Chapter 20

With-profits

20.3 Principles and Practices of Financial Management

Production of PPFM

20.3.1 R

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

	Subject	Issues	
		(a)	procedures for deciding if the *with-profits business* 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 *with-profits policies*.
(4)	Charges and expenses	(a)	The way in which the *firm* applies charges and apportions expenses to its *with-profits business*, 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 *with-profits fund* 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 *inherited estate* and the uses to which the *firm* may put that *inherited estate*.	
(6)	Volumes of new business and arrangements on stopping taking new business	If a *firm's with-profits fund* is accepting new *with-profits business*, its practice for review of the limits on the quantity and type of new business and the actions that the *firm* 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 *with-profits policyholders* are, or may be, affected by the interests of any shareholders of the *firm*.	

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	General (a) Circumstances under which any historical assumptions or parameters, relevant to methods used to determine the amount payable, may be changed;	General (e) For each major class of *with-profits policy*, methods establishing the main assumptions or parameters that decide the output of methods that determine the amount payable; (f) Degree of approximation allowed when assumptions or parameters are applied across generations of *with-profits policyholders* or across different types or classes of *with-profits policies*; (g) Formality with which the methods, parameters or assumptions used are documented; (h) Target range, or target ranges, that have been set for maturity payments; (i) Factors likely to be regarded as relevant to address *policyholders*' interests or security when determining *excess surplus*; and Investment return, expenses or charges and tax (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: (i) any distinctions made in recognising the investment return from a subset of the total assets of a *with-profits fund*; (ii) whether expenses are apportioned between all the policies in a *with-profits fund* or apportioned in some other way;

Reference to PPFM issues (COBS 20.3.6R)	With-profits principles	With-profits practices
		(iii) the relationship between the liability to tax attributed to a *with-profits fund* and the tax that the *firm* imputes to determine the amount payable; (iv) impact on the amount payable of any attributed liability to tax of a *with-profits fund* as a result of the *firm* making a transfer to shareholders; and (v) how any other items are brought into account.
	Bonus rates	Bonus rates
	(b) General aims in setting bonus rates and the constraints to which the *firm* may be subject in changing economic circumstances;	(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 *with-profits policies* 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;
	(c) How the range of *with-profits policies* or generations of *with-profits policies* over which the *firm* 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	(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;
		(m) Maximum amount by which annual bonuses would alter if annual bonus rates were reset;
		(n) Approach to setting any interim bonus rates before the next declaration of annual bonus rates;

Reference to PPFM issues (COBS 20.3.6R)	With-profits principles	With-profits practices
		(o) Relationship or interaction between final bonus rates and any market value reductions, if both can apply at the same time;
		(p) How final bonus rates influence the value of *with-profits policies* that have formulaic surrender or transfer bases (for example, older conventional policies rather than unitised policies); and
	Smoothing	Smoothing
	(d) Statement as to whether smoothing is intended to be neutral over time.	(q) Any differences in approach for: (i) the various types of *with-profits policy*; (ii) different categories of payout, such as between surrendered policies and maturing policies; and (iii) different generations of *with-profits policyholders*.
(2) Investment strategy	(a) How the types, classes or mix of assets are determined; and	(c) Whether and to what extent there is hypothecation of assets;
	(b) Strategy in respect of derivatives and other instruments.	(d) Period between formal reviews of investment strategy;
		(e) Approach to investment in different asset classes, and assets of different credit or liquidity quality, including assets not normally traded; and
		(f) Details of any external support available to the *with-profits fund* and how this affects the investment strategy.
(3) Business risk	(a) Where a *firm* explicitly excludes business risk from a class of *with-profits policies* but there are residual risks, clarification where these risks such as guarantee and	(c) Current limits which apply to the taking on of business risk; and (d) Whether and to what extent particular generations of *with-profits policyholders* or classes of *with-profits*

Reference to PPFM issues (COBS 20.3.6R)	With-profits principles	With-profits practices
	smoothing costs are borne; and (b) Define where compensation costs from a business risk would be borne.	*policies* bear or might bear particular business risks, including for example, crystallised or contingent guarantees to other classes of *policyholders* or whether the out-turn from all business risk is pooled across all *with-profits policies*.
(4) Charges and expenses	(a) Factors that would drive any change to the basis on which the *firm* applies charges to or apportions its actual expenses amongst *with-profits policies*, or exercises any discretion to apply charges to particular *with-profits policies*.	(b) Charges currently applied and the expenses currently apportioned to major classes of *with-profits policies*; (c) Relationship between the *firm's* actual charges and expenses, as applied to determine the amounts payable under *with-profits policies*, and the charges and expenses borne by the *with-profits fund*; (d) Circumstances under which expenses will be charged to the *with-profits fund* at an amount other than cost, and the reasons why; and (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.
(5) Management of inherited estate	(a) Preferred size or scale of *inherited estate* and implications for the values of the *with profits policies*; and	(d) How the *inherited estate* is used, for example, in meeting costs; (e) Whether the investment strategy for the

Reference to PPFM issues (COBS 20.3.6R)	With-profits principles	With-profits practices
	(b) Any existing division of the *inherited estate* between *with-profits funds*; and (c) Any constraints on the freedom to deal with the *inherited estate* as a result of previous dealings.	*inherited estate* differs from the rest of the *with-profits fund*; and (f) Any current guidelines in place as to the size or scale of the *inherited estate* or as to how and over what time period the *inherited estate* would be managed, if it becomes too large or too small.
(6) Equity between the with-profits fund and any shareholders	(a) Arrangements for, and any changes to, profit sharing between shareholders and *with-profits policyholders*.	(b) Current basis on which profit between *with-profits policyholders* and shareholders is divided; and (c) Whether the pricing of any policies being written, and particular policies open to new business, appear to be significantly and systematically reducing the *inherited estate* if the shareholder transfer is taken into account.