

CP12/38^{★★}

Financial Services Authority

Mutuality and with-profits funds: a way forward

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The Financial Services Authority invites comments on this Consultation Paper. Comments should reach us by 19 March 2013.

Comments may be sent by electronic submission using the form on the FSA's website at: www.fsa.gov.uk/Pages/Library/Policy/CP/2012/cp12-38-response.shtml.

Alternatively, please send comments in writing to:

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A confidential response may be requested from us under the Freedom of Information Act 2000. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the Information Commissioner and the Information Tribunal.

Copies of this Consultation Paper are available to download from our website – www.fsa.gov.uk. Alternatively, paper copies can be obtained by calling the FSA order line: 0845 608 2372.

Abbreviations used in this paper

CBA	Cost benefit analysis
COBS	Conduct of Business sourcebook
CP	Consultation Paper
FCA	Financial Conduct Authority
FSA	Financial Services Authority
FSMA	Financial Services and Markets Act 2000
GENPRU	General Prudential sourcebook
PRA	Prudential Regulation Authority
PS	Policy Statement
SCR	Solvency Capital Requirement
Solvency II	Directive 2009/138/EC
WPRR	With-Profits Regime Review

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Overview

Purpose

- 1.1 The purpose of this Consultation Paper (CP) is to present a change in approach to how our rules on with-profits funds in the Conduct of Business Sourcebook (COBS) affect with-profits mutuals.

Scope

- 1.2 This CP discusses the issues relating to with-profits mutuals. We do not intend any changes to have an effect on proprietary with-profits firms.

Who should read this paper?

- 1.3 This CP is directly relevant to all mutual firms writing new with-profits business or with existing books of with-profits business. With-profits policyholders in mutual with-profits funds, whether or not they are members of the mutual that owns their fund, may find themselves affected. Members of financial services mutuals who are not with-profits policyholders may also find this CP relevant to their interests.

Next steps

- 1.4 This consultation will close on 19 March 2013. We will then finalise the draft guidance in light of the responses to this CP with the intention of publishing a Policy Statement giving feedback next year and is therefore likely to be published by the FCA, in consultation where appropriate with the PRA.

Background

- 1.5** The mutual with-profits sector in the UK life insurance industry has changed radically, both in terms of its scale and the nature of the firms it comprises, over the last 30 years. In 1985¹, the long-term business assets of all the life insurance companies that were themselves mutuals or subsidiaries of mutuals amounted to almost 50% of the industry total. By 2010 that proportion had fallen to under 6%.
- 1.6** In 1985, five of the ten largest UK life insurance companies, and 16 of the largest 30, were mutuals or subsidiaries of mutuals. By 2010, according to market data, there were just two such firms in that top 30 and only three others in the top 50.
- 1.7** In the meantime, firms such as Standard Life, Norwich Union, Scottish Widows and Friends Provident have, with the approval of their members, chosen to change their status and have demutualised. The development of the sector suggests that most members of with-profits mutuals who are offered a suitably incentivised choice have elected to take the tangible demutualisation benefits on offer rather than continuing to exercise the ownership rights they previously enjoyed as members of a mutual. So the challenge for those encouraging diversity in financial services provision is not only to support mutuality as a model of corporate ownership, but to ensure that it has a value that is appreciated by members and other policyholders.
- 1.8** At the end of 2011, SynThesys Life indicated 35 with-profits firms as being mutuals. The seven largest of these held over 85% of the total long-term business assets in the mutual sector. Further consolidation activity since then has seen the biggest firm, Royal London, acquiring another of the larger firms, Royal Liver. With-profits mutuals themselves have just over £50bn of with-profits assets or 15% of total with-profits assets under management.²

The need for further consultation on with-profits mutuals

- 1.9** We have undertaken this further review now in order to respond to the concerns of the mutual with-profits sector which is faced with a decline in new with-profits business with the potential to lead to the closure of these firms as their with-profits funds run off. Firms have told us that some of the current rules and guidance are too prescriptive and so effectively prevent mutual insurers moving beyond their with-profits funds and into new non-profit business, even where firms consider that this would be demonstrably fair to all policyholders and in the interests of their members.
- 1.10** The FSA Handbook currently includes guidance that addresses the position for mutuals by suggesting that firms can bring forward new proposals for continuing to write new non-profit business subject to the agreement of the with-profits policyholders. However we are concerned that this may not take sufficient account of factors such as the particular circumstances of some mutuals whose members are not with-profits policyholders or of the

¹ All figures in this section are derived from SynThesys Life data. 1985 is the first year for which data is shown.

² These figures are based on total assets of all with-profits mutuals, excluding smaller friendly societies with less than £1m of assets under management. The total with-profits assets under management, according to SynThesys Life at end of 2011 was £338bn.

governance provisions of some mutuals' constitutions. In practice firms have told us that the option to produce an alternative arrangement agreed to by the with-profits policyholders is not sufficient to enable them to plan for a future business model without with-profits and the risk remains of having to close to new business and go into run-off. This may not be the best outcome for the firm's policyholders more generally.

- 1.11** A significant amount of analysis has taken place as a result of representations made to us by mutual with-profits firms in recent years and in preparing Consultation Papers and Policy Statements in this area. Our approach to this latest review of our rules and guidance in COBS 20 is based on our over-arching requirement that firms treat their with-profits policyholders fairly. More detail on the regulatory background and recent history of this sector is included at Annex 4 followed by a list of firms for whom the proposals in this paper may be of particular interest.

Future regulation of with-profits

- 1.12** Following the planned move to a twin peaks regulatory approach, both the FCA and the PRA will be involved in the supervision and regulation of with-profits firms. As part of its ongoing assessment of the insurer's financial resources, the PRA will seek to ensure that any discretionary benefit allocations or other changes with financial implications that the insurer has proposed are compatible with its continued safety and soundness. The FCA will have responsibility for monitoring whether the proposed changes are consistent with the insurer's previous communications to policyholders, the FCA's conduct rules and the insurer's overriding obligation to treat customers fairly. The draft FCA/PRA Memorandum of Understanding on With-Profits sets out in greater detail how this will work in practice.³

CONSUMERS

This consultation is relevant to consumers with with-profits policies, to their advisers and consumer groups.

³ Draft Memorandum of Understanding on With-Profits between the FCA and the PRA
www.fsa.gov.uk/about/what/reg_reform/with-profits

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Our proposals

- 2.1 This chapter sets out a new approach and our proposed changes to COBS 20 to address the issues we have seen for mutual with-profits providers.
- 2.2 Our primary objective in our proposals is to ensure that with-profits policyholders and other policyholders within the mutual sector are treated fairly and, in particular, that they are no worse off in terms of policy benefits than their counterparts in proprietary firms. The challenge is to achieve fairness to with-profits policyholders whilst at the same time allowing with-profits mutuals that have a viable business plan to continue to provide other financial products after the run-off of their with-profits business.
- 2.3 The changes we propose are intended to provide a new opportunity for mutual with-profits firms to demonstrate fairness to all policyholders as they continue to write long-term business when their with-profits business is in decline.

