

# Feedback Statement on FSA CP12/13 Solvency II – COBS rule changes

October 2014





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In this Feedback Statement we report on the main conduct issues arising from FSA Consultation Paper 12/13: *Transposition of Solvency II part 2*. We plan to make final rules early next year. The PRA will be handling feedback and making rules in due course on prudential aspects.

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# Abbreviations used in this paper

<b>CF PPFM</b>	Consumer Friendly PPFM
<b>COBS</b>	Conduct of Business sourcebook within the FCA handbook
<b>EEA</b>	European Economic Area
<b>FSA</b>	Financial Services Authority
<b>INSPRU, IPRU(INS), GENPRU</b>	Chapters of the FCA Handbook
<b>ORSA</b>	Own Risk & Solvency Assessment
<b>PRA</b>	Prudential Regulation Authority
<b>PPFM</b>	Principles and Practices of Financial Management
<b>SCR</b>	Solvency Capital Requirement
<b>SOLVENCY II</b>	Solvency II Directive 2009/138/EC. This is an EU Directive that codifies and harmonises the EU insurance regulation to increase the protection of consumers
<b>EIOPA</b>	European Insurance and Occupational Pensions Authority

# 1. Overview

## Introduction

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- 1.1** The paper is to provide feedback on the conduct elements of Chapters 7 and 8 of the Financial Services Authority's (FSA's) CP12/13 *Transposition of Solvency II Part 2*.<sup>1</sup> The Prudential Regulation Authority (PRA) is also publishing a consultation paper (CP22/14) at the same time to set out its approach to the prudential regulation of with-profits business.

The final rules will not be made until early 2015 but a revised version of the draft instrument proposing changes to our rules, which takes into account the comments in this feedback statement is attached in the Appendix. The draft instrument has not yet been considered by, and so is subject to review by, the FCA Board. As such the draft rules in the Appendix represent a working draft. Despite this, we think it useful for firms to see the way that our thinking is developing so that they have an opportunity to comment further to us where appropriate. Further changes may be required before the draft rules are proposed to the FCA Board, for example, as a result of consequential changes from other Solvency II work streams (including relating to INSPRU application provisions) or in light of further comments made to us in response to this feedback.

## Who does this affect?

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- 1.2** The paper will be of primary interest to all insurance firms within the scope of Solvency II. It will also be of some interest to non-directive firms, and otherwise out-of-scope Solvency II firms. It may be also of interest to investment firms, representative trade bodies, business and financial advisers, and consultants.
- 1.3** In particular, as the feedback is primarily about COBS 20 (with-profits business) and COBS 21 (unit-linked business) and related consequential amendments, the feedback statement is of interest to insurance firms writing savings business, where we intend to largely (and where possible) maintain our current protections for policyholders in the Solvency II environment. In the FCA's opinion the impact of the rules on authorised mutual societies will not be significantly different from its impact on other authorised persons.

## Is this of interest to consumers?

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- 1.4** The main objective of insurance regulation is stated in the Solvency II Directive as the adequate protection of policyholders and beneficiaries. Retail and other insurance policyholders with savings business may wish to take note of the general content of this paper.

<sup>1</sup> <http://www.fca.org.uk/your-fca/documents/consultation-papers/fsa-cp1213>

## Context

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- 1.5** The Solvency II Directive is primarily about ensuring adequate protection for policyholders and beneficiaries and is mostly being implemented in the UK by the PRA.
- 1.6** The FSA consulted in June 2013 in its CP12/13 on both prudential and conduct changes that it considered needed to be made for the implementation of Solvency II. Since then, the PRA has been set up to take responsibility for the prudential regulation of insurance companies and the FCA has been given responsibility for conduct regulation.
- 1.7** The PRA published feedback on other parts of FSA CP12/13 in CP16/14<sup>2</sup> in August 2014 and will also be publishing a consultation paper to set out its approach to the prudential regulation of with-profits business at the same time as this paper. The FCA now leads on the significant consequential changes required to the with-profits and unit-linked parts of the COBS sourcebook in the Handbook (COBS 20 and COBS 21).
- 1.8** The FSA also consulted previously in CP11/22 and CP11/23 on other aspects (including prudential issues) arising out of Solvency II. Feedback on the COBS 21 parts was provided in its FS12/2.
- 1.9** The recent Omnibus II agreement in Europe means that Solvency II will need to be transposed into UK rules/regulations by March 2015 and firms will need to comply from 1 January 2016. The PRA is taking the lead in transposing Solvency II into rules, as the majority of the content of Solvency II is prudential in nature, including the levels of risk-based capital that insurance firms are required to hold. However, the FCA leads in transposing a small number of Solvency II articles covering solely or primarily conduct issues, including information provision and permitted links in unit-linked business.
- 1.10** The FCA intends to make all the rule changes it is required to make in connection with Solvency II early in 2015. The changes to the rules will come into force from 1 January 2016.

## Summary of feedback and our response

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- 1.11** Firms were broadly supportive of the proposals outlined in Chapters 7 and 8 on changes to the rules in COBS 20 and 21, although in some areas we have amended our proposals in reaction to feedback received. More generally we have also sought to simplify and clarify the consulted-on rules, some of which are expressly mentioned in the main feedback text. Any comments on the proposals should be made to the email address on Page 4.

## Next steps

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### What do you need to do next?

- 1.12** If your firm is affected by these changes, you will need to ensure that you are taking appropriate steps to prepare for compliance by 1 January 2016 with the rules made to implement the Directive.

### What will we do?

- 1.13** Supervisors will continue to discuss progress towards implementation with insurance firms.
- 1.14** We will continue to liaise with the Treasury and the PRA about implementing the Directive.
- 1.15** We plan to make or amend affected FCA rules in early 2015 to allow for Solvency II implementation by 1 January 2016.

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<sup>2</sup> <http://www.bankofengland.co.uk/pr/Pages/publications/cp/2014/cp1614.aspx>

## 2. Feedback on proposed changes to rules for with-profits business

- 2.1** This chapter provides interim feedback (subject to FCA Board consideration) on the responses received to the proposed changes to Chapter 7 of the FSA CP12/13 on with-profits insurance business.
- 2.2** The PRA will set out in its consultation the prudential approach to regulation of with-profits insurance business.

### Conditions relevant to distributions (COBS 20.2.17-20)

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- 2.3** Existing COBS rules on conditions relevant to distributions<sup>3</sup> stipulate that a firm may not make a distribution unless the whole cost of that distribution can be met without eliminating the regulatory surplus in the with-profits fund. For a *realistic basis life firm* making distributions to persons other than with-profits policyholders, there is an additional requirement that the costs can be met from the excess of realistic value of assets over liabilities. CP12/13 proposed that, for Solvency II firms, these provisions would be replaced by the requirement that no distribution could be made unless the cost could be met without eliminating the 'with-profits fund surplus'. So, for Solvency II firms, distributions could be made if the cost would not eliminate the difference between:
- the value of the assets of the with-profits fund, and
  - the value of technical provisions for policies in the with-profits fund and of other liabilities in the fund
- 2.4** However, this would just be a requirement not to eliminate surplus over and above all 'conduct' liabilities including 'planned enhancements' in the with-profits fund. CP12/13 also proposed a new requirement for Solvency II firms that, following any distribution that relates to 'planned enhancements', (referred to in the then draft SOLPRU 2.4.24G), the firm must be able to demonstrate that it will still be able to hold assets of sufficient value to cover technical provisions and other liabilities within the fund. This was aimed at ensuring that, among other things, there is no 'over distribution' to policyholders in early years at the expense of those maturing later.
- 2.5** The FSA asked in question 3 whether readers agreed with the changes proposed in CP12/13 relating to the conduct rules on distributions.
- 2.6** The focus of the distributions rule is to ensure sustainable distribution practices by firms. In accepting the premise behind this change, several respondents nevertheless raised questions

<sup>3</sup> Distributions are, generally speaking, amounts either paid out in cash or permanently added to individual with-profit policy benefits as described in more detail in new guidance COBS 20.2.16BG and 20.2.16CG.



about its practical implementation. Questions were raised as to the inclusion or not of the risk margin within the scope of the definition of surplus and the relationship of that definition with the concept of surplus funds. Respondents also raised the applicability of the rule to closed funds in deficit and to mutuals.

### Our response

The aim of CP12/13 was to amend the Handbook to make it consistent with the Solvency II regime in light of changes to INSPRU and not, in the main, to introduce changes to policy aims. As such, we wish to continue to ensure that customers in each with-profits fund within a Solvency II firm continue to have their benefit expectations protected. Since the risk margin did not exist in the Solvency I regime, we have concluded that a similar level of expectation may continue to be achieved by excluding the risk margin from the definition of liabilities for the purpose of this rule. We have changed the rules to refer instead to the best estimate component of technical provisions.

Following the PRA's decision not to include the concept of 'planned enhancements' within its Rulebook, we have instead chosen to refer here to 'liabilities arising as a result of a firm's regulatory duty to treat customers fairly (where not already included in technical provisions)'. The point here is to make sure that even where those amounts are treated as not amounting to insurance liabilities for prudential purposes, and are therefore potentially available as surplus funds for prudential purposes under PRA rules, they remain as 'conduct' liabilities for the purposes of COBS 20. We have also expanded the scope of the second limb of the distribution rule COBS 20.2.17CR(2)(b) to include distributions that relate to technical provisions.'

These rules will continue to apply to all relevant firms, including mutuals and firms in run-off, as they do now. The interaction of 'other liabilities' in COBS 20.1A.1 R with the PRA's definition of surplus funds, including the position for closed funds, is covered below in our response to feedback on question 16.

### Requirements relating to distributions of an excess surplus (COBS 20.2.21-22)

- 2.7** The current rule relating to distributions of excess surplus requires firms to evaluate at least annually (or every three years in non-directive friendly societies) whether they have an excess surplus in a particular with-profits fund. If they have an excess surplus, they need to make a distribution if retaining the excess surplus would breach Principle 6.<sup>4</sup>
- 2.8** In CP12/13, the FSA proposed to retain the concept of 'excess surplus' for Solvency II firms, but to replace the concept of 'regulatory surplus' and 'realistic value of assets over liabilities' with surplus of assets over technical provisions and other liabilities. The FSA also proposed to make changes to the references to capital requirements to reflect the requirements in the Solvency II Directive.
- 2.9** Question 4 asked whether readers agreed with the proposal to amend the definition of 'excess surplus' for the purposes of the rule and evidential provision relating to the distribution of excess surplus.
- 2.10** Respondents were broadly supportive of the proposed changes, but some were concerned that this approach might restrict firms from adopting a prudent asset management policy. Two respondents commented that the definition was wide and included contingent resources not

<sup>4</sup> <http://fshandbook.info/FS/html/handbook/PRIN/2/1> – a firm must pay due regards to the interests of its customers and treat them fairly.

held within a with-profits fund. One respondent commented that using the ORSA capital level as a measure is wrong as it is a lower limit, and that the firm's own risk appetite should be used instead. Another questioned whether the reference to notional SCR within the definition would work.

### Our response

The changes to the definition of excess surplus were intended to reflect the fact that certain INSPRU concepts are no longer permitted in the Solvency II regime, rather than a change in policy intentions. We reviewed the options available for Solvency II firms and concluded that the capital requirement of the greater of the SCR and the firm's assessed capital requirement, as reflected in their ORSA, was the closest Solvency II concept to the current basis of the greater of the regulatory capital requirement and the firm's individual capital assessment. The current treatment does include items held in support of, but not within, a with-profits fund. We expect this to continue to apply to both Directive and non-Directive firms following the introduction of Solvency II.

We are unclear as to why respondents feel the proposed approach may restrict firms from adopting a prudent asset management policy. With no change in policy intent, the approach is consistent with the present position.

We do not accept the argument that a firm's own risk appetite should be used instead of the Own Risk and Solvency Assessment (ORSA) capital level, as the two should be compatible. A firm with an excess surplus in a with-profits fund should discuss the situation with the FCA.

Regarding reference to the 'notional SCR' within the definition of excess surplus, we propose to change the wording of paragraph (b)(iii) in the definition of excess surplus. The proposed new text is "... the amount required to meet the higher of *any* notional SCR...", whilst the FSA consulted on using "... the amount required to meet the higher of *the* notional SCR...". We recognise that, in certain cases, a firm may not be required to calculate a notional SCR for a with-profits fund.

