

**WITH-PROFITS GOVERNANCE INSTRUMENT 2003****Powers exercised**

- A. The Financial Services Authority makes this instrument in the exercise of the following powers and related provisions of the Financial Services and Markets Act 2000 (the 'Act'):
- (1) section 59 (Approval);
  - (2) section 138 (General rule-making power);
  - (3) section 156 (General supplementary powers); and
  - (4) section 157(1) (Guidance).
- B. The rule-making powers listed above are specified for the purpose of section 153(2) of the Act (Rule-making instruments).

**Commencement**

- C. This instrument comes into force on 31 March 2004.

**Amendments to the Conduct of Business sourcebook**

- D. The Conduct of Business sourcebook is amended by inserting, as COB 6.10 and COB 6.11, the provisions in Annexes A and B to this instrument.

**Amendments to the Supervision manual**

- E. The Supervision manual is amended in accordance with Annex C to this instrument

**Amendments to the Glossary**

- F. The Glossary is amended in accordance with Annex D to this instrument.

**Citation**

- G. This instrument may be cited as the With-Profits Governance Instrument 2003.

By order of the Board  
19 June 2003

**Annex A**  
**Amendments to the Conduct of Business sourcebook**

After *COB* 6.9, insert the following new section:

**6.10 Principles and Practices of Financial Management (PPFM)**

**Application and purpose**

**Application**

**6.10.1 R (1) This chapter applies to a *firm* carrying on *with-profits business* other than:**

**(a) a *non-directive friendly society*; or**

**(b) an *EEA insurer*.**

**(2) This chapter does not apply to *with-profits business* that consists of effecting or carrying out *Holloway sickness policies*.**

**Purpose**

6.10.2 G *Principle 6* (Customers' interests) requires a *firm* to pay due regard to the interests of its *customers* and treat them fairly.

6.10.3 G The *rules* and *guidance* in this section are intended to secure an appropriate degree of protection for *policyholders* and potential *policyholders* of *firms* carrying on *with-profits business* by requiring them to define and make available their *Principles and Practices of Financial Management*. These *rules* and *guidance* are also intended to enable *policyholders* and potential *policyholders* of *firms* carrying on *with-profits business* better to understand the way in which *firms* carry on their *with-profits business*.

6.10.4 G A *firm's Principles and Practices of Financial Management* also play an important role in promoting confidence among *with-profits policyholders* and in the governance arrangements for *with-profits business* set out in *COB* 6.11 (Reporting to *with-profits policyholders* on compliance with PPFM).

**Principles and Practices of Financial Management**

**6.10.5 R (1) A *firm* must establish and maintain the *Principles and Practices of Financial Management* according to which the business of its *with-profits funds* is conducted.**

**(2) A firm must make a record of its *Principles and Practices of Financial Management* in (1), and retain that record for six years from the date on which it was superseded by a more up-to-date record.**

- 6.10.6 G Whether a separate *PPFM* is needed for each *with-profits fund* is a matter for the *firm* in the light of its circumstances, including previous management of those funds and any relevant representations made by the *firm* to *with-profits policyholders*.
- 6.10.7 G In order to comply with *COB* 6.10.5R a *firm* should:
- (1) establish and maintain a document approved by its *governing body*, setting out its *PPFM*; and
  - (2) keep a record of each version of the *PPFM* as it changes over time.

#### **Obligation to provide copies**

- 6.10.8 R **A firm must provide a copy of its *PPFM*, or the *PPFM* applicable to specified *with-profits funds*:**
- (1) free of charge at the request of any *with-profits policyholder* of the *firm*; and**
  - (2) at the request of any *person* who is not a *with-profits policyholder* of the *firm* if that *person* pays any reasonable charge the *firm* may make for providing that copy.**
- 6.10.9 G A *firm* should indicate in any annual statements sent to *with-profits policyholders* that copies of the *firm's PPFM*, or the *PPFM* applicable to specified *with-profits funds*, are available on request, under *COB* 6.10.8R. The *PPFM* might also be published on a *firm's* website.