Analysis of the issue

- 2.4 The current situation is one in which with-profits mutuals have to deal with the consequences of their current with-profits business maturing more quickly than new policies are being sold. Under our current rules firms in this position have to make arrangements to deliver the value of any expected surplus in the fund to its existing with-profits policyholders. Firms which are not writing a material volume of new with-profits business are required to consider closing to new business in order to go into an orderly run-off that is fair to with-profits policyholders.
- 2.5 However in a with-profits mutual the with-profits policyholders do not represent the sole relevant consumer interest. In such a firm the 'with-profits fund' is not necessarily distinct from the firm as a whole and there is no provision within our rules that recognises the interests of the membership (as opposed to with-profits) interests.

- 2.6** When a proprietary with-profits fund goes into run-off, it does not mean that the firm as a whole has to close down as a consequence. We propose giving mutuals the opportunity to achieve a similar outcome using methods that will be considered on a case-by-case basis.
- 2.7** The intention behind the changes we propose is to enable mutuals in this position to move forward in a way that:
- seeks to ensure, given the various different interests in the assets in the common fund, that with-profits policyholders can be treated fairly while also allowing due weight to be given to the potential unfairness to other policyholders of closing down the mutuals' non-profit business;
 - does not have an effect on the existing position on policyholders' interests in proprietary with-profits funds; and
 - encourages firms to provide new means of sharing in profitable future experience with their members.
- 2.8** We have therefore considered how our approach to with-profits policyholders' interests in the with-profits fund, as set out in the FSA Handbook and in Dear CEO letters, interacts with the rules on the run-off of mutual with-profits funds in particular.
- 2.9** COBS 20 contains the following guidance on policyholders' interests:
- ‘With-profits policyholders have an interest in the whole and in every part of the with-profits fund into which their policies are written and from which the amounts payable in connection with their policies are to be paid. Those amounts include those required to satisfy their contractual rights and such other amounts as the firm is required to pay in order to treat them fairly (including but not limited to the amounts required to satisfy their reasonable expectations).’⁴
- 2.10** This high-level principle then interacts with the associated rules on the run-off of with-profits funds that are no longer writing a material volume of new with-profits business. The outcome is that, for a mutual with-profits provider that operates a single common fund, that fund will be caught up in its entirety by these rules and guidance and it may be unable to continue in business beyond the end of the with-profits run-off.
- 2.11** It may well be that in some cases complete closure is a desirable outcome and it can be one that maximises distributions to with-profits policyholders. But, in a mutual with only a single common fund other interests are also involved and we want to assess whether reforms for the regulation of with-profits should recognise that other outcomes may also be fair.
- 2.12** In particular, we consider that a ‘one-size-fits-all’ approach could be unfair to other stakeholders such as non-profit policyholders and those policyholder members of mutuals who are not with-profits policyholders. These are not new issues. Between April 2007 and late 2010 work was carried out by the FSA and representatives of the mutual with-profits

⁴ COBS 20.2.1 G (2) – <http://fsahandbook.info/FSA/html/handbook/COBS/20/2>

sector which considered these issues at some length under the title of ‘Project Chrysalis’. These issues also arose in 2011 in the responses to CP11/5, but no universal rules-based solution was found that was both consistent with our policy on with-profits policyholders’ interests and enabled those with-profits mutuals that wished to continue in business after the run-off of the with-profits element to be able to do so.

- 2.13** Some mutual with-profits firms have found their own solutions, but many face challenges for which a regulatory solution is still required.
- 2.14** We can broadly divide with-profits mutuals into three groups:
- Mutuals limited by guarantee and private unlimited companies:
 - This first category contains mutuals that fall within the scope of the companies’ acts because they are companies limited by guarantee or private unlimited companies. These can take advantage of the legislation on solvent schemes of arrangement that form part of companies acts legislation, and some mutuals have done this in order to reorganise their business successfully.
 - Friendly societies:
 - The majority of the mutual organisations in scope for this exercise are friendly societies, subject to friendly societies legislation which does not allow for such a scheme and one consequence is that those mutuals cannot reorganise their business in such a way.
 - Other mutuals
 - The third category contains any firms not in the first two, such as an industrial and provident society and a mutual established by special Act of Parliament.

The relative interests of policyholders and members

- 2.15** We start from the view that reaching a view on the extent of with-profits policyholders’ interests in the fund, and about what is fair to with-profits policyholders, involves making a judgement that affects other potential stakeholders in that fund. One of the key points to come out of Project Chrysalis was that, without a court ruling on the extent of different legal interests in each mutual’s common fund, it was impossible to say with certainty exactly how those interests should be attributed as a matter of law. This is one of the reasons why we have yet to achieve the aspiration we set ourselves to ‘enable firms with declining levels of with-profits business to maintain their mutual status and their independence’.⁵
- 2.16** To address this we are proposing a new approach through changes to guidance in COBS 20. This will allow mutuals the opportunity to present proposals to identify within their existing

⁵ www.fsa.gov.uk/static/pubs/ceo/ceo_letter1016.pdf

fund the element that relates specifically to the with-profits policyholders (as opposed to what might be called ‘mutual capital’ or the ‘mutual members’ fund’). These proposals will reflect their own particular structures, origins and other circumstances. The key elements of the proposals are as follows:

- COBS 20 should explicitly recognise the potential for with-profits mutuals with a single common fund to undertake an exercise to separate out the relevant interests into a mutual members’ fund and a with-profits fund. Where the existing rights or interests in the mutual’s common fund are unclear and undetermined, the effect of such an exercise would be to seek to determine fairly to what part of that common fund our conduct regime for the regulation of with-profits business should apply. It would not be a reattribution.
- This will not be dependent on any particular legal view of the respective rights and interests of with-profits policyholders and members. Firms may, but will not necessarily be required to, use available legal processes, for example court sanctioned schemes of arrangement to effect a fair separation. However, where such options are not available or viable in the circumstances of a particular firm, firms will still be able to put forward proposals for effecting a separation which gives a fair outcome for all relevant categories of policyholders, taking all relevant circumstances into account. These proposals will vary from firm to firm and so each proposal will need to be assessed on its merits.
- This separation would principally be given regulatory effect in COBS 20 by an indication that firms may apply for a modification of the relevant regulator’s rules, under the new section 138A of FSMA⁶ (as proposed in the current Financial Services Bill) and subject to meeting the statutory tests. This will affect the definition of a with-profits fund in COBS 20, to narrow its focus to the with-profits element of the firm only, to fit the particular circumstances of that firm.
- Where a modification is granted, our rules in COBS 20 on with-profits business will still apply to the with-profits fund as identified but will not apply to the mutual members’ fund. However, fair treatment of policyholders may still affect the mutual members’ fund in other ways, for example, when considering the role of any mutual members’ funds as support for the with-profits fund. Also, whether it would be appropriate for certain compensation and redress costs to continue to be borne by the with-profits element of the fund as opposed to the mutual members’ fund.
- As part of our new approach certain elements of our existing COBS 20 rules and guidance which might otherwise be seen as prescribing a particular process or standard of evidence we now propose to remove or amend.