### Connected persons (COBS 20.2.32)

- 2.11** In CP12/13, question 5 asked whether the existing rule in COBS 20.2.32R about loans or guarantees to connected persons should be dis-applied for Solvency II firms in relation to loans to connected persons and whether the proposed new guidance should be issued instead for Solvency II firms.
- 2.12** The FSA had stated that granting such a loan using assets contained in the with-profits fund was likely to be regarded as an investment of those assets and therefore covered by provisions implementing Article 132 (the Prudent Person Principle) of the Directive.
- 2.13** The proposed new guidance for Solvency II firms is in relation to loans made using assets in the fund. The guidance is based on the current rule in COBS 20.2.32R(4) and sets out regulatory expectations that any loans would be in the best interests of policyholders in the reasonable opinion of the firm's senior management. This, in our view, is consistent with the provisions implementing the Prudent Person Principle (which require that, in cases of conflict, assets should be invested in the best interests of policyholders and beneficiaries).

- 2.14** Only a few respondents commented on this question and all were at least broadly supportive of this proposal. Some firms commented that the wording had been changed from the loan needing to be ‘beneficial’ to policyholders to in their ‘best interests’, and that ‘best interests’ needs consideration of all possible alternatives, which is impractical.

#### Our response

Use of ‘best interests’ in the new guidance is consistent with wording of the Solvency II Prudent Person Principle (Article 132), which will impose a ‘best interests’ test to the investment of all assets held to cover technical provisions and where there is a conflict of interest. We therefore consider the approach on which the FSA consulted to be appropriate in this context.

### Contingent loans and other support assets (COBS 20.2.33-34)

- 2.15** Support assets are assets held outside a with-profits fund that a firm identifies as being available to fulfil certain fund obligations if necessary or which can be relied on to ‘support’ a more risky investment strategy of the fund. CP12/13 proposed introducing a new rule for Solvency II firms, COBS 20.2.34AR. This requires that the precise terms and conditions on which assets outside a with-profits fund operate, including whether and when repayable, need to be adequately documented, and clearly and unambiguously set out in their Principles & Practises of Financial Management (PPFM), and appropriately described in their consumer-friendly PPFM. In addition, any support assets would actually need to be operated in line with terms and conditions set out in communications to policyholders.
- 2.16** It was also proposed that the current COBS 20.2.34G would continue to apply to all firms. The FSA proposed to make it simpler and more reflective of what happens in practice – so that, in relation to assets outside of a fund being used as support, firms could only manage their with-profits funds taking into account support arrangements that have been formally approved by a court or, for friendly societies, the regulator.
- 2.17** Question 6 asked whether current guidance should be retained, and a new rule introduced on support assets.
- 2.18** Respondents raised concerns over restricting permitted support to arrangements approved by the courts, and also that, in relation to the other changes, the effect of the guidance had been changed. One respondent suggested a distinction be made between conduct concerns that support assets should be recognised in managing a with-profits fund in the interest of with-profits policyholders, and any prudential issues. Respondents also raised concerns over the new rule and whether the terms were sufficiently certain to allow firms to comply (e.g. the reference to terms and conditions being ‘adequately’ documented).

#### Our response

We accept that the proposed simplification to the guidance may have consequences for firms that would be inconsistent with our aim of maintaining the existing FCA conduct policy position (save in so far as changes for Solvency II consistency would be desirable). So we propose to keep the existing guidance, and not amend it in the manner proposed in CP12/13.

As support assets relate to the management of the fund at fund level, not at firm level, and have important conduct implications for policyholders, we

consider that retaining the guidance in its current form for conduct purposes would be consistent with Solvency II requirements (which in the main relate to prudential requirements at firm level). We consider that the main challenge for firms is to be able to clearly describe and document the precise way that support assets operate so that policyholders understand them and factor them into their expectations of how the fund will operate.

We note comments about the proposed rule (COBS 20.2.34AR) and some of the terms used, but we consider that firms should be able to take an outcome-focused view as to what is adequate or appropriate in their particular circumstances, bearing in mind the purpose of this new provision.

### **Other rules and guidance on the conduct of with-profits business (COBS 20.2.35-38)**

- 2.19** In CP12/13, question 7 asked whether rules and guidance that overlap with the Prudent Person Principle should be dis-applied for Solvency II firms and replaced with guidance consistent with the Prudent Person Principle.
- 2.20** The FSA proposed dis-applying (for Solvency II firms) the general guidance in COBS 20.2.35G about what firms should take into account when determining their investment strategy. The FSA also proposed to dis-apply the rule and most of the related guidance on strategic investments.
- 2.21** Strategic investments of a with-profits fund are those beyond the normal range of equities, bonds and property and other similar assets that a with-profits fund may invest in. They may include subsidiaries, head office buildings and other assets whose value may not be readily obtainable and which may not be readily realisable.
- 2.22** The FSA proposed to retain the guidance on reviewing non-profit business, reinsurance and disclosure of decisions on strategic investments for all firms. The FSA also proposed some new guidance cross-referring to the PRA provisions implementing the Solvency II investment requirements.
- 2.23** Respondents were broadly supportive of this proposal and suggested that it was helpful, particularly for mutual firms. One respondent thought that the rule should be in SOLPRU rather than in COBS. Another would have preferred that the wording did not use the ‘best interest of policyholders’ wording from the Prudent Person Principle.
- 2.24** One respondent suggested that COBS 20.2.37G be improved to recognise arrangements where the shareholders bear profits and losses on non-profit business written in a with-profits fund.
- 2.25** Question 8 asked whether the FSA should introduce guidance that the provisions implementing the Prudent Person Principle should be applied to the investment of with-profits assets by reference to their particular circumstances.
- 2.26** Respondents generally thought that the proposals were reasonable, although they did not want us to be super-equivalent (i.e. going beyond the requirements of the Directive).

#### **Our response**

We consider that guidance about investment strategy and the subject of strategic investments within a with-profit fund is a conduct requirement and should remain in COBS. To ensure a consistent approach we consider, however, that it is appropriate to use wording consistent with the Directive’s Prudent Person Principle. The policy position regarding the guidance about non-profit

business in COBS 20.2.37G is unchanged, so we are not proposing to make any change to its wording.

We do not consider that our proposals are super-equivalent to the Prudent Person Principle requirements.

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### **Ceasing to effect new contracts of insurance and run-off plans (COBS 20.2.53-60 and SUP Appendix 2.15)**

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- 2.27** When firms cease to write new contracts of insurance they are required by the COBS rules to produce a run-off plan for critical review by both regulators.
- 2.28** In CP12/13, the FSA proposed to change the details of the information required to be submitted. For Solvency II firms, the main change was to the terminology for the balance sheet and financial projections that form part of the requirements needing to be changed for consistency with the Directive.
- 2.29** Question 9 asked whether the changes to the provisions on ceasing to effect new business should be restricted to those required to align the rules with Solvency II terminology.
- 2.30** The responses received for this question indicated that readers were supportive of this approach although one firm commented that the draft text of SUP App 2.15.8 A assumed that an SCR is calculated and projected for a fund in run-off.
- 2.31** Another firm thought that the run-off plan for a Solvency II with-profits fund should consider the impact of closure on the ORSA.

#### **Our response**

When a firm closes to new business, the FCA will wish to review its Business Plan and financial projections. We have modified the wording to say that what is expected is 'any notional SCR' relating to the with-profits fund so that there is no assumption that one is calculated. We would expect a firm to reconsider its risk profile and its ORSA at, or soon after, the time that it closes to new business.

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### **Distributions (IPRU(INS) Chapter 3)**

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- 2.32** The current rules of IPRU(INS) Chapter 3 relate to the distribution of an established surplus between shareholders and policyholders. In CP12/13, the FSA proposed to replace them with new provisions in COBS 20.2 applying to UK Solvency II firms and European Economic Area firms (EEA firms where the state of commitment is the UK) that give a similar outcome to the provisions in IPRU(INS) 3.3.
- 2.33** If firms wish to change the percentage of the surplus distributed to policyholders, part of IPRU(INS) 3.3(1) sets out the process that they need to adopt. Changes of more than 0.5% currently need to be notified in advance to the FCA and to policyholders in the press.
- 2.34** The FSA reviewed these rules and proposed to maintain the broad policy intent, but to change the methods of advising customers. Instead of notification via publication in the press and the Gazettes, firms will have to notify policyholders individually either before or after the event,

depending on the size of the proposed change. Broadly speaking, where the change is more than 2%, then prior notification of policyholders is required, whereas for changes of between 0.5% and 2% notification to policyholders may be given within a reasonable period after the event. As now, for any change above 0.5%, pre-notification to the FCA is required, though the amount of notice required has increased: one month for a 0.5% change and four months for a change of over 2%.

- 2.35** Question 10 asked whether readers agreed with the proposals to amend the changes in surplus distribution notification requirements.
- 2.36** Respondents were broadly supportive.
- 2.37** One company commented that mutuals could report 100% of payments being made to policyholders but distribute cash benefits to members as allowed in their rules; it thought that prejudged the mutual capital issue (which was consulted on by the FSA in CP12/38<sup>5</sup>). Another company thought that the process was unnecessarily bureaucratic. They wanted a blanket exemption from these rules for mutual firms that, they suggested, should be free to enhance member benefits if their rules permit. Some thought that the calculations should be part of actuarial investigation.
- 2.38** One respondent suggested that this is a prudential requirement which they did not want to see moved into the COBS rulebook. Another firm indicated that they thought that policyholder notifications were inappropriate and onerous.
- 2.39** On the detail of the calculations, one firm asked if they should be based on best estimate figures, or whether the risk margin should be included. Another questioned whether the 'required percentage' rule refers to distributions. They thought that this was wider than the current reference to amounts "allocated to policyholders", and, if that was the case, then that should be made clear. They also questioned whether the comparison with distributions in previous years outlined in COBS 20.2.19CG was still applicable; and, they thought that the guidance in paragraph (1) of COBS 20.2.19CG was unhelpful.
- 2.40** Question 11 asked if readers agreed that IPRU(INS) section 3.5 should be transcribed into COBS 20.
- 2.41** Most respondents agreed that this was appropriate, while others felt that this was a prudential rule that should not be included in COBS. One respondent suggested the rule should be in the rules dealing with prudential requirements.

### Our response

These rules are about the sharing of distributions between with-profits policyholders and others and appear to us to be a conduct issue. If with-profits policyholders are going to receive a markedly lower proportion of surplus than previously, we think that it is appropriate that they be told individually.

As firms thought that the proposed guidance in COBS 20.2.19CG(1) was not helpful, we no longer propose to make that guidance.

The FSA was not prejudging the outcome of the consultation in CP12/38 but simply updating the current conduct rule intent. Feedback on CP12/38 was issued on 28 March 2014 in Policy Statement PS14/5 by the FCA<sup>6</sup> and a Supervisory Statement (SS1/14) was issued by the PRA.<sup>7</sup>

<sup>5</sup> <http://www.fca.org.uk/your-fca/documents/consultation-papers/fsa-cp1238>

<sup>6</sup> <http://www.fca.org.uk/news/ps14-05-response-to-cp12-38>

<sup>7</sup> <http://www.bankofengland.co.uk/pr/Pages/publications/mutualityss114.aspx>

For the calculation detail, we consider that excluding the risk margin is consistent with our approach on distributions mentioned above and the appended rules have been changed to give effect to this. We have also added the requirement that the calculations must be determined by actuarial investigation and made some minor changes to COBS 20.2.19AR(2) and 20.2.19BR(1) in order to carry forward the original policy intention.

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### **Principles and Practices of Financial Management (PPFM; COBS 20.3)**

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- 2.42** COBS 20.3 requires firms to establish and maintain a PPFM and prescribes the scope and content of the PPFM. In CP12/13, the FSA proposed that firms that wish to use support assets should adequately document the precise terms and conditions of their use, describe them clearly and unambiguously in their PPFM, and also mention them in their consumer friendly PPFM.
- 2.43** The FSA asked in question 12 if readers agreed with the proposed changes to COBS 20.3.
- 2.44** Respondents were supportive of our proposals, except for comments by one firm that said it was unclear why non-shareholder support has different disclosure requirements. Another suggested that firms should provide an appropriate level of detail, rather than 'precise' details.

#### **Our response**

We are pleased that respondents were supportive of our plans for clearer disclosure of all support arrangements. We shall be clarifying the rule to make it clear that the requirements apply to both mutual and shareholder support arrangements. We regard it as important that firms document full details of exactly how the support assets operate and so we intend to retain the proposed wording.