#### **Principles of Financial Management**

- 6.10.10 R **The *with-profits principles* within the *PPFM* must:**
- (1) be enduring statements of the overarching standards the *firm* adopts in managing *with-profits funds*; and**
  - (2) describe the business model used by the *firm* in meeting its duties to *with-profits policyholders* and in responding to longer-term changes in the business and economic environment.**
- 6.10.11 G The *with-profits principles* are not expected to change often. However, they should be informative enough to enable the *directors*, any *actuary* appointed under *SUP* 4 (Actuaries) and any *With-profits Committee*, amongst others, to judge whether existing or potential *with-profits practices* are appropriate for the *firm*.

- 6.10.12 R A *firm* must send its *with-profits policyholders* written notice, setting out any proposed changes to the *with-profits principles* of the *firm*, three *months* in advance of the effective date of the proposed changes.
- 6.10.13 R If a *firm* maintains more than one *PPFM*, the notice in *COB 6.10.12R* need only be sent to those *policyholders* affected by the *PPFM* being changed.
- 6.10.14 G A *firm* may give the notice required under *COB 6.10.12R* by including the required information in any annual statements sent to *with-profits policyholders* if this is at least three *months* in advance of the effective date of the proposed changes.
- 6.10.15 G Changes to the *with-profits principles* of a *firm* are likely to trigger one or more of the *firm's* obligations to notify the *FSA* under *SUP 15.3* (General notification requirements).

### Practices of Financial Management

- 6.10.16 R The *with-profits practices* within the *PPFM* must:
- (1) describe the *firm's* approach to managing *with-profits funds* and to responding to changes in the business and economic environment in the shorter-term; and
  - (2) contain sufficient detail to enable a knowledgeable observer to understand the material risks and rewards from effecting or maintaining a *with-profits policy* with the *firm*.
- 6.10.17 G Subject to the *with-profits principles*, a *firm's with-profits practices* are expected to change as the *firm's* circumstances and the business environment change, with some alteration, for example, every few years.
- 6.10.18 R A *firm* must send its *with-profits policyholders* written notice, setting out any changes to the *with-profits practices* of the *firm*.
- 6.10.19 R If a *firm* maintains more than one *PPFM*, the notice in *COB 6.10.18R* need only be sent to those *policyholders* affected by the *PPFM* being changed.
- 6.10.20 G A *firm* may give the notice required under *COB 6.10.18R* by including the required information in any annual statements sent to *with-profits policyholders*. The notice can be in arrears but should be within a reasonable time period from the effective date of the change.
- 6.10.21 G Changes to the *with-profits practices* of a *firm* may trigger one or more of the *firm's* obligations to notify the *FSA* under *SUP 15.3* (General notification requirements).

### Scope and content of the Principles and Practices of Financial Management

- 6.10.22 R (1) The *PPFM* of a *firm* must cover any issue that has, or it is reasonably foreseeable may have, a significant impact on the *firm's* management of *with-profits funds*.

**(2) The issues in (1) include: the amount payable under a *with-profits policy*, the investment strategy, business risk, charges and expenses, management of the *inherited estate*, volumes of new business and arrangements on stopping taking new business, and equity between the *with-profits fund* and any shareholders.**

- 6.10.23 G In addition to the issues in *COB 6.10.22R(2)*, a *firm's PPFM* should also cover any other areas that are important to the management of its *with-profits funds* and that may affect the amounts payable under *with-profits policies*.
- 6.10.24 G A *firm's PPFM* should reflect any requirements or constraints relevant to the management of *with-profits funds* that apply to the *firm* as a result of previous dealings: for example, previous business transfer schemes. The *PPFM* should also set out the extent to which the *firm's* freedom to alter its *PPFM* is constrained, including by such previous dealings.
- 6.10.25 G The rest of this section includes *rules* on each of the issues that a *firm's PPFM* must cover, followed in each case by *guidance* on how various information relevant to that issue might be split between *with-profits principles* and *with-profits practices*.

