b) demonstrate that its proposals are fair to its *with-profits policyholders*, and other relevant *policyholders*, having regard to the *mutual's* own particular structure, origins and other relevant circumstances, and including reference to the items in (c) to (j) below;
 - (c) obtain the report of an independent expert approved by, and whose terms of reference are agreed with, the *FCA* on the terms of the *mutual's* proposals and the likely impact and effects on, and fairness to, the *mutual's with-profits policyholders* and other relevant *policyholders*. This report should consider whether the *firm* has sufficiently demonstrated the absence of a *retribution* under (a). The *FCA* will consider using its powers in section 166 of the *Act* (Reports by skilled persons) in appropriate circumstances;
 - (d) demonstrate that the *mutual's with-profits policyholders* and other *policyholders* are appropriately engaged and informed about the proposals;
 - (e) demonstrate that it has complied with the relevant requirements in the *mutual's* constitutional documents, for example that members are appropriately involved in agreeing to any proposals;
 - (f) demonstrate that the *mutual* has a convincing and robust business case for continuing in business, as opposed to run-off;
 - (g) demonstrate how, and the extent to which, continuing membership rights will benefit *with-profits policyholders* and other *policyholders*;
 - (h) explain the nature and terms of any continuing support to be provided to the *with-profits fund* from outside the *with-profits fund*;
 - (i) demonstrate that *with-profits policyholders* under the *mutual's* proposals will not be at a disadvantage compared to equivalent *with-profits policyholders* in a proprietary *with-profits fund*; and
 - (j) explain how it proposes to pay any compensation or redress that is, or may become, due to a *policyholder*, or former *policyholder*.
- (4) For the purposes of (3)(a) and (c), where the issues to be considered by the independent expert include the extent or value (in the particular circumstances of the *mutual*) of the rights and interests of *with-profits policyholders* in the *with-profits fund*, the *FCA* expects the independent expert's terms of reference to require them to take into account other available analyses of such rights and interests which may be more favourable to *policyholders* than the *mutual's* own analysis. The *FCA* considers that any uncertainty in the extent or

value of such rights and interests in the case of a particular *mutual* may mean that the independent expert will need to obtain their own independent legal advice on the issue. In the *FCA's* view the fact of any uncertainty as to the extent or value of the relevant rights and interests, following receipt of independent legal advice, may itself be taken into account by the independent expert when producing their report. The *FCA* will consider on a case by case basis what further information it may provide to the expert and/or independent legal adviser to ensure that the rights and interests of *policyholders* have been appropriately taken into account.

- (5) The *FCA* expects to consult and/or seek information or advice from the *PRA* in accordance with section 3D of the *Act* and the Memorandum of Understanding between the *FCA* and the *PRA* required by section 3E. As part of any such process the *FCA* expects that the *PRA* will wish to consider, among other things, that balance sheet safety and soundness issues have been identified and addressed appropriately.

20.3 Principles and Practices of Financial Management

Production of PPFM

20.3.1

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- (1) A *firm* must:
 - (a) establish and maintain the *PPFM* according to which its *with-profits business* is conducted (or, if appropriate, separate *PPFM* for each *with-profits fund*); and
 - (b) retain a record of each version of its *PPFM* for five years.
- (2) A *firm's with-profits principles* must:
 - (a) be enduring statements of the standards it adopts in managing *with-profits funds*; and
 - (b) describe the business model it uses to meet its duties to *with-profits policyholders* and to respond to longer-term changes in the business and economic environment.
- (3) A *firm's with-profits practices* must:
 - (a) describe how a *firm* manages its *with-profits funds* and how it responds to shorter-term changes in the business and economic environment; and
 - (b) be sufficiently detailed for a knowledgeable observer to understand the material risks and rewards from effecting or maintaining a *with-profits policy* with it.
- (4) A *firm* must not change its *PPFM* unless, in the reasonable opinion of its *governing body*, that change is justified to:
 - (a) respond to changes in the business or economic environment; or
 - (b) protect the interests of *policyholders*; or
 - (c) change the *firm's with-profits practices* better to achieve its *with-profits principles*.
- (5) A *firm* may change its *PPFM* if that change:
 - (a) is necessary to correct an error or omission; or
 - (b) would improve clarity or presentation without materially affecting the *PPFM's* substance; or
 - (c) is immaterial.