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### **Governance and responsibilities for with-profits committees (COBS 20.4 and 20.5)**

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- 2.45** COBS 20.4 contains rules regarding the provision of PPFM, CF PPFM and annual report to policyholders. In CP12/13, the FSA proposed to amend COBS 20.4.4R to set requirements for incoming EEA firms on information they are required to provide to with-profits policyholders that are broadly equivalent to requirements for UK firms.
- 2.46** COBS 20.5 addresses governance requirements and responsibilities for with-profits committees to ensure with-profits policyholders are treated fairly. CP12/13 proposed that the existence and scope of sub-funds and the availability of support assets should be included in the list of issues that the with-profits committee (or alternative governance body) should consider.
- 2.47** In question 13 the FSA asked readers whether they agreed with the proposed amendments to COBS 20.4 and 20.5.
- 2.48** Respondents were broadly supportive of both proposed amendments. One firm queried whether consideration of the existence and scope of sub-funds by the Board would be more appropriate than the with-profits committee. The firm also highlighted the importance of proportionality, stressing the view that firms should not have to recognise funds or sub-funds not previously recognised to avoid complexity and cost. Another respondent queried whether the sub-fund concept will exist at all under Solvency II.



### Our response

We are pleased to see that firms were supportive of our proposals and will be adopting them. We would expect both firms' Boards and their with-profits committees to consider the issue relating to sub-funds, but COBS 20.5 covers the responsibilities of with-profits committees.

With regard to whether the sub-fund concept will exist at all under Solvency II, we do not consider that Solvency II necessarily prohibits sub-funds. However, the existence of sub-funds and whether they constitute a separate with-profits fund may be relevant to the question of whether the fund will be treated as a separate ring-fenced fund under Solvency II. Appropriate categorisation of funds as separate with-profits funds or sub-funds is necessary to ensure fairness.

At the moment the definition of 'with-profits fund' is such that where it is an insurer's usual practice to restrict policyholders' participation in any established surplus to that arising from only a part of the fund, then that part is itself a separate with-profits fund for the purposes of COBS 20.

That concept is carried forward in COBS 20.1A.2R(1)(a), (b) and part of (c), amended to reflect changes brought about by Solvency II. However, COBS 20.1A.2AR also adds a proviso at COBS 20.1A.2R(1)(c) and (d). It says in essence that a restriction on participation to part of the fund must be consistent with, broadly, what policyholders have been told, and treat each category of policyholder fairly.

There is an additional provision in COBS 20.1A.2R(2). It says that regardless of how a firm restricts participation, each part of a with-profits fund constitutes a separate with-profits fund if that is necessary in order to treat each affected category of policyholder fairly. Again firms need to have regard (broadly) to what policyholders were told and the firm's practice.

We continue to consider it appropriate for firms to ensure that they have appropriately identified and categorised any sub-funds, taking into account considerations of fairness and policyholder communications in line with the policyholder protection aims in the recitals in Solvency II. We are not suggesting that we expect that this will result in firms necessarily recognising funds or sub-funds not previously recognised, but we don't rule it out as a possibility. It follows, in our view, that any questions regarding the categorisation of sub-funds should have the appropriate input from the firm's with-profits committee or similar governance arrangement.

See also after 2.69 below.

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### Capital instruments (GENPRU Chapter 2)

- 2.49** GENPRU Chapter 2 currently contains provisions on capital instruments for firms carrying on with-profits insurance business. These conditions set out the treatment of capital instruments regarding the management of with-profits funds, in particular the payment of discretionary benefits consistent with the fair treatment of customers.
- 2.50** In CP12/13 the FSA proposed to make new provisions in COBS 20 for Solvency II firms about their management of the with-profits fund, aimed at achieving the outcome currently provided by GENPRU 2.2.271R(1)-(3).



- 2.51** Question 14 asked whether readers agreed that the proposed new provisions in COBS 20, based on those in GENPRU 2.2.271R(1)-(3), were appropriate.
- 2.52** While most respondents were supportive of this proposal, several respondents did not feel that COBS was an appropriate place for these rules. One respondent felt that the reference to ‘distributions’ in COBS 20.1A.15G(2) may cause confusion with such distributions elsewhere.

#### Our response

We consider that these provisions relate to conduct issues i.e. how the firm manages its with-profits fund at the level of the fund, rather than at firm level (which is what Solvency II is principally concerned with), to ensure fair outcomes for the benefit of the with-profits policyholders. In part at least, firms must manage their with-profits funds to meet representations made to policyholders and treat them fairly in light of their expectations. So, for example, this may mean they have to disregard requirements to make any payments under capital instruments (referred to as distributions in CP12/13). As such, we feel that COBS 20 is the appropriate home for those requirements in future for Solvency II firms. In case the term ‘distributions’ causes confusion we have altered the wording to ‘payments’.

#### Internal contagion risk (INSPRU 1.5)

- 2.53** INSPRU 1.5 contains a number of provisions relevant to the governance and management of with-profits business.
- 2.54** CP12/13 proposed to introduce into COBS 20 new provisions for the operation of with-profits funds currently contained in INSPRU 1.5. These include provisions for separate accounting records for with-profits business, restrictions on the use of with-profits assets and transfer out of with-profits funds, and that financial penalties imposed on proprietary firms must not be paid from the with-profits fund. The proposal also included new rules and guidance on the identification of sub-funds within with-profits funds.
- 2.55** Question 15 asked if readers agreed that the governance and management provisions from INSPRU 1.5 should be converted into new rules in COBS 20 for Solvency II firms for the continued protection of policyholder interests.
- 2.56** While respondents were generally satisfied with the proposals, some felt that the guidance on identification and scope of sub-funds was not reflective of industry practice, and that firms should rely on EIOPA material for guidance on ring-fenced funds. Several respondents felt that requiring each with-profits fund to be treated as a ring-fenced fund was unreasonable, and could force some (sub-)funds to de-risk their assets. Another respondent questioned whether the rules would be better placed within the rules dealing with prudential requirements.

#### Our response:

In light of feedback and in the interest of simplification, we have decided not to make the guidance proposed in COBS 20.1A.3G. However, we will add to the list of considerations set out in COBS 20.1A.2R (which firms have to take account of when determining whether a part of the fund constitutes a separate with-profits fund) to include arrangements approved in court schemes (the proposed guidance had included appropriate consideration of court schemes). We will also amend the proposed rules to clarify that, in both 20.1A.2R(1) and

(2), we are referring here to the question of whether a part of a fund itself amounts to a separate with-profits fund.

This is a conduct requirement and so we consider that it is best placed in COBS 20. The PRA has set out its expectations of firms in respect of the application of ring-fencing requirements in Solvency II to with-profits funds in its supervisory statement SS1/14.

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### **INSPRU 1.1 Assets of a value sufficient to cover technical provisions and other liabilities**

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- 2.57** Current INSPRU rules require a firm to ensure that it has sufficient assets in each with-profits fund, at all times, to cover the liabilities of that fund.
- 2.58** In question 16 the FSA asked if readers agreed that a new rule should be included in COBS 20 to require Solvency II firms to manage their with-profits funds to ensure that assets at least meet liabilities.
- 2.59** Respondents seemed to be broadly supportive of this proposal. A few felt that COBS is not an appropriate place for what they consider to be a prudential rule, while another felt that it was redundant, as the scope was already covered in practice by the Prudent Person Principle. Several respondents questioned the inclusion of the risk margin in the definition of liabilities to be covered.

#### **Our response**

The new rule COBS 20.1A.5R consulted on in CP12/13 intended to capture the substance of the current policy intent within INSPRU 1.1.27R and 1.1.28R. We feel that it is an essential part of the policyholder protection required both by our national specific conduct regime for with-profits business, and because it relates to the management at fund rather than firm level, with consequences for policy benefits and fairness.

The liabilities included in COBS 20.1A.5R should include the best estimate component of technical provisions as well as 'other liabilities', (and so exclude the risk margin). Including the risk margin would not help to achieve the objective of this rule. Solvency II only requires that the risk margin be recognised somewhere within a Solvency II firm, rather than at fund level. Solvency II firms will still be required to calculate and recognise risk margin within their technical provisions calculated for Solvency II purposes.

Exclusion of the risk margin from the rule requiring firms to hold assets sufficient to meet liabilities in each with-profits fund will also provide a consistent treatment of the risk margin within the conduct rules on distributions.

'Other liabilities' for the purposes of COBS 20.1A.5R include liabilities that the FSA regime had previously included in INSPRU as arising out of a firm's regulatory duty to treat its customers fairly, but which are not included in technical provisions. This was reflected in CP 12/13 by the specific inclusion in the proposed COBS 20.1A.1R of 'planned enhancements' as liabilities. This was because of the potential in the prudential rules on surplus funds (in 'SOLPRU 2') for 'planned enhancements' to be treated as not amounting to 'insurance liabilities' in exercise of the national discretion allowed under article 91 of Solvency II (and therefore being available as surplus funds).

As the PRA has moved away from references to ‘planned enhancements’, we have changed the wording in COBS 20.1A.1R accordingly to make clear that we want to include all liabilities that arise from a firm’s regulatory duty to treat customers fairly, though we recognise that some will already be included in firms’ calculations of technical provisions. So this means that what used to be referred to as ‘planned enhancements’ will continue to be treated as ‘conduct liabilities’ for COBS 20. And this is so even if they are treated as not insurance liabilities (and therefore potentially available as surplus funds) for prudential purposes in the PRA rules. This last point is discussed further in rule 3.1 of the PRA Solvency II firms: Surplus Funds Instrument set out in their consultation paper CP16/14 issued in August 2014.

To summarise how FCA “other liabilities” in COBS 20.1A.1R interact with PRA’s formulation of on surplus funds:

- (1) Firms are permitted to distribute amounts treated as surplus funds under the PRA rules, as well as amounts already provided in their best estimate of liabilities. However, they will need to make sure that they comply with the FCA rules on distributions. This means that they will need to ensure that there remains a positive ‘with-profits fund surplus’ calculated in accordance with COBS 20, and are also able to demonstrate that the firm will have sufficient assets to cover all liabilities including ‘conduct’ liabilities.
  - (2) Where there is a closed fund, the expected distributions will be included in both best estimate liabilities and amounts treated as surplus funds under the PRA rules as there is an expectation by us that firms will distribute them all to policyholders over time as the fund runs off. Under the current regime, these funds currently report zero capital in the fund, as assets less liabilities are zero. In practice though for many firms, the ‘planned enhancements’ line on their regulatory returns is treated as de facto capital for the fund, given the loss-absorbing nature of ‘planned enhancements’. Once Solvency II and the PRA rules on surplus come into effect from 1 January 2016, closed funds will be expected to report (non-zero) capital equal to surplus funds as calculated under PRA rules. So the FCA’s new rules will continue to allow closed mutuals to distribute those parts of their assets that are allocated for distribution (e.g. as part of best estimate or the Solvency II equivalent of planned enhancements). However, following the distribution, the assets less liabilities must be greater than zero. Also for distributions in relation to technical provisions or conduct liabilities not included within them (currently ‘planned enhancements’ but part of ‘future discretionary distributions’ under Solvency II), there is an additional rule that says firms must be able to demonstrate that they will be able to continue to have sufficient assets to meet liabilities in the fund as a whole, including all conduct liabilities.
  - (3) Firms should not have a deficit in a with-profits fund because of the rule currently in INSPRU which requires firms to hold assets of a value sufficient to at least cover technical provisions and other liabilities, which we plan to import into COBS 20 apply to Solvency II firms. If a with-profits fund is in deficit, it would not be in a position to make a discretionary distribution. However, firms would need to consider whether, in the light of the deficit, they need to change their estimates of liabilities and expectations of future distributions. If they do so we will require firms to ensure that this is done fairly and in accordance with COBS 20.
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## Handbook glossary – definitions and transitional provision for with-profits funds

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- 2.60** In CP12/13 the FSA proposed amendments to several definitions relating to with-profits business to ensure consistency with other changes made to the FSA Handbook as a result of implementing the Directive. This included definitions for ‘with-profits policy’ and ‘insurance contract’, ‘with-profits fund’, ‘with-profits assets’, and ‘inherited estate’. Some of the changes were needed to reflect the fact that some concepts and definitions (e.g. ‘established surplus’, ‘long-term insurance fund’ amongst others) would not apply in the Solvency II environment.
- 2.61** Question 17 asked readers whether they agreed with the proposals to amend definitions and introduce a transitional provision for with-profits funds. The proposed definitions, including any changes subsequent to CP12/13, are included in the Appendix.