#### **The amount payable under a with-profits policy**

- 6.10.26 R The *PPFM* of a *firm* must cover the methods that the *firm* uses to guide its determination of the amount that it is appropriate to pay individual *with-profits policyholders*, including:**
- (1) the aims of the methods used, and the approximations used;**
  - (2) how the current methods, including any relevant historical assumptions used and any systems maintained to deliver results of particular methods, are documented within the *firm*; and**
  - (3) the procedures for changing either the current method or any assumptions or parameters relevant to a particular method.**
- 6.10.27 G A *firm* may use a number of methods to determine the amount payable to a *with-profits policyholder* and may use more than one method to determine the amount payable to a particular *with-profits policyholder*.
- 6.10.28 G The *firm's with-profits principles* should describe:
- (1) the aims of the methods the *firm* uses to determine the amount payable to *with-profits policyholders*;
  - (2) the degree of approximation that the *firm* is prepared to allow in the application of those methods and in the application of its *with-profits principles*;
  - (3) how the *firm* controls changes to those methods; and

- (4) the circumstances under which the *firm* might change any historical assumptions or parameters relevant to those methods: for example, previously applied investment returns, charges, or allocations of miscellaneous surplus, that have been derived from the historical experience and actions of the *firm*.
- 6.10.29 G The *firm's with-profits practices* should describe, for each major class of *with-profits policy*:
- (1) the methods that the *firm* currently uses to determine the amount payable to *with-profits policyholders*;
  - (2) the methods that the *firm* currently uses to determine the main assumptions or parameters that determine the output of those methods;
  - (3) the degree of approximation that the *firm* allows when it applies assumptions or parameters across generations of *with-profits policyholders* or across different types or classes of *with-profits policies*;
  - (4) the formality with which the *firm* documents the methods, parameters or assumptions that it uses to determine the amount payable to *with-profits policyholders*; and
  - (5) the *firm's* internal procedures for changing either the current methods or the current parameters or assumptions relevant to a particular method.
- 6.10.30 G The *firm's with-profits practices* should describe how the *firm* brings investment return, expenses or charges and tax into account and how the *firm* determines the impact of those items on the amount payable under a *with-profits policy*. In particular, the *firm's with-profits practices* should describe:
- (1) any distinctions that the *firm* makes in recognising the investment return from a subset of the total assets of a *with-profits fund*;
  - (2) whether the *firm* apportions expenses fully between all the policies in a *with-profits fund* or apportions expenses in some other way, for example, by meeting some expenses from the *firm's inherited estate*;
  - (3) the relationship between the actual liability to tax of a *with-profits fund* and the tax that the *firm* imputes to determine the amount payable under a *with-profits policy*;
  - (4) the impact on the amount payable under a *with-profits policy* of any liability to tax of a *with-profits fund* as a result of the *firm* making a transfer to shareholders; and
  - (5) how the *firm* brings any other items into account, including, for example, charges made for the costs of guarantees, charges for the use of capital and charges for other risks.

- 6.10.31 R The PPFM of a firm must cover the firm's approach to setting annual bonus rates applicable to with-profits policies.**
- 6.10.32 G The firm's with-profits principles should:
- (1) describe the firm's general aims in setting annual bonus rates and the constraints to which the firm may be subject in changing economic circumstances; and
  - (2) indicate how the firm would determine the range of with-profits policies or generations of with-profits policies over which the firm believes a single bonus rate would be appropriate and the circumstances under which the firm believes a new bonus series would be necessary.
- 6.10.33 G The firm's with-profits practices should:
- (1) describe the firm's current approach to setting annual bonus rates, including the weight given to recent economic experience;
  - (2) indicate the frequency at which the firm re-sets or expects to re-set annual bonus rates;
  - (3) indicate the maximum amount (if any) by which annual bonuses would alter if the firm were to re-set annual bonus rates; and
  - (4) describe the firm's approach to setting any interim bonus rates before the next declaration of annual bonus rates.
- 6.10.34 R The PPFM of a firm must cover the firm's approach to setting final bonus rates applicable to with-profits policies.**
- 6.10.35 G The firm's with-profits principles should describe the firm's approach to setting final bonus rates, in the context of the firm's general aims in determining the total amount payable under with-profits policies, and by reference to the constraints to which the firm may be subject in changing economic circumstances.
- 6.10.36 G The firm's with-profits practices should:
- (1) describe the firm's current approach to setting final bonus rates, including the weight given to recent economic experience. The description should include any distinctions that the firm makes 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;
  - (2) describe the relationship or interaction between final bonus rates and any market value reductions, if both can apply at the same time;
  - (3) describe how final bonuses influence the value of with-profits policies that have formulaic surrender or transfer bases (for example, older conventional policies rather than unitised policies); and

