

Supervisory Statement | SS14/15

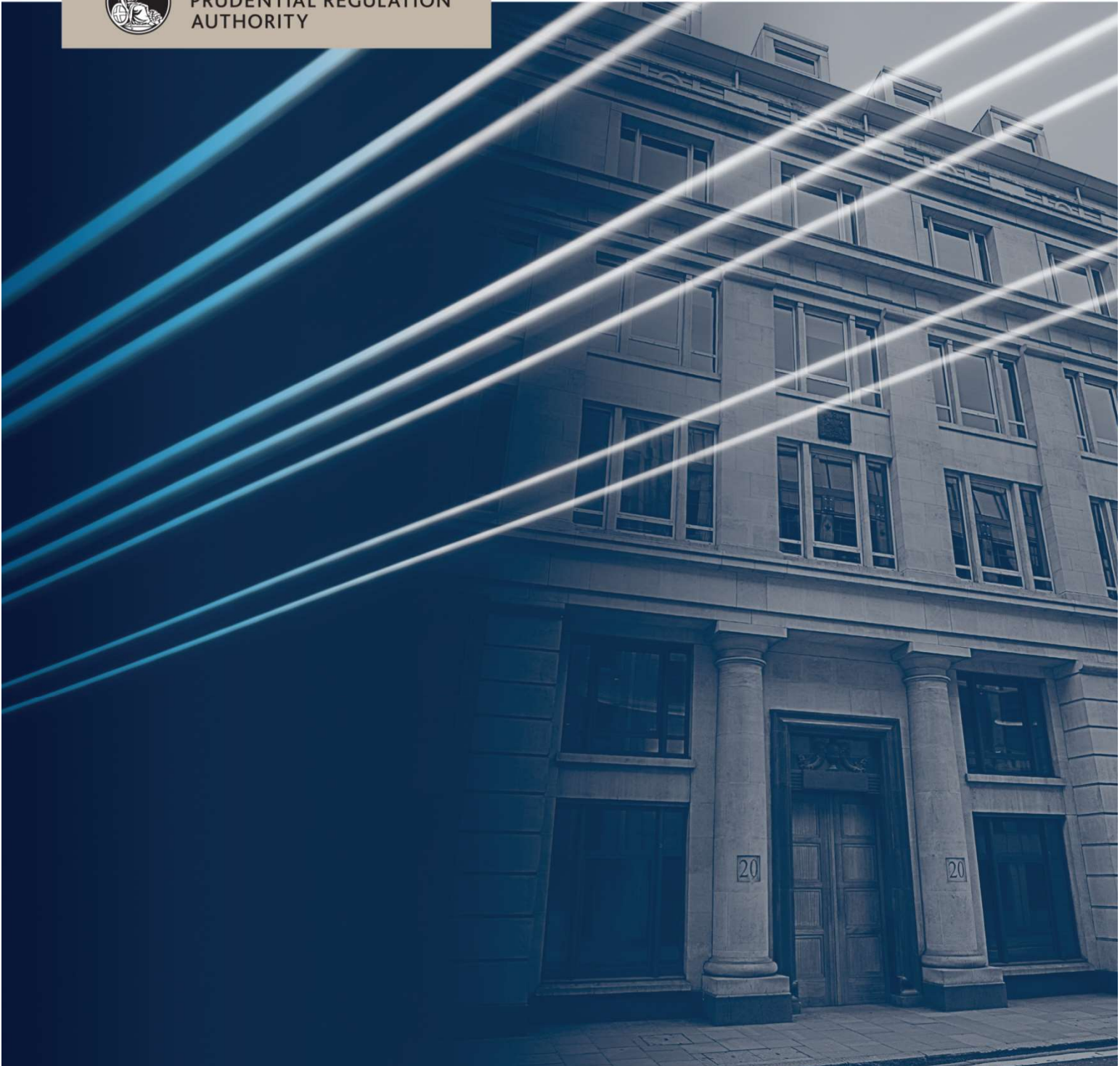
With-profits

November 2024

(Updating March 2015)



BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY



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1 Introduction

1.1 This supervisory statement is directed to all UK firms that write¹ with-profits insurance business. By setting out the Prudential Regulation Authority's (PRA's) expectations of firms that write such business, this statement promotes the safety and soundness of those firms and the benefit security of policyholders.