⁶ Section 138A as proposed in the draft Financial Services Bill is expected to replace the section 148 of FSMA which currently gives FSA the power to modify or waive FSA rules. If FSA makes the guidance prior to the new provisions in the Bill coming into effect then, depending on the circumstances, it is possible that section 148 of FSMA and the current statutory tests will be relevant though we have not set those out in this paper.

- 2.17** In summary therefore we want to give these firms a new option to enable them to carry on writing new insurance business in the future. Not all firms will wish to apply for this option, but for those that do it gives them a potential route to a future beyond with-profits business. Policyholders should not lose out as a result and these mutuals may not have to face closure simply because they are not selling enough with-profits business.
- 2.18** The proposed changes would offer mutuals operating a single common fund the opportunity to identify the with-profits element of their fund in a way that focuses the regulatory protections of COBS 20 on that element of their common fund. What sits outside that is the mutual members' fund in which the members of the mutual, including any with-profits members, have an interest but to which our with-profits regime will not apply directly. So the interests of with-profits policyholders who are members, and the interests of members other than with-profits policyholders, are likely to be shared in the mutual members' fund.
- 2.19** This identification of what may be termed the 'mutual members' fund' does not affect our view of the extent of interests of with-profits policyholders in the with-profits elements of a mutual's common fund. It therefore has no effect on proprietary companies where, as with mutuals, the interests of with-profits policyholders in the with-profits fund are not in our view limited to smoothed asset share. Where a mutual currently has a single common fund, our proposals recognise that the mutual's equivalent of shareholder capital is mixed in with all the other interests in the fund. Our new approach offers mutuals the option to make proposals to separate those interests in a way that recognises the particularities of that mutual so that with-profits regulations will apply only to the with-profits element of the fund.
- 2.20** While we do not believe that our proposals involve any change in the overall financial position of the firm, firms will need to consider their position carefully, having regard to the ability of the mutual members' fund to meet their solvency requirements.
- 2.21** Looking to the future, each firm subject to the Solvency II Directive will need to ensure it has sufficient own funds to meet its Solvency Capital Requirement (SCR) having regard to the effect of the Solvency II ring-fenced fund regime on the with-profits fund and on the solvency calculations for the firm as a whole. In addition the ability of the firm to continue or expand its writing of new business in the new fund would need to have regard to the risks associated with such business and the capital available.
- 2.22** As part of any process for determining an application to modify COBS 20 provisions relating to the definition of a with-profits fund, the FCA would expect to consult with the PRA in accordance with the draft MoU between the FCA and the PRA.⁷ The PRA would also need to take these matters into consideration for any modifications it is asked to make to COBS 20 provisions which are 'shared' and therefore will also become part of the PRA rulebook.⁸ The PRA may also wish to consider any implications for the ongoing safety and soundness of the firm, including the capital resources and associated capital requirements, following any modification.

⁷ See www.fsa.gov.uk/about/what/reg_reform/mou-fca-pra

⁸ The proposed designation of COBS 20 will be published on the FSA website.

- Q1:** Do you agree with this analysis and do you think its conclusions are fair to with-profits policyholders and sustainable for mutual organisations?

Process for recognising a mutual members' fund

- 2.23** A number of suggestions have been made of ways in which mutuals could identify their 'mutual members' fund'. This has been successfully resolved for one firm through a solvent scheme of arrangement for a mutual company limited by guarantee, which was able to take advantage of the Companies Act procedures to divide its fund with the agreement of its with-profits policyholders. As we have noted, friendly societies legislation does not currently provide the same mechanisms.
- 2.24** Some mutuals have suggested that we should therefore simply change the definition of a with-profits fund to narrow the scope of the rules in COBS 20 for all mutual organisations. Our concern is that this would not satisfactorily address, in each and every case, the extent to which our rules on with-profits business should apply to a mutual's common fund or set in place an adequate process for ensuring that policyholders are treated fairly in a firm's particular circumstances.
- 2.25** We are therefore proposing to implement our approach by allowing firms to apply for a modification under what we expect to become s138A of FSMA⁹ to change the definition of a with-profits fund for that firm as it relates to the relevant rules in COBS 20. This change will remove from the direct application of the rules in COBS 20 whatever is identified through a fair and appropriate process as the mutual members' fund. We expect that if a firm applies for a modification and it is granted, then the mutual members' fund will be regarded for regulatory purposes as separate from the with-profits fund. Mutual organisations would need to demonstrate clearly that the statutory tests expected to be set out in section 138A of FSMA (as proposed in the current draft Financial Services Bill) are met.
- 2.26** The relevant regulator would also need to be satisfied that the statutory tests for a rule modification had been met, namely that complying with the rules, or with the rules as unmodified, would be unduly burdensome or would not achieve the purpose for which the rules were made, and that making this change would not adversely affect the advancement of any of the regulator's objectives. For the FCA the 'objectives' refer to its operational objectives which are: securing an appropriate degree of protection for consumers; promoting effective competition in the interests of consumers in the markets for financial services; and protecting and enhancing the integrity of the UK financial system. For the PRA, the general objective is promoting the safety and soundness of the firms it regulates. In addition, the PRA will have a statutory objective specific to its supervision of insurers: to contribute to the securing of an appropriate degree of protection for those who are or may become policyholders.

⁹ See footnote 6 above.