- (4) indicate the frequency at which the *firm* sets or expects to set final bonus rates and the circumstances under which changes in the economic environment would cause the *firm* to change the time between re-setting.
- 6.10.37 R The PPFM must cover the *firm*'s approach to smoothing the value of *with-profits* policies.**
- 6.10.38 G The *firm*'s *with-profits* principles should:
- (1) indicate whether and in what respect the *firm* takes a significantly different approach to smoothing depending on the type of claim arising from *with-profits* policies;
  - (2) indicate whether the *firm* intends smoothing to be neutral over time;
  - (3) indicate whether there is any total scale or cost of smoothing to the *firm* over the shorter-term that the *firm* believes should not be exceeded. The *FSA* takes the cost of smoothing to mean the extent to which the amount actually payable under a *with-profits* policy diverges from the theoretical determinant of policy value under *COB* 6.10.26R, except where due to applicable guarantees; and
  - (4) indicate whether the *firm* applies market value reductions, or changes the surrender bases for *with-profits* policies that are not unitised, only to reflect changes in underlying asset values.
- 6.10.39 G The *firm*'s *with-profits* practices should:
- (1) indicate how rapidly the *firm* might need to adjust the value of *with-profits* policies, by specifying any period over which the *firm* expects smoothing to be neutral;
  - (2) indicate whether there is any overall limit to the accumulated cost of, or excess from, smoothing that the *firm* is prepared to tolerate;
  - (3) indicate whether the *firm* applies a single smoothing strategy to all generations and types of *with-profits* policy, or applies different smoothing strategies to subsets of the *with-profits* fund, in particular whether (and in what respect) the *firm* applies a different smoothing strategy to new entrants to a *with-profits* fund when the accumulated cost or excess from smoothing is large;
  - (4) describe the *firm*'s current approach to smoothing: for example, the acceptable degree of change in the value of similar *with-profits* policies from one year to the next, or the formula the *firm* uses to recognise recent investment performance as a determinant of the value of a *with-profits* policy;
  - (5) describe how the *firm* applies smoothing to classes of *with-profits* policies that participate in final bonuses indirectly: for example, older policies with formulaic surrender or transfer bases;



- (6) describe how accurately the *firm* applies market value reductions or surrender and transfer bases to give effect to smoothing; and
- (7) describe how the *firm* accounts for partial payments under *with-profits policies* to which no penalty (for example, by market value reductions) is applied, in determining the eventual total value of a *with-profits policy*.

### Investment strategy

**6.10.40 R** The *PPFM* of a *firm* must cover the significant aspects of the *firm's* investment strategy for its *with-profits business* or, if different, any *with-profits fund*, including:

- (1)** the degree of matching to be maintained between assets relevant to *with-profits business* and liabilities to *with-profits policyholders* and other creditors;
- (2)** the *firm's* approach to assets of different credit or liquidity quality and different volatility of market values;
- (3)** 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
- (4)** the *firm's* controls on using new asset or liability instruments and the nature of any approval required before new instruments are used.

6.10.41 G The *firm's with-profits principles* should:

- (1) set out the *firm's* investment strategy in terms that allow alternative *with-profits practices* to be judged and where necessary rejected. The *firm's with-profits principles* should therefore specify the specific factors that drive the *firm's* investment strategy, in more detail than, for example, simply achieving the best return within the framework of the likely volatility of asset values;
- (2) if the *firm* relies on assets outside a *with-profits fund* to maintain the *firm's* investment strategy, state on which assets and to what degree the *firm* relies;
- (3) set out how the *firm* views the use, as part of its investment strategy, of *derivatives* and other instruments that may alter the economic out-turn from assets;
- (4) set out any constraints on the *firm's* investment strategy either with respect to parts of a *with-profits fund* (for example, classes of *with-profits policy* or bonus series) or between different generations of *with-profits policyholders*; and

