ISLE OF MAN
FINANCIAL SERVICES AUTHORITY
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Guidance on the requirements of the Insurance (Conduct of Business) (Long-Term Business) Code 2021

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Introduction

This guidance document is issued under section 34 of the Insurance Act 2008 by the Isle of Man Financial Services Authority ("the Authority"). It applies to authorised long-term business insurers.

This guidance is issued to supplement the requirements of the Insurance (Conduct of Business) (Long-Term Business) Code 2021 ("the Code").

The Authority issues guidance for various purposes, including to illustrate best practice, to assist regulated entities to comply with legislation and to provide examples or illustrations. This guidance is, by its nature, not law, however it is persuasive. Where a person follows the guidance, this would tend to indicate compliance with the legislative provisions, and vice versa.

1. Guidance on remuneration

The guidance in this section is issued in consideration of the requirements of the Code and sets out the Authority's expectations in respect of the treatment of different types of remuneration paid to intermediaries under the Code.

The Authority's intention in issuing the Code was to establish principles (in paragraphs 8 and 11 of the Code) surrounding disclosure of remuneration as a way of mitigating the risk of conflicts of interest arising in the sales process and distorting the advice that customers receive.

The Authority is aware that there will be wide variation in models of remuneration and charging structures, although the most common method by which brokers are remunerated is by the payment of a commission. The introduction of the requirement to disclose commission to policyholders has the potential to drive changes in these models of remuneration.

It is the Authority's view that any remuneration used to incentivise intermediaries (whether monetary or not) potentially creates a conflict of interest for the intermediary between its duties to provide appropriate advice to potential policyholders and its relationship with the insurer that is providing the remuneration. Therefore, insurers need to consider how the payment of any remuneration is consistent with the obligation to treat policyholders fairly (in accordance with the Corporate Governance Code of Practice for Insurers ("CGC") and paragraphs 5 and 6 of the Code), and how any resultant conflicts of interest should be managed accordingly. An insurer should document, and be able to explain to the Authority, how their product charging and remuneration structures have been developed to pay due regard to the interests of policyholders and to treat them fairly.

Disclosure of commission

In relation to the scope of the disclosure requirements under the Code, the Authority's expectation is that remuneration paid that is attributable to the initial and ongoing advice and sale of the specific policy (and therefore is likely to be reflected in policy charges) must be disclosed to the policyholder to enable them to make an informed decision. Generally, this would capture initial and ongoing commission paid by the insurer to the intermediary.

When considering whether or not the remuneration should be captured within the disclosure to policyholders, the regulated entity should take into account the degree to which the costs of the remuneration are met by charges reflected in the charging structure of the product and so impact directly on the cost of the product to policyholders.

Form of commission disclosure required in a Key Information Document ("KID")

Paragraph 8 of the Code prescribes the mandatory content of a KID, including mandatory text for disclosing commission. This paragraph allows insurers to disclose commission either as a monetary amount (in policy currency), or as a percentage of premiums being paid. Where adopting a percentage of premium disclosure insurers should note the following guidance:

<u>Initial Commission - Single premium policies</u>

The disclosure for commission paid at the commencement of single premium policies should be calculated as:

$$Comm\,\% = \frac{Total\ Commission\ Paid}{Contractual\ Single\ Premium}\ x\ 100$$

where—

- *Comm %* denotes the disclosure of commission as a percentage in the KID;
- *Total Commission Paid* denotes the actual amount of initial commission paid to a broker, including any override; and
- *Contractual Single premium* denotes the amount of single premium paid by the policyholder and therefore excludes any additional or reduced premium allocation.

<u>Initial Commission - Regular premium policies</u>

The disclosure for commission paid at the commencement of regular premium policies should be calculated as one of the following:

$$Comm\,\% = \frac{Total\ Commission\ Paid}{Annual\ Premium}\ x\ 100$$

where—

- *Comm %* denotes the disclosure of commission in the KID;
- *Total Commission Paid* denotes the actual amount of initial commission paid to a broker, including any override and indemnity payment; and
- *Annual Premium* denotes the amount of premiums contractually due per annum.