1.2 Both conduct and prudential matters are relevant to the regulation of with-profits insurance business. The PRA expects that firms will need to have regard to the following rules and regulations when writing and administering with-profits insurance business:

(a) for Solvency II firms, the PRA Rulebook including ring-fenced fund provisions, and for non-Directive firms any PRA-designated rules in prudential sourcebooks;²

(b) any relevant supervisory statements; and

(c) the Financial Conduct Authority's (FCA's) Handbook.

1.3 The PRA has considered matters to which it is required to have regard, and it considers that this statement is compatible with the Regulatory Principles and relevant provisions of the Legislative and Regulatory Reform Act 2006. This statement is not expected to have any direct or indirect discriminatory impact under existing UK law.

1.4 This statement has been subject to public consultation³ and reflects the feedback that was received by the PRA.

2 Solvency II ring-fenced fund (RFF) regime

2.1 The PRA Rulebook contains provisions which affect both the determination of own funds and the solvency capital requirement (SCR), where RFFs arise. The assessment of whether an arrangement gives rise to a RFF is based on the restrictions which apply to the use of certain assets or own funds. These restrictions may arise from the particular characteristics of the arrangement, contract or product.⁴

2.2 Restrictions on assets and own funds result from the nature of, and regulatory regime for, with-profits insurance business in the United Kingdom. As communicated in SS1/14,⁵ the PRA expects that such restrictions will generally mean that each with-profits fund displays the characteristics of a RFF. A Solvency II firm will therefore be required to reflect the lack of availability of assets and own funds within the with-profits fund to cover the risks of the rest of the firm.

2.3 Where a firm operates sub-funds within a with-profits fund, it will need to determine whether any or all of those sub-funds should be treated as separate with-profits funds as provided for in the FCA's Conduct of Business Sourcebook chapter 20 (COBS 20). If the

¹ By referring to firms that write with-profits business, the PRA intends for this to capture not only firms which actively write new with-profits business, but also firms with closed with-profits funds.

² Prudential Sourcebook for Insurers (INSPRU); General Prudential Sourcebook (GENPRU); Interim Prudential Sourcebook for Insurers (IPRU(INS)); Supervision (SUP); and Interim Prudential Sourcebook for Friendly Societies (IPRU(FSOC)).

³ PRA Consultation Paper CP16/14, 'Transposition of Solvency II: Part 3';

⁴ <http://www.bankofengland.co.uk/pru/Documents/publications/cp/2014/cp1614.pdf>.

⁵ More information on RFF restrictions is available in EIOPA's guidelines paper on RFFs: <https://www.bankofengland.co.uk/-/media/boe/files/paper/2020/december/gl-ring-fenced-funds.pdf>

⁵ PRA Supervisory Statement SS1/14, 'Mutuality and with-profits funds: a way forward';

<https://www.bankofengland.co.uk/prudential-regulation/publication/2014/mutuality-and-with-profit-funds-a-way-forward-ss#:~:text=The%20PRA%20updated%20Supervisory%20Statement,a%20change%20in%20PRA%20policy.>

arrangements governing a sub-fund mean that the fund needs to be treated as a separate with-profits fund then the PRA expects that each such fund would be treated as a RFF under Solvency II.

3 Support arrangements

3.1 Firms sometimes seek to provide support to a with-profits fund from financial resources outside that fund. These support arrangements can take a variety of forms and are intended for use in a wide range of different circumstances. Where such support arrangements are intended to provide benefit security for policyholders, the PRA will need to consider, in the light of the terms governing their use and other relevant factors, whether they achieve their purpose. In particular, the PRA will expect firms to be able to justify their use of these arrangements, where the financial resources to which they relate may also be intended to support other areas of the firm's business.

3.2 The PRA expects Solvency II firms to consider whether any support arrangements that exist in relation to a with-profits fund also fall within the Solvency II RFF requirements, having regard to the terms and conditions of those arrangements. In particular, firms should take into account the extent of any restrictions on a firm's use of assets associated with support arrangements, and the expected availability of such assets in stressed conditions.