- 2.27** We also propose to remove the existing guidance for mutuals in COBS 20.2.60G, which says with-profits policyholders should be asked to agree alternative arrangements for carrying on non-profit business after with-profits run-off. We believe it is reasonable to allow firms more flexibility in the process they adopt for identifying mutual capital than having to secure explicit agreement from with-profits policyholders.¹⁰
- 2.28** This is a change from our previous approach. In our September 2010 ‘Dear CEO’ letter we said that our rules currently provide that distributions from a with-profits fund should be made in the required percentage. Without an established practice of using a different split, this is normally at least 90% to policyholders. This allowed firms with a specific past practice that they had communicated clearly and unambiguously to policyholders to demonstrate these practices to us to continue them.
- 2.29** However, evidence we have seen suggests that the majority of mutuals have in fact been making 100% distributions to their with-profits policyholders. Mutuals have disputed that what looks like an ‘established practice’ is in fact what it seems because while all of what is distributed goes to with-profits policyholders, some funds are in practice kept back to serve the wider membership and to provide working capital for the rest of the business. We said that we wanted to see any practice of retaining funds in this way to have been clearly and unambiguously communicated to policyholders in order for firms to be able to rely on it. This is difficult if not impossible for firms to do.
- 2.30** Our proposed new approach potentially enables mutuals to demonstrate retrospectively that they have mutual members’ funds without needing to show that the practice of keeping and not distributing this capital has been clearly communicated to policyholders. What policyholders are told will remain a relevant factor in our consideration of the fairness of any proposals as mutuals will still have to explain and communicate this recognition of mutual members’ funds effectively. We will also encourage firms to make membership of a mutual more meaningful as part of addressing any governance gap in mutual with-profits firms. It is in firms’ interests to demonstrate how they are taking their members with them in establishing their future structure.

Q2: Do you agree with our approach to a proposed process for recognising mutual members’ funds?

Supporting the application process

- 2.31** We propose that this process should be supported by firms obtaining the report of an independent expert, the identity of whom and terms of reference of which are agreed with the FCA (including appropriate consultation with PRA, as relevant) in advance and if

¹⁰ See also 2.33 below.

appropriate include effective pre-consultation with policyholders and other members. This may be effected under existing FSMA procedures (reports by skilled persons).

- 2.32** A key relevant factor will be the individual features of the mutual concerned. We can see that, for example, a mutual fund with sufficient good quality capital and a robust business plan that looks beyond with-profits could make a case for saying that it would be fair to all policyholders for it not to be forced into closure and run-off simply because at some point in time it introduced with-profits policies into its common fund. Not all such funds will be in that position, and some may be better advised to merge or close, in the interests of their policyholders.
- 2.33** We have a statutory objective to protect consumers and this has led us to consider consulting on the basis of requiring firms to seek with-profits policyholder approval for significant changes to how with-profits funds are run. However we have decided not to do so. We acknowledge that such a voting exercise to demonstrate majority approval is expensive for mutuals to run and that there is no source of funds outside the with-profits fund to which they can turn. Also that by keeping the cost of this process down, more capital will be left either for potential future distributions to with-profits policyholders or as mutual members' funds supporting the mutual in writing future new business in the interests of its broader membership.
- 2.34** While some of the mutuals within scope for this exercise are substantial firms with widely recognised businesses, the majority are relatively modest in size and are likely to need a process much more straightforward and less costly than the kind of process envisaged for a reattribution. Even though what we are proposing is not intended to cover reattributions, there are still likely to be issues of significant interest to with-profits policyholders to warrant consideration of an appropriate process for engaging those policyholders in the firm's proposals allowing them the opportunity to influence the outcome. So there is tension between effective engagement and consultation with policyholders and protecting their interests in other ways by keeping costs down, but we will be interested to see firms' own proposals that are appropriate to their individual circumstances.
- 2.35** We envisage that a modification, if granted, will be time limited and therefore capable of being reviewed. However, if granted, a modification should enable mutuals to run off their with-profits business fairly and safely, so we do not anticipate the relevant regulator having to revoke or not renew a modification before that occurs, provided the original justification for granting it continues to hold. As we have stated above, we propose to require firms, as part of the process, to commission a report from an independent expert. We expect the cost of such a report will be proportionate to the scale and complexity of the firm concerned, so that a small mutual with relatively little with-profits business will find the process easier than a larger and more complex mutual with a substantial book of with-profits business. As stated above, the independent expert should be approved by the FCA, including appropriate consultation with the PRA, and we will review their findings as part of the modification process.

2.36 In general there are some high-level principles that we propose to use to guide us in our consideration of any applications from firms. These are as follows:

1. The firm has a convincing and robust business case. What we are proposing is not an alternative to run-off for firms where that would be a better choice for their members.
2. The firm can demonstrate that its proposals are compatible with its obligations to treat policyholders fairly.
3. An independent assessment of the proposals and how they affect policyholders is carried out.
4. With-profits policyholders under the firm's proposals will be no worse off than equivalent with-profits policyholders in a proprietary with-profits fund.
5. The firm has a strategy to ensure that with-profits policyholders and the wider membership of the mutual are appropriately engaged and informed.
6. Safety and soundness issues are identified and addressed appropriately.
7. The rule variation applied for meets the appropriate statutory tests.

Q3: Do you agree with the support elements we are proposing for the process and the principles outlined?

Other issues

- 2.37** There are two further elements of with-profits mutuals that need to be considered. The first is the matter of governance and how that interacts with mutuality. The second is related and concerns future distributions arising from the business funded by the mutual members' fund as opposed to the with-profits element.
- 2.38** We will encourage all with-profits mutuals to review their engagement with their with-profits policyholders and with members in their capacity as owners of the business. In particular we will encourage firms to describe how they have, or how they intend to, address this as part of their proposals if they apply for a modification under section 138A. We think this will have a bearing on the overall fairness of what is proposed and therefore whether we can be satisfied that the statutory tests in section 138A are met.
- 2.39** It is difficult for individual policyholders to hold the managers of the business to account. This is less acute when policyholders have a close connection with the mutual, as in the case of some mutuals linked to certain affinity groups, or those that focus on policyholders within a geographic area. But larger mutuals with a national spread, a more diffuse membership or a broader range of businesses will need in particular to consider how to make membership more meaningful.
- 2.40** Connected to this is the future of distributions arising from positive experience in certain lines of business, or from profits arising from business generally. Mutuals are already developing

member dividends and premium reductions as part of the means of sharing out the experience of the fund with their members. This needs to take place without recreating the issues raised by the current decline in with-profits business. Where new business is funded by the mutual members' fund, with-profits policyholders who are also members will benefit in their capacity as members along with other non-profit members. We will encourage further developments in this area. It is also important that the basis for remuneration of membership interests is consistent with the prudential regime and the safety and soundness of the firm.

- Q4:** We are not proposing new rules in this area, but we would welcome comment from members and other policyholders in mutuals about governance and accountability and how they see their involvement in how the business is managed.

