

This article is reproduced with the kind permission of Informa

Back to the start line

FSA rows back to start line on with-profits insurance for mutuals



Andy Tromans, partner, and Samantha Jones, associate
Clyde & Co

On March 7, the UK's Financial Services Authority (FSA) set out its final rules on "protecting with-profits policyholders", almost a year after it published its controversial consultation paper on the subject.

While it is clear nothing the FSA does in this area will satisfy everyone, or perhaps indeed anyone, there is a noticeable feel of back-paddling in the policy statement, particularly in relation to mutual insurers.

One cannot be entirely unsympathetic to the FSA's position, as it sits between on the one hand policyholders and consumer groups that want the FSA to acknowledge a greater policyholder interest than it does, and on the other many firms that still consider the FSA's legal view on the extent of with-profits policyholder interests exaggerates the true extent of these.

The FSA says the approach taken is based on its view the interests of with-profits policyholders is wider than some firms consider it to be and the fair treatment of policyholders requires it to take this broader view of the relationships than can be encapsulated by a legal analysis of the ownership of the firm's assets.

While the controversy surrounding with-profits insurance is far from new, it is the mutual insurance sector that has created the most challenge in finding a resolution with which all parties can live.

Proprietary firms, many of which have been outspoken about the FSA's approach, have nevertheless been able to continue to operate within the regime, albeit with frequent friction with the FSA. The outcome for mutual insurers is somewhat more dramatic.

Mutual insurers often write all

business into a common long-term fund, which comprises both the with-profits fund as well as the firm itself. In simplistic terms, the FSA's position is where a firm is no longer writing sufficient volumes of new business into a with-profits fund, it needs to consider if it should close the fund to new business and start making distributions.

All policyholders of a mutual, whether or not they hold with-profits policies, are usually members and, as such, are the owners of the mutual. The FSA does not attribute much value to these ownership rights. As mutual insurers often only have one fund,

Changes to the Conduct of Business Sourcebook

Many of the FSA's proposals for chapter 20 of its *Conduct of Business Sourcebook* (COBS) were criticised by both the industry and consumer groups, albeit for different reasons. The following are some of the key changes:

- The rule regarding the writing of new business has been tightened, meaning a firm should not write new business into the with-profits fund unless it can demonstrate it is likely to have no adverse effect on with-profits policyholders. This is a shift from the existing approach requiring no material adverse effect;
- Additional guidance has been included as to when a firm may be regarded as having ceased to write material volumes of new business;

- Funds that closed before 2005 must now produce run-off plans;
- The ability of proprietary firms to impose a market value reduction has been reduced;
- The rules relating to the holding of strategic investments in a with-profits fund, such as in another business, have been tightened, including requiring a firm's governing body to satisfy itself it is likely to have no adverse impact on with-profits policyholders and to keep adequate records detailing its strategic purpose; and
- There have been changes to the reattribution process in light of experience.

It is not clear if this marks the start of the FSA changing its position on mutual insurers, although the industry will hope this is the case,

given the consequences of the FSA's position. The FSA's inclusion of guidance on the interests of with-profits policyholders will concern some firms.

This guidance will have a similar status to the FSA's perimeter guidance; it is an expression of the FSA's view but not a statement of the law and only the courts can ultimately make a determination. The regulatory reform programme may change the regulator's position in relation to with-profits, particularly as the Prudential Regulation Authority (PRA) will take the lead in this area.

Only time will tell if this will be a positive change for firms, or if there will be friction between the PRA and Financial Conduct Authority in this area, given their different mandates. ■

In simplistic terms, the FSA's position is where a firm is no longer writing sufficient volumes of new business into a with-profits fund, it needs to consider if it should close the fund

the FSA's position could, ultimately, mean the closure of some mutual insurers entirely.

The sale of with-profits business has been declining for a number of years, proving unpopular with consumers and financial advisers; therefore, this is a very real prospect. Many mutual insurers have long histories with the customers

they serve and the impact of their closure could be significant.

Mutual insurers are limited in how they can raise capital in comparison with companies. The only real sources are from writing profitable business and contributions by members (usually in the form of insurance premiums). This exacerbates the impact of the FSA's position.

The recent policy statement suggests the FSA may not now have the appetite to impose a very broad definition of policyholder interests on with-profits mutuals, but is instead reconsidering whether to look at a number of other factors in its analysis, including the broader consumer interest in having a diverse financial market.

While the FSA has been debating this issue since 2007, it has decided it needs to revisit the issue in a discussion paper either later this year or next. While this shows clear signs of back-paddling from its original position and a reluctance to provide certainty to the industry, this is nevertheless a positive outcome, particularly for mutual insurers.

As a result, the FSA has not proceeded with the majority of rule changes, which would have affected mutual insurers writing with-profits business, and may reconsider the pleas of the industry to take a sensible approach that both reflects the sector's rich and long history and will not adversely affect their members, whether they hold with-profits policies or not. ■



Financial Services Authority: recent policy statement shows the regulator may not pursue its imposition of a broad definition of policyholder interests