3.3 Where the terms and conditions of a support arrangement state clearly that the support is for the exclusive use of a with-profits fund, the PRA expects that arrangement will be treated as a RFF following the definition in the PRA Rulebook Glossary. Any assets associated with such a support arrangement will form part of the RFF constituted by the with-profits fund receiving support. The PRA considers support for a with-profits fund to be 'exclusive' if under the terms of the arrangement it cannot be used to meet losses arising in other areas of the business.

3.4 Where support is not for the exclusive use of a with-profits fund, the PRA expects that assets associated with support arrangements should not generally form part of the Solvency II RFF constituted by the with-profits fund receiving support. In this case, the expectations of the PRA in respect of those arrangements are as follows:

(a) The extent to which the PRA will permit a Solvency II firm to recognise and use such support assets as part of the financial resources available to meet the liabilities of the with-profits fund will depend on the PRA's view of the financial strength of the overall firm, including the parts of the firm which are subject to the RFF regime and those which are not. The PRA's view will be based on an assessment of the risks involved, the degree of reliance placed on such support, and may include consideration of factors outside a with-profits fund which could have a negative or detrimental impact on the financial strength of the firm, including the ability of the arrangement to support the with-profits fund in periods of stress.

(b) In certain circumstances the PRA might expect a Solvency II firm to recognise a with-profits support arrangement as providing exclusive support to a with-profits fund. In those cases, the PRA might expect a firm to identify specific support assets and to include them within the RFF constituted by the with-profits fund receiving support, in advance of it drawing upon a support arrangement, and any transfer of assets from outside to inside the with-profits fund associated with such an action.

4 Affordability and sustainability of distribution strategies

4.1 When assessing the affordability and sustainability of distribution strategies of with-profits firms, the PRA will consider whether those strategies are consistent with its objectives. The PRA expects firms not to make distributions from with-profits funds which could endanger the safety and soundness of the overall firm, or which could have a significant negative impact on the benefit security of any group of policyholders.

4.2 Firms should not set with-profits distribution strategies which accelerate the transfer of profits outside the with-profits fund and which increase shareholder distributions while posing increased risk to benefit security and the safety and soundness of the firm. This includes the approach firms might take when making or considering special/one-off distributions.

4.3 When taking a view on the affordability of distributions from a with-profits fund, firms should give due consideration to the With-Profits 2.1 in the With-Profits Part of the PRA Rulebook, which requires firms to hold assets sufficient to meet liabilities within the with-profits fund.

5 Investment strategy of with-profits funds

5.1 When setting an investment strategy for a with-profits fund, the PRA expects firms to take into account any regulatory requirements, including:

(a) for Solvency II firms, the prudent person principle set out in Investments 2 to 5 in the PRA Rulebook and RFF requirements in Own Funds 3L in the PRA Rulebook, and for non-Directive firms any PRA-designated rules in prudential sourcebooks;

(b) financial resources requirements and the availability of capital resources;

(c) any applicable conduct rules and guidance issued by the FCA; and

(d) any communication to policyholders in compliance with the relevant FCA conduct rules.

6 Separation of different with-profit business

6.1 The PRA expects firms to maintain, in respect of each with-profits fund, separate accounting records so as to enable the firm to satisfy all relevant requirements in relation to that fund and in particular, having regard to:

(a) the relevant FCA conduct rules in COBS 20;

(b) the PRA rules in respect of with-profits and surplus funds; and

(c) for Solvency II firms, the prudent person principle and the RFF requirements of the PRA Rulebook, and for non-Directive firms any PRA-designated rules in relevant prudential sourcebooks.

7 Significant changes in with-profits funds

7.1 Consistent with the Fundamental Rules, the PRA expects firms to inform their supervisors of any plans to make significant changes to the operation, management or business strategy of a with-profits fund, so that the PRA can take a view on the impact of those changes on the safety and soundness of the firm. This would include providing the PRA with appropriate advance notification of the following actions:

- (a) ceasing to effect new contracts of insurance in a with-profits fund;
- (b) proposing changes to run-off plans for a closed with-profits fund; 4 With-profits March 2015
- (c) proposing a reattribution of inherited estates;
- (d) proposing a demutualisation; and
- (e) planning a Part VII transfer.

