



Financial Services Authority

Insurance Sector Briefing:

Update on Closed With-Profit Funds

November 2005





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Foreword

Since we published our last Sector Briefing in September 2004, the closed with-profits sector has been anything but a closed book. Change has ranged from continuing regulatory reform to shifts in the dynamics of the commercial environment.


From a regulatory standpoint, 2005 has been a critical year, with the majority of our new requirements beginning to embed. Designed to deliver an industry that is adequately capitalised, soundly managed and treats its customers fairly, the new regime is just as applicable to firms with closed funds as to those with open funds. Moreover, in our desire to ensure that policyholders in these funds are treated fairly, we also introduced new rules specifically for closed funds focusing on enhanced transparency and disclosure requirements.

Commercially, the shape of the closed funds sector has also been radically altered by the emergence of third party consolidators looking to acquire significant books of closed business, seeking economies of scale and shareholder returns while continuing to meet their obligations to policyholders. Here, our role in approving such acquisitions is crucial. To ensure that policyholders' interests are appropriately protected, third parties wishing to purchase closed funds must prove to us not only are they 'fit and proper' to be the owners of such a fund, but also that policyholder interests will not be threatened.

With all of this change afoot, it is all the more important that consumers have clear and useful information to be able to make informed decisions about their with-profits investments. It is fair to say that since our last Sector Briefing, public commentary on closed funds has in our view been more balanced than in the past, now typically recognising that there is no 'one size fits all' answer to policyholders who want to know whether they should keep their policy until maturity or surrender it. We continue to stress the importance of consumers considering the full range of issues involved in such a decision, and seeking advice where it is available.

Again, we emphasise that while cashing-in a policy may be an entirely sound course of action for some policyholders, it would not be for others – who may, for example, have valuable guarantees and options. However, while we strongly caution against decisions based purely on whether the fund is closed to new business, we do think that policyholders have a right to know whether their policy is invested in such a fund. And although this should not be the only factor taken into account, it is still clearly a material one. So, we include in this document a list of insurers who have books of, or write, with-profits business, indicating whether they are open or closed to new business.

Drawing on our day-to-day dealings over the past year with insurers in the closed fund sector, this Sector Briefing illustrates our ongoing commitment to give feedback to the industry as the new regulatory regime embeds. As such, it should be viewed as part of an ongoing dialogue with the industry and, as ever, we welcome comments and views on any of the points made.



David Strachan

Insurance Sector Leader



1. Overview

- 1.1 In 2004 we published our first Insurance Sector Briefing on closed with-profits funds setting out how we regulate firms with closed with-profits funds and giving a preview of the changes to our approach that we were then developing.¹ Since then, there has been a range of important developments – both commercial and regulatory. In addition to a new capital regime for all insurance companies, we have introduced new rules designed to help ensure with-profits policyholders get a fair deal. Importantly, there have also been significant changes to the commercial landscape, most notably with the emergence of third party consolidators looking to buy closed books of business. While there have been no new closures since the 2004 publication, media and political interest in these funds – and particularly the prospects for policyholders – remains high.
- 1.2 Against this background, we are publishing this subsequent Sector Briefing to give an update on our thinking in relation to closed with-profits funds. This is an important part of our wider commitment to maintain a dialogue with the industry as the new regulatory regime for insurers embeds. In addition, we highlight:
- closed funds continue to be very high on our agenda – be this in relation to our day-to-day supervision of closed funds, our role in protecting consumers when a closed fund is sold, or through the provision of consumer information on our consumer website;
 - some of the issues explored in this document are relevant to open funds as well as those that are closed to new business – particularly those that are ‘nearing closure’; and
 - consumers need to think very carefully about their with-profits investments – not simply focusing on whether a fund is open or closed to new business.
- 1.3 We expect this Sector Briefing to be of interest to a wide range of stakeholders – ranging from insurance firms (including those which only currently have open funds) and financial advisers, through to commentators and policyholders alike.

The sector

- 1.4 It remains our view that there is little homogeneity in the closed funds sector, and as such generic statements about these funds tend not to stand up to scrutiny. For example, closed funds are often associated with poor performance. While this may be true for some closed funds, it is by no means the case across the board.

¹ *Insurance Sector Briefing: the regulation of closed with-profits funds* (September 2004). Our focus in the Sector Briefings is on with-profits, but clearly there are unit-linked funds which are also closed to new business also.



New regulatory environment

- 1.5 Known as the ‘Tiner Reforms’, our new rules seek to deliver an industry that has adequate capital, is soundly managed and, critically, treats its policyholders fairly. The majority of the specific reforms developed to deliver this over-arching objective are now being implemented. First, the new Individual Capital Adequacy Standards (ICAS) regime has overhauled the way in which insurers (both life and general) calculate how much capital they need to support the business that they write and the risks that they run. Second, the requirement for firms to set out how they run their with-profits funds in a document called the Principles and Practices of Financial Management (PPFM) and the introduction of new actuarial roles in life offices mark important improvements to the governance of life insurance firms. And third, new rules for with-profits focusing specifically on the fair treatment of policyholders in these funds will help ensure that consumers get a fair deal.²

Implications for firms

- 1.6 Our new rules require that on closure the senior management of the fund must inform their policyholders (setting out options available to them) and submit a run-off plan to us. It is clear though, that while some funds are technically open, they are nevertheless ‘nearing’ closure. As such, they may have issues in common with those that are completely closed. Where we think this is the case, we will typically ‘refocus’ our supervisory approach to concentrate on these issues, helping ensure that policyholders are appropriately protected.
- 1.7 Some of the areas where our supervisory interest may increase in relation to closed funds include:

Policyholder communication – all with-profits insurers are required to produce a PPFM setting out how they intend to manage the fund. From the end of this year, firms are also required to produce a consumer-friendly version of this document. In addition, our new rules require that when a fund closes to new business it must inform its policyholders within 28 days setting out the options available to them.

We think it is encouraging that some firms in the closed funds sector are communicating regularly and clearly with their policyholders on issues such as market value reduction (MVR) free dates, the existence of guarantees and options available in their policies. However, other firms still clearly have some way to go.

Investment strategy – one particular challenge for closed funds is to have an investment strategy that meets both the expectations of different groups of policyholders and which sufficiently safeguards the solvency of the fund. We recognise that from a commercial

2 The detail of the specific components of the Tiner Reforms are described in our *Insurance Sector Briefing: delivering the Tiner Reforms* (April 2005). Subsequent Sector Briefings on PPFMs and ICAS were published in October 2005 and November 2005 respectively. These are on the Insurance Sector pages on our website: <http://www.fsa.gov.uk/Pages/About/Teams/Insurance/publications/index.shtml>.



standpoint, some firms will be taking account of shareholder expectations too. Given the challenging market conditions earlier in the decade, it is not surprising that our supervisors have dedicated (and will continue to dedicate) time to this area. We are clear that it is the responsibility of individual firms to determine the investment strategy for their with-profits business. However, firms need to consider whether it would be appropriate in some cases to increase previously reduced equity exposures to increase the potential upside for policyholders where this is possible without threatening the fund's solvency position.

Management of inherited estate – our rules require firms to distribute (or reattribute) any excess surplus, regardless of whether the fund is open or closed. We recognise though that where a fund has closed to new business, fair distribution of any inherited estate becomes an issue. Particular challenges relate to how to distribute between different generations of policyholders to ensure a solvent run-off is maintained without unduly disadvantaging (or advantaging) policyholders whose policies mature in the shorter term.

Charges – our rules permit firms to charge to the fund only those costs that have been incurred in the operation of the fund. Particular issues for closed funds include the potential for rapid rises in unit costs because of redundancy payments to staff or upfront costs of other operational change.


Outsourcing – outsourcing is extremely common in the closed fund community and typically can include contracts covering administration, investment management, actuarial and finance. Our priority here is the fair allocation of costs of outsourcing as well as the question of whether policyholders are, in turn, getting a fair deal.

Management information – one particular issue to emerge since the last Sector Briefing on closed funds relates to the limited provision of management information (MI) to the senior management of closed funds. Given the lack of comprehensive and timely MI, we think there may be questions about the ability of some firms' governing bodies to challenge and deliver Treating Customers Fairly (TCF) obligations. Where this is the case we will feedback our concerns to relevant firms.