20.3.2

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[deleted]

20.3.3 **G** [deleted]

Scope and content of PPFM

20.3.4 **R** A firm's PPFM must cover the issues set out in the table in **■ COBS 20.3.6 R**.

20.3.5 **R** A firm's PPFM must cover any matter that has, or it is reasonably foreseeable may have, a significant impact on the firm's management of with-profits funds, including but not limited to:

- (1) any requirements or constraints that apply as a result of previous dealings, including previous business transfer schemes;
- (2) the nature and extent of any shareholder or other commitment to support the with-profits fund; and
- (3) the precise terms and conditions of support asset arrangements, as described in **■ COBS 20.2.34A R**.

20.3.6 **R** Table: Issues to be covered in PPFM

	Subject	Issues
(1)	Amount payable under a with-profits policy	<p>(a) Methods used to guide determination of the amount that is appropriate to pay individual with-profits policyholders, including:</p> <ul style="list-style-type: none"> (i) the aims of the methods and approximations used; (ii) how the current methods, including any relevant historical assumptions used and any systems maintained to deliver results of particular methods, are documented; and (iii) the procedures for changing the current method or any assumptions or parameters relevant to a particular method.

	Subject	Issues
		<p>(b) Approach to setting bonus rates.</p> <p>(c) Approach to smoothing maturity payments and surrender payments, including:</p> <p>(i) the smoothing policy applied to each type of <i>with-profits policy</i>;</p> <p>(ii) the limits (if any) applied to the total cost of, or excess from, smoothing; and</p> <p>(iii) any limits applied to any changes in the level of maturity payments between one period to another.</p>
(2)	Investment strategy	<p>Significant aspects of the <i>firm's</i> investment strategy for its <i>with-profits business</i> or, if different, any <i>with-profits fund</i>, including:</p> <p>(a) the degree of matching to be maintained between assets relevant to <i>with-profits business</i> and liabilities to <i>with-profits policyholders</i> and other creditors;</p> <p>(b) the <i>firm's</i> approach to assets of different credit or liquidity quality and different volatility of market values;</p> <p>(c) the presence among the assets relevant to <i>with-profits business</i> of any assets that would not normally be traded because of their importance to the <i>firm</i>, and the justification for holding such assets; and</p> <p>(d) the <i>firm's</i> controls on using new asset or liability instruments and the nature of any approval required before new instruments are used.</p>
(3)	Business risk	<p>The exposure of the <i>with-profits business</i> to business risks (new and existing), including the <i>firm's</i>:</p>

	Subject	Issues
		(a) procedures for deciding if the <i>with-profits business</i> may undertake a particular business risk;
		(b) arrangements for reviewing and setting a limit on the scale of such risks; and
		(c) procedures for reflecting the profits or losses of such business risks in the amounts payable under <i>with-profits policies</i> .
(4)	Charges and expenses	(a) The way in which the <i>firm</i> applies charges and apportionment expenses to its <i>with-profits business</i> , including, if material, any interaction with connected firms. (b) The cost apportionment principles that will determine which costs are, or may be, charged to a <i>with-profits fund</i> and which costs are, or may be, charged to the other parts of its business of its shareholders.
(5)	Management of inherited estate	Management of any <i>inherited estate</i> and the uses to which the <i>firm</i> may put that <i>inherited estate</i> .
(6)	Volumes of new business and arrangements on stopping taking new business	If a <i>firm's with-profits fund</i> is accepting new <i>with-profits business</i> , its practice for review of the limits on the quantity and type of new business and the actions that the <i>firm</i> would take if it ceased to take on new business of any significant amount.
(7)	Equity between the with-profits fund and any shareholders	The way in which the interests of <i>with-profits policyholders</i> are, or may be, affected by the interests of any shareholders of the <i>firm</i> .

20.3.7 G The table in ■ COBS 20.3.8 G sets out *guidance* on how various information relevant to some of the issues covered in a *firm's PPFM* (■ COBS 20.3.6 R) might be split between *with-profits principles* and *with-profits practices*. This is an example of the matters a *firm* should address in its *with-profits principles* and *with-profits practices* and is not exhaustive. A *firm* should consider carefully the scope and content of its *PPFM* as appropriate.