- (5) set out any overarching constraints on the *firm's* exposure to any one counterparty including *derivative* exposures.
- 6.10.42 G The *firm's with-profits practices* should:
- (1) describe what procedures the *firm* follows to transfer assets to the *with-profits fund* under COB 6.10.41G(2) and at what point such transfers would be recognised as irretrievable by the provider of outside assets;
  - (2) set out the period between formal reviews of the *firm's* investment strategy;
  - (3) describe the degree of matching the *firm* maintains between the assets of a *with-profits fund* and liabilities to *with-profits policyholders* and other creditors, and the basis of the liabilities assessed for such purposes;
  - (4) explain the *firm's* approach to investment in different asset classes, and assets of different credit or liquidity quality. This may include, for example, the *firm's* guidelines as to the overall limit on the amount of a *with-profits fund* that may be invested in particular asset classes and the overall credit rating of parts of the portfolio, the minimum credit quality of new and existing investments as well as the overall liquidity constraints on the *with-profits fund*; and
  - (5) explain the approval process that the *firm* operates before investing in new or novel *investment* instruments.
- 6.10.43 G A *with-profits fund* may include assets that would not normally be traded because of their importance to the *firm*. These might be physical assets: for example, the *firm's* head office building, but may include contingent support or guarantee arrangements to or from other entities.
- 6.10.44 G In relation to assets that would not normally be traded because of their importance to the *firm*, the *with-profits principles* of the *firm* should:
- (1) describe why such assets are of use to a *with-profits fund*;
  - (2) describe what reviews the *firm* carries out to ensure those assets still remain of use;
  - (3) set out any limits that the *firm* imposes on the scale of investment in those assets;
  - (4) indicate whether the out-turn from investment in those assets will impact on the amounts payable under *with-profits policies*; and
  - (5) indicate what credit or liquidity requirements the *firm* applies to *investments* in those assets.

6.10.45 In relation to assets that would not normally be traded, the *with-profits practices* of the *firm* should describe those assets, their current application in determining claim values and any constraints imposed on the *firm's* investment freedom as a result of its investment in those assets.

### **Business risk**

**6.10.46 R The PPFM of a firm must cover the exposure of the firm's with-profits business to business risk, including the firm's:**

- (1) procedures for deciding if the with-profits business may undertake a particular business risk;**
- (2) arrangements for reviewing and setting a limit on the scale of such risks; and**
- (3) procedures for reflecting the profits or losses of such business risks in the amounts payable under with-profits policies.**

6.10.47 G Business risk for a *with-profits fund* can include a number of exposures, for example:

- (1) exposure to maintaining and acquiring *with-profits policies*;
- (2) exposure to maintaining and acquiring non-profit policies;
- (3) exposure to risks from other *investments*: for example, in investment management companies, service companies or overseas subsidiary insurance companies.

6.10.48 G The *PPFM* of a *firm* should make clear how the *firm* considers such exposures before they are taken up or entered into, and how the *firm* intends to deal with rewards or risks going forward. In particular, the *PPFM* should make clear what alternatives the *firm* sets as a benchmark when reviewing existing business risk and new business risks to determine whether the rewards are reasonable given the risks undertaken.

6.10.49 G Where the *firm* explicitly excludes business risk from a class of *with-profits policies* there may often be residual risks from the class that are natural to *with-profits policies* such as guarantee and smoothing costs. The *PPFM* should make clear where such costs are borne.

6.10.50 G The *firm's with-profits principles* should set out the general limits that the *firm* applies to the taking on of business risk and the control that the *firm* exercises over existing business risk. In particular, the *with-profits principles* should define where compensation costs from a business risk would be borne.

6.10.51 G The *firm's with-profits practices* should:

- (1) describe the current limits that the *firm* applies to the taking on of business risk;

- (2) describe the *firm's* approach to the application of the rewards and losses from business risks as a determinant of the amount payable under a *with-profits policy*;
- (3) describe the degree to which the *firm* smoothes any profits or losses from business risks before applying them to determine the amount payable under a *with-profits policy*;
- (4) indicate whether profits or losses from business risks must exceed a minimum value or scale before the *firm* will treat them as a determinant of the amount payable under a *with-profits policy*; and
- (5) indicate whether and to what extent particular generations of *with-profits policyholders* or classes of *with-profits policy* bear or might bear particular business risks, including, for example, crystallised or contingent guarantees to other classes of *policyholder* or whether the out-turn from all business risk is pooled across all *with-profits policies*.