Legacy knowledge and information – firms should regularly review contracts and marketing material for their products when determining and reserving for policy benefits to help ensure that TCF requirements are met and that reserves are adequate. This is particularly important in light of the recent volume of transactions in this sector.

Sale of closed funds

- 1.8 Some commentators have raised questions over the fair treatment of policyholders in closed books of business that are changing ownership. There are two statutory tests that must be met before we approve the sale of a closed book of business: that the acquirer is a fit and proper person to have control; and that the interests of consumers would not be threatened by the acquirer's control. These give us a baseline to determine whether the new owners will appropriately protect policyholders' interests.



But in addition, we are also able to attach – and have in practice attached – specific conditions to protect policyholder interests – for example, stipulating the amount of capital that should be held and/or restricting the amounts and timing of dividend releases to shareholders.

Implications for consumers

- 1.9 Most of this Sector Briefing focuses on the implications of the new regulatory (and commercial) environment for firms. However, in addition to our day-to-day supervisory work to protect consumers, we are also focusing on consumer understanding of what it means to be in a closed fund. We think that consumers will benefit from the enhanced disclosure and transparency that underpin the new ‘treating with-profits policyholders fairly’ rules. But we recognise that despite these improvements many policyholders still need help when considering their with-profits investments. Because it is so difficult, if not impossible, to give generic advice to policyholders in these funds, we have published material about this on our consumer website. This is designed to help policyholders think about the wider issues they need to take into account. In particular, we stress that the decision to keep or surrender a policy should not rest solely on whether the fund in question is open or closed to new business.
- 1.10 Notwithstanding this, we do think that consumers should know whether their policy is invested in a fund that is open or closed to new business. So, we include at the end of this document a list of with-profits firms indicating whether their funds are open or closed. Again, we emphasise that although this information is relevant, the status of the fund should not be the only factor considered when thinking about with-profits policies.

Next steps

- 1.11 We expect the senior management of all life insurers with closed with-profit funds to consider the issues raised in this document carefully. In addition we would expect life offices which have with-profit funds that are ‘nearing’ closure to do so as well. Consumers should consider their with-profits investments in the round, taking financial advice where they have access to it. Closed funds will continue to be high on our agenda and, as with any other sector, we expect these funds to be soundly managed, adequately capitalised and for firms to treat their customers fairly. Our forward work programme – both day to day supervision and thematic reviews – will continue to focus on delivering this outcome.



2. *The closed funds sector*


- 2.1 As emphasised in the previous Sector Briefing on closed funds, although funds that are no longer writing new business are all categorised as ‘closed funds’, there is less homogeneity in this sector than might first appear.
- 2.2 The reasons for closure vary, and it is by no means always the case that funds close to new business because they are financially weak. Clearly, in some cases the financial strength of the fund can be the deciding factor, but there is a range of other reasons why with-profits funds close to new business. These include: the profitability of writing new business; the size of the fund (the fund may simply be too small to be viable in the future); or structural changes, such as a demutualisation or the distribution or reattribution of an inherited estate. In addition, we recognise that changes in the economic and regulatory environments may also influence the decision to close.

Performance of closed funds

- 2.3 Closed funds are often associated with poor performance. While this generalisation is certainly true of some funds, it does not stand up to scrutiny for all. Even within otherwise poorly performing closed funds, individual policies can still perform comparatively well due to the existence of guarantees. Misconceptions about these and other issues can lead to consumers taking poor decisions about their with-profits investments.
- 2.4 Every year we carry out a private survey of maturity payouts and surrender values for with-profits policies. Our latest survey examines the payouts at March 2005 for the with-profits funds that have liabilities in excess of £500m – otherwise known as ‘realistic reporters’.³ To analyse the payouts, we typically divide these into quartiles; the top 25% fall into the first quartile with the bottom 25% in the fourth quartile.
- 2.5 To compare the relative performance of closed with open funds, as we did last year, we counted the number of times that payouts from closed funds feature in the top and bottom quartiles over the last three payout surveys. As illustrated in the table below, the results have been divided into three groups, determined by how long the fund has been closed, and the results compared with those for open funds.

	Open funds	Closed 1-5 years	Closed 5-10 years
% of funds in 1st Quartile	34	15	28
% of funds in 4th Quartile	14	35	46

³ Realistic reporters are with-profits insurers with liabilities in excess of £500m. They are required to produce a realistic balance sheet at year end. They make up 98% of the with-profits sector.

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- 2.6 As with last year's data, it is clear that being in a closed fund is not necessarily detrimental to a policyholder in terms of payouts. What is equally clear is that performance depends squarely on which fund a policyholder has invested in and also what type of policy they have in that fund. As such, policyholders and their advisers need to consider very carefully the circumstances of the individual and the position of the fund they are invested in before taking any decision on whether to keep the policy to maturity or to surrender it. The issues surrounding this difficult decision are explored in more detail in Chapter 6.

Definition of closure

- 2.7 Our rules require firms that close a with-profits fund to new business to take certain specific actions (e.g. to inform policyholders and submit a run-off plan to us – these requirements are covered in more detail in Chapter 3). But we recognise that there are some funds that are technically open for the purposes of these rules but which nevertheless could be viewed as 'near-closed' and as such have issues in common with funds that are completely closed.
- 2.8 Our rules define a closed fund as follows:⁴

"...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."

- 2.9 So, whether a fund is open or closed therefore depends primarily on whether the relevant firm is actively seeking to effect – or actually effecting – new contracts of insurance in that fund. The more actively the firm is seeking to effect new contracts of insurance and/or the more new contracts of insurance it is effecting in a particular fund, the more likely it is that that fund is open for the purposes of the rules.

4 COB6.12.95



2.10 For these purposes:

- ‘actively seeking’ need not constitute extensive marketing activity (e.g. mailshot campaigns), but the firm must be carrying out some activity to attract/generate new business, if the fund is to be regarded as open; and
- ‘new policies’ means totally new business, not increments or the exercise of options on existing business.⁵

2.11 New guidance, effective from the end of June 2005, indicates that:

“A firm should not avoid taking a formal decision to cease to effect new contracts of insurance in a with-profits fund in an attempt to avoid the requirements of COB 6.12.94R” (i.e. the requirements to notify policyholders of closure and to submit a run-off plan to the FSA)”; and

“A firm should contact the FSA to discuss whether it has, or should be taken to have, ceased to effect new contracts of insurance,....if:

(1) COB 6.12.95R(2) may apply;

(2) it is no longer effecting a material volume of new with-profits policies in a particular with-profits fund, other than by reinsurance;

(3) it is effecting only new reinsurance business in a particular with-profits fund; or

(4) it cedes by way of reinsurance most of the new with-profits policies it continues to effect.”⁶

2.12 In considering the positions of funds in these circumstances, as well as exploring whether a fund is still actively marketing new business, we will want to understand whether the fund is receiving the economic benefit and/or bearing the risks of any new business written. Where a fund is taking on the risk and/or receiving the economic benefit of new business, we are likely to regard it as open for the purposes of our rules.

2.13 There are, however, situations where funds fall into the grey area between open and closed; for example:

- where the firm is still offering new with-profits policies but, in practice, is selling very small amounts compared with levels of existing business;
- where the fund does not write any new direct business but inwardly reinsures business written directly in another part of the firm’s group or written by another firm;
- where the fund is closed to new with-profits business but is still accepting new non-profit business; and

⁵ COB6.12.95R(2)

⁶ COB 6.12.96G and COB 6.12.97G

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- where the fund writes new with-profits business but then reinsures this wholly or substantially to another firm.