Annex 1

Cost benefit analysis

Introduction

1. When proposing new rules, we are obliged (under section 155 of FSMA) to publish a cost-benefit analysis (CBA), unless we believe the proposals will give rise to no costs or to a minimal increase in costs. As a matter of policy, we also provide a CBA for significant proposed guidance relating to rules. The CBA is an estimate of the costs and an analysis of the benefits to different parties that will arise from the proposals. It is a statement of the differences between the baseline (broadly speaking, the current position) and the position that will arise if we implement the proposals. In some cases, the differences could be transfers from one party to another, rather than a change in overall welfare.

Market failure analysis

2. As set out in the Overview, the rules and guidance in COBS 20 are designed to mitigate the effect of the conflict of interest between firms managing with-profit funds and the policyholders, resulting in fairer outcomes for policyholders. These rules state that the potential interests of the with-profits policyholders extend to the whole of the long-term business fund of a mutual. If little or no new with-profits business appears likely to be written in the fund, the current generation of with-profits policyholders becomes the last such generation. Without new with-profits policyholders to inherit an interest in the surplus, our rules envisage that the firm should make arrangements to make the value of that expected future surplus distributable to the remaining with-profits policyholders.
3. This creates a problem for mutual firms as there is no equivalent to 'shareholder' funds to provide the required finance to enable the mutual to continue following this payment to with-profits policyholders. The outcome is that a mutual with-profits provider that operates a single common fund may be unable to continue in business beyond the end of the with-profits run-off, leading to a loss of mutuals from financial services and the potential benefits their diversity brings. This imposes a cost on mutuals' non-profit consumers as they lose the benefits of mutual membership. There is also a detrimental effect on wider financial markets as mutuals are likely to provide stronger competition in financial markets as

mutuals rather than as proprietary firms, and therefore provides better outcomes for all market participants.

Counterfactual: results of no change

4. Maintaining the existing approach is expected to lead to the winding up of existing with-profits friendly societies as their with-profits business runs off, especially those mutual with-profits providers that operate a single common fund. Winding up would require them to sell their non-profit business, potentially to other mutuals, but most likely to proprietary firms. These businesses would be unlikely to close but the benefits arising as a result of being part of a mutual would be lost.
5. This is not however universal. Mutuals with different corporate structures may be able to take advantage of Companies Act provisions to put forward a scheme of arrangement, or may have other options according to their individual constitutions.

Benefits

6. The proposal is to introduce new guidance in COBS 20.2.1G (2A) and remove COBS 20.2.60 (2) to encourage with-profits mutuals to apply for a modification of the definition of a with-profits fund to allow mutual firms to clarify members' interests and with-profits policyholders' interests where there is uncertainty and they are undetermined. The intention is to enable with-profits mutuals to be able to write new business when with-profits are in run-off and prevent them needing to wind up. If firms were forced to wind up, this would be to the detriment of other member policyholders, who are not with-profits policyholders, who do not want their mutual to close and have to find an alternative product provider. Mutuals' non-profit policyholders will therefore benefit from the continuance of their mutual. This is a transfer from with-profits policyholders to other members in the sense that the broader mutual will not go into run-off but will continue in the interests of all members.
7. The key benefit of the proposal is that it helps maintain diversity in the provision of retail financial services. There is evidence that non-profit ownership plays a role in limiting firms' incentives to exploit consumer biases and as a result that mutuals presence in markets can reduce the social costs that may result from consumers' mistakes.¹ Further, the additional competitive constraint that mutuals place on wider financial services markets as a result of being mutuals, rather than proprietary firms, is maintained.
8. By avoiding run-off mutuals will be able to avoid any costs arising from winding-up and sale of assets.

¹ *Consumer biases and firm ownership*, New York University School of Law, Ryan Bubb and Alex Kaufman (October 2011) http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1945852

9. These proposals should ensure with-profits policyholders and other policyholders within the mutual sector are treated fairly and, in particular, that they are no worse off in terms of policy benefits than their counterparts in proprietary firms. The challenge is to achieve this while at the same time supporting diversity in financial services provision by enabling with-profits mutuals to continue in business after the run-off of their with-profits business where that is appropriate.
10. Mutual firms may no longer need to seek agreement from with-profits holders on non-profits business after with-profits run-off. Mutuals in some instances will not be required to gain with-profits policyholder approval, avoiding the cost of these votes.

Costs

Compliance costs

11. Firms that apply for a waiver face incremental costs. The cost of actually applying for the waiver is likely to be minimal. The majority of costs will come from commissioning an independent expert's report. We estimate this will be a one-off cost of approximately £32,000 for each mutual choosing to apply for a waiver, based on the costs associated with an expensive and complex case. Some firms may wish to incur extra costs to provide additional assurance.
12. Additional costs will also be incurred in ensuring that with-profits policyholders and other members are appropriately engaged and informed. The key variable will be the number of people affected and whether or not communication with members and other policyholders can happen through normal communication methods (such as annual statements) or whether an additional exercise has to be carried out. In that event costs in the order of at least £1 per member are expected.
13. Firms may also face a cost in setting up and maintaining a register of membership rights, where one is not already in place.

Direct costs

14. The proposal will also create costs for the FSA, or for the FCA and PRA. If a large proportion of mutual firms in the sector were to apply for a waiver, we estimate this will cost the FSA, or the FCA and PRA, £60,000 to process and assess all the requests.
15. Section 138I of the Financial Services Bill requires the FCA to provide an estimate of the benefits of the changes we propose, where practicable. We do not believe in this instance it is practicable for an estimate of the benefits to be calculated. This is because it is not possible to identify how many mutuals will apply for, or be successful in a gaining, a modification.

Annex 2

Compatibility statement

Compatibility with the FSA's general duties

1. This section sets out our assessment of the compatibility of the proposals outlined in this CP with our general duties under section 2 of FSMA and with the regulatory objectives set out in sections 3 to 6. Given that making any guidance following consultation may be made by the FCA rather than the FSA, this section also carries out an assessment of the proposals in the CP against the general duties that we expect the FCA will have, as proposed in the Financial Services Bill. To the extent that elements of these proposals become general policy and principles by reference to which the PRA performs its functions then we have considered those elements against the general duties we expect the PRA to have as proposed in the Bill.

Duty to act in a way that is compatible with the statutory objectives

Compatibility with FSA objectives

2. Our proposals for amending the guidance concerning with-profits mutuals are primarily designed to meet our consumer protection objective but will also improve market confidence. They do not deal directly with our other two statutory objectives, which are financial stability and the reduction of financial crime.
3. The proposed changes to guidance aim to set fair boundaries where the position in relation to with-profits policyholders' existing rights and interests is not clear and so should not add to nor take away from the rights of policyholders and members. The principles proposed as part of the modification process for the rules are intended to successfully safeguard policyholders' interests in with-profits funds. We consider that an appropriate degree of protection to consumers is being applied by requiring firms to demonstrate the fairness of their proposals to all relevant policyholders including those who are members.
4. If the proposed changes allow with-profits mutuals to continue writing new business when their with-profits business is in run-off, it could have a positive effect on market confidence.
5. There are no expected implications for our financial stability objective.

