GN22: Disclosure – FSA Rules

Classification
Recommended Practice

MEMBERS ARE REMINDED THAT THEY MUST ALWAYS COMPLY WITH THE PROFESSIONAL CONDUCT STANDARDS (PCS) AND THAT GUIDANCE NOTES IMPOSE ADDITIONAL REQUIREMENTS UNDER SPECIFIC CIRCUMSTANCES

Definitions

Defined terms appear in italics when used in the standard.

Reference	Definition
FSA	Financial Services Authority

Legislation or Authority
Financial Services Authority Conduct of Business Rules (COB Rules)

Application
Any actuary called upon to advise a life office or friendly society or other provider of retail investment products (hereinafter referred to as the 'Actuary').

This Guidance Note deals with:

(i) advice given on the disclosure of remuneration;

(ii) advice given on the allocation of expenses to with-profits business and investment-linked contracts where some or all of the charges may not be explicit.

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Part I: Remuneration Disclosure

1 Introduction

1.1 Where a policy is sold by a company representative, or where a representative otherwise receives remuneration from the sale of the policy, the rules of the *FSA* require firms to disclose the remuneration appropriate to the policy.

1.2 The remuneration to be disclosed is to include both cash payments and the cost of benefits and services provided. UK firms should take the advice of an actuary regarding the costs of benefits and services to be included in determining the remuneration and the way in which the total of those costs will be apportioned over individual packaged product transactions. The remuneration must be disclosed ‘ in a way that is clear, fair and not misleading.’

1.3 *FSA* Guidance which accompanies the COB Rules should be carefully studied.

1.4 In the case of a company representative employed by an appointed representative who is not a connected person vis-à-vis the firm, the remuneration will be based on the amount of commission paid and services provided to that appointed representative by the firm.

1.5 Where the company representative is employed by an appointed representative who is a connected person vis-à-vis the firm or where the company representative is employed by a marketing associate (e.g. a Bank) which is itself regulated by *FSA*, the remuneration will be the payments, benefits and services provided to the company representative whether provided by the product provider or by the appointed representative or marketing associate. In addition a profit margin will be added to reflect comparability with IFA firms and unconnected appointed representative firms, where the commission payments effectively include a profit element.

1.6 In cases where a commission payment is made to a marketing associate or connected appointed representative, the amount disclosed should not be less than the amount which would be disclosable were the marketing associate or appointed representative unconnected with the firm.

1.7 The objective of the rules is that the amounts disclosed by company representatives should be, as far as possible, consistent with the amounts of commission that would be disclosed by an independent intermediary. For example, benefits which can be excluded from IFA commission disclosure can be excluded from the disclosure of company representative remuneration.

1.8 In Part I of this Guidance Note, benefits and services refer to those benefits and services the costs of which must be disclosed as part of the cost of remuneration according to section 5.7 of the COB Rules. The Actuary should consult with the firm’s Compliance Officer to ensure that all the costs of those categories of benefits and services which fall within remuneration disclosure have been included.

1.9 There may be circumstances where the firm believes that a straight addition of all the disclosable costs may give rise to a misleading result. One such situation might be the start-up of a new company where the very high initial overhead costs of establishing distribution channels are being met out of shareholders' capital rather than expense loadings. For equivalence with established firms, it may be appropriate in this situation for some of the otherwise disclosable costs to be excluded. Such circumstances should be discussed with the Compliance Officer.

1.10 In cases of doubt about whether certain categories of cost should be included or excluded, the Compliance Officer may wish to consult directly with *FSA* or the Actuary should consult directly, with the agreement of the Compliance Officer.

2 Remuneration

2.1 The estimation of the cost of benefits and services should normally be based on the most recent relevant experience of the firm. Deviation from this will be appropriate, however, when:

2.1.1 the Actuary has reasonable grounds to believe that the remuneration for the period concerned will be higher than that implied by the experience; or

2.1.2 the Actuary has strong grounds to believe that the remuneration for the period concerned will be lower than that implied by the experience; or

2.1.3 no such experience is available, in which case the estimation should be based on business plans which the Actuary has strong grounds to believe are achievable.

2.2 The costs of benefits and services should be split into new business costs and the costs of servicing existing clients. The costs attributable to servicing (e.g. handling enquiries on existing policies or processing claims) should be assessed directly in relation to the work carried out by the representatives. It should be noted that it may not be appropriate to assume that the split bears the same ratio as new business payments bear to renewal payments.

2.3 The profit margin referred to in Paragraph 1.5 should either be 15% or such lesser amount as the firm, after consultation with its Actuary, considers to represent the profit margin made from carrying out activities the costs of which are disclosable as part of remuneration ('disclosable activities'). In estimating whether a lesser profit margin than 15% would be appropriate possible approaches include:

2.3.1 A comparison with the remuneration scales of similar unconnected appointed representatives either of the same company or more generally in the market. For example, if the remuneration without the 15% uplift is lower than scales typically payable to unconnected representatives but with the 15% uplift the remuneration is higher, then an intermediate uplift may be appropriate.