### With-profits policy and insurance contract

- 2.62** A new definition of a with-profits policy is necessary to make it consistent with other changes to the FCA Handbook in light of Solvency II (for example, the removal of the concept of ‘established surplus’). However, the FSA also said it wanted to take the opportunity to clarify certain other points, including the differentiation between unit-linked and with-profits contracts, and that participations expected must not be immaterial and must be made by way of periodic discretionary additions.
- 2.63** Respondents were generally not in favour of the proposed wording for the definition of the with-profits policy, claiming it was in part restrictive, and in part inappropriate in the context of a Solvency II consultation. On the first point, some respondents suggested that the definition appears to include non-profit parts of mixed policies. On the second point, respondents suggested deletion of the terms ‘material’ and ‘periodic’ from the definition.

### Our response

In light of feedback from respondents, we propose to exclude the terms ‘material’ and ‘periodic’ from the definition of with-profits policy. However, we do not feel that deleting these terms changes our policy intent, which is to avoid artificial labelling of non-profit business as with-profits policies by including non-material profit participation and/or participation only when making a claim.

We also propose to remove the phrase ‘at least in part’, from the definition of with-profits policy. This referred to the benefits associated with a contract through eligibility to participate in discretionary distributions.

It was not our intention to include non-profit parts of mixed policies within the definition. Our view continues to be that only an investment in a unitised with-profits fund is with-profits business.

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### With-profits fund

- 2.64** The definition of with-profits fund consulted on in CP12/13 contains an additional requirement that assets described in a firm’s PPFM (or other relevant communications) as available to cover liabilities of the with-profits fund, form part of the with-profits fund even if they are not included in the firm’s accounting for it.
- 2.65** Respondents felt the definition of with-profits fund was lengthy and complicated, and that it did not recognise funds with both with-profits and non-profit business. A number of respondents highlighted that the wording ‘written into’ could be interpreted as excluding transferred business. Some also expressed concern over the treatment of support assets, and questioned whether or not they would be considered part of a with-profits fund.

### Our response

The intention in formulating this definition was in the main to update the current definition to reflect changes arising out of the Solvency II Directive. Consideration was given to replacing the existing definition with a high-level principle, but the FSA felt that this might have led to greater uncertainty. Given the policy preference not to change the scope (subject to any changes necessary to align with policyholder representations), it considered that carrying over the existing concepts applying to long-term funds, tailored just to a with-profits fund, would be more likely to achieve that aim, which is why it takes the form that it does.

That said, we now think there is some scope for simplification and so have removed those provisions that were included for the benefit of doubt. For example:

- the reference in (2)(a)(iii)(C) to ‘any other assets identified by the firm as being available for that purpose’
- the reference in (2)(b)(i) to outgoing for non-profits contracts ‘written using the support of or as an investment of assets in (a) above’, as we consider that the reference to ‘if relevant, [outgoings in respect of] non-profits contracts’ is sufficient, and
- the guidance regarding the inherited estate

We consider that the definition does recognise funds with both with-profits and non-profit business, and (2)(a)(v) and (vi) expressly provide for the inclusion of non-profit business where there is a relevant connection to the with-profits business. However we have simplified (2)(a)(vi) so that receipts and other income from any non-profit business written or transferred into the fund is in scope.

The FSA’s proposal was that assets available only on a contingent event, and where the firm has not restricted availability to with-profits liabilities, would be excluded from the fund. However, in light of responses, we recognise that legitimate arrangements for external support assets may not have both of these characteristics and the terms will vary depending on the relevant court scheme, Board resolution or other arrangement under which they arise.

We plan to revise the definition of this part. This will make clear that support assets are excluded if the firm has clearly and properly identified (in its PPFM if it is required to produce one or other relevant customer-facing documentation) that they are available only in particular circumstances and that they remain outside the with-profits fund. This treatment also needs to be consistent with the firm’s established practice.

In response to the feedback on the wording ‘written into’, whilst this is language currently used in parts of INSPRU, we intend to change the definition to make it clearer that the scope includes policies transferred into a fund.

### With-profits assets

**2.66** The FSA proposed to expand the definition of ‘with-profits assets’ to include both Solvency II firms and non-Solvency II firms, aligning the text with Solvency II terminology where relevant.

**2.67** Some respondents indicated they found the definition overly complex. Several respondents also voiced concern over an inconsistency of including non-profit liabilities in the inherited estate and the exclusion of assets backing the non-profit business from with-profits assets. Two responses suggested a simple definition along the lines of ‘assets which belong to the with-profits fund’.

### Our response

The proposed changes to the definition of ‘with-profits assets’ were intended to ensure consistency with the wider Solvency II regime, rather than a change in policy intentions. In proposing the changes, the FSA set out to avoid any ambiguity for both Solvency II firms and non-Directive firms, in particular by defining ‘with-profits surplus’ (not currently defined), even though this lengthened the definition.

We consider that some simplification is possible from the existing definition and so we propose to refer to ‘the assets in a *with-profits fund* except those meeting liabilities in respect of *non-profit insurance*’. This is consistent with the definition proposed by the PRA in its recently published draft Surplus Funds Instrument in chapter 10 of PRA CP16/14.

We think that the suggestion of ‘assets belonging to the with-profits fund’ begs the question of which assets are considered to belong to the with -profits fund. It also appears to change the scope of the existing definition, which in part is limited to assets that match liabilities in respect of with-profits insurance business, which is defined as the business of effecting or carrying out with-profits insurance contracts.

### Inherited estate

**2.68** The FSA also proposed to extend the definition of ‘inherited estate’ to include both Solvency II firms and non-Solvency II firms, aligning the text with Solvency II terminology where relevant.

**2.69** Some respondents expressed concern over the definition of ‘inherited estate’, in particular its application to mutual insurers. Several respondents questioned whether the definition excludes assets backing non-profit business.

### Our response

The FSA’s intention was to revise the wording so as to make it compatible with Solvency II terminology, rather than alter the scope of the definition. The position regarding mutual insurers is unchanged. The definition is intended to exclude assets backing non-profits business from the inherited estate. Assets backing non-profit business are not with-profits assets. We have amended the definition to clarify this point. Taking these points into account, for Solvency II firms, assuming that non-profit asset and liabilities are equal, the definition of inherited estate becomes the same as ‘with-profits fund surplus’, so we have amended the rules to say this.

### Guidance that with-profits funds give rise to ring-fenced funds

**2.70** In CP12/13 the FSA proposed to include guidance in COBS to communicate the view that with-profits funds and sub-funds should be treated as separate ring-fenced funds under Solvency II.

**2.71** Several respondents questioned whether sub-funds should be treated as separate ring-fenced funds under Solvency II. In their view, such treatment could impose unintended restrictions on funds and prevent cross-fund support. Some firms found the guidance in CP12/13 ambiguous and felt that they should instead rely on ring-fenced fund provisions in the Delegated Acts and/or EIOPA guidelines. Some respondents felt that not all with-profits funds will be ring-fenced funds under Solvency II.

### Our response

We consider that this is principally a PRA issue and so plan to remove the guidance from COBS 20.1A.3G, which said that each with-profits fund will be treated as a separate ring-fenced fund.

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### Rules to collect data on assets and technical provisions for each individual with-profits fund

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- 2.72** CP12/13 outlined the need for rules to specify the reporting to regulators of each item in addition to those included in the standard templates in order to comply with the Directive. The FSA indicated that it intended to propose to require firms to identify separately all of the assets of each with-profits fund, and to report separately the technical provisions of each with-profits fund.
- 2.73** There were no responses about this item.

### Our response

Please refer to PRA publications for information on the detailed items to be included within the National Specific Templates for with-profits business.

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### Transitional Provision TP2.23

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- 2.74** The FSA proposed a one-year Handbook Transitional Provision to the effect that current with-profits funds will be deemed to fall within the new definition from the commencement of Solvency II.
- 2.75** Several respondents said TP2.23 was too restrictive to allow mutuals to separate the with-profits fund from the common fund. Another was in favour of making the transitional provision permanent to allow for indefinite grandfathering.

### Our response

To limit the unintended consequences to firms and policy holders of having the new definition we propose to allow existing with-profits funds at the commencement of Solvency II to be deemed to fall under the new definition permanently, but only if the scope of those funds is consistent with policy holder communications and other relevant considerations set out in the rules and general fair treatment of customers.

We believe that the specific concern of mutual funds in terms of identifying mutual capital has been covered in PS14/5 and SS1/14 from the FCA and PRA respectively.

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### Amendment of existing transitional provision

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- 2.76** The current COBS rules include a Transitional Provision COBS TP2.9 for firms with funds or sub-funds that had been transferred to them under Court Schemes, or transfers approved by regulatory authorities, on or before 20 January 2005. They do not have to comply with certain of the rules introduced on 1 November 2007 where the Schemes are in conflict with COBS 20.
- 2.77** Although there are a significant number of funds affected by TP2.9, the FSA wished to ensure that consumers invested in those funds enjoy similar rights to other with-profits policyholders. To this end, CP12/13 proposed that, if a scheme is brought back to court for any reason (for example, for changes needed in light of Solvency II), the firm should request that the court reviews the continuing appropriateness of their reliance on the transitional provision. Where appropriate, the scheme should be required to become fully compliant with the current rules. The FSA proposed to implement this change from 31 March 2013 ahead of Solvency II implementation.
- 2.78** Question 18 asked whether firms should be required to ask the court to review the appropriateness of their continued reliance on the transitional provision with the regulators when bringing a scheme back to court.
- 2.79** Respondents were not in favour of our proposal. Some felt that this was unnecessary and risked unbalancing contractual arrangements. One respondent indicated that it felt retrospective and inappropriate, and that such a proposal would not form part of the remit of the courts. Another pointed out that a large number of schemes are likely to return to court for reinterpretation for Solvency II, and that our proposed approach could lengthen the time and increase the complexity of a court process, increasing the costs to firms.

#### Our response

In light of responses received, we are not proceeding with this proposal. We consider that we have powers in relation to firms' compliance with Principle 6 that cover the fair treatment of policyholders under Court Schemes, and we may intervene as and when appropriate to protect policyholders' interests when firms take their schemes to court.

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### Cost benefit analysis

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- 2.80** Most proposed changes outlined in this chapter are in light of feedback received on CP12/13, and to further increase the consistency of the rules with Solvency II. As such, the original cost benefit analysis in that CP still stands.



### 3.

## Feedback on proposed changes to unit-linked rules in COBS 21

- 3.1** In CP11/23 *Solvency II and linked long-term insurance business*, the FSA consulted on the majority of the changes to COBS 21 to implement Solvency II. In doing this, our intention was to implement the Directive's new requirements while maintaining an appropriate level of consumer protection. Feedback on that consultation was published in the FSA's FS12/2. Handbook text was not included with FS12/2, but draft rules are appended to this feedback statement and will be put to the FCA Board in early 2015 (these include some small simplification changes).
- 3.2** The FSA was unable to cover in that CP how they proposed to deal with issues related to derivatives, stock lending, and governance because of continuing uncertainty on the likely outcome of work on these areas at an EU level. Chapter 8 of CP12/13 *Transposition of Solvency II Part 2* set out our proposals in these three areas and this chapter summarises the comments received and our response.

#### Derivatives

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- 3.3** The FSA proposed amending COBS 21 rules where derivatives are used for purposes other than efficient portfolio management and reduction of risks. Specially, the FSA proposed guidance referred back to COLL 5.3 requirements that apply when benefits are linked to the performance of derivatives used for investment purposes. These requirements will apply where policyholders and/or beneficiaries are natural persons<sup>8</sup> and bear the direct investment risk of the assets. Where policyholders/beneficiaries are not natural persons, we will be relying on the fact that firms will be subject to the Prudent Persons Principle<sup>9</sup> requirements of the Directive as set out in PRA rules.
- 3.4** The FSA also noted that, where firms continue to use derivatives on the current basis (i.e. for efficient portfolio management or risk reduction) and maintain their existing systems and controls, then they are likely to meet the new requirements and they did not propose to make any new Handbook rules.
- 3.5** Question 21 sought agreement with the proposals for the use of derivatives.
- 3.6** There was broad agreement from respondents, with few comments on this question. One

<sup>8</sup> Natural person means a human being as opposed to a legal construct such as a corporate body

<sup>9</sup> Article 132 of the Directive

respondent said the approach removed an anomaly that unit-linked funds could hold speculative derivatives within a Undertakings for Collective Investment in Transferable Securities (UCITS) structure but not hold the assets directly. Question 22 asked whether firms agreed with our proposals to amend COBS 21 to refer to the requirements of COLL 5.3 where funds using wider investment powers are offered to policyholders and beneficiaries who are natural persons and bear the direct investment risk. This was broadly supported.

#### Our response

Given the unanimous support, we intend to maintain the proposed approach of relying on firms being subject to the Directive requirements set out in PRA rules and any directly applicable Solvency II regulations and will not create additional rules.

