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Financial Services Authority
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By post and email (cp12_38@fsa.gov.uk)

Dear Sir

Re: CLLS Insurance Law Committee response to FSA consultation paper CP 12/38 ("Mutuality and with-profits funds: a way forward")

The City of London Law Society ("CLLS") represents approximately 15,000 City lawyers through individual and corporate membership including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multi jurisdictional legal issues.

The CLLS responds to a variety of consultations on issues of importance to its members through its 19 specialist committees. This response in respect of FSA consultation paper 12/38 ("Mutuality and with-profits funds: a way forward") has been prepared by the CLLS Insurance Law Committee.

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

1.1 We do not express a view on whether or not the proposals are fair to with-profits policyholders. We have, however, highlighted below some areas where we think the proposals lack clarity or provide insufficient certainty for firms.

1.2 Paragraph 2.16 of the paper states that "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, it is not clear in what circumstances

a firm would be required to use such a legal process and there is no reference to this as a requirement in the draft Handbook text. It would be helpful if this point were clarified. Although there may be circumstances in which a legal process is necessitated by the firm's constitution or policyholder documents, we think it should be clear that the proposed new mechanism is available as an alternative in all other cases and not only where other processes are not available/ viable.

1.3 In describing the process for separating the different interests in the common fund, the FSA comments in paragraph 2.16 that "It would not be a reattribution." However, the draft Handbook text requires a mutual undertaking this process "to demonstrate that the exercise does not amount to a reattribution". The narrative suggests that the process would be deemed not to be a reattribution, whereas the Handbook text puts the burden on the firm to show that the exercise does not involve a reattribution. This creates a degree of uncertainty.

It would be preferable if the Handbook text stated clearly that, provided certain basic criteria were met, the process would be deemed not to be a reattribution, and set out what these criteria are. This should also apply to situations where an available legal process is used to achieve the same result.

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

As outlined in paragraph 2.25, the proposed process would involve a firm applying for a modification to change the definition of a with-profits fund for that firm "as it relates to the relevant rules in COBS 20". The same paragraph goes on to state 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".

The draft Handbook text suggests that the rule modification will modify "the relevant provisions in COBS 20 which are dependent on the definition of the with-profits fund". The FSA does not stipulate to which provisions the rule modification could apply.

It is therefore unclear from the paper whether the effect of the rule modification will be to:

- amend the definition of the with-profits fund to recognise the mutual members' fund separately but only in the application of the COBS 20 rules

- amend the definition of the with-profits fund to recognise the mutual members' fund separately for "regulatory purposes" generally (i.e. in whatever context the defined term "with-profits fund" is used in the Handbook)

- amend the provisions of COBS 20 which use the defined term "with-profits fund".

This point should be clarified. In addition, if the intention is that the modification will only be relevant to COBS 20 then consideration should be given to whether this is the correct approach. For example, INSPRU 1.1.27 provides that:

"A firm carrying on long-term insurance business must ensure that it has admissible assets in each of its with-profits funds of a value sufficient to cover:

(1) the technical provisions in respect of all the business written in that with-profits fund; and

(2) its other long-term insurance liabilities in respect of that with-profits fund.

Where a mutual members' fund has been separated from the with-profits assets, it would seem logical for the definition of the with-profits fund to be adjusted for the purposes of INSPRU 1.1.27 so that it is clear that the mutual members' fund is not part of the with profits fund for these purposes. Similar issues arise with the application of the WPICC under INSPRU 1.3.

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

No comment.

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.

No comment.

Yours sincerely

Alasdair Douglas
Chair, CLLS

THE CITY OF LONDON LAW SOCIETY
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