2.3.2 An apportionment of the expected profit on the policy between that generated by disclosable activities and that by other activities (e.g. risk taking, administration, etc). In making such an apportionment, the Actuary should be careful not to overestimate the profit made on the other activities.

3 Construction of Remuneration Scales - General

3.1 The remuneration costs should be spread across the business using a new business remuneration scale and a servicing remuneration scale.

3.2 The principles set out in Paragraphs 3.3 to 3.7 should apply to the construction of remuneration scales.

3.3 The incidence of the remuneration should be disclosed as well as the amounts.

3.4 The new business remuneration scales when applied to the total value/volumes of business should reproduce the total remuneration costs (payments, benefits and services plus profit (if appropriate)), and similarly for the servicing scales.

3.5 The remuneration scale (for a given product) can be an average across the company representative sales force as a whole. If, however, a firm operates two or more different structures of sales force remuneration then the remuneration scale should be calculated separately for each.

3.6 Where a company representative agrees with an investor to forgo a part of his normal payment in order to improve the terms of the contract, the same uplift factor (see Paragraph 4.2.3) may be applied to the reduced payment, or the same monetary cost of benefits and services may be used, subject to the following constraints:

3.6.1 The ‘same uplift factor’ approach should only be adopted if the policyholder will *also* receive the full benefit of the lower of:

(i) the reduction in the amount of disclosed remuneration for non-financial benefits and services.

(ii) an equivalent proportion of the policy loadings intended to cover non-financial benefits and services.

3.6.2 Where the ‘same uplift factor’ approach (in Paragraph 3.6) is adopted, the proportion of payments forgone must be allowed for in calculating the uplift factor.

3.6.3 Where an average scale of remuneration is used, the percentage reduction in payment in respect of the individual salesman may be applied to the average payment in order to calculate the reduced payment.

3.7 Payments, benefits and services relating to non-investment business are to be disclosed in the circumstances outlined in COB Rules section 5.7.15 1(c)

4 Construction of Remuneration Scales -Suggested Methods

4.1 After being consulted by the firm, it will be up to the Actuary to recommend to that firm a suitable remuneration scale which conforms to the principles outlined above and those set out in the regulatory guidance. The following methods, however, are suggested in the circumstances outlined.

4.2 Where the company representative is paid by a transaction based payment scale related to volume and/or value of business sold:

4.2.1 The payment scale is adjusted for any over-ride payments based on new business volumes. Furthermore any additional (and previously undisclosed) commission (e.g. additional renewal commission) in respect of previous years' business is added. The payment scale applied to the anticipated new business should reproduce the anticipated payments.

4.2.2 The payment scale is divided into a new business payment scale and a renewal payment scale.

4.2.3 The cost of benefits and services is expressed in the form of a new business uplift factor and a servicing uplift factor.

$$\text{New business uplift factor} = \frac{\text{Cost of new benefits and services}}{\text{New business payments}}$$

$$\text{Servicing uplift factor} = \frac{\text{Cost of servicing benefits and services}}{\text{Renewal payments}}$$

4.2.4 The calculation may be done separately for as many or as few different classes of business as will ensure that any resulting differences are justified by actual differences in circumstances and that any significant differences are not masked. The calculation may be done separately for different classes of company representative or averaged across the sales force (see Paragraph 3.5).

4.2.5 The payment scales are grossed up by new business uplift factors or servicing uplift factors as appropriate to reflect the cost of benefits and services. The grossed up scales represent the new business and servicing remuneration scales, and are applied to the individual policy concerned to derive the disclosable remuneration.

4.2.6 Where the level of payment in the first year of a policy equals the level of payment in subsequent years (level payment scale) then, for the purposes of paragraph 4.2.3, 'new business payments' refers to the payments in the first policy year and 'renewal payment' refers to the level of payment in subsequent policy years.

4.2.7 If servicing costs are expected to be incurred in any year in which no renewal payments are to be made on a policy, disclosure should still be made, for example by using a technique similar to that described in Paragraph 4.3.

4.3 Where company representatives do not receive any payments related directly to value or volume of business (e.g. are paid by a fixed salary), item 11 of section 5.7.15 of COB Rules states that "costs should be apportioned over individual transactions in a way that reflects the value of the contract to the firm or the firm's marketing group".

4.3.1 The Actuary, in consultation with the firm, ascertains the relative measure of value placed on the individual contracts by the firm (or the firm's group). In this context it is appropriate to judge 'value' in relation to any (non-remunerated)

internal scale of success or validation which the firm applies to judge the relative success of individual salesmen, branches or regions. If no such scale exists it may be appropriate to judge 'value' broadly in relation to the expense contributions or charges generated by the contract or on a scale of value mutually agreed between the Actuary and the firm as being appropriate.

4.3.2 Salary costs are added to the costs of benefits and services and split between new business and servicing costs to determine new business remuneration and servicing remuneration. The apportionment of new business remuneration between individual contracts is according to the relative measure of value and an appropriate relative measure of value should be used to apportion servicing remuneration.

4.4 Where other methods of remuneration are employed, e.g. part salary and part related to the volume/value of sale, the salary element should be added to the cost of benefits and services and the method in Paragraph 4.2 may be employed.