OR

$$Comm\ \% = \frac{Total\ Commission\ Paid}{Total\ Contractual\ Premiums}\ x\ 100$$

where—

- *Comm %* denotes the disclosure of commission in the KID;
- *Total Commission Paid* denotes the actual amount of initial commission paid to a broker, including any override and indemnity payment; and
- *Total Contractual Premiums* denotes the sum of premiums contractually due over the policy premium payment term. For whole of life policies with no contractual premium payment term, payment term shall be assumed to be to period between policy commencement and the last insured attaining 80 years of age.

The disclosure of commission paid on an ongoing, renewal basis is set out in paragraph 8(g)(iii) and 8(g)(v) of the Code.

Managing the payment of other inducements

The Authority is cognisant of the risk that the payment of commission may be substituted by other financial inducements, or benefits, that are intended to achieve the same outcome, i.e. to secure distribution of a regulated entity's products. These other financial inducements (such as marketing allowances, sales competitions and volume related payments) may not generally directly affect the charges on a product and therefore would not need to be disclosed to a policyholder under the Code, but these other inducements must still be considered by a regulated entity in terms of how the payment meets the entity's obligations under its fair treatment of customers and product development policies and procedures and in particular the requirement to identify and manage any conflicts of interest in the product design and distribution.

Criteria that may be taken into account when considering whether a conflict of interest may arise from the provision of benefits other than commission, include a consideration of whether the benefits:

- are reasonable and proportionate, commensurate with the benefit obtained by the insurer or its customers;
- enhance the quality of service to customers;

- are not relied on by the intermediary firm in the future in order to continue to service its customers (so that should the benefit cease to be provided, the impact on the advisory firm or its customers would not be significant); and
- could reasonably not be expected to result in the channelling of business from the intermediary to the provider.

"Soft commission" from fund / asset managers

For unit linked business there are instances of observed market practice where an intermediary receives remuneration directly from the fund manager for placing business under a unit linked contract with an insurer (e.g. soft commissions), in addition to receiving a commission from the insurer. Such arrangements present a high risk of customer detriment.

Although the insurer would not ordinarily be directly party to these payments, the Authority is of the view that insurers are well placed to identify and mitigate the risk of conflicts of interest arising from such practice. Insurers offering products that link the value of benefits payable under the policy to assets provided by parties external to the insurer, should include in product development and asset vetting procedures, specific consideration and mitigation of the risk of customer detriment arising from the payment of soft commission that may lead to unreasonable levels of remuneration to brokers.

For example, at asset vetting stage insurers should consider including, as part of the review of asset/fund literature, a review of the level of charges associated with the asset; often the availability of intermediary commission is directly disclosed in fund literature or reflected in higher front end charges or exit fees.

Alternatively, insurers may seek direct disclosure from the fund/asset manager of its approach to commission payments.

2. Guidance for unit-linked single premium bonds – suitability of assets to policyholders

The Code requires insurers to apply a range of principles to business practices in order that policyholders of such insurers are treated fairly.

In particular, insurers are required to design and market their products in a way that pays due regard to the interests of policyholders and ensure that policyholders are provided with clear information about insurers' products before, during and after the point of sale.

This guidance applies to insurers authorised to undertake Class 1 linked long-term business and specifically relates to single premium "portfolio bond" style contracts, under which the policyholder may link the value of benefits payable under the policy to a wide range of assets that are provided by parties external to the insurer.

As with other unit-linked insurance contracts, under such structures investment risk is borne by the policyholder and therefore investment due diligence is the responsibility of the policyholder and is typically undertaken by an adviser acting on his or her behalf.

Because the insurer is, in legal terms, the investor in any underlying assets held to match the unit-linked liability under the contract, and will almost always be deemed to be a sophisticated or professional investor, the Authority considers that a risk associated with this product structure is that less sophisticated or less experienced policyholders, may indirectly "invest" in an asset that is ordinarily not suitable, or in certain instances not permissible, for policyholders to access on a direct basis.