### Charges and expenses

- 6.10.52 **R** **The *PPFM* must cover the way in which the *firm* applies charges and apportions expenses to its *with-profits business*, including, if material, any interaction with *connected firms*.**
- 6.10.53 G The *firm's with-profits principles* should:
- (1) describe the overall aim of the *firm's* approach to applying charges and apportioning expenses to *with-profits policies*, covering all types of charges and expenses including investment costs, commissions and charges borne from investment through *collective investment schemes*; and
  - (2) set out the 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*.
- 6.10.54 G The *firm's with-profits practices* should:
- (1) give a general description of the charges that the *firm* currently applies and the expenses that it currently apportions to major classes of *with-profits policies*;
  - (2) describe the 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*;
  - (3) state the circumstances under which the *firm* will charge expenses to the *with-profits fund* at an amount other than cost, and the reasons why the *firm* will do so; and

- (4) state the interval at which the *firm* will review any arrangements under which it obtains out-sourced services, including those provided by connected parties, and give a broad indication of the terms on which the *firm* would be able to terminate the agreements to provide those services.
- 6.10.55 G The *PPFM* of a *firm* should make clear the criteria that the *firm* will apply when it has to make judgements about how to apply charges and apportion expenses between *with-profits funds* or between a *with-profits fund* and *shareholder* owned funds, *firms* or *service companies*.

### Management of the inherited estate

- 6.10.56 R The *PPFM* of a *firm* must cover the *firm's* management of any *inherited estate* and the uses to which the *firm* may put that *inherited estate*.
- 6.10.57 G The *firm's with-profits principles* should:
- (1) describe how the *firm* will manage its *inherited estate*;
  - (2) describe the purposes for which the *firm* will apply the *inherited estate*;
  - (3) indicate the size or scale of *inherited estate* for which the *firm* is aiming, for example, by reference to the volume of the *firm's* existing business or the risks borne by the *firm's* existing business;
  - (4) explain the implications of the *firm's* preferred size or scale of *inherited estate* for the value of the *firm's with-profits policies*;
  - (5) describe any existing division of the *firm's inherited estate* between *with-profits funds* within the *firm*; and
  - (6) describe any constraints on the *firm's* freedom to deal with the *inherited estate* as a result of previous dealings: for example, a transfer of business scheme or attribution or re-attribution of a previous *inherited estate*.
- 6.10.58 G The *firm's with-profits practices* should:
- (1) describe how the *firm* uses the *inherited estate* by, for example, reference to the costs the *inherited estate* is meeting;
  - (2) state whether the *firm's* investment strategy for the *inherited estate* is different to the *firm's* investment strategy for the rest of the *with-profits fund*; and
  - (3) describe any current guidelines that the *firm* has in place as to the size or scale of the *inherited estate* or as to how the *firm* would manage the *inherited estate* and over what time period, if it became too large or too small.

### Volumes of new business and arrangements on stopping taking new business

**6.10.59 R The PPFM of a firm whose with-profit fund is accepting new business must cover the firm's practice for review of the limits on the quantity and type of new with-profits business and the actions that the firm would take if it ceased to take on new with-profits business of any significant amount.**

6.10.60 G The firm's with-profits principles should:

- (1) set out the firm's approach to setting the volume of new business, both new with-profits business and non-profit business written in the with-profits fund; and
- (2) set out the firm's anticipated reaction to closure to significant amounts of new business and, in particular, what action it would take in that event as regards the distribution of any inherited estate.

6.10.61 G The firm's with-profits practices should:

- (1) describe the approach the firm takes to setting any maximum volume of new business each year and any particular limits on classes of business, including non-profit business within the with-profits fund; and
- (2) describe what the firm considers should be the minimum proportion and scale of new business of a with-profits type to justify the with-profits fund staying open to new business.

#### **Equity between the with-profits fund and any shareholders**

**6.10.62 R The PPFM of a firm must cover the firm's approach to achieving a balance between the interests of with-profits policyholders and the interests of any shareholders of the firm.**

6.10.63 G The firm's with-profits principles should:

- (1) describe the firm's arrangements for profit sharing between shareholders and with-profits policyholders and the scope for changes in the share of profits allotted to each; and
- (2) indicate the approach that the firm will take before any changes to the profit sharing arrangements are implemented.

