

**CONDUCT OF BUSINESS SOURCEBOOK (CONDITIONAL PERMITTED LINKS)
INSTRUMENT 2020**

Powers exercised

- A. The Financial Conduct Authority (“the FCA”) makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
- (1) section 137A (The FCA’s general rules);
 - (2) section 137T (General supplementary powers); and
 - (3) section 139A (Power of the FCA to give guidance).
- B. The rule-making provisions listed above are specified for the purposes of section 138G(2) (Rule-making instruments) of the Act.

Commencement

- C. This instrument comes into force on 4 March 2020.

Amendments to the Handbook

- D. The Glossary of definitions is amended in accordance with Annex A to this instrument.
- E. The Conduct of Business sourcebook (COBS) is amended in accordance with Annex B to this instrument.

Citation

- F. This instrument may be cited as the Conduct of Business Sourcebook (Conditional Permitted Links) Instrument 2020.

By order of the Board
27 February 2020

Annex A

Amendments to the Glossary of definitions

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

Insert the following new definitions in the appropriate alphabetical position. The text is not underlined.

<i>conditional permitted immovables</i>	<p>in relation to <i>conditional permitted links</i>, any <i>permitted immovable</i> which is:</p> <p>(a) not <i>permitted land and property</i>; and</p> <p>(b) either:</p> <p>(i) owned directly by the <i>firm</i>; or</p> <p>(ii) held in a structure, or a series of structures, that do not pose a materially greater risk to <i>linked policyholders</i> than a direct holding.</p>
<i>conditional permitted links</i>	<p>where the conditions in <i>COBS 21.3.16R</i> are met, the property in <i>COBS 21.3.15R</i> that an <i>insurer</i> may use for the purposes of determining <i>property-linked benefits</i> or <i>index-linked benefits</i> under <i>linked long-term contracts of insurance</i>.</p>
<i>conditional permitted loan</i>	<p>in relation to <i>conditional permitted links</i>, a loan with any person, provided that the loan:</p> <p>(a) is documented in a written agreement setting out the rate of interest and the amount of, and due dates for, repayments; and</p> <p>(b) is fully secured by a mortgage or charge on <i>conditional permitted immovables</i> that, if made to someone other than a body corporate, is not used wholly or mainly for domestic purposes.</p>
<i>conditional permitted scheme interests</i>	<p>in relation to <i>conditional permitted links</i>, and in respect of a <i>firm's</i> business with <i>linked policyholders</i>, a <i>qualified investor scheme</i> or its <i>EEA</i> equivalent, or any <i>unregulated collective investment scheme</i> that:</p> <p>(a) is not a <i>permitted scheme interest</i>;</p> <p>(b) invests in <i>conditional permitted links</i>, either exclusively or in combination with <i>permitted links</i>; and</p> <p>(c) publishes its prices regularly.</p>
<i>conditional permitted</i>	<p>in relation to <i>conditional permitted links</i>, any investment (including a share, debt security, Treasury Bill, Tax Reserve Certificate or Certificate</p>

unlisted securities of Tax Deposit) that is not a *permitted unlisted security* or *listed security*, but provided always that the *insurer* is able to demonstrate, on a continuing basis, that the investment is realisable in a timeframe necessary to meet the liquidity requirements of the *linked fund* in which it is held.

Amend the following definitions as shown.

index-linked assets in relation to *permitted links* and *conditional permitted links*, the assets held by an *insurer* for the purposes of matching *index-linked liabilities*.

linked fund a real or notional account to which an *insurer* appropriates *linked assets* for the purposes of their being *permitted links* or *conditional permitted links*, and which may be subdivided into units, the value of each of which is determined by the *insurer* by reference to the value of those *linked assets*.

permitted links the property in COBS 21.3.1R(1) and (2)(a) to (l) that an insurer may use for the purposes of determining *property-linked benefits* or *index-linked benefits* under *linked long-term* contracts of insurance.

permitted scheme interests (a) [deleted]

(b) in respect of a firm's business with *linked policyholders*, any of the following:

...

(v) a *qualified investor scheme* or its *EEA* equivalent or any *unregulated collective investment scheme* that invests only in *permitted links* and publishes its prices regularly, provided that either:

(A) no more than 20% of the gross assets of the *linked fund* are so invested; or

(B) provided that the firm treats it as a conditional permitted link and meets the conditions in COBS 21.3.16R and the requirements in COBS 21.3.20R and COBS 21.2.4R(3), it complies with the aggregated limit in COBS 21.3.19R.

Annex B

Amendments to the Conduct of Business sourcebook (COBS)

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

21 Permitted Links and conditional permitted links

...

21.2 Rules for firms engaged in linked long-term insurance business

21.2.1 R For the purposes of determining *policyholder* benefits, a *firm* must ensure that the values of its *permitted links* and conditional permitted links are determined fairly and accurately.

...

21.2.4 R A *firm* must notify its *linked policyholders* of the risk profile and investment strategy for the *linked fund*:

(1) at *inception*; ~~and~~

(2) before making any material changes; and

(3) (in relation to conditional permitted links) at other appropriate times, taking into account a policyholder's needs.

...

21.3 Further rules for firms engaged in linked long-term insurance business

...