Paragraph 6 of the Code sets out the principles that insurers should apply to the development, marketing and promotion of products such that policyholders are treated fairly and the risk of potential policyholder detriment is minimised.

The Authority issues this guidance to set out, in more detail, how insurers may approach the oversight of portfolio bond products:

Asset vetting

In deciding what assets may be made available for linking to a portfolio bond product, insurers will typically develop investment acceptance guidelines to set out the categories of asset that will be considered acceptable and the additional information that insurers may consider when reviewing the acceptability of an asset.

The Authority considers that in complying with the Code, in particular paragraph 6, within this process insurers should consider including the following when reviewing the acceptability of an asset for a particular product and target market:

a) the minimum investment level established by the asset / fund manager or by any regulatory requirements applicable to the asset / fund, and a comparison made to the minimum premium level for the insurer's product. The Authority does not consider the pooling of multiple policyholder investments to meet minimum investment levels for an asset / fund to be an appropriate practice in the context of the requirements of the Code;
b) whether the asset is regulated;
c) whether the asset is held on a list considered suitable for retail investors e.g. of a type listed with the UK Financial Conduct Authority's list of 'retail investment products';
d) whether there is any protection against loss of capital, either by means of a guarantee or a compensation scheme; and
e) the dealing frequency of the asset and the likelihood that it may become illiquid.

Disclosure and informed consent

Paragraph 6(3) of the Code requires a regulated entity to take reasonable steps to identify the intended target market for its products, including an assessment of the degree of financial capability of the target market policyholders.

Accordingly, insurers would be expected to have a reasonable understanding of their target market and the typical policyholder expectations within such groups.

As noted, the Authority considers that the particular characteristics of portfolio bonds are such that there is increased potential for adverse policyholder outcomes, for example in circumstances where the assets being selected by the policyholder are of a type that the policyholder would not be considered sufficiently experienced or sophisticated to invest into directly.

Accordingly, where an insurer has made available assets for linking to its portfolio bond products that are stated to be suitable only for experienced, sophisticated or professional categories of investor, the Authority considers it appropriate for insurers to take steps to determine that the policyholder meets the criteria for investment in the chosen asset, including obtaining informed consent from the policyholder. This may be in the form of disclosure to the policyholder and informed consent/certification by the policyholder that he or she is of the required investor status for the asset/fund. The specific form of disclosure may be determined by the insurer, although it should meet the requirements of the Code in that information should be clear and provided before, during and after point of sale, as required.

Portfolio product design

Where an insurer makes available assets for linking to its product that are stated to be suitable only for experienced, sophisticated or professional categories of investor, insurers may consider only making these assets available through products that have been developed and marketed specifically for those categories of investor.

Under such a segregated product approach separate products may be designed for specific customer groups such as retail[1] and non-retail policyholders.

The Authority considers such an approach to be consistent with the intended outcome of paragraph 6(4) of the Code.

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[1] the term “retail” is used to describe a customer’s financial capability and investment expertise. In this context, retail policyholders are those considered to not possess the required expertise, experience and knowledge to adequately understand the features and risks associated with the product and services being offered to them.

Use of a discretionary asset / fund manager ("DFM")

Where the policyholder has appointed a DFM that DFM will have an obligation to ensure that the investment decisions made are suitable for the policyholder. Under such arrangements DFMs may operate different client agreements for specific customer types, for example, retail or non-retail clients.

Additionally, DFM agreements will typically contain categories of investment that are permitted under the agreement.

In allowing policyholders to access DFM services the Authority considers it appropriate that insurers take steps to:

- Review the standard of disclosure in DFM client agreements to ensure that information is provided in a clear manner that explains the features and risks of the service;
- Ensure information provided to policyholders clearly signposts the degree of discretion allowed under the agreement for the DFM to act without permission of the policyholder, for example;
  - the purchase and sales of assets;
  - the collection of income;
  - the application of dividends;
  - voting, accepting takeovers or the taking up and exercising of rights;
- Review the permitted investments under the agreement to ensure they fall within insurers' investment acceptance guidelines as set out in 2.1; and
- Review any reference to the suitability / non-suitability of the DFM service to particular customer groups e.g. retail or non-retail against the insurers' own assessment of the target market under paragraph 6(3) of the Code.

