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13 February 2012

Dear James

## **CP11/23\*\*\* Solvency II and linked long-term insurance business**

This is the Financial Services Consumer Panel's response to CP11/23\*\*\* Solvency II and linked long-term insurance business.

### **Overview**

The Consultation Paper relates to important technical issues that will have an impact on existing and prospective unit-linked policyholders. With a small number of exceptions set out in our response to specific questions below, we support the approach set out in the Paper. In particular we are pleased to see that the protection provided by COBS 21 extends to members of defined contribution pension schemes.

Firms' compliance with COBS 21 is crucial to protecting policyholders' interests. Non-compliance could have a significant impact on the financial position of individual consumers, as well as on the sector as a whole. We were concerned by the instances of non-compliance in relation to unit-linked business referred to in the Paper where, for example, funds have been invested in non-permitted assets. We agree that poor or inappropriate governance arrangements can be responsible for failings of this type and we strongly encourage the FSA to proceed with additional consultation on improving governance arrangements, in the light of further work currently being carried out by EIOPA.

The cases of non-compliance identified in the Paper also underline the need for effective supervision of firms within this sector – for example, as we have set out below, where firms are investing in unlisted securities, as well as measures to deter this kind of activity in the first place and incentivise good governance. .

## Questions

***Q1: Do you agree with our proposals to delete COBS 21.1.2R? Please provide details of how any existing policies might be adversely affected by the removal of the exemptions in COBS 21.1.2R.***

The Panel does not have access to information about policies in existence where the removal of the exemptions in COBS 21.1.2R (1) to (6) would have an impact. Our understanding is that the exemptions themselves are obsolete and, provided that the FSA is certain that this is the position, we would not object to the removal of the exemptions as proposed. Clearly there is no point in keeping rules that serve no purpose or no longer make sense. We would like the FSA to keep an open mind until the consultation process is complete in case evidence is provided that the exemptions are an integral part of a necessary level of protection for consumers, and that they should therefore be retained. As a further safeguard we would like to see a specific, targeted review conducted after a reasonable period to ensure that no consumer detriment has arisen as a result of the removal of the exemptions.

***Q2: Do you agree with these proposals to amend COBS 21.2?***

Yes, we support these proposals. In particular we agree there is no point in duplicating rules in SOLPRU Chapter 7 within COBS 21.2. and we support the addition of guidance to assist firms. We agree too that the rule in COBS 21.2.1R should be clarified to reflect the requirement that valuation of the permitted links is determined fairly and accurately without materially changing the investment profile of the fund.

***Q3: The only policies not to be subject to the specific requirements of COBS 21.3 because the ultimate beneficiary does not bear the direct investment risk will be those affected on behalf of defined benefit occupational pension schemes. Do you agree?***

Yes, we agree with this analysis and we strongly support the FSA's conclusions. It is particularly important that there is recognition that members of defined contribution pension schemes enjoy the protection provided by COBS 21.3. We would like assurance from the FSA that Additional Voluntary Contributions to defined benefit schemes that take the form of defined contribution investments - ie they buy additional benefits rather than added years - are covered by COBS 21.3.

***Q4: Do you agree with our proposal on approved securities and listed and unlisted securities?***

We are not persuaded that the fact that there has been no significant failure in the past is a sufficiently compelling reason not to impose the UCITS 10% limit on unlisted securities. If the FSA decides to go ahead with its proposal however the requirement that unlisted securities have to be realisable in the short term will be the single most important means of risk mitigation. The regulator will need to monitor firms' compliance with this requirement on a regular and routine basis and be ready to take enforcement action at short notice to protect policyholders' interests if firms make inappropriate investments in these generally higher risk and illiquid assets.

***Q5: Do you have any comments relating to our concerns over land and property? Do you agree with our proposal to maintain the rules relating to investments in land and property?***

The issues relating to land and property are set out in the Paper and we agree that they raise a number of concerns from the policyholder standpoint. Clearly the further consultation on governance proposals will be important, but the fact that the FSA took regulatory action where some funds breached the existing COBS rules relating to property holdings/gearing is indicative also of issues that can arise in relation to the nature of property investment itself, not simply how it is managed. We would like the FSA to give further consideration to whether additional changes or exclusions should be put in place.

***Q6: Do you agree with our proposals on loans, deposits and cash and money-market instruments?***

We fully support the FSA's position that residential backed mortgage securities do not meet the definition of a money market instrument and are not eligible to be used in linked funds. We understand that the term "residential backed mortgage securities" includes buy-to-let mortgages and loans secured against second homes, as well as mortgages secured against a borrower's main residence, but it would be helpful for this to be clarified in the FSA's eventual policy statement. The regulatory position on money-market instruments needs to be made absolutely clear to firms and routinely supervised. We agree also with the proposals on deposits, cash and money-market instruments.

***Q7: Do you agree with our proposals for collective investment schemes and permitted units?***

We agree with the FSA's proposals for collective investment schemes. We have concerns about the risks to policyholders arising from the use of permitted units, particularly around the risk - not covered by the Financial Services Compensation Scheme - that passes to policyholders where reinsurance takes place and there is no 'close matching' as described in the Paper. It is not clear whether the maintenance of the existing COBS rule 21.3.3R provides adequate safeguards for policyholders who are required to carry these rather complicated risks, nor whether the FSA has undertaken any work to establish the effectiveness of disclosure to policyholders and prospective policyholders of this risk and what it means in practical terms. If not already done, this is an area of research that we would like the FSA to take forward.

***Q8: Do you agree with our proposals in relation to index-linked benefits?***

As the Paper points out, investment in index-linked policies is a significant area of consumer interest. We have no objection to the approach set out in the Paper of maintaining the current COBS definition of approved index, but taking account of the wider indices permissible under UCITS and the related exposure limits, subject to overall compliance with the prudent person investment principle.

**Q9: Do you agree with our Diversity Impact Assessment?**

Yes, we agree with the Diversity Impact Assessment.

Yours sincerely

A handwritten signature in black ink that reads "Adam Phillips". The signature is written in a cursive style with a long, sweeping tail on the final letter.

Adam Phillips  
Chair  
Financial Services Consumer Panel