The FCA's general duties

6. Section 1B of FSMA (as proposed by the Financial Services Bill) will require the FCA, when discharging its general functions (which includes giving general guidance), so far as is reasonably possible, to act in a way that is compatible with its strategic objective and advances one or more of its operational objectives. The FCA will also need to, so far as is compatible with acting in a way that advances the consumer protection objective or the integrity objective, carry out its general functions in a way that promotes effective competition in the interests of consumers.
7. The intention of these proposals is to secure an appropriate level of protection for consumers. The principles proposed as part of the modification process, including requiring firms to demonstrate the fairness to all policyholders, should ensure consumer protection, having regard to the considerations set out in section 1C(2) (as proposed in the Bill).
8. The proposed changes could also maintain competition within the financial services market by allowing mutual firms to continue to write new business, and therefore advances the objective of promoting effective competition in the interests of consumers in the market. It will not affect the FCA's other operational objective of enhancing the integrity of the financial system. This approach is compatible with the draft strategic objective of ensuring that the relevant markets function well.

The PRA's general duties

9. Section 2B of FSMA (as proposed by the Financial Services Bill) requires the PRA, when carrying out its general functions (which includes determining the general policy and principles by which it performs its functions), so far as is reasonably possible, to act in a way that is compatible with its general objective of promoting the safety and soundness of PRA-authorized persons. Section 2C (as proposed in the Bill) requires the PRA, when discharging its general functions relating to PRA-authorized persons effecting or carrying out of contracts of insurance, so far as is reasonably possible, to act in a way which is compatible with its general objective and its insurance objective and that the PRA considers most appropriate for the purpose of advancing those objectives. The PRA's insurance objective is contributing to securing an appropriate degree of protection for those who are or may become policyholders. We believe all proposals in this paper, to the extent they may be determined by the PRA as part of its general policy and principles, are compatible with the duties set out above.

Principles of good regulation

10. In making these proposal we have had regard for both the current FSA principles of good regulation and the proposed principles for good regulation which will apply to the FCA and PRA, which are set out in section 3B of FSMA (as proposed in the Financial Services Bill).

FSA Principles of good regulation

11. Section 2(3) of FSMA requires that in carrying out our general functions we have regard to the principles of good regulation.

The need to use our resources in the most efficient and economic way

12. The proposed guidance will mean that firms can choose to apply for a modification to the rules which will create some costs for the FSA. These costs are small compared with the benefits of maintaining diversity in the provision of financial services.

The role of management

13. The proposals are intended to result in membership of a mutual becoming more meaningful which could lead to improvements in governance and more accountable senior management.

Proportionality

14. The changes proposed in this CP result from the findings of CP11/05, PS12/4 and work on Project Chrysalis. Informed by our CBA, we consider the overall benefits of these proposals are proportionate to the costs.

Innovation, international character and competition

15. The proposals should promote both competition and innovation in the market by allowing firms the opportunity to maintain diversity in the provision of retail financial services. Mutual insurers contribute to more efficient competition in the financial services sector and this is helpful to consumers.

Regard to public awareness

16. The changes are unlikely to have a significant effect on this principle of good regulation. They may marginally raise public awareness of long-term savings.

Compatibility with our duties under equalities legislation

17. The policy proposals described in this CP are designed to improve the treatment of with-profits policyholders as a whole class of interested parties. We have conducted an assessment of the equality issues that arise in our proposals. Since the proposals deal with with-profits policyholders' interests as a whole, we believe our proposals do not give rise to discrimination and that the proposals are of low relevance to the equality agenda. We would nevertheless welcome any comments respondents may have on any equality issues they believe arise from the proposals in this CP.

FCA and PRA principles of good regulation

In discharging their general functions the FCA and PRA must have regard to the regulatory principles set out in section 3B FSMA (as proposed by the Financial Services Bill and required by proposed sections 1B(5) and 2H).

18. We believe that the proposed changes are compatible with the draft principles of good regulation. In particular, we believe that an appropriate balance has been struck between the need to ensure the FCA's regulatory objectives are fulfilled and the need to keep regulatory burdens to a minimum.

Annex 3

List of questions

- Q1:** Do you agree with this analysis and do you think its conclusions are fair to with-profits policyholders and sustainable for mutual organisations?
- Q2:** Do you agree with our approach to a proposed process for recognising mutual members' funds?
- Q3:** Do you agree with the support elements we are proposing for the process and the principles outlined?
- Q4:** We are not proposing new rules in this area, but we would welcome comment from members and other policyholders in mutuals about governance and accountability and how they see their involvement in how the business is managed.

Annex 4

Regulatory history

Regulation of with-profits business

1. In 2005 we introduced a set of detailed rules covering many aspects of the operation of with-profits funds that might, if a firm were to use its discretion inappropriately, result in the unfair treatment of policyholders. These rules are based on the principle that, although at any time it may be unlikely that the part of the with-profits fund held as working capital will cease to be needed for that purpose and become potentially available for distribution, this may change. In that case, actions taken by the firm that may reduce the potential for distributions may be inconsistent with the fair treatment of with-profits policyholders.
2. With a few specific exceptions, these rules apply to mutuals in the same way as they do to proprietary firms. Where there are differences, this is due to the intention to avoid certain costs being charged to funds in proprietary firms in which with-profits policyholders have a contingent interest while recognising that, in a mutual, there is no other place from which these costs can be found.
3. By framing the rules in this way, we have taken the view that the interests of the with-profits policyholders extend to the whole of the long-term business fund of a mutual. Or, to put it another way, that the long-term business fund of a with-profits mutual does not include a separate category of assets, possibly called ‘mutual capital’ to which these rules do not apply.
4. If new with-profits business continues to be written into the fund, we accept that any contingent interest in the working capital of the fund, if it becomes potentially distributable, shifts over time from the current generation of with-profits policyholders to the next. This process is known as the ‘inter-generational transfer’. If non-profit business is also written within the fund, the capital financing strain of that non-profit business, which defers but does not prevent the emergence of surplus, is borne by the with-profits fund and is expected to deliver a return in the future during the relevant period of the business so that the new business is financially self supporting.
5. However, if little or no new with-profits business appears likely to be written in the fund, the current generation of with-profits policyholders becomes the last such generation. Without anyone else to inherit an interest in the surplus arising after that time, the effect

and application of the rules is such that the firm should make arrangements so that the value of that expected future surplus is distributable over time to the remaining with-profits policyholders and COBS 20 includes guidance to that effect.