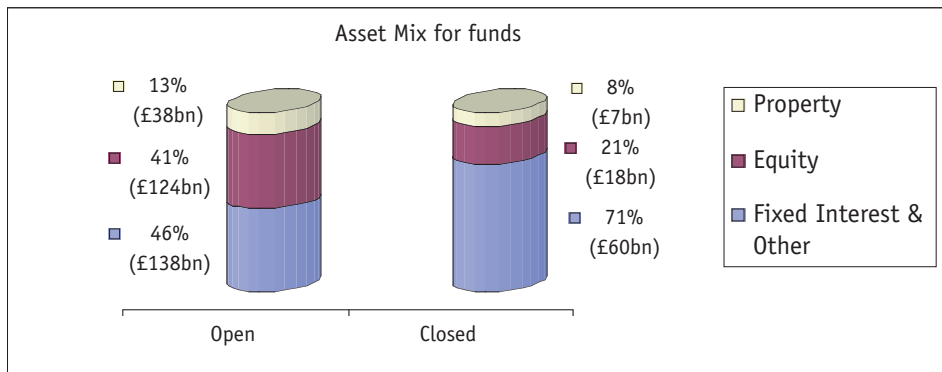
- 2.14 In the first three situations, we are likely to take the view that the fund is still technically open but that a number of the special considerations for closed funds are likely to apply. For example, certain operations may be run-down and the distribution of inherited estate is likely to be a consideration relevant to a fund whose new business volumes have diminished significantly or which only accepts new non-profit business. In contrast, we are likely to consider a fund which wholly reinsures its new business to another firm (and does not retain any risk or economic benefit from that) to be closed, as is a fund which only accepts the reinsurance of previously closed books.
- 2.15 Our rules define a fund as closed in relation to whether it is actively seeking to effect or is effecting new business (which could be new non-profit business only). But in this Sector Briefing, in certain cases – for example distribution of any inherited estate – we also consider the position of funds that are closed to with-profits business but which continue to write new non-profit business as such funds are affected by a number of the issues that are relevant to funds that are completely closed to new business.

Some data on the sector

- 2.16 There are now 51 firms that manage closed funds (out of a total of 99 with-profits firms). A list of with-profits firms, indicating which firms have open and closed funds, is attached as Annex A.
- 2.17 The closed with-profits sector has developed quite dramatically over the last 6 years. We estimate around 13% of firms that had a with-profits fund with liabilities over £500 million or more were closed to new business in 1998. By 2004 this figure had risen to around 42%. This increase was largely driven by a significant number of closures after 2001. The stock market decline through 2001 was a catalyst to closure for many firms, particularly those in the with-profits sector. And in some cases, the decline was a catalyst to withdraw from the UK life sector altogether.
- 2.18 There have been no new closures of with-profits funds since we published the last Sector Briefing. However, several funds fall into the grey area mentioned above (in paragraphs 2.7 – 2.15). While such funds remain technically open for the purposes of our rules, some of the particular issues for closed funds are likely to apply to them as a result of, for example, substantially diminished business volumes. Where this is the case our supervisors will begin to focus on the range of issues highlighted in this document to help ensure that policyholders are adequately protected.



2.19 Analysis of the realistic balance sheets for year-end 2004 indicates that in terms of with-profits funds' assets under management, closed funds have £85bn invested in equities, fixed interest and managed or pooled investments, cash and property. In comparison, firms that are still open to new business have funds under management of £300bn. The chart below illustrates the breakdown of assets in the with-profits sector, comparing the realistic reporters in open funds with those in closed funds, as of 31 December 2004.





3. *Developments since 2004*

- 3.1 In September 2004 we were still consulting on new rules on the treatment of with-profits policyholders. Since then, the majority of these rules have now been implemented. In addition, the new capital framework – Individual Capital Adequacy Standards (ICAS) – has been rolled out for all insurers. Firms with with-profits liabilities in excess of £500m are also now required to produce a realistic balance sheet.
- 3.2 Beyond pure regulatory matters, we have also worked with the Financial Ombudsman Service to develop a working arrangement to deal with complaints about closed funds that potentially have wider implications for whole groups of policyholders. This chapter explores each of these issues in more detail.

Treating with profits policyholders fairly


- 3.3 In January 2005, we published a Policy Statement (PS05/1) containing rules and guidance on treating with-profits policyholders fairly. The bulk of these rules and guidance came into effect on 30 June 2005, including the specific provisions for closed funds.
- 3.4 Some of these new requirements relate specifically to closed funds.⁷ As well as providing a definition of a closed fund (as described in Chapter 2), these rules and guidance:
- i) require a firm to inform us and its with-profits policyholders within 28 days of ceasing to effect new contracts of insurance in a with-profits fund;
 - ii) require a firm to submit a run-off plan to us as soon as reasonably practicable and, in any event, within three months of closing to new business; and
 - iii) identify considerations relevant to the distribution of any inherited estate in the fund.
- 3.5 Details of how firms should notify policyholders about fund closure were set out in our previous Sector Briefing and remain unchanged. More detail on the new rules are included in Annex B.

Run-off plans for closed with-profits funds

- 3.6 Firms that close with-profits funds to new business must now submit a run-off plan to us as soon as reasonably practicable, but within three months at the latest.⁸ This is so that we can check how the firm proposes to manage the run-off, how it will cope with the additional risks associated with a declining asset portfolio and how it will

7 COB6.12.94R to COB6.12.107G

8 COB6.12.94(2)R



distribute any inherited estate. All of these are important supervisory considerations that will help protect policyholders.

- 3.7 Guidance on what firms should consider including in a run-off plan took effect in June 2005 and is set out in more detail in Annex B.

ICAS for closed funds

- 3.8 The Individual Capital Assessment (ICA) for a closed fund will be assessed in the same way as that for open funds, and many of the risks will be common to both.⁹ We do not expect to see additional capital allocated simply because a fund is closed, and nor would we propose Individual Capital Guidance solely as a result of this. However, there may be a number of risks present in a fund which can become more acute when a fund closes such as how expenses are apportioned and how surplus capital will be distributed through run-off. We would expect to see these covered in a firm's ICA submission and will give them particular attention during our assessment.
- 3.9 In addition, the ICA can be a very useful tool in clarifying the amount of free capital available in a fund, both at a point in time and (through the modelling behind the ICA) through the run-off. In many cases the owners of closed funds are seeking to extract capital, for example in the form of dividends. We have the power to restrict such payments if they threaten the fair treatment of policyholders. With an ICA we, and the firm itself, will often have a much better idea of the extent to which, and over what period, capital may be released.

Wider implications arrangements with the Financial Ombudsman Service (FOS)

- 3.10 In late 2004 and during the first few months of 2005, we developed arrangements with the FOS for dealing with complaints about closed funds that raise wider implications issues (i.e. that potentially affect groups of policyholders). The types of complaints covered by these new arrangements are complaints about management actions taken by firms managing closed funds.¹⁰ They include, for example, moving into less risky investments which have a lower potential for increased returns in good investment conditions and increases in charges made to policyholders. These types of complaint potentially have wider implications because the management actions firms take can affect entire groups of policyholders within a fund or even all of the policyholders within a with-profits fund. These arrangements do not cover complaints about, for example, the suitability of a particular with-profits policy for a policyholder as this type of complaint will depend on the particular circumstances of the individual case.

⁹ A progress report on the implementation of the ICAS framework was published in our Insurance Sector Briefing: ICAS (November 2005)

¹⁰ Management actions are actions that a firm's management might propose to take to manage the firm's insurance business and which may have implications for the fair treatment of customers. These may include, but are not limited to: changes in future bonus rates; reductions in surrender values; changes in asset disposition (taking into account the associated selling costs); and changes in the amount of charges deducted from asset shares for with-profits insurance contracts (PS 04/16 PRU 7.4.52 G).



- 3.11 When the FOS receives a complaint about a management action taken by a firm managing a closed with-profits fund which appears to have wider implications, it will refer the issue to us through our FOS-Liaison Team. We will then establish whether the issue has already been considered, or is in the process of being considered by the relevant team as part of our normal supervisory work. If we have not formally considered the issue, the FOS referral may prompt us to take action – we would normally ask the firm to demonstrate to us why its management action was fair. However, we could also decide that we did not think that the action was significant enough to justify any further action by us.
- 3.12 We then establish the nature of any previous decisions that we have taken on a particular management action, any work in progress considering such actions and whether to initiate an investigation of such actions. Once we have established this, we will respond to the FOS in one of three ways:
- we have already considered the management action and decided not to object to it;
 - we are in the process of considering the action or will consider it as a result of the FOS referral; or
 - we have decided not to investigate the action.¹¹
- 3.13 Depending upon our response, the FOS may then dismiss the complaint and tell the policyholder that the FSA has already considered the issue and decided not to object to it. The FOS may defer any investigation while we consider the issue or it might decide to investigate the individual circumstances of the complaint. The FOS may decide on the latter, regardless of whether we have considered a particular issue.
- 3.14 These wider implications arrangements help distinguish between regulatory and complaints issues and avoid any unhelpful overlap between these and duplication of effort by the FOS and us. The arrangements also make the approach more efficient and co-ordinated, including information sharing between the FSA and FOS, which helps policyholders. Finally, policyholders also benefit from increased transparency about our regulatory decisions as they will be informed of the FSA’s view on an issue as well as the FOS’s decision on their complaints.
- 3.15 There is further information on our process for considering management actions by with-profits firms and our supervision of closed with-profits funds on our website.¹²

11 We would not respond to the FOS saying that we had considered an action and decided to raise objections to it because, in this case, we would have asked the firm to reconsider its management actions and the issue would therefore still be in the process of being considered by us.