Permitted links and conditional permitted links

21.3.1 R An *insurer* must not contract to provide benefits under *linked long-term contracts of insurance* that are determined:

...

(2) wholly or partly by reference to the value of, or the income from, or fluctuations in the value of, property other than any of the following:

...

(k) *permitted stock lending*; ~~and~~

(l) *permitted derivatives contracts*; and

(m) conditional permitted links.

- 21.3.1A R A *firm* must classify the types of property listed in *COBS* 21.3.1R(2)(a) to (2)(~~h~~)(m) according to their economic behaviour ahead of their legal form.
- 21.3.2 G (1) Nothing in these rules prevents a *firm* making allowance in the value of any *permitted link* or *conditional permitted link* for any notional tax loss associated with the relevant *linked assets* for the purposes of fair pricing.

...

...

Requirements for Permitted derivative derivatives contracts

- 21.3.13 R ...

Insert the following new provisions after *COBS* 21.3.14G. The text is not underlined.

Conditional permitted links

- 21.3.15 R A *conditional permitted link* is any of the following property where the conditions in *COBS* 21.3.16R are met:
- (1) *conditional permitted unlisted securities*;
 - (2) *conditional permitted immovables*;
 - (3) *conditional permitted loans*; and
 - (4) *conditional permitted scheme interests*.
- 21.3.16 R The conditions for the property in *COBS* 21.3.15R to be a *conditional permitted link* are that an *insurer* must ensure, on a continuing basis, that:
- (1) a *linked policyholder* is not prevented by the nature of any *conditional permitted link* from exercising any right under the *linked long-term contract of insurance* within the timeframe specified in that contract and, in any event;
 - (a) (in relation to rights to take benefits due under the contract) within a reasonable timeframe based on the needs of the *linked policyholder*; and
 - (b) (in relation to other rights under the contract) within a timeframe that may be reasonably necessary to allow the *firm* to manage the *linked fund* prudently and in the best interests of all relevant *policyholders* linked to the fund.

- (2) the investment risks of any *conditional permitted links*, both individually and in combination with other investments within a linked fund, are suitable and appropriate for:
- (a) circumstances where investment risk is borne by a *linked policyholder*;
 - (b) the expected period to maturity of the *linked long-term contract of insurance*; and
 - (c) the purpose for which the *linked policyholder* holds the *linked long-term contract of insurance*.
- 21.3.17 G (1) Rights under a *linked long-term contract of insurance* which may be relevant for the purposes of COBS 21.3.16R(1) would include a *linked policyholder's* right to:
- (a) change the property to which the benefits of the *linked long-term contract of insurance* are linked;
 - (b) take benefits due under the *linked long-term contract of insurance*. Benefits due are those which the contract envisages will be paid at a particular date or on the occurrence of a particular event; or
 - (c) withdraw early or transfer the proceeds of, or benefits under, the *linked long-term contract of insurance*. Early withdrawal refers to withdrawals prior to the time or event for paying benefits due that is specifically envisaged in the contract.
- (2) A *firm* will have to pay benefits due under a *linked long-term contract of insurance* (for example on death or maturity) as specified in the contract. A *firm* is not permitted to specify in the contract that it can defer the payment of any such benefits as, in any event, benefit payments have to be made within a reasonable period based on the needs of the *policyholder*.
- (3) A *linked long-term contract of insurance* may provide that the *policyholder's* right to exercise rights under (1)(a) or (1)(c) is deferred for as long as may be reasonably necessary to allow the *firm* to ensure that a *linked fund* can be managed in a manner that is prudent and in the best interests of all relevant *policyholders* linked to the fund. The *firm* will need to ensure that it explains clearly to a *policyholder* the impact of any such provision on the *policyholder's* rights to withdraw early, switch or transfer.
- 21.3.18 G The assessment in COBS 21.3.16R(2), in relation to a *linked fund* which is included in a default or similar arrangement for a pension scheme, would include ongoing consideration of whether the investment risks of any *conditional permitted links* remain suitable and appropriate for a particular

cohort of *linked policyholders*, including as that cohort moves toward retirement.

Conditional permitted links: requirements

- 21.3.19 R Where a *linked fund* is invested in any *conditional permitted link*, no more than 35% of the gross assets of the *linked fund*, when aggregated together, can be invested in:
- (1) *permitted scheme interests* in (b)(v) of the *Glossary* definition of that term; and
 - (2) *conditional permitted links*.
- 21.3.20 R Where a *linked fund* is invested in any *conditional permitted link*, the information that a *firm* must give a *linked policyholder* under COBS 21.2.4R must also prominently include, clearly and in language capable of being understood by a *linked policyholder*:
- (1) an explanation of the risks associated with any *conditional permitted links* and/or gross assets in *permitted scheme interests* exceeding 20%, how these might crystallise and how they might impact on a *linked policyholder*;
 - (2) a description of the tools and arrangements which the *insurer* would propose using, including those required by *FCA rules*, to mitigate the risks in (1);
 - (3) an explanation of the circumstances in which these tools and arrangements would typically be deployed and the likely consequences for *linked policyholders*; and
 - (4) an explanation of the possible impact on the *policyholder* of any provision in a *linked long-term contract of insurance* permitted under this section which allows for the deferral of the exercise of any rights under the contract.