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### Stock Lending

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- 3.7** The Directive text is relatively silent on stock lending, but the current detailed rules in INSPRU 3.2.36R will be replaced by PRA rules copying out the high-level requirements of the Directive. The FSA proposed relying on the application of the rules giving effect to the Prudent Person Principle to maintain current practice.
- 3.8** Where the policyholder and/or beneficiary is a natural person and bears the direct investment risk, the FSA proposed adopting rules in COLL 5.4 amended as appropriate. This includes those in COLL 5.4.4R on stock lending requirements and COLL 5.4.6R on the treatment of collateral.
- 3.9** The FSA also proposed importing the conduct requirements in INSPRU 3.2.36AR relating to where assets backing linked benefits are lent. Policyholders and beneficiaries must receive all recompense, less fees and expenses, to maintain this important consumer protection.
- 3.10** Question 23 asked firms if they agreed with our proposals on stock lending.
- 3.11** Question 24 asked whether the proposals maintain the effect of the current level of protection in place in relation to stock lending for policyholders and beneficiaries.
- 3.12** There were few detailed comments to these questions. One respondent said the proposals did not allow collateral to be held by third parties, something the current INSPRU rules allowed and was included within existing COLL rules.

#### Our response

We intend to make the rules as consulted on (apart from several simplification changes) and will address the detailed comments.

We note the current flexibility where firms are able to use third parties to hold collateral which would not be possible in the rules as they were drafted. As this is consistent with the policy approach we consulted on we intend to include this flexibility within the final rules.

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## Governance

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- 3.13** On governance, the PRA has consulted on transposing the governance provisions of the Directive into PRA rules, and these will be supported by implementing measures and guidelines associated with the Directive. The FCA will continue to rely on its existing governance arrangements in addition to these PRA rules.
- 3.14** In question 25 firms were asked if they agreed that the Directive provides appropriate protection for unit-linked policyholders and beneficiaries.
- 3.15** Question 26 asked whether firms agreed with the assessment of the appropriateness of the systems firms have in place. The FSA also queried if they agreed that no further guidance is required.
- 3.16** All respondents agreed with this approach. One respondent separately questioned the lack of FSCS coverage for reinsured assets.

### Our response

Given the unanimous support we intend to maintain the proposed approach and will not create additional rules.

In relation to increasing coverage of the FSCS, the FSA made it clear in FS12/2 that it had no intention of expanding FSCS coverage.

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## Cost benefit analysis

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- 3.17** There are no significant changes to the policy and so the original cost benefit analysis in CP12/13 still stands.

# Annex 1

## List of non-confidential respondents

[This annex lists the non-confidential respondents to FSA's CP12/13. Respondents to CP11/22 and CP11/23 were listed in the Policy Statements issued in 2012.]

Allianz

Association of British Insurers (ABI)

Association of Financial Mutuals (AFM)

Aviva

Co-operative Insurance

Steve Dixon

Ernst & Young

Financial Reporting Council (FRC)

Friends Life

Herbert Smith

Investment and Life Assurance Group (ILAG)

Institute and Faculty of Actuaries

International Underwriting Association

Legal & General (L&G)

Lloyd's

Lloyd's Market Association (LMA)

LV=

Milliman

Oxford Actuaries & Consultants (OAC)

Phoenix

Police Mutual

Reliance Mutual

Matthew Rodhouse

Royal London

Scottish Friendly

Scottish Widows

Sheffield Mutual

Standard Life

Towers Watson

Wesleyan

Zurich

# Appendix 1 (Draft legal instrument)

## SOLVENCY II INSTRUMENT 2015

### Powers exercised

- A. The Financial Conduct Authority makes this instrument in the exercise of the following powers and related provisions in or under the Financial Services and Markets Act 2000 (“the Act”):
- (1) section 137A (General rule-making power);
  - (2) section 137T (General supplementary powers); and
  - (3) section 139A (Power of the FCA to give guidance).
- B. The rule-making powers listed above are specified for the purpose of section 138G(2) (Rule-making instruments) of the Act.

### Commencement

- C. This instrument comes into force on 1 January 2016.

### Amendments to the Handbook

- D. The modules of the FCA’s Handbook of rules and guidance listed in column (1) below are amended in accordance with the Annexes to this instrument listed in column (2) below:

(1)	(2)
Glossary of definitions	Annex A
General Prudential sourcebook for Banks, Building Societies, Insurers and Investment Firms (GENPRU)	Annex B
Prudential sourcebook for Insurers (INSPRU)	Annex C
Amendments to the Interim Prudential sourcebook for Insurers (IPRU(INS))	Annex D
Conduct of Business sourcebook (COBS)	Annex E
Supervision manual (SUP)	Annex F

### Citation

- E. This instrument may be cited as the Solvency II Instrument 2015.

By order of the Board of the Financial Conduct Authority

[ ]

## Annex A

### Amendments to the Glossary of definitions

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

**Note to reader:** Some references in these Glossary definitions are related to, or used in, the proposed version of the PRA Instruments for Solvency II Insurers which have not been made and are subject to change. Also note that these are not the only consequential changes to the Glossary. These changes are included here as most relevant for the purposes of this feedback statement.

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

<i>SCR</i>	means the solvency capital requirement calculated in accordance with the Solvency Capital Requirement – General Provisions; Standard Formula; and Internal Models Parts of the <i>PRA</i> Rulebook Solvency II Firms Instruments.
<i>Solvency II Directive</i>	the Directive of the European Parliament and of the Council of 25 November 2009 on the taking up and pursuit of the business of Insurance and Reinsurance (Solvency II) (No 2009/138/EC).
<i>Solvency II firm</i>	A <i>firm</i> which is any of: <ol style="list-style-type: none"><li>(1) a UK Solvency II firm as defined in section 2 of the <i>PRA</i> Rulebook Solvency II Firms General Application Instrument;</li><li>(2) a third country insurance undertaking, namely an undertaking that would require authorisation as an insurance undertaking in accordance with article 14 of the <i>Solvency II Directive</i> if its head office was situated in the <i>EEA</i>; and</li><li>(3) an undertaking authorised in accordance with a non-UK <i>EEA State's</i> measures which implement article 14 of the <i>Solvency II Directive</i>.</li></ol>
<i>Solvency II Regulations</i>	the directly applicable EU Regulations adopted in accordance with the <i>Solvency II Directive</i>
<i>with-profits fund surplus</i>	The difference between: <ol style="list-style-type: none"><li>(1) the value of the assets of the <i>with-profits fund</i> identified in accordance with <i>COBS</i> 20; and</li><li>(2) the value of the best estimate component of <i>technical provisions</i> in respect of the <i>policies</i> written out of or transferred into that <i>with-profits fund</i> and the value of the other liabilities, including those referred to in <i>COBS</i> 20.1A.1R, in the fund;</li></ol>



calculated in accordance with the *PRA Rulebook Solvency II Firms Instruments (Valuation and Technical Provisions Parts and provision 2 of the Surplus Funds Part)* and applicable parts of the *Solvency II Regulations*, and as determined by *actuarial investigation*.

Amend the following as shown.

*actuarial investigation* (other than in *COBS*) an investigation to which *IPRU-INS* rule 9.4 applies.  
(in *COBS* and *SUP* 4) for a *Solvency II firm*, an investigation having regard to generally accepted actuarial practice, carried out at least once in every 12-month period with advice, as appropriate, from the persons holding the *with-profits actuary function* and the *actuarial function*.

*approved index* in relation to *permitted links*:

- (a) ...
- (aa) a relevant indices meeting the requirements of *COLL 5.2.33R*; or
- ...

*capital instrument* (in *COBS*, *GENPRU*, *BIPRU* and *INSPRU* and in relation to an *undertaking*) any *security* issued by or loan made to that *undertaking* or any other investment in, or external contribution to the capital of, that *undertaking*.

- collateral*
- (1) ...
  - (2) (in *COBS* (except *COBS 21.3*) and *CASS*) any of the following:  
...
  - (3) (in *INSPRU*, *COBS 21.3* and *SYSC*):  
...

- excess surplus*
- (a) a *firm that is not a Solvency II firm* will have an excess surplus in a *with-profits fund* if, and to the extent that:
    - ~~(a)~~ the *regulatory surplus* (or in the case of a *realistic life firm* the (i) *excess of realistic value of assets over realistic value of liabilities*) in that *with-profits fund*; and
    - ~~(b)~~ any other financial resources applied to, or expected to be (ii) applied to, that *with-profits fund*;

exceed

~~(e)~~ the amount required to meet the higher of any regulatory  
(iii) capital requirement or the *firm's individual capital assessment*  
(at the *firm's* own risk appetite) for existing business; and

~~(d)~~ any further amount necessary to support the new business  
(iv) plans of that *with-profits fund*.

(b) a Solvency II firm will have an excess surplus in a with-profits fund if, and to the extent that:

(i) the with-profits fund surplus in that with-profits fund; and

(ii) any other financial resources applied to, or expected to be applied to, that with-profits fund;

exceed

(iii) the amount required to meet the higher of any notional SCR in relation to that with-profits fund and any capital provision determined in relation to the with-profits fund at the firm's own risk appetite, as reflected in the firm's own risk and solvency assessment carried out from time to time as detailed in the PRA Rulebook Solvency II Firms Conditions Governing Business Instrument at provisions 3.6-3.8; and

(iv) any further amount necessary to support the new business plans of that with-profits fund.

*inherited estate*

in relation to each with-profits fund:

(1) for a firm which is not a Solvency II firm, an amount representing the fair market value of the with-profits assets less the realistic value of liabilities of a with-profits fund except liabilities in relation to non-profit insurance business;

(2) for a Solvency II firm means the with-profits fund surplus.

*permitted derivatives contract*

in relation to *permitted links*, a contract involving a *derivative* or *quasi-derivative* that:

(a) (for a Solvency II firm) satisfies COBS 21.3.13R to COBS 21.3.14G, as applied in relation to assets covering liabilities in respect of linked long-term contracts of insurance; and

(b) (for an insurer which is not a Solvency II firm), satisfies INSPRU 3.2.5R to INSPRU 3.2.35AG with the exception of INSPRU 3.2.18R, as applied in relation to assets covering liabilities in respect of linked long-term contracts of insurance.

*permitted*

(a) ~~in respect of a firm's business with institutional linked policyholders~~

*scheme interests*

~~only, any of the following:~~

- ~~(i) a *qualified investor scheme* or its *EEA* equivalent;~~
- ~~(ii) any *unregulated collective investment scheme* that invests only in *permitted links* and publishes its prices regularly;~~
- ~~(iii) any of the interests set out in (b)(i) to (b)(iv); [deleted]~~

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

...

*permitted stock lending*

in relation to *permitted links*, a *stock lending* transaction (including a *repo* transaction) that:

- (a) (for a *Solvency II firm*) satisfies *COBS* 21.3.11R to *COBS* 21.3.12R (inclusive); and
- (b) (for an *insurer* which is not a *Solvency II firm*) satisfies *INSPRU* 3.2.36AR to *INSPRU* 3.2.42G (inclusive).

*technical provision*

for a *firm* which is not a *Solvency II firm*, a technical provision established:

- (a) for *general insurance business*, in accordance with *INSPRU* 1.1.12R; and
- (b) for *long-term insurance business*, in accordance with *INSPRU* 1.1.16R

For a *Solvency II firm*, has the meaning in the *PRA* Rulebook *Solvency II Firms Technical Provisions Instrument*.

*with-profits assets*

~~assets that match liabilities in respect of *with-profits insurance business* or represent a *with-profits surplus* assets in a *with-profits fund*, except those meeting liabilities in respect of *non-profit insurance business*~~

*with-profits fund*

(1) for a *firm* that is not a *Solvency II firm* (except in *INSPRU*):

...

(2) for a *Solvency II firm*:

subject to (c), is comprised of the items in (a) as adjusted to take account of the outgoings in (b):

- (a) (i) *premiums* and other receivables in respect of *with-profits policies*;
- (ii) other receipts of the *with-profits insurance business*

including, but not limited to, tax receipts;

- (iii) (A) assets identified as available to cover its insurance liabilities arising from the *with-profits insurance business* including, but not limited to, as required under *COBS 20.1A.4R*; or where identified in policy documentation or other relevant communications or by virtue of the *firm's* established practice,

but excluding:

- (B) any support assets which the *firm* has clearly and properly identified, in the *PPFM* or other *policyholder* communication, as available only in particular circumstances and as remaining outside the *with-profits fund*, provided that this is consistent with the *firm's* established practice;

- (iv) all income and capital receipts in respect of the items in (a)(i) to (iii);

- (v) assets into which the items in (i) to (iv) have been converted, and

- (vi) *premiums*, receivables, other receipts, income and capital receipts from, and assets identified by the *firm* as available to cover, its insurance liabilities arising out of *non-profits insurance business* falling within (v) or otherwise written or transferred into the *with-profits fund*;

- (b) outgoings:

- (i) outgoings in respect of the *with-profits insurance business* and, if relevant, *non-profits insurance contracts*;

- (ii) transfers made in accordance with *COBS 20.1A.8R*;

- (c) where *COBS 20.1A.2R* applies, each sub-fund identified in accordance with that provision constitutes a separate *with-profits fund*

- (3) for the purposes of *INSPRU*, a *long-term insurance fund* in which *policyholders* are eligible to participate in any *established surplus*.