12 http://www.fsa.gov.uk/pages/Library/Other_publications/Miscellaneous/2005/wp_supervision.shtml




4. *Implications for firms*

- 4.1 In the light of the new regulatory requirements taking effect, this chapter explores some of the issues that we have seen emerge in the closed funds context and which firms should take into account.
- 4.2 As illustrated in Chapter 2, the distinction between open and closed funds is not always a clear one, with firms often technically running off business before they are designated as ‘closed’. Generally, as a fund moves towards closure, our supervisory stance, dialogue and, in some cases challenge, all increasingly focus on risk mitigation issues relevant to the ‘closed’ fund agenda. In other words, although there are specific regulatory requirements that a firm must act on in the event of ‘closure’, our supervisory interest will change its focus as a firm moves closer towards closure. Similarly, we would also expect the focus of a fund’s senior management to change in these circumstances. As such, the areas discussed in this chapter will also be relevant to the senior management of funds which are moving towards closure.

Policyholder communication

- 4.3 A key element of ensuring that consumers get a fair deal is the provision of clear and timely policyholder information so they are equipped to make informed decisions about their policies. This applies to all with-profits funds, be they open or closed.
- 4.4 Since April 2004, all with-profits firms have had to produce a PPFM. The PPFM is designed to set out how the firm manages its with-profits business. It covers key information including how policy payouts are determined, the investment strategy, charges and expenses, and is aimed at knowledgeable participants. From the end of the year, all with-profits insurers will also be required to produce a consumer-friendly version of this document, the CFPPFM.¹³ The CFPPFM must describe the most important information under each of the main headings within a firm’s PPFM. It must be written in clear and plain language that can be easily understood by a policyholder who has no specialist knowledge of with-profits business.
- 4.5 But in addition to the PPFM and CFPPFM, we have also introduced specific rules on policyholder communication that take effect when a fund closes. One of our particular concerns in relation to closed funds was the inconsistency of the information that policyholders receive when a fund closes to new business and post closure. As

13 These must be made available to the public and prominently signposted on firms’ websites, provided once to all existing policyholders as part of periodic mailings (and again if there are any material changes since the last one sent) and be given to potential with-profits policyholders along with the Key Features document.



described in the previous chapter, to help address this firms are now required to inform both us and their policyholders within 28 days of closing a fund. We have also introduced detailed rules about amendments to PPFMs and specifically the speed of notifying policyholders of any changes to principles or practices. We will challenge firms that do not meet these standards.

- 4.6 Beyond this, there is the wider question over ongoing policyholder communication. What we have seen over the last year indicates a mixed picture; this applies as much to open funds as it does to those closed to new business. We are encouraged to see that some firms are communicating regularly with their policyholders and, in particular, giving adequate and timely notice of the existence of guarantees, open market options for pensions business, MVR-free dates and other options on their policies. This is a good example of firms taking the lead without any need for specific regulatory intervention.
- 4.7 Examples of good practice that we have seen included a provider that had disbanded its direct sales force providing customers with access to a facility to source suitable financial advice. Another provider offers a similar arrangement with a designated group of IFA firms. Others have started to give policyholders early warning of forthcoming MVR-free dates so that they know when they can exit their policy if they wish to without incurring a penalty. Unfortunately though, these examples of good practice are not in evidence across the sector.

Case study: MVR free dates and TCF

A medium sized life insurer has a number of life bonds that will reach their MVR-free date this month. It is the first tranche of life bonds to reach the MVR-free date and the firm has not yet decided whether it will contact policyholders before this date to draw their attention to the option.

Furthermore, to date it has not reminded life bond policyholders about MVR-free dates on annual statements, nor has it advised life bond policyholders who are thinking of surrendering their policy that it contains an MVR-free date.

In light of the obligation for firms to treat their customers fairly (Principle 6) and the requirement for firms to have regard to the information needs of their customers (Principle 7) we have raised our concerns with the firm, and subsequently it has confirmed that it is revisiting this position.

- 4.8 We have also recently carried out a desk-based review of annual bonus statements to determine how clearly these documents communicate key information to policyholders. Again, a mixed picture emerged, with a number of obvious omissions in annual statements, for example no cash-in values provided, premium amounts paid,



date of maturity or even the value of current terminal bonus. Further, in a number of cases, the firms did not explain key terminology – for example to explain what with-profits means and what the different types of bonus are.

- 4.9 At present, we do not require with-profits firms to produce annual statements for their policyholders. Those that do so produce these as part of the accreditation to the Association of British Insurers' Raising Standards Scheme. We very much welcome industry led efforts to improve standards. However, it is apparent that more could be done here to help ensure policyholders receive this information in a clear and meaningful way. We recognise though that the ABI is currently consulting on reforming the current Scheme. We will take account of the outcome of that consultation in considering whether any post-sale regulatory disclosure requirements are necessary in the with-profits sector.

Investment strategy

- 4.10 Guidance on our new rules suggests that when a firm (whether open or closed) determines its investment strategy and the acceptable level of risk within that strategy, it should take into account:
- i) the extent of the guarantees in its with-profits policies;
 - ii) any representations that it has made to its with-profits policyholders;
 - iii) its established practice; and
 - iv) the amount of capital support available.¹⁴
- 4.11 In addition, a firm should only change its investment strategy when it is necessary or appropriate to do so, to take account of material changes in its economic circumstances or the wider economic environment, changes in policyholder take-up of policy options or changes in the level of capital support available to the with-profits fund.¹⁵
- 4.12 One particular challenge for firms managing closed with-profits funds is to have an investment strategy that both meets the expectations of different groups of policyholders (including expectations of an increased return in favourable investment conditions) and which sufficiently safeguards the solvency of the fund. In some cases, firms will also be taking account of shareholder expectations. Clearly, the degree of investment freedom and the scope for investing in the more volatile asset types, such as equities and property, will depend on the circumstances of the fund concerned. These include:

¹⁴ COB 6.10.9FR

¹⁵ COB 6.10.6G. It should also be noted though that Principle 7 requires firms to have regard to the information needs of their clients and to communicate information to them in a way that is clear, fair and not misleading. In some cases, this may also point to the need for separate documents.



- **how financially constrained the fund is.** A fund that is under financial pressure will have a lower amount of investment freedom than a fund with a significant inherited estate in excess of its ICA or one for which external capital support is available;
- **the extent to which the fund is exposed to guarantees that are, or are close to being, ‘in the money’.** Where guarantees are heavily in the money, there may be limited potential for gaining any upside from investing in the more volatile assets. Funds which are heavily exposed to guarantees are therefore more likely to invest a higher proportion of assets in fixed interest securities; and
- **the run-off profile, including the period left to run on the remaining policies.** A high equity backing ratio (EBR) may be expected to produce greater long-term returns. But a firm with a large number of policies maturing in the near future may need to match its liabilities closely with a greater proportion of fixed interest securities. This will help ensure that sufficient capital is available for distribution and to protect the solvency of the fund.

4.13 Firms also need to ensure that the investment strategy is consistent with representations made to policyholders and explanations given in the PPFM. Where it is necessary to change the investment policy – for example, to reduce the EBR because of adverse financial conditions affecting the fund – fair treatment suggests policyholders should be informed where this is material and particularly if the PPFM needs to be amended.

4.14 When equity markets fell during the early part of this decade, many with-profits insurers (including those with both closed and open funds) reduced their EBRs quite substantially. Following the recent recovery of the equity markets there have been few instances of firms increasing their equity exposures, although the position varies between different firms. Some closed funds have maintained relatively high EBRs, while others have minimal holdings in equities and property or are wholly invested in fixed interest securities. As noted above, the determining factors in these cases include the degree to which the funds are financially constrained, the extent of exposure to in the money guarantees and the nature of the run-off profile. While it is the responsibility of the relevant firm to determine the investment strategy for its with-profits funds, firms need to consider whether it would be appropriate to increase EBRs without threatening their solvency positions. This would increase the potential for policyholders (and shareholders in 90:10 funds) to receive a higher risk adjusted return.