3. Guidance on the provision of illustrations for long term insurance products

The guidance in this section is issued in consideration of the requirements of the Code and sets out the Authority's expectations where a regulated entity chooses to provide illustrations to prospective policyholders.

There is no requirement to issue an illustration to a prospective policyholder within the Code. The Authority has observed poor practice in relation to the use of illustrated returns in product literature and the Authority's conclusion is that prospective policyholders may have difficulty in assessing the relative importance of any stated potential investment returns against the investment risk and the uncertainty of such returns. Additionally, the Authority

considers the use of a range of prescribed growth rates as potentially introducing unnecessary complexity, whilst not fully being reflective of the wide investment options that may be made available under certain unit-linked products.

As a result, the Authority decided that projected illustrations should not be used to demonstrate the impact of charges within the Key Information Document ("KID"), on the grounds of simplicity for policyholders and to avoid the use of misrepresentative growth rates. However, some insurers may still wish to provide personalised illustrations to prospective policyholders or are required to provide such illustrations where local regulation requires it. Prospective policyholders are obviously very interested in the potential returns of a product when deciding whether to invest and so the Authority would not object to personalised illustrations being provided, subject to these being provided separately to the KID.

To ensure consistency of approach where illustrative documents are provided, the Authority expects that any illustrations issued by authorised insurers should:

- show realistic projections of the potential growth of an investment that are not overly optimistic;
- unless expressly prohibited or restricted by other local regulatory requirements, accurately project the effect of charges associated with the product as disclosed within the KID under the requirement of paragraph 8(3)(g) of the Code;
- where a regulated entity's product offers policyholders a range of options for investment, clearly disclose the degree to which charges linked to those investments are taken account of in the illustration projections and the basis on which they are included. For example, where an estimated or average charge is used to produce illustrated returns this should be made clear to policyholders;
- appraise policyholders of a zero growth scenario, alongside other growth scenarios;
- reflect both policy value and surrender value for products where these values differ;
- include an appropriately worded statement that draws attention to the impact of inflation on the projected returns; and
- be kept under review to ensure that new illustrations remain relevant and not misleading.

4. Guidance on procedures for monitoring terms of business with brokers

The guidance in this section is issued in consideration of the requirements the Code and sets out the Authority's expectations in respect of the procedures that regulated entities should have in place to ensure that any broker with which it has established terms of business remains an appropriate distribution channel for its products and target markets.

The monitoring procedures required under paragraph 17 of the Code should include, but not be limited to a consideration of:

a) A review of the broker's authorisation, regulatory or licence permissions granted in the jurisdictions in which it operates. For the purposes of this review a regulated entity may use the information sources described in (i) where the regulated entity is satisfied and is able to demonstrate the veracity and reliability of the information source;
b) Number of complaints received;
c) Persistency Rate, including early cancellations and surrenders;
d) Overdue premiums;
e) The level of any advance commission debts;
f) Any evidence of 'churning';
g) Standards of documentation issued by the broker to which the insurer business is party;
h) Any inconsistencies between the anticipated and actual levels and patterns of business; and
i) Monitoring and review of information available through external databases, either proprietary or in the public domain.

The Authority expects that regulated entities will undertake a regular review of brokers with which it has established terms of business. This may be done using a risk based approach to determine the frequency of reviews.

Where a regulated entity chooses not to follow all aspects of this guidance, or considers other methods of monitoring brokers with which it has established terms of business to be appropriate, the consideration and rationale for the method adopted should be documented by senior management.

5. Guidance on post-sale disclosure requirements

The guidance in this section is issued in consideration of the Code and sets out the Authority's expectations in respect of the considerations that regulated entities should make in considering what information must be provided to policyholders.

