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Two Vital Questions for the FSA

Spottiswoode writes to Treasury Select Committee about reattribution rules

Clare Spottiswoode CBE, policyholder advocate in the proposed Norwich Union reattribution of inherited estates, has written today to the Chairman of the Treasury Select Committee, as the Financial Services Authority prepares to give evidence on its Annual Report on Tuesday 22 January. (Letter attached.)

She said today:

'I have written today with two vital questions for the FSA that could affect the outcome of reattributions for millions of with-profits policyholders.

'First, the FSA has said that it is content for current policyholders to subsidise new business by allowing a firm to keep capital in an inherited estate which would otherwise have been available to be paid out to current policyholders as special distributions. This has the effect of passing on rights to an inherited estate between generations of policyholders. If the fund was to close the benefits would be shared 90 per cent to policyholders and 10 per cent to shareholders. In a reattribution the estate becomes shareholder owned. I have asked whether the FSA regards it as important that current policyholders should be compensated for this transfer.

'Second, the FSA's recent guidance confirms that it expects firms to distribute excess capital in an inherited estate as it arises. The FSA also said 'The policyholder advocate will take into account the probability that there may be future surpluses generated by the fund that would be distributed to policyholders.' In the light of this it is important to confirm that the concept of Policyholders Reasonable Expectations (PRE) can no longer be said to be zero.

'This is important because the industry maintains that PRE does equal zero. If that is the case, any incentive payment offered in a reattribution is regarded as a windfall and the firm may consider that it could limit its offer to the rights that current policyholders are giving up, taking the share of the estates that would otherwise fall to future policyholders for free. Clarification that PRE no longer equals zero can have a significant effect on the benefits that current policyholders might be offered.

'It is important to pursue these matters with the FSA and the FSA itself has confirmed that a policyholder advocate "...can challenge any part of the with-profits fund in the course of negotiations with the firm." (FSA letter dated 6 December 2007 titled 'Reattribution of inherited estates'.)

'I have raised these matters with the FSA over a number of months during which time I have pursued the negotiations with Norwich Union on that

specific reattribution. I am committed to doing all I can to achieve a fair deal. Ultimately, however, it will be for policyholders to decide whether the outcome is fair when it is put to them. ‘

Jonathan Haslam

Notes for editors

1. Clare Spottiswoode was appointed policyholder advocate on 21 November 2006 in the case of the possible reattribution of inherited estates by Norwich Union.
2. There are about 1 million policyholders and the two funds concerned are worth more than £5 billion.
3. An inherited estate is defined by the FSA as the excess of realistic assets over realistic liabilities in a with-profits fund. These surplus funds are used for a number of purposes including to provide working capital to support the with-profits fund.
4. Under FSA rules every year the firm must assess whether there is excess surplus in the inherited estate. The calculation will depend on the level of working capital required, for example, the more the firm wants to invest in higher risk and higher return assets, the more assets have to be retained to minimise the risk that the policyholders' guaranteed benefits will not be met. The calculation of excess surplus importantly also depends on the firm's forecast of new business now that the FSA has confirmed that the intergenerational subsidy from current policyholders will continue. The greater the new business subsidy the lower will be the excess surplus available for distributions to current policyholders.