20.3.8 G Table: Guidance on with-profits principles and practices

Reference to PPFM issues (COBS 20.3.6R)	With-profits principles	With-profits practices
(1) Amount payable under a with-profits policy	<p>General</p> <p>(a) Circumstances under which any historical assumptions or parameters, relevant to methods used to determine the amount payable, may be changed;</p>	<p>General</p> <p>(e) For each major class of <i>with-profits policy</i>, methods establishing the main assumptions or parameters that decide the output of methods that determine the amount payable;</p> <p>(f) Degree of approximation allowed when assumptions or parameters are applied across generations of <i>with-profits policyholders</i> or across different types or classes of <i>with-profits policies</i>;</p> <p>(g) Formality with which the methods, parameters or assumptions used are documented;</p> <p>(h) Target range, or target ranges, that have been set for maturity payments;</p> <p>(i) Factors likely to be regarded as relevant to address <i>policyholders'</i> interests or security when determining <i>excess surplus</i>; and</p> <p>Investment return, expenses or charges and tax</p> <p>(j) How investment return, expenses or charges and tax are brought into account and how the impact of those items is determined on the amount payable. In particular:</p> <p>(i) any distinctions made in recognising the investment return from a subset of the total assets of a <i>with-profits fund</i>;</p> <p>(ii) whether expenses are apportioned between all the policies in a <i>with-profits fund</i> or apportioned in some other way;</p>

Reference to PPFM issues (COBS 20.3.6R)	With-profits principles	With-profits practices
	<p>Bonus rates</p> <p>(b) General aims in setting bonus rates and the constraints to which the <i>firm</i> may be subject in changing economic circumstances;</p> <p>(c) How the range of <i>with-profits policies</i> or generations of <i>with-profits policies</i> over which the <i>firm</i> believes a single bonus rate would be appropriate is determined and the circumstances under which it believes a new bonus series would be necessary; and</p>	<p>(iii) the relationship between the liability to tax attributed to a <i>with-profits fund</i> and the tax that the <i>firm</i> imputes to determine the amount payable;</p> <p>(iv) impact on the amount payable of any attributed liability to tax of a <i>with-profits fund</i> as a result of the <i>firm</i> making a transfer to shareholders; and</p> <p>(v) how any other items are brought into account.</p> <p>Bonus rates</p> <p>(k) Current approach to setting bonus rates, including the weight given to recent economic experience. For final bonus rates, the description should include any distinctions made between <i>with-profits policies</i> that remain in force until contractual dates, or dates on which no market value reduction applies (for example, maturity or retirement dates) and policies that are surrendered or transferred at other dates;</p> <p>(l) Frequency at which bonus rates are re-set or expected to be re-set and the circumstances under which changes in the economic environment would cause the time between re-setting to change;</p> <p>(m) Maximum amount by which annual bonuses would alter if annual bonus rates were reset;</p> <p>(n) Approach to setting any interim bonus rates before the next declaration of annual bonus rates;</p>

Reference to PPFM issues (COBS 20.3.6R)	With-profits principles	With-profits practices
	<p>Smoothing</p> <p>(d) Statement as to whether smoothing is intended to be neutral over time.</p>	<p>(o) Relationship or interaction between final bonus rates and any market value reductions, if both can apply at the same time;</p> <p>(p) How final bonus rates influence the value of <i>with-profits policies</i> that have formulaic surrender or transfer bases (for example, older conventional policies rather than unitised policies); and</p> <p>Smoothing</p> <p>(q) Any differences in approach for:</p> <ul style="list-style-type: none"> (i) the various types of <i>with-profits policy</i>; (ii) different categories of payout, such as between surrendered policies and maturing policies; and (iii) different generations of <i>with-profits policyholders</i>.
(2) Investment strategy	<p>(a) How the types, classes or mix of assets are determined; and</p> <p>(b) Strategy in respect of derivatives and other instruments.</p>	<p>(c) Whether and to what extent there is hypothecation of assets;</p> <p>(d) Period between formal reviews of investment strategy;</p> <p>(e) Approach to investment in different asset classes, and assets of different credit or liquidity quality, including assets not normally traded; and</p> <p>(f) Details of any external support available to the <i>with-profits fund</i> and how this affects the investment strategy.</p>
(3) Business risk	<p>(a) Where a <i>firm</i> explicitly excludes business risk from a class of <i>with-profits policies</i> but there are residual risks, clarification where these risks such as guarantee and</p>	<p>(c) Current limits which apply to the taking on of business risk; and</p> <p>(d) Whether and to what extent particular generations of <i>with-profits policyholders</i> or classes of <i>with-profits</i></p>

