



## Guidance for unit linked single premium bonds – suitability of assets to policyholders

### 1. Introduction

The Insurance (Conduct of Business) (Long Term Business) Code 2018 (“the Code”), binding guidance issued under the Insurance Act 2008, requires insurers authorised to carry out insurance business of Class 1 and 2, pursuant to the Insurance Regulations 2018 (hereafter “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.

**The Financial Services Authority (“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 guidance this would tend to indicate compliance with the legislative provisions, and vice versa.**

### 2. Single premium “portfolio bonds”

This guidance applies to insurers authorised to undertake Class 1 linked long term business and specifically relates to “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 to 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:

## 2.1 Asset vetting

In deciding what assets may be made available for linking to a portfolio bond product, insurers will typically develop and publish 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 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 within the UK FCA'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.

## 2.2 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 policy 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.

### **2.3 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<sup>1</sup> and non-retail policyholders.

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

### **2.4 Use of a discretionary asset / fund manager (“DFM”)**

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<sup>1</sup> 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. The Authority has not defined what a retail client is because the Code as written does not require this.



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 DFM's 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 income;
  - apply dividends;
  - vote, accept takeovers or the take up and exercise rights
- Review the permitted investments under the agreement to ensure it falls within the insurers investment acceptance guidelines as set out in 2.1
- 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