As a general principle a regulated entity should take account of the fact that the information needs of policyholders differ depending on the type of insurance product, which should influence the frequency and content of information to be provided. Without limitation to this principle, the following guidance is issued by the Authority in respect of classes of long term insurance business.

Class 1 unit-linked business

Periodic Reporting

A regulated entity should periodically report appropriate and timely on-going information to existing policyholders, including the investment progress of unit linked policies.

Frequency of reporting

The frequency of reporting may vary in accordance with the nature and complexity of assets to which the benefits payable under a unit-linked policy are linked, however, reporting should not be less frequent than on an annual basis.

Where a policyholder requests to receive information on a reasonable, more frequent basis, a regulated entity should comply with such requests.

In general, the Authority considers a reporting frequency of at least every three months to be appropriate where assets to which the benefits of a Class 1 unit linked policy are linked are external to the insurer i.e. portfolio bonds.

Content of reports

Information to be provided on an ongoing basis will vary by type of policy but in most cases should include:

- the name of the firm;
- the name and reference number of the policy;
- premiums paid to date;
- a valuation statement of the linked investments, including details of:
    - each linked investment held and its market value, or fair value if market value is unavailable;
    - the current cash surrender value;
    - where applicable to the product, the cash balance at the beginning and at the end of the reporting period; and
    - the performance of the portfolio during the reporting period;
- details of fees and charges levied during the reporting period (where appropriate to the product, fees should be itemised between total management fees and costs associated with execution, or if not, a statement that a more detailed breakdown will be provided on request);
- details of investment performance during the period covered by the statement and a comparison with the investment performance benchmark (as applicable);
- the total amount of dividends, interest and other payments received during the reporting period; and
- information about other corporate actions giving rights in relation to designated investments held in the portfolio.

Occasional Reporting

Unit-linked transactions including switching, withdrawal, part and full surrenders

Where a regulated entity receives instructions from policyholders (or persons appointed to act on behalf of policyholders) to switch or redeem unit linked investments, a regulated entity should report appropriate and timely information to those policyholders to confirm the fulfilment of such requests. Information reported should include:

- the date of execution of the sale and purchase (as applicable) of units / shares;
- the number of units / shares involved;
- the price at which the units / shares were subscribed or redeemed;
- the reference valuation date; and
- the value of any charges, commissions or expenses levied for subscription or redemptions.

Class 2 non-linked with-profit business

Principles and Practice of Financial Management ("PPFM") – with-profits business

Definitions:

"established surplus" means excess of assets representing the whole or a particular part of the long-term business fund or fund over the liabilities, or a particular part of the liabilities, of the insurer attributable to that business as certified by the appointed actuary.

"inherited estate" means an amount representing the fair market value of the with-profits assets less the realistic value of liabilities of a with-profits fund.

"With-profits business" means any business of an authorised insurer that may affect the amount or value of the assets comprising a with-profits fund.

"With-profits fund" means a long-term business fund in which policyholders are eligible to participate in any established surplus.

"With-profits policy" means a contract falling within Class 2 of long-term insurance business, pursuant to the Insurance Regulations 1986, which is eligible to participate in any part of any established surplus

"With-profits policyholder" means a policyholder under a with-profits policy.

Production of PPFM

1) A regulated entity should:
    a) establish and maintain the PPFM according to which its with-profits business is conducted (or, if appropriate, separate PPFM for each with-profits fund); and
    b) retain a record of each version of its PPFM for five years.
2) A regulated entity's with-profits principles should:
    a) be enduring statements of the standards it adopts in managing with-profits funds; and
    b) describe the business model it uses to meet its duties to with-profits policyholders and to respond to longer-term changes in the business and economic environment.
3) A regulated entity's with-profits practices should:
    a) describe how a regulated entity manages its with-profits funds and how it responds to shorter-term changes in the business and economic environment; and

   b) be sufficiently detailed for a knowledgeable observer to understand the material risks and rewards from effecting or maintaining a with-profits policy with it.