6.10.64 G The firm's with-profits practices should:

- (1) indicate the current basis on which the firm divides profit between with-profits policyholders and shareholders, including the method of calculating the profit to be divided;
- (2) indicate whether the division of profit between with-profits policyholders and shareholders would change if there was a change in the underlying basis on which the shareholder share is computed (normally the valuation basis of the mathematical reserves);

- (3) indicate other factors that would have a significant impact on the balance between the *shareholder* share and the *with-profits fund*, for example:
  - (a) tax or other imposts; or
  - (b) distributions in anticipation of a surplus; or
  - (c) the *firm's* approach to *with-profits policies* with both an entitlement to final bonus and an exposure to a market value reduction; or
  - (d) the impact of guaranteed bonuses; and
- (4) state whether the pricing of any policies that the *firm* is writing, and particular policies open to new business, appear to be significantly and systematically reducing the *firm's inherited estate* if the *shareholder* transfer is taken into account.

**Annex B**  
**Amendments to the Conduct of Business sourcebook**

After *COB* 6.10, insert the following new section:

**6.11 Reporting to with-profits policyholders on compliance with PPFM**

**Application and purpose**

**Application**

**6.11.1 R** This chapter applies to a *firm* carrying on *with-profits business* other than:

- (1) a *non-directive friendly society*; or
- (2) an *EEA insurer*.

**6.11.2 R** This section does not apply to *with-profits business* that consists of effecting or carrying out *Holloway sickness policies*.

**Purpose**

6.11.3 G The *rules* and *guidance* in this section are intended to secure an appropriate degree of protection for *with-profits policyholders* and potential *with-profits policyholders* and to promote confidence among such *policyholders* by:

- (1) giving *guidance* on governance arrangements relevant to the way in which *with-profits firms* comply with *SYSC* in the conduct of *with-profits business*; and
- (2) requiring *firms* to make an annual report available to *with-profits policyholders*.

**Governance arrangements for with-profits business**

6.11.4 G In complying with *SYSC* 3.2.6R, a *firm* should maintain governance arrangements designed to ensure that in the conduct of *with-profits business* it complies with, maintains and records any applicable *PPFM*.

6.11.5 G The governance arrangements referred to in *COB* 6.11.4G should:

- (1) be appropriate to the scale and complexity of a *firm's with-profits business*; and
- (2) involve some independent judgement in the assessment of compliance with *PPFM* and how any competing or conflicting rights and interests of *policyholders* and, if applicable, *shareholders* have been addressed.



- 6.11.6 G The independent judgement in *COB 6.11.5G(2)* can be provided in different ways. These may include but are not confined to:
- (1) establishing a committee of the *governing body* (a With-profits Committee), including non-executive members of the *governing body* and possibly some external non-directors with appropriate skills and experience;
  - (2) asking an independent person with appropriate skills and experience to report on these matters to the *governing body* or to any With-profits Committee; or
  - (3) for small *firms* in particular, asking a non-executive member (or members) of the *governing body* to report to the *governing body* on these matters.
- 6.11.7 G For the purposes of *COB 6.11.6G(2)*, appropriate skills and experience could have been gained in, for example, consumer protection, the life insurance industry, regulation or as a member of the accountancy, actuarial or legal professions.
- 6.11.8 G If a *person* or committee who provides the independent judgement under *COB 6.11.5G(2)* wishes to make a statement or report to *with-profits policyholders*, in addition to that made by a *firm* under *COB 6.11.9R*, a *firm* should facilitate this. *COB 6.11.12G* is also relevant to such a report.

#### **Annual report to with-profits policyholders**

- 6.11.9 R **A *firm* must produce an annual report to its *with-profits policyholders* stating whether, throughout the *financial year* to which the report relates, the *firm* believes it has complied with the obligations relating to *PPFM* referred to in *COB 6.11.4G* and setting out the *firm*'s reasons for that belief.**
- 6.11.10 R **The annual report in *COB 6.11.9R* must address all significant relevant issues, including the way in which the *firm* has:**
- (1) exercised, or failed to exercise, any discretion that it has in the conduct of its *with-profits business*; and
  - (2) addressed any competing or conflicting rights, interests or expectations of its *policyholders* (or groups of *policyholders*) and, if applicable, *shareholders* (or groups of *shareholders*).
- 6.11.11 R **Any report to *with-profits policyholders* from an *actuary* appointed under *SUP 4 (Actuaries)* must be annexed to the annual report in *COB 6.11.9R*.**
- 6.11.12 G Any statement or report made under *COB 6.11.8G* should be annexed to the annual report in *COB 6.11.9R*.
- 6.11.13 G The competing rights, interests or expectations in *COB 6.11.10R(2)* include the competing interests of different classes and generations of *with-profits policyholders*, and, if applicable, *shareholders*.