Reference to PPFM issues (COBS 20.3.6R)	With-profits principles	With-profits practices
(4) Charges and expenses	<p>smoothing costs are borne; and</p> <p>(b) Define where compensation costs from a business risk would be borne.</p> <p>(a) Factors that would drive any change to the basis on which the <i>firm</i> applies charges to or apportions its actual expenses amongst <i>with-profits policies</i>, or exercises any discretion to apply charges to particular <i>with-profits policies</i>.</p>	<p><i>policies</i> bear or might bear particular business risks, including for example, crystallised or contingent guarantees to other classes of <i>policyholders</i> or whether the out-turn from all business risk is pooled across all <i>with-profits policies</i>.</p> <p>(b) Charges currently applied and the expenses currently apportioned to major classes of <i>with-profits policies</i>;</p> <p>(c) Relationship between the <i>firm's</i> actual charges and expenses, as applied to determine the amounts payable under <i>with-profits policies</i>, and the charges and expenses borne by the <i>with-profits fund</i>;</p> <p>(d) Circumstances under which expenses will be charged to the <i>with-profits fund</i> at an amount other than cost, and the reasons why; and</p> <p>(e) Interval for reviewing any arrangements for out-sourced services, including those provided by connected parties, giving a broad indication of the terms for termination.</p>
(5) Management of inherited estate	<p>(a) Preferred size or scale of <i>inherited estate</i> and implications for the values of the <i>with profits policies</i>; and</p> <p>(b) Any existing division of the <i>inherited estate</i> between <i>with-profits funds</i>; and</p> <p>(c) Any constraints on the freedom to deal with the <i>inherited es</i></p>	<p>(d) How the <i>inherited estate</i> is used, for example, in meeting costs;</p> <p>(e) Whether the investment strategy for the <i>inherited estate</i> differs from the rest of the <i>with-profits fund</i>; and</p> <p>(f) Any current guidelines in place as to the size or scale of the <i>inherited estate</i> or as to</p>

Reference to PPFM issues (COBS 20.3.6R)	With-profits principles	With-profits practices
(6) Equity between the with-profits fund and any shareholders	<p><i>tate</i> as a result of previous dealings.</p> <p>(a) Arrangements for, and any changes to, profit sharing between shareholders and <i>with-profits policyholders</i>.</p>	<p>how and over what time period the <i>inherited estate</i> would be managed, if it becomes too large or too small.</p> <p>(b) Current basis on which profit between <i>with-profits policyholders</i> and shareholders is divided; and</p> <p>(c) Whether the pricing of any policies being written, and particular policies open to new business, appear to be significantly and systematically reducing the <i>inherited estate</i> if the shareholder transfer is taken into account.</p>

20.4 Communications with with-profits policyholders

Provision and publication of PPFM

- 20.4.1** **R** A firm must:
- (1) on request, provide its *PPFM*, or the *PPFM* applicable to specified *with-profits funds*:
 - (a) free of charge to its *with-profits policyholders*; or
 - (b) for a reasonable charge to any person who is not its *with-profits policyholder*; and
 - (2) if the firm publishes its *PPFM* on its website, prominently signpost its location there.

Notification of changes

- 20.4.2** **R** A firm must send its *with-profits policyholders* who are affected by any change in its *PPFM*, written notice, setting out any:
- (1) proposed changes to the *with-profits principles*, three months in advance of the effective date; and
 - (2) changes to the *with-profits practices*, within a reasonable time.

- 20.4.3** **R** A firm need not give the notice required if the change to its *PPFM*:
- (1) is necessary to correct an error or omission; or
 - (2) would improve clarity or presentation without materially affecting the *PPFM*'s substance; or
 - (3) is immaterial.