4) A regulated entity should not change its PPFM unless, in the reasonable opinion of its board of directors, that change is justified to:
   a) respond to changes in the business or economic environment; or
   b) protect the interests of policyholders; or
   c) change the regulated entity's with-profits practices better to achieve its with-profits principles.
5) A regulated entity may change its PPFM if that change:
   a) is necessary to correct an error or omission; or
   b) would improve clarity or presentation without materially affecting the PPFM's substance; or
   c) is immaterial.

Scope and content of PPFM

A regulated entity's PPFM should cover any matter that has, or it is reasonably foreseeable may have, a significant impact on the regulated entity's management of with-profits funds, including:

1) any requirements or constraints that apply as a result of previous dealings, including previous transfers of insurance business; and
2) the nature and extent of any shareholder commitment to support the with-profits fund.

A regulated entity's PPFM should cover the issues set out in the following table:

	Subject	Issues		
(1)	**Amount payable under a with-profits policy**	(a)	Methods used to guide determination of the amount that is appropriate to pay individual with-profits policyholders, including:	
			(i)	the aims of the methods and approximations used;
			(ii)	how the current methods, including any relevant historical assumptions used and any systems maintained to deliver results of particular methods, are documented; and
			(iii)	the procedures for changing the current method or any assumptions or parameters relevant to a particular method.
		(b)	Approach to setting bonus rates.	
		(c)	Approach to smoothing maturity payments and surrender payments, including:	
			(i)	the smoothing policy applied to each type of with-profits policy;
			(ii)	the limits (if any) applied to the total cost of, or excess from, smoothing; and
			(iii)	any limits applied to any changes in the level of maturity payments between one period to another.

(2)	**Investment strategy**	Significant aspects of the regulated entity's investment strategy for its with-profits business or, if different, any with-profits fund, including:	
		(a)	the degree of matching to be maintained between assets relevant to with-profits business and liabilities to with-profits policyholders and other creditors;
		(b)	the regulated entity's approach to assets of different credit or liquidity quality and different volatility of market values;
		(c)	the presence among the assets relevant to with-profits business of any assets that would not normally be traded because of their importance to the regulated entity, and the justification for holding such assets; and
		(d)	the regulated entity's controls on using new asset or liability instruments and the nature of any approval required before new instruments are used.
(3)	**Business risk**	The exposure of the with-profits business to business risks (new and existing), including the regulated entity's:	
		(a)	procedures for deciding if the with-profits business may undertake a particular business risk;
		(b)	arrangements for reviewing and setting a limit on the scale of such risks; and
		(c)	procedures for reflecting the profits or losses of such business risks in the amounts payable under with-profits policies.
(4)	**Charges and expenses**	(a)	The way in which the regulated entity applies charges and apportions expenses to its with-profits business, including, if material, any interaction with connected firms / persons.
		(b)	The cost apportionment principles that will determine which costs are, or may be, charged to a with-profits fund and which costs are, or may be, charged to the other parts of its business of its shareholders.
(5)	**Management of inherited estate**	Management of any inherited estate and the uses to which the regulated entity may put that inherited estate.	
(6)	**Volumes of new business and arrangements on stopping taking new business**	If a regulated entity's with-profits fund is accepting new with-profits business, its practice for review of the limits on the quantity and type of new business and the actions that the regulated entity would take if it ceased to take on new business of any significant amount.	
(7)	**Equity between the with-profits fund and any shareholders**	The way in which the interests of with-profits policyholders are, or may be, affected by the interests of any shareholders of the regulated entity.	

The following table sets out guidance on how various information relevant to some of the issues covered in a regulated entity's PPFM (as above) might be split between with-profits principles and with-profits practices. This is an example of the matters a regulated entity should address in its with-profits principles and with-profits practices and is not exhaustive. A regulated entity should consider carefully the scope and content of its PPFM as appropriate.