*with-profits insurance business* the business of *effecting* or carrying out ~~*with-profits insurance contracts*~~ *with-profits policies*.

*with-profits* a contract falling within the ~~*class of long-term insurance business*~~ which is

*policy*

~~eligible to participate in any part of any *established surplus*, a *long-term insurance contract* which provides benefits through eligibility to participate in discretionary distributions based on profits arising from the *firm's* business or from a particular part.~~

## Annex B

### Amendments to the General Prudential sourcebook for Banks, Building Societies, Insurers and Investment Firms (GENPRU)

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

**Note: these are not the only consequential changes to this sourcebook. These changes are included here as most relevant for the purposes of this feedback statement.**

## 2 Capital

### 2.1 Calculation of capital resources requirements

Application

2.1.1 R This section applies to:

...

(2) an *insurer*, unless it is:

...

(e) an *incoming Treaty firm*; or

(f) a *Solvency II firm*.

2.1.2 G ~~The scope of application of this section is not restricted to *firms* that are subject to the relevant *EU Directives*. [deleted]~~

...

### 2.2 Capital resources

Application

2.2.1 R This section applies to:

...

(2) an *insurer* unless it is:

...

(e) an *incoming Treaty firm*; or

(f) a *Solvency II firm*.

...

Other requirements: insurers carrying on with-profits business (Insurer only)

2.2.270 R *GENPRU 2.2.270R to GENPRU 2.2.275G* only apply to an *insurer* falling within *GENPRU 2.2.*

## Annex C

### Amendments to the Prudential sourcebook for Insurers (INSPRU)

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

**Note: these are not the only consequential changes to this sourcebook. These changes are included here as most relevant for the purposes of this feedback statement.**

#### **1 Capital resources requirements and technical provisions for insurance business**

##### **1.1 Application**

1.1.1 R *INSPRU* 1.1 applies to an *insurer* unless it is:

...

(3) an *incoming Treaty firm*; or

(4) a *Solvency II firm*.

...

##### **1.2 Mathematical reserves**

###### Application

1.2.1 R *INSPRU* 1.2 applies to a *long-term insurer* unless it is:

...

(3) an *incoming Treaty firm*; or

(4) a *Solvency II firm*.

...

##### **1.5 Internal-contagion risk**

###### Application

...

1.5.2A R *INSPRU* 1.5 does not apply, to the extent stated, to any *insurer* in (1) to (3):

(1) none of the provisions apply to:

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

(b) *Solvency II firms*; or



(c) firms which qualify for authorisation under Schedule 3 of the Act;

(2) none of the provisions, apart from *INSPRU* 1.5.33R (payment of financial penalties) apply to *firms* which qualify for authorisation under Schedule 3 ~~or 4~~, but not under Schedule 3, of the *Act*;

(3) *INSPRU* 1.5.33R (payment of financial penalties) does not apply to a mutual.

1.5.3 G ~~The scope of application of *INSPRU* 1.5 is not restricted to *firms* that are subject to the relevant *EU* directives. [deleted]~~

...

1.5.30 R (1) A *firm* must apply or use a *long-term insurance asset* only for the purposes of its *long-term insurance business*.

(2) For the purposes of (1), applying or using an asset includes coming under any obligation (even if only contingently) to apply or use that asset.

1.5.31 R A *firm* must not agree to, or allow, any mortgage or charge on its *long-term insurance assets* other than in respect of, and for the purposes of, a *long-term insurance liability*.

### 3 Market risk

#### 3.1 Market risk in insurance

3.1.1 R *INSPRU* 3.1 applies to an *insurer*, unless it is:

...

(3) an *incoming Treaty firm*; or

(4) a *Solvency II firm*.

...

#### 3.2 Derivatives in insurance

3.2.1 R This section applies to an *insurer*, unless it is:

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

(2) an *incoming EEA firm*; or

(3) an *incoming Treaty firm*; or

(4) a *pure reinsurer*; or

(5) a *Solvency II firm*.

3.2.2 G ~~The scope of application of *INSURU* 3.2 is not restricted to *firms* that are subject to the relevant *EU* directives. [deleted]~~

## Annex D

### Amendments to the Interim Prudential sourcebook for Insurers (IPRU(INS))

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

**Note: these are not the only consequential changes to this sourcebook. These changes are included here as most relevant for the purposes of this feedback statement.**

#### Chapter 1

#### APPLICATION RULE

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#### Application

##### Insurers

- 1.1 An *insurer* must comply with *IPRU(INS)* unless it is -
- (a) a *friendly society*<sup>1</sup>; or
  - (b) an *EEA insurer* or an *EEA pure reinsurer* qualifying for authorisation under Schedules 3 or 4 to the Act-; or
  - (c) a *Solvency II firm*.
-

## Annex E

### Amendments to the Conduct of Business sourcebook (COBS)

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

**Note: these are not the only consequential changes to this sourcebook. These changes are included here as most relevant for the purposes of this feedback statement.**

#### 20.1 Application

...

20.1.3 R For an *EEA insurer*:

- (1) (a) the rules and guidance on the with-profits fund (COBS 20.1A); on treating with-profits policyholders fairly (COBS 20.2.1G to COBS 20.2.41G and COBS 20.2.53R to COBS 20.2.60G); and the governance provisions in COBS 20.5 apply only in so far as responsibility for the matter in question has not been reserved to the *firm's Home State regulator* by a European Community an EU instrument;

notwithstanding the above:

(b) COBS 20.2.26AR (financial penalties and the with-profits fund) applies;

(c) the rules and guidance on the notification of policyholders where there is a change in the percentage allocation of distributions (COBS 20.2.19AR to 20.2.19CG) apply but only to the extent that the UK is the state of the commitment;

...

- (3) ~~the rule on providing information to with-profits policyholders who are habitually resident in~~ where the United Kingdom is the state of the commitment (COBS 20.4.4R) and the rule on production and provision of a CFPPFM (COBS 20.4.5R) apply, but the rest of COBS 20.4 (Communications with with-profits policyholders) does not; and
- (4) ~~the rule on production and provision of a CFPPFM (COBS 20.4.5R) applies as if a reference to a firm was a reference to an EEA insurer in relation to any of its with-profits policyholders who are habitually resident in~~ where the state of the commitment is the United Kingdom; and
- (5) references in COBS 20 to a with-profits fund or to terms derived from the Solvency II Directive requiring transposition in the home state, apply as if they were references to the relevant fund or terms

established in accordance with the requirements of the *home state*.

The following section (COBS 20.1A) is all new and is not underlined. Insert this new section after COBS 20.1 as follows.

**20.1A The with-profits fund**

‘Other liabilities’ in the with-profits fund

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

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

Sub funds

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

- (a) identifies particular assets in connection with a particular part of its *with-profits fund*; and
- (b) restricts discretionary additions to *policy* benefits to those arising from the investment or other experience of only that part of the fund,

then, provided that:

- (c) such identification and restriction is consistent with the considerations in (3), and
  - (d) the *firm* treats each affected category of *with-profits policyholder* fairly, having regard to those considerations,
- each such part constitutes a separate *with-profits fund*.
- (2) Notwithstanding (1), each different part of its *with-profits fund* constitutes a separate *with-profits fund* if that is necessary in order to treat each affected category of *with-profits policyholder* fairly, having regard to the considerations in (3).
  - (3) The considerations referred to in (1) and (2) are the terms of the relevant *with-profits policies*; the *firm’s* established practice; its *PPFM* and/or other relevant communications to affected *with-profits*

*policyholders*, and the terms of any arrangement formally approved by a court of competent jurisdiction, *appropriate regulator* or *previous regulator*.

- 20.1A.3 R (1) For a *Solvency II firm* operating a *with-profits fund* prior to 1 January 2016:
- (a) assets in the *with-profits fund* on 31 December 2015 are deemed to be items in a *with-profits fund* for the purposes of *COBS 20* from 1 January 2016, provided that any transfers out of, and any outgoings from, the fund up to 31 December 2015 were made in accordance with, and/or do not as at 31 December 2015, constitute, or continue to constitute, a breach of *INSPRU 1.5.21R* and *1.5.27R*;
  - (b) any assets transferred out of the fund in breach of *INSPRU 1.5.21R* and *1.5.27R* are deemed not to have been transferred out of the fund and remain part of the *with-profits fund*;
  - (c) to the extent that the assets in (b) have also been transferred out of the *firm* then, before (a) can apply to the *firm*, the *firm* must transfer into the *with-profits fund* assets equal to the value of the assets referred to in (b), and of a similar quality, having regard to the *PRA Rulebook Solvency II Firms Investments Instrument*.
- (2) *Firms* to which (1)(a) applies must, in any event, comply with *COBS 20.1A.2R*. (1)(a) does not apply if *COBS 20.1A.2R* requires a *firm* to create or make changes to sub-funds amounting to separate *with-profits funds*.

#### Governance arrangements for the with-profits fund

- 20.1A.4 R A *Solvency II firm* effecting or carrying out *with-profits insurance business* must identify the assets relating to all the business written in, or transferred into, each *with-profits fund* which it is required to hold under *COBS 20.1A.5R*.
- 20.1A.5 R A *Solvency II firm* must ensure that it holds assets in each of its *with-profits funds* of a value at least sufficient to cover the best estimate component of *technical provisions*, and other liabilities in respect of all of the business written in, or transferred into, that *with-profits fund*.
- 20.1A.6 R A *Solvency II firm* must maintain separate accounting records for each of its *with-profits funds*. The accounting records must identify:
- (1) all of the assets of that *with-profits fund*;
  - (2) the best estimate component of *technical provisions* for the *with-profits policies* written in, or transferred into, that *with-profits fund*;

- (3) the best estimate component of *technical provisions* for the *non-profit insurance contracts* written in, or transferred into, that *with-profits fund*;
  - (4) any other liabilities of the *with-profits fund* not covered by (2) or (3), and their value calculated in accordance with PRA Rulebook Solvency II Firms Valuation Instrument and applicable parts of the *Solvency II Regulations*.
- 20.1A.7 G A *Solvency II firm* must ensure that the assets in its *with-profits funds* are separately identified and allocated to the relevant *with-profits fund* at all times. Assets in external accounts (eg with banks, custodians, or brokers) should be segregated in the *firm's* books and records into separate accounts for *with-profits insurance business* and other business. Where a *firm* has more than one *with-profits fund*, separate accounting records must be maintained for each fund. Accounting records should clearly document the allocation.
- 20.1A.8 R A *Solvency II firm* must not transfer assets out of a *with-profits fund* unless:
- (1) the assets represent any part of a *with-profits fund surplus*, or represent assets held in accordance with *COBS 20.1A.5R* in relation to the part of a distribution that has been made which is properly attributable to shareholders, in accordance with *COBS 20*; and
  - (2) no more than three months have passed since the *actuarial investigation* determining that surplus.
- 20.1A.9 G For the purposes of *COBS 20.1.A8R*, an *actuarial investigation* is required to determine any *with-profits fund surplus* for the requirements in *COBS 20* and remains in-date for three months from the date when the determination of the surplus was made. However, even where the investigation is still in-date, the *firm* should not make the transfer unless there is sufficient surplus at the time of the transfer to cover the value of the assets being transferred. The *actuarial investigation* carried out may rely, in part, on any relevant and sufficiently up-to-date valuation exercise carried out for the purposes of calculating *technical provisions* under the *PRA Rulebook Solvency II Firms Technical Provisions Instrument* and applicable parts of the *Solvency II Regulations*, provided that the person carrying out the *actuarial investigation* considers it appropriate to do so.
20. 1A.10 R (1) A *Solvency II firm* must use or apply an asset in a *with-profits fund* only for the purpose of the business in the *with-profits fund*.
- (2) For the purpose of (1), applying or using an asset includes any obligation (even if only contingent) to apply or use that asset.
20. 1A.11 R A *Solvency II firm* must not agree to, or allow, any mortgage or charge on the assets in any of its *with-profits funds*, other than in respect of, and for the purposes of, the business in the *with-profits fund*.