6. In the case of a proprietary firm, that course of action would put it in the position of needing to finance new non-profit business out of shareholder funds and to write that business outside the with-profits fund that was running down. It leads to a more acute problem for a mutual firm in a similar position as there is no equivalent to 'shareholder' funds to provide the required finance and no other obvious place in which to write the business. It seems to us that this is a situation that needs to be addressed, as it does not give sufficient recognition to the firms that give genuine meaning to the membership of a mutual organisation, quite apart from their obligations to with-profits policyholders.

Project Chrysalis

7. Project Chrysalis refers to work undertaken between the FSA and representatives of the mutual with-profits sector between April 2007 and late 2010. It was brought about by an approach from firms asking questions about how our rules apply to a mutual's business where that mutual writes with-profits business. A key point was whether a mutual was entitled to sub-divide its common fund into one part that is a with-profits fund and another that could be termed 'mutual capital'.
8. The significance of this point was whether a mutual, faced with the prospect of a substantial decline in new with-profits business, would be able to either:
 - set aside a part of its fund to provide the financing and capital support necessary to continue writing other types of new business; or
 - be obliged under existing rules to distribute most of its fund to with-profits policyholders as that business ran off.
9. Sub-dividing the mutual's common fund in this way, firms have argued, would enable mutuals potentially to avoid the problems associated with the run-off of with-profits business.
10. A key milestone in this process was a 'Dear CEO' letter that we published in October 2009. In that letter we explained that we had taken advice from leading Counsel regarding our policy position. While particular firms might be exceptions, the general position was that with-profits policyholders will be entitled ultimately to all or nearly all of the assets in a mutual's long-term fund after all other contractual obligations have been satisfied.
11. The letter also set out our views on the options for mutuals facing a decline in with-profits business. We noted that we believed there were a range of courses of action, other than closure and run-off, open to mutuals. These included ways in which they might continue to write non-profit business or to develop new products. We noted that it might be possible to write new business into a new sub-fund financed as a strategic investment of the existing fund or to seek policyholders' consent to take other actions.

12. A number of responses were received to the October 2009 letter from the industry and others. The main point that emerged from this was the extent of diversity in the mutual insurance sector. This was emphasised in a number of specific areas by firms' responses, for example:
- the differences in mutual insurers' form and size and how their origins and development have had an effect on their fund structures;
 - the wide variety of purposes for which mutual insurers were formed and the different ways in which membership has been acquired; and
 - the split between types of business written historically and currently by mutual insurers and their different approaches to providing discretionary benefits.
13. We published a second 'Dear CEO' letter in September 2010 which advised that the with-profits policyholders of any firm, be it a mutual or a proprietary company, clearly have entitlements and expectations in relation to the fund in which their policies have been written. We stated our concern as being to ensure that they are treated fairly in relation to those entitlements and expectations and, in considering whether or not that is the case, we saw no reason why the fair treatment of with-profits policyholders in mutuals should differ to their detriment from that of their counterparts in proprietary companies. We went on to say that the value of membership interests in a mutual was, in the ordinary course of business, likely to be of negligible value or effect, and even though the value may increase on a winding up that would not generally warrant policyholders receiving less on a distribution of surplus than their counterparts would in a proprietary company.
14. We also set out our view that:
- it would be surprising if the reasonable expectations of with-profits policyholders in a mutual firm were fundamentally less extensive than those of similar policyholders in a proprietary company and we would expect our requirement for firms to treat their customers fairly to produce at least as favourable an outcome for mutual with-profits policyholders as for those in proprietary companies;
 - the factors that could conceivably operate to justify a different outcome are the same in relation to the with-profits policyholders of a mutual as they are for those of a proprietary company;
 - diversity within the mutual sector means that the existence and effect of these factors varies to some extent from firm to firm but, based on our review of firms' responses, it appears to us that the fair treatment of mutual with-profits policyholders makes it likely that they should, if anything, share more extensively, not less, in any surplus in the long-term fund than those in proprietary companies; and
 - if a firm suggests that its own particular circumstances warrant a different outcome, it must be able to point to clear and unambiguous communications to policyholders to justify this.

With-profits regime review (WPRR)

15. The current set of conduct of business rules on with-profits policies, which has been in place since 2005, was the culmination of the major regulatory reforms of the with-profits sector embarked on by the FSA in 2001 following the closure to new business of Equitable Life, itself a with-profits mutual.
16. Although there has been no repeat of these circumstances, the new rules were not seen to have been as successful as we had intended them to be in addressing some of the issues that had led to their introduction. A number of external commentators continued to focus on with-profits business. This resulted in Hector Sants' commitment to the Treasury Committee of the House of Commons in 2008 to review the way in which firms have implemented the rules in COBS 20, which in turn triggered the With-Profits Regime Review (WPRR). The WPRR covered both mutual and proprietary firms representing 80% of the with-profits industry by assets under management to assess their implementation of COBS 20. The findings of the review were published in June 2010.

CP11/05 and PS12/4

17. As a result of the WPRR we issued CP11/5 in May 2011. This CP addressed a range of conduct of business issues that applied to both proprietary and mutual insurers. Among a range of proposals we decided to put forward a change to make it clear in our rules that with-profits policyholders have an interest in the whole with-profits fund and in every part of it and that this applied equally to mutual and proprietary firms. The value of this interest is dependent on the decisions of the insurer, but is separate from the ownership of the fund.
18. Further, we proposed adding guidance on fair treatment for with-profits policyholders in mutual insurers. In particular, that with-profits policyholders are entitled to a share of any distribution made, following established practice. Following feedback this was not incorporated into the Handbook. We also proposed to strengthen requirements on conflicts of interest by making the existing guidance in that area into a rule with which firms have to comply. In mutual insurers specifically, we wanted the rules to recognise that conflicts of interest could arise between with-profits policyholders and the members of mutually-owned firms where those groups are not identical.
19. We then published PS12/4 in March 2012 which clarified a number of points relevant to with-profits business generally and to mutual insurers. In particular:
 - restating the FSA's view that the with-profits policyholders have an interest in all of the with-profits fund;
 - that new business should only be sold on terms where it can be demonstrated that there is no adverse effect on with-profits policyholder interests in the inherited estate; and

- that strategic investments should only be held in with-profits funds if it can be demonstrated that to do so will not be adverse to the interests of with-profits policyholders.
20. PS12/4 recognised that there were issues specific to with-profits mutuals that still needed further consideration. In particular, it did not seek to address the issue of under what circumstances a category or space outside the with-profits fund might be established.