Requirements on EEA insurers

- 20.4.4** **R** [deleted]
- 20.4.5** **R** [deleted]
- 20.4.6** **G** [deleted]

Annual report to with-profits policyholders

- 20.4.7** **R** A *firm* must produce an annual report to its *with-profits policyholders*, which must:
- (1) state whether, throughout the *financial year* to which the report relates, the *firm* believes it has complied with its obligations relating to its *PPFM* and setting out its reasons for that belief;
 - (2) address all significant relevant issues, including the way in which the *firm* has:
 - (a) exercised, or failed to exercise, any discretion that it has in the conduct of its *with-profits business*; and
 - (b) addressed any competing or conflicting rights, interests or expectations of its *policyholders* (or groups of *policyholders*) and, if applicable, *shareholders* (or groups of *shareholders*), including the competing interests of different classes and generations.
- 20.4.8** **G** The following documents should be annexed to the annual report in this section:
- (1) the report to *with-profits policyholders* made by a *with-profits actuary* in respect of each financial year (see SUP 4.3.16AR(4)); and
 - (2) any statement or report provided by the *person* or committee who provides the independent judgement under the *firm's* governance arrangements for its *with-profits business*.
- 20.4.9** **G** In preparing the annual report to *with-profits policyholders*, a *firm* should take advice from a *with-profits actuary*.
- 20.4.10** **G** A *firm* should make the annual report available to *with-profits policyholders* within six *months* of the end of the *financial year* to which it relates. A *firm* should notify its *with-profits policyholders* in any annual statements how copies of the report can be obtained.

20.5 With-profits governance

Requirement to appoint a with-profits committee or advisory arrangement

- 20.5.1** **R** A firm must, in relation to each *with-profits fund* it operates:
- (1) appoint:
 - (a) a *with-profits committee*; or
 - (b) a *with-profits advisory arrangement* (referred to in this section as an 'advisory arrangement'), but only if appropriate, in the opinion of the *firm's governing body*, having regard to the size, nature and complexity of the fund in question;
 - (2) ensure that the *with-profits committee* or advisory arrangement operates in accordance with its *terms of reference*; and
 - (3) make available a copy of any *terms of reference* on the *firm's* website, or if the *firm* does not have a website, at the request of *policyholders*.
- 20.5.2** **G**
- (1) Ultimate responsibility for managing a *with-profits fund* rests with the firm through its *governing body*. The role of the *with-profits committee* or advisory arrangement is, in part, to act in an advisory capacity to inform the decision-making of a *firm's governing body*. The *with-profits committee* or advisory arrangement also acts as a means by which the interests of *with-profits policyholders* are appropriately considered within a *firm's* governance structures. The *with-profits committee* or advisory arrangement should address issues affecting *policyholders* as a whole or as separately identifiable groups of *policyholders* generally rather than dealing with individual *policyholder* complaints or taking management decisions with respect to a *with-profits fund*.
 - (2) If a *firm* considers that it is appropriate to appoint an advisory arrangement, a *firm's governing body* will need to decide whether it is appropriate to appoint an independent person or one or more *non-executive directors* to carry out the role. The *FCA* expects *firms* to make this determination according to the nature, size and complexity of the fund in question. So the larger or more complex the fund is, the more likely it would be that it would be appropriate to appoint an independent person.
 - (3) Where a *firm* has appointed a *with-profits committee* to one of its *with-profits funds* it may also decide to appoint that *with-profits*

committee to some or all of its other *with-profits funds*, even if the *firm* would not have determined it appropriate to appoint a *with-profits committee* to those other funds when considered individually having regard to their size, nature or complexity.

Terms of reference of with-profits committee or advisory arrangement

20.5.3

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A *firm* must ensure that the *terms of reference* contain, as a minimum, terms having the following effect:

- (1) the role of the *with-profits committee* or advisory arrangement is, as relevant, to assess, report on, and provide clear advice and, where appropriate, recommendations to the *firm's governing body* on:
 - (a) the way in which each *with-profits fund* is managed by the *firm* and, if a *PPFM* is required, whether this is properly reflected in the *PPFM*;
 - (b) if applicable, whether the *firm* is complying with the principles and practices set out in the *PPFM*;
 - (c) whether the *firm* has addressed effectively the conflicting rights and interests of *with-profits policyholders* and other *policyholders* or stakeholders including, if applicable, shareholders, in a way that is consistent with *Principle 6* (treating customers fairly); and
 - (d) any other issues with which the *firm's governing body*, *with-profits committee* or advisory arrangement considers *with-profits policyholders* might reasonably expect the *with-profits committee* or advisory arrangements to be involved;
- (2) that the *with-profits committee* or advisory arrangement must:
 - (a) decide on the specific matters it will consider in order to enable it to carry out its role described in (1)(a) to (d) as appropriate to the particular circumstances of the *with-profits fund(s)*; and
 - (b) in any event give appropriate consideration to the following non-exhaustive list of specific matters:
 - (i) the identification of surplus and *excess surplus*, the merits of its distribution or retention and the proposed distribution policy;
 - (ii) how bonus rates, smoothing and, if relevant, market value reductions have been calculated and applied;
 - (iii) if relevant, the relative interests of *policyholders* with and without valuable guarantees;
 - (iv) the *firm's* with-profits customer communications such as annual policyholder statements and product literature and whether the *with-profits committee* or advisory arrangement wishes to make a statement or report to *with-profits policyholders* in addition to the annual report made by a *firm*;
 - (v) any significant changes to the risk or investment profile of the *with-profits fund* including the management of material illiquid investments and the *firm's* obligations in relation to *strategic investments*;

- (vi) the *firm's* strategy for future sales supported by the assets of the *with-profits fund* and its impact on surplus;
 - (vii) the impact of any management actions planned or implemented;
 - (viii) relevant management information such as customer complaints data (but not necessarily information relating to individual customer complaints);
 - (ix) the drafting, review, updating of and compliance with run-off plans, court schemes and similar matters;
 - (x) the costs incurred in operating the *with-profits fund*;
 - (xi) the identification and extent of the *firm's with-profits funds*, with particular regard to the considerations as to whether a part of the *with-profits fund* constitutes a separate *with-profits fund* in accordance with ■ COBS 20.1A.2 R (Sub-funds); and
 - (xii) the use and purpose of, and terms under which, support assets are available to the *with-profits fund*, having regard to the considerations in ■ COBS 20.2.33 G to ■ COBS 20.2.34 G and ■ COBS 20.2.34A R.
- (3) that any person appointed as a member of the *with-profits committee* or as a person carrying out the advisory arrangement must have the appropriate skills, knowledge and experience to perform, or contribute to, as appropriate, the role set out in (1) and (2);
- (4) if the firm appoints a *with-profits committee*:
- (a) that there must be three or more members;
 - (b) that the quorum for any meeting (or decision by written procedure) must be at least half of the number of, and no less than two, members; and
- (5) that the *with-profits committee* or advisory arrangement must:
- (a) advise the *governing body* on the suitability of candidates proposed for appointment as the *with-profits actuary*; and
 - (b) assess the performance of the *with-profits actuary* at least annually, and report its view to the *governing body* of the *firm*.

20.5.4

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- (1) The *FCA* expects that a *with-profits committee* will meet at least quarterly and ad hoc if required.
- (2) The *FCA* expects that, in general, a *with-profits committee* or advisory arrangement will work closely with the *with-profits actuary*, and obtain his opinion and input as appropriate.

Role of with-profits committee or advisory arrangement in the firm's governance

20.5.5

R

A *firm* must:

- (1) ensure that its *governing body*, in the context of its consideration of issues referred to in ■ COBS 20.5.3R (1)(a) to ■ (d) and ■ (2)(b)(i) to ■ (x):

- (a) obtains, as relevant, assessments, reports, advice and/or recommendations of the *with-profits committee* or advisory arrangement, if the *governing body*, the *with-profits committee* or advisory arrangement considers that significant issues concerning the interests of *with-profits policyholders* need to be considered by the *firm*;
 - (b) allows the *with-profits committee* or advisory arrangement sufficient time to enable it to provide fully considered input on the issues to be considered;
 - (c) considers fully and gives due regard to the input of the *with-profits committee* or advisory arrangement when determining issues concerning the management of the *with-profits funds* and the interests of *with-profits policyholders*;
 - (d) if the *governing body* decides to depart in any material way from the advice or recommendations of the *with-profits committee* or advisory arrangement, sets out fully its reasons and allows the *with-profits committee* or advisory arrangement a reasonable period to consider them and respond; and
 - (e) considers any further representations from the *with-profits committee* or advisory arrangement and, if appropriate, sets out fully any additional reasons if it continues to depart from the *with-profits committee* or advisory arrangement's advice or recommendation;
- (2) provide a *with-profits committee* or advisory arrangement with sufficient resources as it may reasonably require to enable it to perform its role effectively;
 - (3) notify the *FCA* of the decision of the *governing body* to depart from the advice or recommendation of the *with-profits committee* or advisory arrangement if the *with-profits committee* or advisory arrangement considers that the issue is sufficiently significant and requests of the *governing body* that the *FCA* be informed; and
 - (4) consult the *with-profits actuary* on the appointment of a new member of the *with-profits committee* or of the person or persons carrying out the advisory arrangement.