4.15 Even in cases where the fund is heavily exposed to guarantees and/or a peak in maturities in the short term, there may be some scope, subject to the specific contracts governing blocks of business, for increasing the EBR through different use of asset hypothecation (i.e. employing different investment strategies and holding different asset mixes for different groups of policies). For example, a firm might reduce the equity holdings backing policies where guarantees were heavily in the money and increase them for the remainder of policies, perhaps according to the outstanding term



to run. Such actions could improve the overall position for policyholders while not materially increasing risk (and required risk capital) in the fund. There may also be other ways to deliver capital efficiencies that can have the same effect in producing greater scope for favourable assets mix adjustments.

- 4.16 Our role here is to ensure that firms treat their customers fairly and have due regard to their interests. We recognise the potential for conflicts of interest between shareholders and policyholders in proprietary firms, and for all firms the potential for conflicts can also exist between different groups of policyholder in all firms. Firms will need to demonstrate they have considered the full range of options open to them in their particular circumstances to ensure they continue to treat policyholders fairly. As part of this, firms should also keep management actions under review in light of any changes to circumstances to verify whether the action remains fair to policyholders.

Case study: asset hypothecation

One firm, which was financially constrained, proposed to vary asset mix for different groups of policies depending on the extent to which asset shares were expected to exceed, or fall below, guaranteed minimum benefit levels at maturity. For some policyholders this meant removing the possibility of receiving benefits in excess of contractual obligations.

In considering this proposed course of action, we were concerned to ensure:

- that there would be no negative impact on the accrued contractual rights of policyholders (only on additional benefits);
- that the approach was consistent with previous policyholder literature;
- that the firm satisfied us that the methodology for grouping policies was applied consistently across each of the with-profits funds; and
- that there were no policyholders who would lose out by being marginally on the wrong side of a hypothecation band.

Once the firm satisfied us on these matters, we decided not to raise objections to the proposal. As a result, the firm was able to avoid cutting asset shares – which would have reduced policyholders’ benefits generally.



Management of inherited estate

- 4.17 Whether a with-profits fund is open or closed, our rules require firms to distribute or reattribute any excess surplus¹⁶.
- 4.18 Where a fund is closed to new business, fair distribution of any inherited estate¹⁷ becomes a particular issue. As noted in the section on treating with-profits policyholders fairly in Chapter 3, our Handbook contains guidance on the distribution of inherited estate for closed funds:
- to ensure a fair distribution, a firm will normally have to distribute that part of the with-profits fund that is not required to support any continuing business, including any inherited estate;
 - to ensure a fair and prudent distribution, a firm may have to distribute a lower proportion of any inherited estate attributable to a closed fund to policyholders whose policies mature in the shorter term, compared with those whose policies mature in the longer term; and
 - if non-profit 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 business are available for distribution during the lifetime of the with-profits business.
- 4.19 One particular challenge for firms is how to distribute any inherited estate between different generations of policyholders to ensure that a solvent run-off is maintained but without unduly disadvantaging (or advantaging) those policyholders whose policies mature in the shorter term. Another challenge is how to distribute embedded value fairly within the fund. This could include both embedded value from non-profit business and also embedded value from any major subsidiaries owned by the fund (whether these are insurers or otherwise). Such ‘assets’ may not be easily liquidated or realised except over a long period of time. There will be additional challenges over the fair distribution of embedded value from non-profit business if this business is expected to run off more slowly than the with-profits business.¹⁸

16 COB6.12.57R to COB6.12.60E. For these purposes, COB6.12.58R provides that “A firm will have an excess surplus in a with-profits fund if, and to the extent that:

- (1) the regulatory surplus in that with-profits fund;
- (2) the other financial resources of the firm that are applied to that with-profits fund; and
- (3) any other financial resources that are expected to be made available for the benefit of that with-profits in the event of reasonably foreseeable adverse experience; exceed:
- (4) the amount required to meet the higher of any relevant enhanced capital requirement or individual capital assessment; and
- (5) the amount necessary, in the reasonable opinion of the firm’s governing body, to:
 - (a) support the current and future insurance business of the firm or the relevant with-profits fund;
 - (b) maintain the financial strength of the firm or the relevant with-profits fund; or
 - (c) address any other matters relevant to policyholders’ interests or security.”

17 An inherited estate is defined in our Handbook Glossary as “an amount representing the fair market value of the with-profits assets less the realistic value of liabilities of a with-profits fund.”

18 COB6.12.103G to COB6.12.105G




- 4.20 To ensure that any inherited estate is distributed fairly, firms will need to carry out detailed financial projections of expected outcomes. One way of crystallising the embedded value of any non-profit business or subsidiaries held by the fund could be to sell the business or subsidiary. This would involve determining a fair price now, but which would have the advantage of increasing the liquidity and reducing the volatility of future expected returns.

Charges

- 4.21 Our new rules permit firms to charge to a with-profits fund only those costs that, in the reasonable opinion of the firm's senior management have been, or will be, incurred in the operation of that fund.¹⁹ These provisions also require a fair and consistent apportionment of costs between with-profits funds, other business and shareholders and that the principles for such apportionment be disclosed in a firm's PPFM.²⁰
- 4.22 Additional issues for closed funds include the potential for rapid rises in unit costs as the fund runs down and the fact that such funds may suffer one-off costs such as redundancy payments to sales staff or upfront costs of other operational changes. In particular, it will be important to ensure that expenses are charged in a way that is fair between different generations of policyholders as well as between policyholders and shareholders. If the firm is continuing to write, or administer, other business the potential for rising unit costs should be reduced or might fall away completely. However, where a firm is completely closed to new business, this will be an issue. To mitigate this, some firms have chosen to outsource certain operations based on a fee per policy contract rather than a fixed charge, with a view to reducing overhead costs as the business runs off. Other actions firms might take include restructuring and perhaps selling their closed book.
- 4.23 Our rules and guidance relating to charges for specific types of costs, including guarantees, compensation and redress and costs of obtaining skilled persons' reports under Section 166 of the Financial Services and Markets Act apply equally to both closed and open funds. There are no particular issues for closed funds in respect of these other than issues associated with the diminishing policyholder base already mentioned above.
- 4.24 Finally, it is worth noting that a number of closed funds have significant exposure to guarantees that are in the money. Any charges made to the with-profits fund for such guarantees must be reviewed regularly to ensure that they are adequate, fair and lawful, taking into account the firm's circumstances and the wider economic environment. In particular, if a firm has made charges for guarantees to alleviate pressure on its financial position and the financial position of the firm and the fund have subsequently improved,

¹⁹ COB6.12.61R to COB6.12.72G


²⁰ COB6.12.61R to COB6.12.63R



it should consider whether it should reduce its charges. This will, of course, depend on the overall circumstances of the fund/firm including the projected profile for the guarantees. This issue is equally relevant to both open and closed funds.

Outsourcing

- 4.25 Outsourcing of services – including administration, investment management, actuarial and finance – is common in the closed fund sector because it may be more cost effective than continuing to maintain in-house facilities. Outsourcing is not, however, devoid of risk, with the exact nature of these risks depending on the nature of the mandate given to the outsourcer and the strength of the controls operated by the firm over the outsource provider.
- 4.26 Most outsourcers are not regulated firms. In any case, we are absolutely clear that it is the responsibility of the insurance firm’s senior management to ensure that any activities that are carried out on its behalf comply with our rules. In particular, we expect firms to have service level agreements in place to monitor the performance of any outsource partner, including investment performance. But, in addition to focusing on risk management controls over outsourcing, firms also need to ensure that they have robust contingency plans in the event of an outside service provider failing, backed also by adequate capital to support any contingency arrangements.
- 4.27 As with other operating costs, there is scope for unfair allocation of costs of outsourcing services. Here, our rules and requirements for disclosure of charging bases in PPFMs should mitigate against this.
- 4.28 Outsourcing contracts are typically long-term – usually for 10 years or more. While we recognise that long duration outsourcing contracts provide stability in operations, this does bring a lack of competitive pressure that may act against the interests of policyholders. Firms normally hold a tender process when initially choosing their providers, but they do not necessarily perform regular comparisons of the costs and service that they pay/receive with the potential costs/services of competitors. Senior management should consider whether they have sufficient access to management information to allow them to benchmark the performance and costs of outsource providers regularly, including the investment managers, so that they are confident that they continue to receive an appropriately efficient and competitive service. It also helps firms when renegotiating renewals of outsource contracts on expiry. As a means to maintaining the commercial pressure, firms might consider incorporating break clauses in their long-term outsource contracts so they can switch provider mid-term if there are concerns about performance.