With-profits firms involved in Project Chrysalis

Firm name	Categorisation
Co-operative Insurance Society	Industrial & Provident Society
The Royal London Mutual Insurance Society Limited	Company limited by guarantee
The Equitable Life Assurance Society	Private unlimited company
Liverpool Victoria Friendly Society Limited	Friendly Society
The National Farmers Union Mutual Ins. Soc. Ltd	Company limited by guarantee
Wesleyan Assurance Society	UK Company incorporated by Special Act/Royal Charter
Marine and General Mutual Life Assurance Society	Private unlimited company
Police Mutual Assurance Society Limited	Friendly Society
Scottish Friendly Assurance Society Limited	Friendly Society
Tunbridge Wells Equitable Friendly Society Limited	Friendly Society
Teachers Provident Society	Friendly Society
Reliance Mutual Insurance Society Limited	Company limited by guarantee
Homeowners Friendly Society Limited (Engage Mutual)	Friendly Society
Dentists' Provident Society Limited	Friendly Society
National Deposit Friendly Society Limited	Friendly Society
Metropolitan Police Friendly Society	Friendly Society
The Ancient Order of Foresters Friendly Society	Friendly Society
Cirencester Friendly Society Limited	Friendly Society
The Shepherds Friendly Society Limited	Friendly Society
The Original Holloway Friendly Society Limited	Friendly Society
The Rechabite Friendly Society Limited	Friendly Society
The Dentists & General Mutual Benefit Society	Friendly Society
Exeter Friendly Society Ltd	Friendly Society
Royal Artillery Widows Insurance Society	Company limited by guarantee

Firm name	Categorisation
British Friendly Society	Friendly Society
Family Assurance Friendly Society Limited	Friendly Society
The Kensington Friendly Collecting Society Ltd	Friendly Society
Kingston Unity Friendly Society	Friendly Society
Pharmaceutical & General Provident Society Limited	Friendly Society
Railway Engineman's Assurance Society Limited	Friendly Society
The Red Rose Friendly Society Limited	Friendly Society
Transport Friendly Society Limited	Friendly Society
Wiltshire Friendly Society Limited	Friendly Society
Manchester Unity Friendly Society (The Oddfellows)	Friendly Society
Sheffield Mutual Friendly Society	Friendly Society

Appendix 1

Draft Handbook text

CONDUCT OF BUSINESS SOURCEBOOK (MUTUALS) INSTRUMENT 2013

Powers exercised by the Financial Conduct Authority

- A. The Financial Conduct Authority makes this instrument in the exercise of its powers under section 139A (Power of the FCA to make guidance) of the Financial Services and Markets Act 2000 (“the Act”).

Commencement

- B. This instrument comes into force on [*date*].

Amendments to the Handbook

- C. The Conduct of Business sourcebook (COBS) is amended in accordance with the Annex to this instrument.

Citation

- D. This instrument may be cited as the Conduct of Business Sourcebook (Mutuals) Instrument 2013.

By order of the Board of the Financial Conduct Authority
[*date*]

Annex

Amendments to the Conduct of Business sourcebook (COBS)

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

20.2 Treating with-profits policyholders fairly

Introduction

20.2.1 G ...

(2) ...

(2A) (a) A mutual operating a single common fund may seek to undertake an exercise to identify that part of the fund to which the mutual considers it would be fair for relevant provisions in COBS 20 not to apply.

(b) In order to give regulatory effect to the identification exercise the FCA expects that such a mutual may need to apply to the FCA to modify the relevant provisions in COBS 20 which are dependent on the definition of the with-profits fund.

(c) Such a mutual will need to demonstrate that the appropriate statutory tests set out in section 138A of the Act are met. The FCA expects that mutuals will need to do at least the following in order to allow the FCA to consider whether granting the modification would adversely affect the advancement of the FCA's consumer protection objective:

(i) to demonstrate that the exercise does not amount to a reattribution;

(ii) to demonstrate that its proposals are fair to its with-profits policyholders, and other relevant policyholders, having regard to the mutual's own particular structure, origins and other relevant circumstances, and including reference to the items set out in (iii) to (x) below;

(iii) to have obtained the report of an independent expert approved by, and whose terms of reference are agreed with, the FCA, on the terms of the mutual's proposals and the likely impact and effects on, and fairness to, the mutual's with-profits policyholders, and on other relevant policyholders. The FCA will consider using its powers in section 166 of the Act (Reports by skilled persons) in appropriate circumstances;

- (iv) to demonstrate that the *mutual's with profits policyholders* and other *policyholders* are appropriately engaged and informed in relation to the proposals;
 - (v) to demonstrate that the *mutual* has complied with the relevant requirements set out in the *mutual's constitutional documents*, for example that members are appropriately involved in agreeing to any proposals;
 - (vi) to demonstrate that the *mutual* has a convincing and robust business case for continuing in business as opposed to run-off;
 - (vii) to demonstrate how and the extent to which continuing membership rights will benefit *with-profits policyholders* and other *policyholders*;
 - (viii) to explain the nature and terms of any continuing support to be provided to the *with-profits fund* from outside the *with-profits fund*;
 - (ix) to demonstrate that *with-profits policyholders* under the *mutual's* proposals will not be at a disadvantage compared to equivalent *with-profits policyholders* in a proprietary *with-profits fund*; and
 - (x) to explain how it proposes to pay any compensation or redress that is or may become due to a *policyholder*, or former *policyholder*;
- (d) the *FCA* expects to consult and/or seek information or advice from *PRA* in accordance with section 3D of the *Act* and the Memorandum of Understanding between the *FCA* and the *PRA* required by section 3E. As part of any such process the *FCA* expects that the *PRA* will wish to consider, amongst other things, that balance sheet safety and soundness issues have been identified and addressed appropriately.

...

...

20.2.60 G ...

- (2) ~~Where it is agreed by its *with-profits policyholders*, and subject to meeting the requirements for effecting new *contracts of insurance* in an existing *with-profits fund* (*COBS 20.2.28R*), a *mutual* may make alternative arrangements for continuing to carry on *non-profit insurance business*, and a *non-directive friendly society* may make~~

~~alternative arrangements for continuing to carry on non insurance
related business. [deleted]~~

Appendix 2

Designation of Handbook Provisions

1. FSA Handbook provisions will be ‘designated’ to create a FCA Handbook and a PRA Handbook on the date that the regulators exercise their legal powers to do so. Please visit our website¹ for further details about this process.
2. We plan to designate the Handbook Provisions which we are proposing to create and/or amend within this Consultation Paper as follows. These designations are draft and are subject to change prior to the new regulators exercising their legal powers.

Handbook Provision	Designation
COBS 20.2.1	FCA
COBS 20.2.60	FCA

¹ One-minute guide <http://media.fsahandbook.info/latestNews/One-minute%20guide.pdf>

PUB REF: 004630

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