7.2 The above list is not intended to be exhaustive, and the PRA expects firms to engage in early dialogue with it, in addition to complying with any FCA requirements, in advance of any significant changes to the business or structure of a with-profits fund.

8 Reducing new business sales, closing to new business and submission of run-off plan

8.1 A firm should notify the PRA on a timely basis if it plans to reduce sales of new with-profits policies to a minimal level and to explain the expected impact of such plans on its with-profits fund.

8.2 A firm proposing to close a with-profits fund to new business should notify the PRA on a timely basis. The PRA expects such a firm to submit a run-off plan as soon as reasonably practicable.

8.3 The PRA expects that a firm operating a closed with-profits fund would periodically review and update its run-off plan in light of experience, to ensure that the run-off plan remains appropriate. Any revisions to the run-off plan for a closed with-profits fund should be submitted to the PRA.

9 Reattributions of inherited estate

9.1 A reattribution of inherited estate will need to be considered by the PRA to assess its implications on the PRA's objectives. It must also comply with any FCA requirements.

9.2 When assessing a proposed reattribution, the PRA will consider the impact of the scheme and any payments or adjustments to benefits associated with it on the:

- Firm's safety and soundness; and
- Degree of protection for the firm's with-profits policyholders.

9.3 A firm that is seeking to make a reattribution of the inherited estate associated with a with-profits fund should first submit to the PRA:

- (a) projections for capital required to support existing business and financial resources available to meet those requirements;
- (b) an assessment of the firm's future risk appetite for the with-profits fund and other relevant business;

(c) projections for capital required to support future new business, including an assessment of new business volumes, product terms and pricing margins; and

(d) any restrictions on the transferability or availability of assets likely to result from the reattribution and their impact on the solvency position and financial strength of the firm.

10 Demutualisation

10.1 A mutual firm that is seeking to demutualise should first discuss with the PRA the expected impact on the firm's financial position, structure, business model, and strategy, so that the PRA can take a view on the potential impact of the transaction and assess if, in the context of the firm, the transaction is consistent with the PRA's objectives.

11 With-profits mutual waivers

11.1 As set out in SS1/14,⁶ a mutual firm seeking to apply for a with-profits mutual waiver should apply to the FCA in the first instance. The FCA and PRA will then co-ordinate activities during their review of the waiver application.

11.2 The PRA expects a firm applying for a with-profits mutual waiver to submit appropriate supporting evidence to enable it to assess the application and to determine whether the proposed actions are likely to meet the statutory tests, and are consistent with the PRA's objectives.

12 Part VII transfers

12.1 Firms considering a transfer of with-profits insurance business should first discuss with the PRA the expected impact of the transfer on the financial position, structures, business models, and strategies of both the transferring and receiving firm, so that the PRA can take a view on the potential impact of the transaction and assess if, in the context of those firms, the transaction is consistent with the PRA's objectives.

⁶ PRA Supervisory Statement SS1/14, 'Mutuality and with-profits funds: a way forward'; <https://www.bankofengland.co.uk/prudential-regulation/publication/2014/mutuality-and-with-profit-funds-a-way-forward-ss#:~:text=The%20PRA%20updated%20Supervisory%20Statement,a%20change%20in%20PRA%20policy..>

Appendix: SS14/15 updates

SS14/15 was originally published in March 2015.

This appendix details the changes that were made to this SS following its initial publication.

15 November 2024

This SS has been updated alongside the publication of Policy Statement (PS) 15/24 - Review of Solvency II: Restatement of assimilated law.⁷ This includes updating all previous references to the Commission Delegated Regulation (EU) 2015/35 so as to now refer to the relevant rule(s) in the PRA Rulebook. In addition, the following changes were made:

- minor re-drafting to paragraph 3.3 to accommodate the introduction of the definition of the term 'ring-fenced fund' in the PRA Rulebook Glossary; and
- minor corrections to fix broken links in footnotes.

⁷ www.bankofengland.co.uk/prudential-regulation/publication/2024/november/review-of-solvency-ii-restatement-of-assimilated-law-policy-statement.