20.5.6

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- (1) ■ COBS 20.5.5R (2) requires that a *firm* provides a *with-profits committee* or advisory arrangement with sufficient resources. A *with-profits committee* or advisory arrangement should be able to obtain external professional, including actuarial, advice, at the expense of the *firm*, if the *with-profits committee* or advisory arrangement considers the advice to be necessary to perform its role effectively. In a proprietary *firm* the *with-profits committee* or advisory arrangement should be able to request that the cost of the external professional advice either is not chargeable to the *with-profits fund* in question, or is shared with the *with-profits fund*, according to whether the issue under consideration is wholly or partly to the benefit of the *firm* rather than *policyholders*. A *with-profits committee* or advisory arrangement should also be adequately supported by the *firm's* own internal resources and support functions. This may include the *firm* ensuring that relevant employees, including the *with-profits actuary*, are made sufficiently available, and provide

relevant information and input, to assist the *with-profits committee* in its role, as required.

- (2) If the *with-profits committee* or advisory arrangement wishes to make a statement or report to *with-profits policyholders* in addition to the annual report made by a *firm*, the effect of ■ COBS 20.5.5R (2) is that a *firm* will need to facilitate this.
- (3) In order to comply with ■ SYSC 3.2.20 R the *FCA* expects *firms* to keep full records of all requests of, and material produced by, the *with-profits committee* or advisory arrangement, and of all decisions and reasons of the *governing body* as described in ■ COBS 20.5.5R (1)(d) and ■ (e).
- (4) For the purposes of ■ COBS 20.5.5R (3), the *FCA* expects that it will only be in exceptional circumstances that a *with-profits committee* or alternative arrangement will consider a departure from a recommendation or advice to be sufficiently significant to warrant its making a request of the *governing body* that the *FCA* be informed.

Assessment of independence by governing body

20.5.7

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- (1) The *FCA* expects the *governing body* of the *firm* to decide whether a member of the *with-profits committee* or a person (other than a *non-executive director*) carrying out the advisory arrangement is independent. The *FCA* expects a *firm's governing body* to adopt the following approach and have regard to the following factors when making this assessment:
 - (a) the *governing body* should determine whether the person is independent in character and judgment and whether there are relationships or circumstances which are likely to affect, or could appear to affect, the person's judgment; and
 - (b) the *governing body* should state its reasons if it determines that a person is independent notwithstanding the existence of relationships or circumstances which may appear relevant to its determination, including if the person:
 - (i) has been an employee of the *firm* or group within the last five years; or
 - (ii) has, or has had within the last three years, a material business relationship with the *firm* either directly, or as a partner, shareholder, director or senior employee of a body that has such a relationship with the *firm*; or
 - (iii) has received or receives additional remuneration from the *firm*, participates in the *firm's* share option or a performance-related pay scheme, or is a member of the *firm's* pension scheme; or
 - (iv) has close family ties with any of the *firm's* advisers, directors or senior employees; or
 - (v) has significant links with the *firm's* directors through involvement in other companies or bodies; or
 - (vi) represents a significant shareholder; or
 - (vii) has served on the *governing body* for more than nine years from the date of their first election.

- (2) If a *firm* appoints one or more *non-executive directors* to carry out the advisory arrangement, the *FCA* expects the *governing body* of the *firm* to be satisfied that that person or persons is or are adequately able to provide independent judgment.

Governance arrangements in relation to the PPFM

20.5.8

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In complying with the *rule* on systems and controls in relation to compliance, financial crime and money laundering (■ SYSC 3.2.6 R), a *firm* should maintain governance arrangements designed to ensure that it complies with, maintains and records, any applicable *PPFM*. These arrangements should:

- (1) be appropriate to the scale, nature and complexity of the *firm's with-profits business*; and
- (2) include the approval of the *firm's PPFM* by its *governing body*.