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- 4.29 A final issue in the outsourcing context that firms need to take account of relates to the European Court of Justice's decision that outsourced insurance activities should no longer be exempt from VAT. Clearly, the decision on the timing to implement this ruling is one for the Government and not for the FSA. However, given the prevalence of outsourcing contracts in the closed funds sector, we will be closely monitoring the way in which firms respond to this change, being particularly vigilant of any moves that may undermine the fair treatment of policyholders.

Management information

- 4.30 In some cases, we have found that management information (MI) given to the senior management of firms with closed books of business is fairly minimal, limited to reports that are required by our rules, such as financial condition reports, reports of the with-profits actuary and, where applicable, reports on realistic solvency positions. Given the lack of comprehensive and timely MI being received by Boards, it is questionable in some instances how far there is adequate focus and challenge to deliver the TCF agenda. One piece of information that is commonly missing is any form of benchmarking data on wider performance issues beyond just charging such as customer service quality, compared with peers. Where we have concerns, we will feed these back to respective firms.
- 4.31 We have also found that some firms do not provide much by way of forward-looking financial projections to their senior management. Without this, it is difficult for firms' governing bodies to have a full understanding of their run-off profile, and to assess the fairness of their investment strategy for a fund.

Legacy knowledge and information

- 4.32 As set out in the Dear CEO letter we sent to life insurers in August 2004, firms should be regularly reviewing contract and marketing literature for their products when determining and reserving for policy benefits to help ensure that TCF is met and that their reserves are adequate. Clearly, firms will not be able to do this properly if their contract libraries lack the necessary information on legacy products.
- 4.33 This is particularly important in light of the number of transactions that are currently taking place in the sector. Given the number of mergers and acquisitions that we see, there is a real danger of increased failure to retain knowledgeable staff and legacy libraries. Similarly in the quest to cut costs and integrate systems through run-off, and in particular as a result of a take-over or through placing contracts with an outsourcer, the ability to access legacy knowledge may be lost or diluted.



- 4.34 Over the past year and more, we have found good – and less good – practices in this area. For example, some firms with rich histories of mergers kept detailed libraries of legacy contracts and marketing material. Firms which retain members of staff from legacy insurers also further strengthen corporate memory.
- 4.35 Other firms are much weaker in this area, having patchy contract libraries and having lost nearly all staff with knowledge of legacy portfolios. Rebuilding libraries and knowledge of past business is a difficult challenge – as once knowledge is lost, it is hard to recreate.



5. *Sale of closed with-profits funds*

- 5.1 The recent arrival of a number of closed fund consolidators has focused attention on our process for considering purchases of insurance firms by new owners – known as ‘changes in control’. In particular some commentators have questioned whether our process for considering changes in control is rigorous enough when closed funds are involved and have asked what measures we take to protect policyholders’ interests.
- 5.2 Our powers to object to a change in control application are set out in Section 186 of FSMA and are reflected in the Handbook in SUP 11.7.5G – 11.7.8G. In practical terms, to approve the transaction, we must be satisfied that:
- i) the purchaser is fit and proper to be a controller of the insurer being acquired;
 - ii) the interests of policyholders would not be threatened; and
 - iii) as part of ii), that the insurer being acquired will continue to meet the threshold conditions for authorisation.
- 5.3 In addition to these two statutory tests, we have the power to impose conditions as part of the change in control. This gives policyholders an additional layer of protection.
- 5.4 The requirements for the proposed acquirer to be fit and proper and for the insurer being acquired to continue to meet our threshold conditions (i.e. i) and iii) above) are ‘absolute’ in the sense that the required standards do not differ between funds. The second test, however, has to be judged in relation to the current position of the fund. In doing this, we take into account, at the very least, the following factors which are considered both individually and in total:
- **financial strength** – whether the purchaser’s plans satisfy us that the fund is at least as strong as under the existing owner. We also need to be satisfied that expected returns to policyholders are not reduced and that the new buyer holds enough capital to allow it to hold sufficiently diverse assets to meet the requirement to treat customers fairly;
 - **financing methods** – whether the means of financing the transaction will increase the likelihood of excessive capital withdrawal from the fund;
 - **governance arrangements** – whether the structures to be put in place provide sufficient independent challenge, experience of managing life funds and measures for policyholder protection;
 - **investment strategy** – whether the new owner intends to change the fund’s exposure to riskier assets and whether this is consistent with treating customers fairly and the firm’s communications with policyholders;

- **customer service** – how the firm plans to interact and communicate with its customers both regarding the sale and on an ongoing basis; and
- **contingent liabilities** – what arrangements the purchaser has made with the vendor for dealing with possible future contingent liabilities (e.g. mis-selling costs) and whether these are robust and sufficient.

5.5 In practice, changes in control involving sales of closed funds to wholly new owners involve extensive and detailed discussions between the purchaser, the target firm and us. Where we consider it necessary – for example, because we have been unable to obtain the information that we need to form a view on the effects of a proposed transaction, or where we feel that proposed communications with policyholders are inadequate – we could use our powers to require the purchaser and/or the target firm to take appropriate steps that we consider appropriate. For example, we could require the target firm to commission a report by a skilled person (under S166 of FSMA) on the effects of the change in control on policyholders. As noted above, we also have the power to impose conditions as part of a change of control. As an ultimate sanction, we would object to a proposed transfer if we were satisfied that any of the tests above were not met.

Consolidation activity

- 5.6 Since 2004, there have been a number of transactions involving closed funds. Among the most significant of these have been:
- **Resolution Life Group** acquiring the life funds of **Royal & Sun Alliance**;
 - **Life Company Investor Group** acquiring the life companies of **HHG** (Pearl Assurance, London Life, National Provident Institution and their subsidiaries including National Provident Life);
 - **Britannic Assurance** acquiring the life funds of **Allianz Cornhill**;
 - **Resolution Life Group** acquiring the **Swiss Life UK Group**;
 - **Britannic Assurance** acquiring **Century Life**; and
 - **Resolution Life Group** and **Britannic Assurance** merging.

Case study: change in control – policyholder protection

In one recent case, conditions attached require the new controllers to maintain a margin of capital above the base regulatory requirements. In addition, we agreed a schedule for any capital release and restrictions determining when dividends could be paid to shareholders, as well as specific corporate governance requirements. Our action means that over two million policyholders will benefit from a more secure capital position.



6. *Implications for consumers*

- 6.1 The previous chapters have focused predominantly on the implications of the new regulatory environment and the impact of wider commercial change for firms. Clearly though, there are major implications for policyholders too. In this chapter we explore some of these in more detail and set out what we are doing to help address these.
- 6.2 Consumers will benefit from the enhanced transparency and disclosure requirements which are central to our new rules on treating with-profits policyholders fairly. As with any long-term financial investment, consumers need to consider at regular intervals whether their with-profits investment continues to meet their needs. This applies regardless of whether their policy is in a closed or open with-profits fund. We recognise though that, despite the improvements we have made, many policyholders still need help to be able to make informed decisions about their with-profits investments.
- 6.3 Anecdotal evidence suggests that difficulties for policyholders are compounded by the fact that few financial advisers are proactively engaging with their customers on this subject. In the absence of professional financial advice given individually, for many policyholders the only source of information and opinion is often through third party commentary in the media. As we stressed in last year's Sector Briefing, generic advice suggesting that closed funds are bad and that open funds are good should be treated with caution, at least until the policyholder has investigated the position more fully. While for some policyholders surrendering a policy would be a reasonable course of action, for others (even others in the same fund) it would not be. This might be the case, for example if a policyholder's policy is nearing maturity; where the life insurance component of the policy was bought at a particular rate which would be lost on surrender; or where there are valuable guarantees written into the terms and conditions.
- 6.4 Because of these complexities and the fact that it is difficult, if not impossible, to give generic advice to policyholders in closed funds (or indeed with-profits more broadly), we have published on our consumer website the questions listed in the box overleaf, together with some of the considerations that should help consumers when thinking about what to do with their with-profits investment.