Reference to PPFM issues	With-profits principles	With-profits practices
(1) Amount payable under a with-profits policy	General (a) Circumstances under which any historical assumptions or parameters, relevant to methods used to determine the amount payable, may be changed;	General (e) For each major class of with-profits policy, methods establishing the main assumptions or parameters that decide the output of methods that determine the amount payable; (f) Degree of approximation allowed when assumptions or parameters are applied across generations of with-profits policyholders or across different types or classes of with-profits policies; (g) Formality with which the methods, parameters or assumptions used are documented; (h) Target range, or target ranges, that have been set for maturity payments; (i) Factors likely to be regarded as relevant to address policyholders' interests or security when determining excess surplus; and Investment return, expenses or charges and tax (j) How investment return, expenses or charges and tax are brought into account and how the impact of those items is determined on the amount payable. In particular: (i) any distinctions made in recognising the investment return from a subset of the total assets of a with-profits fund; (ii) whether expenses are apportioned between all the policies in a with-profits fund or apportioned in some other way; (iii) the relationship between the liability to tax attributed to a with-profits fund and the tax that the regulated entity imputes to determine the amount payable; (iv) impact on the amount payable of any attributed liability to tax of a with-profits fund as a result of the regulated entity making a transfer to shareholders; and (v) how any other items are brought into account.
	Bonus rates (b) General aims in setting bonus rates and the constraints to which the regulated entity may be	Bonus rates (k) Current approach to setting bonus rates, including the weight given to recent economic experience. For final bonus rates, the description should include any

	subject in changing economic circumstances; (c) How the range of with-profits policies or generations of with-profits policies over which the regulated entity believes a single bonus rate would be appropriate is determined and the circumstances under which it believes a new bonus series would be necessary; and	distinctions made between with-profits policies that remain in force until contractual dates, or dates on which no market value reduction applies (for example, maturity or retirement dates) and policies that are surrendered or transferred at other dates; (l) Frequency at which bonus rates are re-set or expected to be re-set and the circumstances under which changes in the economic environment would cause the time between re-setting to change; (m) Maximum amount by which annual bonuses would alter if annual bonus rates were reset; (n) Approach to setting any interim bonus rates before the next declaration of annual bonus rates; (o) Relationship or interaction between final bonus rates and any market value reductions, if both can apply at the same time; (p) How final bonus rates influence the value of with-profits policies that have formulaic surrender or transfer bases (for example, older conventional policies rather than unitised policies); and
	Smoothing (d) Statement as to whether smoothing is intended to be neutral over time.	Smoothing (q) Any differences in approach for: (i) the various types of with-profits policy; (ii) different categories of pay-out, such as between surrendered policies and maturing policies; and (iii) different generations of with-profits policyholders.
(2) Investment strategy	(a) How the types, classes or mix of assets are determined; and (b) Strategy in respect of derivatives and other instruments.	(c) Whether and to what extent there is hypothecation of assets; (d) Period between formal reviews of investment strategy; (e) Approach to investment in different asset classes, and assets of different credit or liquidity quality, including assets not normally traded; and (f) Details of any external support available to the with-profits fund and how this affects the investment strategy.
(3) Business risk	(a) Where a regulated entity explicitly excludes business risk from a class of with-profits policies but there are residual risks, clarification where these risks such as guarantee and smoothing costs are borne; and	(c) Current limits which apply to the taking on of business risk; and (d) Whether and to what extent particular generations of with-profits policyholders or classes of with-profits policies bear or might bear particular business risks, including for example, crystallised or contingent guarantees to other classes of