20.1A.12 G References in *COBS 20.1A.10R* and *COBS 20.1A.11R* to ‘the purposes of the business’ in the *with-profits fund* include the payment of claims, expenses and liabilities arising from that business, the acquisition of lawful access to fixed assets to be used in that business and the investment of assets. The payment of liabilities may include repaying a loan but only where that loan was incurred for the purpose of the business written into the *with-profits fund*. The purchase or investment of assets may include an exchange at fair market value of assets (including cash) between the *with-profits fund* and other assets of the *firm*. A *Solvency II firm* may also lend securities held in a *with-profits fund* under a stock lending transaction, or transfer assets as collateral for a stock lending transaction, where the *firm* is the borrower and where such lending or transfer is for the benefit of the business written into the *with-profits fund*.

#### Management of the with-profits fund

- 20.1A.13 R A *Solvency II firm* which is subject to contractual terms providing for payments under a *capital instrument* included in that *insurer's own funds*, must:
- (1) manage any *with-profits fund* so that discretionary benefits under a *with-profits policy* are calculated and paid, disregarding, insofar as is necessary for its *customers* to be treated fairly, any requirements in such contractual terms whether or not they are absolute, contingent or at the discretion of the *firm*; and
  - (2) disclose its intention to manage the *with-profits fund* on the basis set out in (1) in the *firm's PPFM*.
- 20.1A.14 G (1) A *Solvency II firm* is expected to manage its *with-profits fund* so that amounts (whether interest, principal, or other outgoings) payable by the *firm* under a *capital instrument* included in that *insurer's own funds* (as determined in accordance with the *PRA Rulebook Solvency II Firms Own Funds Instrument*) do not impact on the *with-profits fund's* assets or on the *firm's* ability to declare and pay under a *with-profits policy* discretionary benefits that are consistent with the *firm's* obligations under *Principle 6* (Customers' interests).
- (2) A *firm*, other than a *mutual*, should not regard any asset held in the *with-profits fund* as necessarily available to cover payments or other obligations arising under a subordinated loan.
- 20.1A.15 R A *Solvency II firm* must ensure that it has adequate arrangements in place for ensuring that transactions affecting the assets of the *firm* operate fairly between *with-profits policyholders* and other persons interested in the other assets of the *insurer* and, where the *firm* has more than one *with-profits fund*, those transactions operate fairly between the *with-profits policyholders* in each of those funds.

Amend the following provisions as shown.



## 20.2 Treating with-profits policyholders fairly

...

20.2.5 R ...

(3) A *firm* must calculate unsmoothed asset share by:

(a) (i) for a *firm* which is not a *Solvency II firm*, applying the methods in *INSPRU* 1.3.119R to *INSPRU* 1.3.123R;

(ii) for a *firm* which is a *Solvency II firm*, applying the methods in the *PRA Rulebook Solvency II Firms Instruments (Valuation, Technical Provisions and Surplus Funds Parts)* and applicable parts of the *Solvency II Regulations*;

...

...

Conditions relevant to distributions

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

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

...

20.2.17C R A *firm* must not make a distribution from a *with-profits fund*, unless:

(1) if it is not a *Solvency II firm* the whole of the cost of that distribution can be met without eliminating the *regulatory surplus* in that *with-profits fund*; and

(2) if it is a *Solvency II firm*:

- (a) the whole of the cost of that distribution can be met without eliminating the *with-profits fund surplus* in that *with-profits fund*; and
- (b) following any distribution that relates to *technical provisions* or other liabilities the *firm* is able to demonstrate that it reasonably expects to be able to continue to comply with the requirements in *COBS 20.1A.5R (Governance arrangements for the with-profits fund)*.

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

20.2.19 R ...

Notification and other requirements in relation to certain distributions

20.2.19A R If a *firm* which is a *Solvency II firm* proposes to make a distribution from a *with-profits fund* to any person who is not a *with-profits policyholder*, where:

(1) the distribution to *policyholders* is smaller than the ‘pre-notification to *policyholder* minimum’ calculated in accordance with *COBS 20.2.19BR(1)* then the *firm* must:

- (a) provide the *FCA* with written details of the proposed distribution at least four months prior to the proposed distribution, together with copies of draft notifications it proposes to send to *policyholders* to satisfy (b); and
- (b) give affected *policyholders* in the fund at least three months prior written notice stating:
  - (i) that it proposes to make no distribution to them, or
  - (ii) that it proposes to make a distribution of an amount which is smaller than the ‘pre-notification to *policyholder* minimum’, and setting out the amount and how the distribution is calculated; and
  - (iii) the reasons for (i) or (ii) as relevant; or

(2) the distribution to *policyholders* does not meet the test in (1) but is smaller than the ‘after the event notification to *policyholder* minimum’ calculated in accordance with *COBS 20.2.19BR(2)* then

the firm must:

- (a) provide the FCA with written details of the proposed distribution at least one month prior to the proposed distribution together with copies of draft notifications it proposes to send to policyholders to satisfy (b); and
- (b) give affected policyholders in the fund notice of the distribution within a reasonable period from the date of the distribution, setting out the amount of the distribution, how it was calculated and the reasons for the change compared to the last previous distribution.

20.2.19B    R    (1) The ‘pre-notification to policyholder minimum’ referred to in COBS 20.2.19AR is as follows:

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

where

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

b is the amount of the most recent previous distribution to policyholders; and

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

(2) The ‘after the event notification to policyholder minimum’ referred to in 20.2.19AR is as follows:

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

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

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

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

(2) When calculating the amounts distributed in COBS 20.2.19AR and COBS 20.2.19BR:

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

...

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

...

20.2.26 R ...

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

...

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

...

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

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

- (a) such loans comply with the PRA Rulebook Solvency II Firms Investments Instrument having regard to COBS 20.2.35AG; and
- (b) in the reasonable opinion of the *firm's* senior management, they are in the best interests of the *with-profits policyholders* in the relevant *with-profits fund*.

...

### Support arrangements

- 20.2.34A R (1) A Solvency II firm must ensure that, in relation to any arrangements where assets outside a *with-profits fund* provide or may provide support to it, both the following requirements are met:
- (a) the precise terms and conditions on which those support asset arrangements operate and assets may become available, including whether and when they are repayable,
    - (i) are adequately documented in the *firm's* records; and
    - (ii) if the *firm* is required to produce a *PPFM*, are set out clearly and unambiguously in its *PPFM*, and an appropriate description is set out in the *CFPPFM*,
  - (b) the operation of those support asset arrangements is consistent with terms and conditions in communications to *with-profits policyholders* including any *PPFM* and *CFPPFM*.

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

- 20.2.35 G When a *firm*, other than a *Solvency II firm*, determines its investment strategy ...
- 20.2.35A G (1) A Solvency II firm is required to consider its investment strategy in relation to the assets in a *with-profits fund*, including any *strategic investments*, in accordance with the PRA Rulebook Solvency II Firms Investments Instrument. *Firms* are expected, in applying the PRA Rulebook Solvency II Firms Investments Instrument, to take into account the particular circumstances and requirements of the liabilities in the *with-profits fund* to which those assets relate. For example, a *Solvency II firm* will need to consider whether:
- (a) a *strategic investment* meets the criteria in the PRA Rulebook Solvency II Firms Investments Instrument; and
  - (b) that the investment will ensure the quality, security, liquidity of the portfolio of assets of the *firm* as a whole and that the investment(s) are localised to ensure their availability.
- (2) Where there is a conflict of interest (eg, between the *with-profits policyholders* and the *firm*) the *firm* must ensure that the *strategic investment* is made in the best interests of *policyholders*. It is expected that a *Solvency II firm* applying the provisions in PRA Rulebook Solvency II Firms Investments Instrument in this manner will lead to *with-profits policyholders* being treated no less fairly than if the *firm* was not a *Solvency II firm* and was subject to COBS 20.2.35G and COBS 20.2.36R.
- 20.2.36 R A *firm*, other than a *Solvency II firm*, must not:

...

...

20.2.36B G ...

- (2) *A firm should also consider whether making or retaining the ~~investment~~ a strategic investment should be disclosed to with-profits policyholders.*

...

### 20.3 Principles and Practices of Financial Management

...

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

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

...

### 20.4 Communications with with-profits policyholders

...

Requirements on EEA insurers

20.4.4 R *In relation to any with-profits policyholder ~~who is habitually resident in~~ where the member state of the commitment is the United Kingdom, an EEA insurer must:*

- (1) ~~on request~~, provide the information necessary to enable that *policyholder* properly to understand the *insurer's* commitment under the *policy*;
- (2) ensure that the information provided is not narrower in scope or less detailed in content than the ~~equivalent~~ information required to be provided in the PPFM produced by a firm subject to COBS 20.3;

and

...

...

## 20.5 With-profits governance

...

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

...

(2) that the *with-profits committee* or advisory arrangement must:

...

(b) in any event give appropriate consideration to the following non-exhaustive list of specific matters:

...

(ix) the drafting, review, updating of and compliance with run-off plans, court schemes and similar matters; ~~and~~

(x) the costs incurred in operating the *with-profits fund*;

(xi) the identification and extent of the *firm's with-profits funds*, with particular regard to the considerations as to whether a part of the *with-profits fund* constitutes a separate *with-profits fund* in accordance with COBS 20.1A.2R (Sub-funds); and

(xii) the use and purpose of, and terms under which, support assets are available to the *with-profits fund*, having regard to the considerations in COBS 20.2.33G to COBS 20.2.34G and 20.2.34AR.

...

## 21 Permitted Links

### 21.1 Application

21.1.1 R ...

Limit to the application of COBS 21.3

21.1.1A R COBS 21.3 (Further rules for firms engaged in linked long-term insurance business) applies only in respect of linked long-term contracts of insurance where the investment risk is borne by a policyholder who is a natural person.

21.1.2 R ~~The rules in this section do not apply to:~~

- ~~(1) contracts that were effected before 1 July 1994, and under which linked benefits were permitted to be determined before that date;~~
- ~~(2) contracts effected by an insurer that are linked long-term contracts only because the policyholder is eligible to participate in any established surplus;~~
- ~~(3) contracts effected by an EEA insurer that are linked long-term contracts only because the policyholder is eligible to participate in an excess of assets representing the whole or a particular part of the long-term insurance fund over the liabilities, or a particular part of the liabilities, of the insurer as determined by the law of the EEA state in which the head office of the insurer is situated;~~
- ~~(4) [deleted]~~
- ~~(5) contracts effected before 30 June 1995, to the extent that they provide for benefits to be determined by reference to a collective investment scheme that was a listed security immediately before 1 July 1994; and~~
- ~~(6) contracts linked to permitted units that were effected before 1 February 1992, except to the extent that they relate to acts or omissions on or after that date. [deleted]~~

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

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

21.2.1A R An insurer must not contract to provide benefits under linked long-term contracts of insurance that are determined wholly or partly, directly or indirectly, by reference to fluctuations in any index or wholly or partly by reference to the value of, or the income from, or fluctuations in the value of, property other than in accordance with the rules in this section.

21.2.1B G Insurers other than EEA insurers effecting linked long-term contracts of insurance are obliged to comply with the requirements on investments in the PRA Rulebook Solvency II Firms Investments Instrument.

21.2.2 R A firm must ensure that its *linked assets*:

- ~~(1) are capable of being realised in time for it to meet its obligations to~~



*linked policyholders; and*

(2) ~~are matched with its *linked liabilities* as required by the *close matching rules*. [deleted]~~

21.2.3 R ~~A *firm* must ensure that there is no reasonably foreseeable risk that the aggregate value of any of its *linked funds* will become negative. [deleted]~~

21.2.4 R ...

#### Reinsurance

21.2.4A R A *firm* that has entered into a *reinsurance contract* in respect of its *linked long-term insurance business* must nevertheless discharge its responsibilities under its *linked long-term insurance contracts*, as if no *reinsurance contract* had been effected.

21.2.4B G To comply with the requirements of *COBS 21.2.4AR*, a *firm* should:

(1) disclose to *policyholders* the implications of any credit-risk exposure they may face in relation to the solvency of the reinsurer; and

(2) suitably monitor the way the reinsurer manages the business in order to discharge its continuing responsibilities to *policyholders*.