What should I do now? Ten questions to help you decide

1. What sort of policy do I have?
2. Does the policy still meet my needs?
3. How long have I had the policy and how long is left?
4. What can I expect my policy to be worth if I keep it until it matures?
5. What benefits does my policy have?
6. What could I get if I cashed-in my policy today?
7. Is there any way I can cash-in my policy without the company charging a surrender penalty?
8. If I do cash-in the policy, what should I do with the money?
9. I've received a letter from my insurers saying I can switch to a unit-linked fund – should I?
10. Should I move my money to another insurer?

(www.fsa.gov.uk/consumer/01_WARNINGS/updates/with_profits/questions.html)

- 6.5 What should be absolutely clear from our work in this area is that, from a policyholder perspective, the decision to keep or surrender a with-profits policy should not rest upon whether the fund in question is open or closed to new business. Not only is the distinction between open and closed funds often blurred (as illustrated earlier in this document) but, in addition, there are a range of other, more useful indicators that consumers should take into account.
- 6.6 That said, we do think policyholders have a right to know whether their policy is invested in a closed fund. This is why we introduced our new rules requiring firms to inform their policyholders of the options available to them in the event of closure. Clearly though, this will only affect policyholders in funds that close from now onwards. We also think that it is important information for consumers who have policies in funds that have already closed to new business. It is for this reason that we include in Annex A, a list of insurance companies that have with-profits business, indicating whether their funds are open or closed to new business.
- 6.7 We would strongly recommend that the list is used in conjunction with the '10 Questions' and hope that policyholders and their advisers find this helpful in making appropriately informed decisions about their investments.



7. *Next steps*

For firms

- 7.1 We expect that the senior management of all life insurers with closed with-profit funds to consider carefully the issues raised in this Sector Briefing. In addition we would expect life offices which have, with-profit funds that are ‘nearing’ closure to do so as well. Those with funds that have already closed to new business, or which are nearing closure, will wish to consider in some detail the issues covered in Chapters 4 and 5 as these are the areas on which there is likely to be most supervisory scrutiny and challenge.

For policyholders (and their advisers)

- 7.2 As with any long-term investment product, policyholders should consider at regular intervals whether the product continues to meet their needs. Given the complex nature of with-profits products and the range of reforms and commercial change that this sector has undergone in the recent past, revisiting and reconsidering any with-profits investments should be a priority for consumers. Where possible, consumers should seek financial advice on whether to keep or surrender their policy. But we hope that the information on our consumer website will prove a useful starting point for that decision-making process.

For the FSA

- 7.3 Closed funds and the issues surrounding them will continue to be very high on our agenda: whether in relation to funds that have already closed to new business, funds that are nearing closure, or indeed funds that are about to be acquired by third party consolidators. As with any other sector within the insurance industry, we expect closed funds to be adequately capitalised, soundly managed and to treat their customers fairly. In the coming months, our work – both supervisory and thematic will focus on helping deliver this outcome.



Annex A: List of with-profits firms open and closed to new business

The following list provides details of all life insurance firms at 1 January 2005 with with-profits business that agreed to be included in it. We hope that this list will help policyholders (and their advisers) to make more informed decisions about their with-profits investments. We stress that a policyholder should not, however, make a decision on whether to keep or surrender their policy solely on the status of the fund without considering the position more fully. If policyholders cannot find their firm on this list and want to know that firm's status, we recommend that they contact the firm to seek clarification on whether the fund in which their policy is invested is open or closed to new business.

Where there is only a tick in the closed funds column, this denotes that the insurer's with-profits fund/s is/are closed to new business. Where a tick appears in brackets, this indicates that although the firm has one or more with-profits fund/s that is/are open to new business, there are also one or more with-profits fund/s that is/are closed. Where this is the case funds which are closed are listed in the notes.

Name of with-profits insurer	Status of funds		Notes
	Open	Closed	
Abbey Life Assurance Company Limited		✓	
Alba Life Limited		✓	
Allianz Cornhill Insurance PLC		✓	
Ancient Order of Foresters Friendly Society	✓	(✓)	Tunstall Fund and Pure Endowment funds are both closed to new business
AXA Sun Life plc	✓		
Bradford Insurance Company Limited		✓	
Britannic Assurance Public Limited Company		✓	




Name of with-profits insurer	Status of funds		Notes
	Open	Closed	
British Benefits Friendly Society	✓		
Canada Life Limited		✓	
Century Life plc		✓	
CGNU Life Assurance Limited	✓		
Cirencester Friendly Society Limited	✓		
Clerical Medical Investment Group	✓		
Communication Workers Friendly Society	✓		
Co-operative Insurance Society	✓		
Commercial Union Life Assurance Company Limited	✓		
The Dentists' & General Mutual Benefit Society	✓		
Dentists' Provident Society Limited	✓		
Ecclesiastical Life Limited	✓		
The Equitable Life Assurance Society		✓	
Family Assurance Friendly Society		✓	
Forester Life Limited		✓	
Friends Provident Life and Pensions Limited	✓		Including reinsurance of unitised with-profits policies written by Friends Provident Pensions Limited and Friends Provident Life Assurance Limited



Name of with-profits insurer	Status of funds		Notes
	Open	Closed	
Friends Provident Life Assurance Limited		✓	Closed fund - Contains conventional with-profits policies originally written by NM Life Assurance Limited Unitised with profits Fund – these policies written by NM Life Assurance Limited are wholly reassured into the open Friends Provident Life and Pensions Limited with-profits fund.
GE Pensions Limited		✓	
Guardian Assurance plc		✓	
Healthy Investment (The Rechabite Friendly Society Limited)	✓		
Hearts of Oak Friendly Society Limited		✓	
Homeowners Friendly Society Limited (engage Mutual Assurance)	✓		
The Kensington Friendly Collecting Society Ltd	✓		
Legal & General Life Assurance Society	✓		
Life Insurance Corporation of India	✓		
Lincoln Assurance Limited		✓	
Liverpool Victoria Friendly Society	✓		
Liverpool Victoria Life Company Limited		✓	
London Aberdeen & Northern Mutual Assurance Society Limited		✓	
London Life Limited		✓	



Name of with-profits insurer	Status of funds		Notes
	Open	Closed	
Metropolitan Police Friendly Society	✓		
Marine and General Mutual Life Assurance Society	✓		
Momentum Group Limited		✓	
National Deposit Friendly Society	✓		
National Farmers Union Mutual Insurance Society Limited	✓		
Norwich Union Life & Pensions Limited	✓	(✓)	Provident Mutual fund is closed to new business
Nottingham Oddfellows Assurance Friendly Society Limited	✓		
National Provident Life Limited		✓	
The Original Holloway Friendly Society Limited	✓		
Pearl Assurance Public Limited Company		✓	
Pharmaceutical & General Provident Society Limited	✓	(✓)	Open for Holloway business
Phoenix Assurance Limited		✓	
Phoenix and London Assurance Company Limited		✓	
Phoenix Life & Pensions Limited		✓	
Pioneer Friendly Society Limited	✓		
Police Mutual Assurance Society Limited	✓		
The Prudential Assurance Company Limited	✓	(✓)	Scottish Amicable Insurance Fund is closed to new business



Name of with-profits insurer	Status of funds		Notes
	Open	Closed	
Railway Engineman's Assurance Society Limited	✓		
Rational Shelley Friendly Society Limited		✓	
Reassure UK Life Assurance Company Ltd		✓	
The Red Rose Friendly Society Limited	✓		
Reliance Mutual Insurance Society		✓	Reliance Mutual is closed to new with-profits business but remains open to non-profit business
Royal Liver Assurance Limited	✓		
The Royal London Mutual Insurance Society Limited	✓	(✓)	Scottish Life Fund is closed to new business
Save & Prosper Insurance Limited		✓	
Save & Prosper Pensions Limited		✓	
Scottish Equitable plc	✓	(✓)	The following funds are closed: Traditional With Profits Fund; Unitised With Profits Fund (WP1); Unitised With Profits Fund (WP2); Unitised With Profits Fund (WPB); Unitised With Profits Fund (WPE)
Scottish Friendly Assurance Society Limited	✓	(✓)	Ordinary Business fund is open to new business; Industrial Branch fund is closed to new business
The Scottish Legal Life Assurance Society Limited		✓	
Scottish Mutual Assurance plc		✓	
Scottish Provident Limited		✓	



Name of with-profits insurer	Status of funds		Notes
	Open	Closed	
Scottish Widows plc	✓		
The Shepherds Friendly Society Limited	✓		
Skandia Life Assurance Company Limited		✓	
The Standard Life Assurance Company	✓		
Sun Life Assurance Society plc	✓		
Sun Life Assurance Company of Canada (UK) Ltd		✓	
Swiss Life (UK) plc		✓	
Teachers Provident Society	✓		
Transport Friendly Society Limited	✓		
Tunbridge Wells Equitable Friendly Society Limited (Children's Mutual)	✓		
UIA (Insurance) Ltd		✓	
University Life Assurance Society		✓	
Wesleyan Life Assurance Company Limited	✓	(✓)	Medical Sickness Society Fund is closed to new business
Wiltshire Friendly Society	✓		
Windsor Life Assurance Company Limited	✓		
Winterthur Life UK Limited		✓	
Zurich Assurance Limited		✓	



Reinsured business

The following list includes a number of life insurers that offer/have offered with-profits policies but do not have a with-profits fund themselves, and that reinsure the with-profits business to another insurer/s.