- 6.11.14 G In preparing the report to *with-profits policyholders* in COB 6.11.9R, a *firm* should take advice from an *actuary*.
- 6.11.15 G A *firm* should make the report in COB 6.11.9R available to *with-profits policyholders* within six *months* of the end of the *financial year* to which it relates. A *firm* may choose how it makes the report available. Methods of delivery might include publishing the report on the *firm's* website, providing copies on request, or including it in the *firm's* annual financial statements. A *firm* should notify its *with-profits policyholders* in any annual statements how copies of the report can be obtained.

## Annex C

### Amendments to the Supervision manual

In this Annex, underlining indicates new text and striking through indicates deleted text.

10.6.8 R (1) If a *firm* is a *body corporate*, the *non-executive director function* is the function of acting in the capacity of a *non-executive director* of that firm.

(2) ~~If a *firm* is a *long-term insurer*, the *non-executive director function* is also the function of acting in the capacity of an individual (other than an individual performing the *director function* or the *non-executive director function* under (1)) who, as a member of a committee having the purpose of a With-profits Committee (see COB 6.11.6G(1)), has responsibility in relation to governance arrangements for *with-profits business* under COB 6.11 (Reporting to with-profits policyholders on compliance with PPFM).~~

10.6.9G Examples of responsibilities of a *non-executive director* may include:

...

(3) carrying out other responsibilities as assigned by the *firm*: for example, as a member of a board committee on audit or remuneration or as a member of a committee having the purpose of a With-profits Committee (see COB 6.11.6G(1)).

## Annex D

### Amendments to the Glossary

Insert the following new definitions in the appropriate alphabetical position:

<i>EEA insurer</i>	(in <i>COB</i> ) an <i>insurer</i> , other than a <i>pure reinsurer</i> or a <i>non-directive insurer</i> , whose head office is in any <i>EEA State</i> except the <i>United Kingdom</i> and which has received <i>authorisation</i> under article 6 of the <i>First Life Directive</i> or the <i>First Non-Life Directive</i> from its <i>Home State Regulator</i> .
<i>inherited estate</i>	the excess of assets maintained within a <i>with-profits fund</i> over and above the amount required to meet liabilities (including liabilities which arise from the regulatory duty to treat <i>customers</i> fairly in setting discretionary benefits).
<i>PPFM</i>	<i>Principles and Practices of Financial Management</i> .
<i>Principles and Practices of Financial Management</i>	the Principles and Practices of Financial Management which a <i>firm</i> carrying on <i>with-profits business</i> must establish, maintain and record under <i>COB</i> 6.10 (Principles and Practices of Financial Management).
<i>with-profits business</i>	any business of an <i>insurer</i> that may affect the amount or value of the assets comprising a <i>with-profits fund</i> .
<i>with-profits fund</i>	for the purposes of <i>COB</i> : (a) a <i>long-term insurance fund</i> (or that part of such a fund) in which <i>policyholders</i> are eligible to participate in any <i>established surplus</i> ; and (b) where it is an <i>insurer's</i> usual practice to restrict <i>policyholders'</i> participation in any <i>established surplus</i> to that arising from only a part of the fund (or part fund) falling within (a), that part (or that part of the part fund).
<i>with-profits policy</i>	a contract falling within a <i>class</i> of <i>long-term insurance business</i> which is eligible to participate in any part of any <i>established surplus</i> .
<i>with-profits policyholder</i>	a <i>policyholder</i> under a <i>with-profits policy</i> .
<i>with-profits practices</i>	the with-profits practices that a <i>firm</i> must establish, maintain and record under <i>COB</i> 6.10 (Principles and Practices of Financial Management).
<i>with-profits principles</i>	the with-profits principles that a <i>firm</i> must establish, maintain and record under <i>COB</i> 6.10 (Principles and Practices of Financial Management).