21.2.5 R ~~A *firm* must ensure that its systems and controls and other resources are appropriate for the risks associated with its *linked assets* and *linked liabilities*. [deleted]~~

21.2.6 R (1) ~~A *firm* must ensure when selecting *linked assets* that there is no reasonably foreseeable risk of a conflict of interest with its *linked policyholders*. [deleted]~~

(2) ~~If a conflict does arise, the *firm* must take reasonable steps to ensure that the interests of the *linked policyholders* are safeguarded. [deleted]~~

21.2.7 R ~~In applying the rules in this section, a *firm* must consider the economic effect of its *permitted links* and *linked assets* ahead of their legal form. [deleted]~~

#### Notification to the FCA

21.2.8 R A *firm* must notify the ~~appropriate regulator~~ FCA in writing as soon as it becomes aware of any failure to meet the requirements of ~~this section~~ *COBS 21*, or of the *PRA Rulebook Solvency II Firms Investments Instrument* to the extent applicable to *linked long-term contracts of insurance*.

...

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

Application

21.3.1-A R The rules in this section apply to linked long-term contracts of insurance where the investment risk is borne by a policyholder who is a natural person.

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:

...

(h) ~~approved money market instruments meeting the requirements in COBS 21.3.6R to COBS 21.3.8R;~~

...

(l) *permitted derivatives contracts;*

(3) a firm must classify the types of property listed in (a) to (l) above according to their economic behaviour ahead of their legal form.

...

21.3.3 R ~~A firm that has entered into a reinsurance contract in respect of its linked long-term insurance business must nevertheless discharge its responsibilities under its linked long-term insurance contracts as if no reinsurance contract had been effected. [deleted]~~

21.3.4 G In order to comply with the requirements of COBS 21.3.3 R a firm should:

(1) ~~disclose to policyholders the implications of any credit risk exposure they may face in relation to the solvency of the reinsurer; and~~

(2) ~~suitably monitor the way the reinsurer manages the business in order to discharge its continuing responsibilities to policyholders. [deleted]~~

21.3.5 R (1) ~~Except in the case specified in (2), a firm which proposes to undertake linked long-term insurance business, which is linked to the average earnings index and used for the purposes of orders made by the Department for Work and Pensions under section 148 of the Social Security Administration Act 1992, must notify the FSA in writing of its intention to do so in good time before effecting any such business for the first time, or if there is a material change in the volume of such business, and explain how the risks associated with~~

~~this business will be safely managed. [deleted]~~

- (2) ~~These requirements do not apply in respect of liabilities for which a limited revaluation premium has been paid to the Department for Work and Pensions so that the liability for revaluation, while still linked to orders made under section 148 of the Social Security Administration Act 1992, is limited to 5%. [deleted]~~

The following text is new and is not underlined. Insert provisions after the deleted provision of COBS 21.3.5R

#### Money-market instruments

- 21.3.6 R A *money-market instrument* shall be regarded as normally dealt in on the money market if it:
- (1) has a maturity at issuance of up to, and including, 397 days;
  - (2) has a residual maturity of up to, and including, 397 days;
  - (3) undergoes regular yield adjustments in line with money market conditions at least every 397 days; or
  - (4) undergoes regular yield adjustments in line with money market conditions at least every 397 days.
- 21.3.7 R (1) A *money-market instrument* shall be regarded as liquid if it can be sold at limited cost in an adequately short timeframe.
- (2) A *money-market instrument* shall be regarded as having a value which can be accurately determined at any time if accurate and reliable valuations systems, which fulfil the following criteria, are available:
- (a) enabling the *firm* to calculate a net asset value in accordance with the value at which the instrument held in the portfolio could be exchanged between knowledgeable willing parties in an arm's length transaction; and
  - (b) based either on market data or on valuation models, including systems based on amortised costs.
- (3) A *money-market instrument* that is normally dealt in on the money market and is admitted to, or dealt in, on an *eligible* market shall be presumed to be liquid and have a value which can be accurately determined at any time, unless there is information available to the *firm* that would lead to a different determination.
- 21.3.8 R A *firm* should assess the liquidity of a *money-market instrument* in accordance with *CESR's UCITS eligible assets guidelines*, with respect to

article 4(1) of the *UCITS eligible assets Directive*.

Permitted stock lending transactions

- 21.3.9 R A *permitted stock lending* transaction is one which satisfies the requirements in *COBS* 21.3.11R to *COBS* 21.3.12R
- 21.3.10 G The specific method of *stock lending* permitted is an arrangement of the kind described in section 263B of the Taxation of Chargeable Gains Act 1992, under which the lender transfers *securities* to the borrower other than by way of *sale* and the borrower is to transfer those *securities*, or *securities* of the same type and amount, back to the lender at a later date. In accordance with good market practice, a separate transaction by way of transfer of assets is also involved for the purpose of providing *collateral* to the "lender" to cover him against the risk that the future transfer back of the *securities* may not be satisfactorily completed.

Stock lending: requirements

- 21.3.11 R (1) The *stock lending* arrangement is of the kind described in section 263B of the Taxation of Chargeable Gains Act 1992 (without extension by section 263C), and:
- (a) all the terms of the agreement under which *securities* are to be reacquired by the *firm* for the account of the unit-linked fund are in a form which is acceptable to the *firm* and in accordance with good market practice;
  - (b) the counterparty is:
    - (i) an *authorised person*; or
    - (ii) a *person* authorised by a *Home State regulator*; or
    - (iii) a *person* registered as a broker-dealer with the Securities and Exchange Commission of the United States of America; or
    - (iv) a bank, or a branch of a bank, supervised and authorised to deal in investments as principal, with respect to *OTC derivatives*, by at least one of the following federal banking supervisory authorities of the United States of America:
      - (A) the Office of the Comptroller of the Currency;
      - (B) the Federal Deposit Insurance Corporation;
      - (C) the Board of Governors of the Federal Reserve System; and
      - (D) the Office of Thrift Supervision; and

- (c) *collateral* is obtained to secure the obligation of the counterparty under the terms in (a) and the *collateral* is:
  - (i) acceptable to the *firm*;
  - (ii) adequate; and
  - (iii) sufficiently immediate; and
- (d) for the purposes of *property-linked assets* only:
  - (i) where the *linked policyholder* bears the whole of the risk associated with the *stock lending* transaction, the *linked policyholder* receives the whole of the recompense (net of fees and expenses);
  - (ii) the extent of any risk that the *linked policyholder* bears in relation to the *stock lending* transaction is disclosed to them; and
  - (iii) where the risk associated with the *stock lending* transaction is borne outside the *linked fund*, the *linked fund* receives a fair and reasonable recompense for the use of the *linked policyholders'* funds.
- (2) The counterparty for the purpose of (1) is the *person* who is obliged under the agreement in (1)(a) to transfer to the *firm* the *securities* transferred by the *firm* under the *stock lending* arrangement or *securities* of the same kind.
- (3) COBS 21.3.11R(1)(c) does not apply to a *stock lending* transaction made through Euroclear Bank SA/NV's Securities Lending and Borrowing Programme.

Stock lending: treatment of collateral

- 21.3.12 R (1) *Collateral* is adequate for the purposes of this section only if it is:
- (a) transferred to the *firm* or the *firm's* agent;
  - (b) at least equal in value, at the time of the transfer to the *firm* or its agent, to the value of the *securities* transferred by the *firm*; and
  - (c) in the form of one or more of:
    - (i) cash;
    - (ii) a certificate of *deposit*;

(iii) a letter of *credit*;

(iv) a *readily realisable security*;

(v) commercial paper with no embedded *derivative* content;

(vi) a *qualifying money market fund*.

- (2) *Collateral* is sufficiently immediate for the purposes of this section if:
- (a) it is transferred before or at the time of the transfer of the *securities* by the *firm*; or
  - (b) the *firm* takes reasonable care to determine at the time referred to in (a) that it will be transferred at the latest by the close of business on the *day* of the transfer.
- (3) The *firm* must ensure that the value of the collateral at all times is at least equal to the value of the *securities* transferred by the *firm*.
- (4) The duty in (3) may be regarded as satisfied in respect of *collateral* the validity of which is about to expire, or has expired, where the *firm* takes reasonable care to determine that sufficient *collateral* will be transferred at the latest by the close of business on the *day* of expiry.

#### Requirements for derivative contracts

- 21.3.13 R A *permitted derivatives contract* is one which is effected or issued:
- (a) on or under the rules of a *regulated market*; or
  - (b) off-market with an *approved counterparty*.
- 21.3.14 G *Firms* are also required to comply with the PRA Rulebook Solvency II Firms Investment Instrument and ensure that the use of *derivative* contracts is adequately covered. *Firms* are also referred to the *rules* in COLL 5.3 (Derivative Exposure) in relation to the use of *derivatives* in investment funds and the further guidance from CESR and its successor body, ESMA, which represent good practice in this area.

...

Amend the following provisions as shown.

### Sch 1: Record keeping requirements

...

#### Sch 1.3G

Handbook reference	Subject of record	Contents of record	When record must be made	Retention period
...				
<i>COBS</i> 19.2.3R	...			
<u><i>COBS</i> 20.2.34A R(1)(a)(i)</u>	<u>Support assets outside the <i>with-profits fund</i></u>	<u>Precise terms and conditions on which support assets operate and are available including whether and when they are repayable</u>	<u>when a <i>firm</i> first has support assets outside the <i>with-profits fund</i></u>	<u>Until the <i>firm</i> ceases to use support assets outside the <i>with-profits fund</i></u>
...				

## Sch 2: Notification requirements

### Sch 2.1G

Handbook reference	Matters to be notified	Contents of notification	Trigger event	Time allowed
<u><i>COBS</i> 2.2.19AR(1)</u>	<u>Details of a proposed distribution.</u>	<u>Written details of the proposed distribution, together with copies of draft notifications it proposes to send to <i>policyholders</i>.</u>	<u>The proposed distribution to <i>policyholders</i> is smaller than the ‘pre-notification to <i>policyholder</i> minimum’ calculated in accordance with <i>COBS</i> 20.2.19BR(1).</u>	<u>At least four months prior to the proposed distribution</u>
<u><i>COBS</i> 2.2.19AR(2)</u>	<u>Details of a proposed distribution.</u>	<u>Written details of the proposed distribution, together with copies of draft notifications it proposes to send to <i>policyholders</i>.</u>	<u>The distribution to <i>policyholders</i> does not meet the test in <i>COBS</i> 20.2.19AR(1) but is smaller than the ‘after the event notification to <i>policyholder</i> minimum’ calculated in accordance with <i>COBS</i> 20.2.19BR(2).</u>	<u>At least one month prior to the proposed distribution</u>
<i>COBS</i> 20.2.45R	...			

...				
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## Annex F

### Amendments to the Supervision manual (SUP)

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

**Note: these are not the only consequential changes to this manual. These changes are included here as most relevant for the purposes of this feedback statement.**

#### 4.3 Appointment of actuaries

...

4.3.16A R An *actuary* appointed to perform the *with-profits actuary function* must:

...

- (6) advise the *firm* as to the data and systems that he reasonably considers necessary to be kept and maintained to provide the duties in (5); ~~and~~
- (7) in the case of a *friendly society* to which this section applies, perform the function of appropriate actuary under section 12 (Reinsurance) of the Friendly Societies Act 1992 or section 23A (Reinsurance) of the Friendly Societies Act 1974 as applicable, in respect of those classes of its *with-profits business* covered by his appointment; and
- (8) advise on any *actuarial investigation* required to determine the *with-profits-fund surplus*.

...

#### App 2 Insurers: Regulatory intervention points and run-off plans

...

#### App 2.15 Run-off plans for closed with-profits funds

...

Financial projections

App 2.15.8 G A ~~firm's~~ *firm*, other than a *Solvency II firm*, the *Society* and *managing agents* should include in its run-off plan ~~should include~~:

...

App 2.15.8A      G      Subject to SUP App 2.15.8BG a Solvency II firm, the Society and a managing agent should include in its run off plan:

- (1)      a forecast summary revenue account for the with-profits fund, in accordance with SUP App 2.12.7R;
- (2)      a forecast summary balance sheet and eligible own funds and any notional SCR for the with-profits fund, in accordance with SUP App 2.12.8R; and
- (3)      a forecast summary balance sheet and eligible own funds and MCR and SCR for the entire firm, in accordance with SUP App 2.12.8R and SUP App 2.12.9R;

in each case, for at least a three-year period, beginning on the date of closure.

App 2.15.8B      G      Delegated acts or implementing technical standards may be adopted under article 35(6) and (7) of the Solvency II Directive in relation, among other things, to run-off plans. In that event, Solvency II firms, the Society and managing agents should comply with those acts and standards to the extent that they supersede SUP App 2.15.8AG.

...

App 2.15.11      G      A firm's The run-off plan of a firm to which INSPRU 7 applies should include:

...

Financial Conduct Authority



**PUB REF: 004941**

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