Name of with-profits insurer	Notes
Abbey National Life plc	Reinsured to Scottish Mutual Assurance plc
Countrywide Assured plc	Reinsured to Guardian Assurance Plc
Friends Provident Pensions Limited	Reinsured to Friends Provident Life and Pensions Limited
Halifax Life Limited	Reinsured to Clerical Medical Investment Group
National Westminster Life Assurance Limited	Pension Regular With Profits Fund, Pension Single With Profits Fund and Life Regular With Profits Fund are all 100% reinsured to Clerical Medical Investment Group
Norwich Union Life (RBS) Limited	Reinsured to CGNU Life Assurance Limited; Commerical Union Life Assurance Company Limited; and Norwich Union Life & Pensions Limited
NPI Limited	Reinsured to Pearl Assurance Public Limited Company
Prudential (AN) Limited	Reinsured to The Prudential Assurance Company Ltd
Royal Scottish Assurance plc	Unitised With Profit Fund: life insurance element 100% reinsured to Scottish Equitable plc; pensions element 100% reinsured with Scottish Widows plc
Scottish Mutual Pensions Limited	Reinsured to Scottish Mutual Assurance plc



Annex B: details of new regulatory requirements

Treating with-profits policyholders fairly (PS05/01)

The rules and guidance in PS05/1 which are specific to closed funds are broadly similar to the draft rules and guidance published in CP04/14. However, COB6.12.101G to COB6.12.102G (which contained guidance on the contents of run-off plans) have since been deleted as more detailed guidance has been incorporated in SUP Appendix 2.15²³.

PS05/1 also contains rules and guidance on various aspects of treating with-profits policyholders fairly which apply to both open and closed funds. These include, among other matters:

- the general approach to operating a with-profits fund;
- amounts payable under with-profits policies for maturity payments and surrender payments;
- the approach to smoothing;
- conditions relevant to distributions;
- distribution of any excess surplus;
- charges to a with-profits fund;
- major changes in with-profits funds;
- provision of information and communications to with-profits policyholders; and
- other guidance on the conduct of with-profits business. This includes guidance on investment strategy.²⁴


Policyholder information to be issued on closure to new business

When a firm tells its with-profits policyholders that it has closed a with-profits fund, it should also explain:

- i) why it has closed the fund;
- ii) what changes it has made, or proposes to make, to the fund's investment strategy, if any;

23 These handbook amendments were published in June 2005 in Handbook Notice 45 and were made by the Run-Off Plans for Closed With-Profits Funds Instrument 2005.

24 COB6.12

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- iii) how closure may affect with-profits policyholders, including effects on future bonus prospects;
 - iv) the options available to with-profits policyholders and an indication of the potential costs associated with each of these options; and
 - v) any other material factors that a policyholder may reasonably need to be aware of before deciding how to respond to this information.²⁵

If a firm is not able to provide its with-profits policyholders with all of this information (e.g. because it needs to prepare its run-off plan first), it should explain what is missing and give an estimate of when the outstanding information will be available.

Guidance on run-off plans

Following consultation in CP05/1 (the Quarterly CP published in January 2005), we made new guidance on the contents of a run-off plan.²⁶ This came into force at the same time as the new ‘treating with-profits policyholder fairly’ rules.

The information which firms should set out in a run-off plan includes details of the firm’s strategy for managing the run-off and, in particular:

- details of the expected duration and costs of fully running-off the fund’s liabilities and an explanation of how a solvent run-off will be funded;
- an explanation of its future investment strategy, including any changes it expects to make to as a result of closure;
- details of how it will address any additional operational risks that may flow from the closure of the with-profits fund (including any changes that it proposes to make staffing arrangements for the run-off, an estimate of the cost of proposed operational changes, including redundancy costs, and any material outsourcing arrangements it proposes to enter into);
- an explanation of how the firm anticipates capital will become available for distribution to policyholders (and shareholders where appropriate) and will ensure a full and fair distribution of the closed with-profits fund, including any inherited estate;
- details of any proposed changes to various matters including reinsurance and corporate governance arrangements, charges for costs and guarantees, maturity and surrender target ranges, smoothing policy and the PPFM as a consequence of closure; and
- an explanation of whether the firm will be seeking to expand any other business after closing the with-profits fund.

²⁵ COB6.12.99G

²⁶ Published in June 2005 in Handbook Notice 45 and is set out in SUP Appendix 2.15.



The run-off plan should also include financial projections comprising a forecast revenue account and balance sheet and statement of solvency for the closed fund and a forecast balance sheet and statement of solvency for the firm. These should cover a period of at least three years from the date of closure.

Realistic reporting firms should confirm whether their realistic solvency position is materially different from their last realistic solvency submission to us. If it is materially different, they submit a revised realistic balance sheet and statement of solvency position.

In addition, all firms should confirm whether their latest Individual Capital Assessment (ICA) will be materially affected by the closure and, if it is, send us an appropriately revised ICA. They should also provide details of material intra-group balances and investments in group companies held by the fund and material guarantees given by the firm.



Annex C: Useful publications

Consultation Papers

CP04/14: Treating with-profits policyholders fairly (August 2004)

CP04/11: A basic advice regime for the sale of stakeholder products (June 2004)

CP207: Treating with-profits policyholders fairly (December 2003)

CP202: Insurance regulatory reporting: changes to the publicity available annual return for insurers (September 2003)

CP195: Enhanced capital requirements and individual capital assessments for life insurers (August 2003)

CP191: Miscellaneous amendments to the Handbook (No.0) (July 2003)

CP170: Informing consumers: product disclosure at the point of sale (February 2003)

CP167: With-profits governance, the role of actuaries in life insurers, and certification of insurance returns (January 2003)

CP144: a new regulatory approach to insurance firms' use of financial engineering (July 2002)

Issues Papers

Issue Paper 5: Governance of with-profits funds and the future role of the appointed actuary (March 2002)

Issues Paper 4: Discretion and fairness in with-profits policies (February 2002)

Issues Paper 3: Disclosure to consumers (January 2002)

Issues Paper 2: Regulatory reporting (November 2001)

Issues Paper 1: Process for dealing with attribution of inherited estates (October 2001)

Responses

PS04/16: Integrated Prudential Sourcebook for insurers (July 2004)

PS: With-profits governance and the role of actuaries in life insurers (June 2003)

PS: A new regulatory approach to insurance firms' use of financial engineering – proposed changes to the regulatory returns for life insurers (December 2002)

Feedback Statement on the with-profits review (May 2002)



Feedback Statement: Future role of the actuaries in the governance of life insurers (May 2002)

Public Submissions to the with-profits review

Discussion papers

DP20: Issues for with-profits business arising from the Sandler Review (February 2003)

DP19: Options for regulating the sale of “simplified investment products” (January 2003)

With-profits Review: Open Meeting Discussion Paper (May 2001)

With-profits Review: Summary of open meeting (July 2001)

Sector Briefings

Insurance Sector Briefing: The regulation of closed with-profits funds (September 2004)

Insurance Sector Briefing: Delivering the Tiner Insurance Reforms (April 2005)

Insurance Sector Briefing: Principles & Practices of Financial Management (October 2005)

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