	(b) Define where compensation costs from a business risk would be borne.	policyholders or whether the out-turn from all business risk is pooled across all with-profits policies.
(4) Charges and expenses	(a) Factors that would drive any change to the basis on which the regulated entity applies charges to or apportions its actual expenses amongst with-profits policies, or exercises any discretion to apply charges to particular with-profits policies.	(b) Charges currently applied and the expenses currently apportioned to major classes of with-profits policies; (c) Relationship between the regulated entity's actual charges and expenses, as applied to determine the amounts payable under with-profits policies, and the charges and expenses borne by the with-profits fund; (d) Circumstances under which expenses will be charged to the with-profits fund at an amount other than cost, and the reasons why; and (e) Interval for reviewing any arrangements for out-sourced services, including those provided by connected parties, giving a broad indication of the terms for termination.
(5) Management of inherited estate	(a) Preferred size or scale of inherited estate and implications for the values of the-with profits policies; and (b) Any existing division of the inherited estate between with-profits funds; and (c) Any constraints on the freedom to deal with the inherited estate as a result of previous dealings.	(d) How the inherited estate is used, for example, in meeting costs; (e) Whether the investment strategy for the inherited estate differs from the rest of the with-profits fund; and (f) Any current guidelines in place as to the size or scale of the inherited estate or as to how and over what time period the inherited estate would be managed, if it becomes too large or too small.
(6) Equity between the with-profits fund and any shareholders	(a) Arrangements for, and any changes to, profit sharing between shareholders and with-profits policyholders.	(b) Current basis on which profit between with-profits policyholders and shareholders is divided; and (c) Whether the pricing of any policies being written, and particular policies open to new business, appear to be significantly and systematically reducing the inherited estate if the shareholder transfer is taken into account.

6. Guidance on claims handling procedures

The guidance in this section is issued to supplement the requirements of paragraph 24 of the Code. It covers the Authority's expectations for the fair treatment of customers in circumstances of non-disclosure or misrepresentation occurring during the insurance application, servicing and claims process.

The Authority expects insurers to ask clear questions about facts they consider material as part of the application and renewal process.

Where an insurer has asked a clear question, it is reasonable to assume that the policyholder realised that the information would be relevant to the insurer.

Insurers should also expect customers to answer such questions carefully, accurately and to the best of their knowledge or belief.

However, customers cannot be expected to provide information that they are not asked for.

Categories of Non-Disclosure / Misrepresentation

When considering non-disclosure for the purpose of assessing a claim, the failure of policyholder to disclose material information that an insurer has asked for may be considered under the following groupings:

- Innocent – where it is apparent that the customer has acted honestly and reasonably;
- Negligent – applies in circumstances where a policyholder has failed to exercise reasonable care in providing material information requested by an insurer;
- Deliberate, reckless or without any care – where it is evident, on the balance of probabilities, that a policyholder knew or must have known that the information was incorrect and relevant to the insurer, or that the policyholder did not care whether it was or not.

Assessment of claims

In assessing claims, insurers should -

- rely only on the answers given or withheld;
- consider the circumstances of the non-disclosure or misrepresentation and in particular whether it was deliberate, negligent or innocent as described above. Before making any judgement, the insurer should ask the policyholder why the information was incomplete or incorrect. A credible explanation might indicate to the insurer that the policyholder was not acting deliberately or without care.
- consider whether the information omitted or misrepresented was material to the claim, in that it would have induced the insurer to make a different underwriting decision.

If the customer has a credible explanation and/or there are other credible mitigating circumstances, or if the information omitted or misrepresented was relatively unimportant, consideration should be given to whether a proportionate remedy could be proposed based on what would have happened if the information had been disclosed correctly.

The Authority considers that rejecting or avoiding a policyholder's claim should be limited to circumstances where the non-disclosure or misrepresentation can be demonstrated to have been deliberate or reckless.

7. Guidance on products closed to new business

The guidance in this section is issued in consideration of the requirements of the Code and sets out the Authority's expectations in respect of products that are closed to new business.

The Code explicitly exempts regulated entities from the requirement to produce a Key Information Document ("KID") for any product that is closed to new business (under paragraph (7)(2)(b)) and so paragraphs (8)-(10) in relation to content and issue of the KID also would not apply. This also means that any top up made on a product that is closed to new business would not require a KID to be issued.

In relation to top ups on products closed to new business, there is no exemption from paragraph 18 of the Code (cancellation rights) and so any top ups paid will require disclosure of the right to cancel.

Those sections of the Code that are relevant to in force business, e.g. paragraph 23 in relation to post sale disclosure and paragraph 24 in relation to claims handling, will remain a requirement for products closed to new business. However, it is the Authority's expectation that paragraphs 6, 16 and 17 will also not apply to products closed to new business because regulated entities will not continue to market such products.