5 Review of Scales

The Actuary should advise the firm if at any time the Actuary becomes aware that the remuneration figures have become misleading. A review should take place at least annually in consultation with the Compliance Officer.

Part II: Projections and Charges and Expenses Disclosure

6 Introduction

6.1 The Rules of *FSA* require firms to take into account charges and expenses, including cost of risk benefits, when calculating any projections of future benefits under retail investment products.

6.2 In determining appropriate charges regard shall be had to the principles contained in the *FSA* Guidance.

6.2.1 For a with-profits policy, the appropriate charges and expenses are defined as those expenses which a firm.

"reasonably determines to be appropriate to the contract having regard to:

(a) the principal terms of the contract;

(b) any tax relief which will be available to the firm in respect of so much of the firm's gross expenses as can properly be attributed to the contract;

(c) any transfers to shareholders' funds or equivalent retentions from established surplus offset by any sustainable rate of transfer of surplus from non-profit business;

(d) excluding dealing costs of the underlying portfolio; and

(e) any guidance published by the Institute of Actuaries or the Faculty of Actuaries (or by both jointly)."

6.3 The Rules of *FSA* also require disclosure of the accumulation of the charges and expenses expected to be levied against the contract including the cost of any protection benefits ('effect of deductions to date' and 'total actual deductions to date') and a statement of the effect of the appropriate charges (only) on the investment growth (reduction in yield).

6.4 Disclosure has to be made in the following documents:

6.4.1 Documents containing projections of future benefits (COB Rules section 6.6)

6.4.2 Key Features, which firms are required to prepare according to section 6.1.4 of COB Rules.

6.4.3 Post-Sale confirmation, which Life offices are required to send by post (or 'give' in the case of industrial life business) to investors in accordance with COB Rules sections 6.3.1 to 6.3.5.

6.4.4 The With-Profits Guide, which firms must provide to anyone requesting a copy (COB Rules section 6.9).

6.5 In the first three cases, the disclosure relates to the particular policy under consideration or, in certain circumstances, a contemporary example policy (using expenses and mortality at the level expected to be incurred over the period of use of the figures).

6.6 For With-Profits Guides, disclosure, limited to the reduction in yield, is also required in respect of example policies issued in past years (using actual expenses incurred).

6.7 The *FSA* states that a UK firm should consult with an actuary before making the determination referred to in Paragraph 6.2.

7 Applicability of Guidance

7.1 Part II of this Guidance Note has been prepared to assist the Actuary in providing advice when consulted by the firm in the circumstances set out above.

7.2 This guidance applies to both conventional and accumulating with-profits business.

7.3 This guidance, suitably interpreted, also applies to investment-linked contracts where some or all of the charges may not be explicit (including contracts the benefits of which are fully or partly linked to the value of an external index).

8 Equity and Commercial Sensitivity

8.1 The outcome of the apportionment will ultimately be reflected in published figures. The Actuary should ensure that the results of the apportionment give rise to figures which, in the context in which they will be presented, fairly reflect the expected effect of the appropriate charges upon the return under the policy and which are not believed to mislead.

8.2 The Actuary should bear in mind the commercial sensitivity of these figures, particularly projections, and should adopt an approach which is neither too conservative nor unduly optimistic (i.e. a ‘best estimate’ approach should be used).

9 Adjustments to Reported Expenses

9.1 The most recent commission and management expenses that were, or will be, reported in Form 41 of the HM Treasury Returns or, in the case of an authorised friendly society, Form 41 of the FSC Returns, will normally provide a suitable starting point for any expense apportionment.

9.2 Adjustments should be made where necessary to make the base more relevant to the purpose of the apportionment. Such adjustments may be required because of timing differences, for example accounting year vis-à-vis base year for expense

disclosure, and to ensure that all expenses properly attributable to the long-term business fund are included. For example, due allowance should be made for:

9.2.1 Notional interest forgone on subsidised loans to staff, appointed representatives or company representatives, including investments in appointed representative firms on non-commercial terms, using an appropriate commercial rate as a guideline;

9.2.2 Full commercial rent on premises occupied by the firm and owned by the firm (whether by the life fund or the shareholders' fund) or any other company within the group;

9.2.3 Either actual or SSAP 24/FRS17 contributions to staff pension schemes and medical expenses schemes. Whichever approach is adopted, that approach should be followed consistently from year to year;

9.2.4 Amortisation of capital expenditure in respect of purchase of equipment or of development costs (see Paragraph 9.3);

9.2.5 Bad debts on commission or any other advances or loans to appointed or company representatives or independent intermediaries;

9.2.6 Costs of investment management, but excluding dealing costs of the underlying portfolio and costs associated with the routine management and servicing of existing property investments;

9.2.7 Any cost incurred on behalf of the firm by another company within the same group, to the extent to which that other company is not reimbursed in full by the firm;

9.2.8 Where with-profits policies do not participate in the profits or losses of certain classes of business, expenses allocated to these classes do not need to be taken into account.

9.3 Development costs will normally be written off in the year in which they are incurred. Where, however, the development costs are of an exceptional one-off nature, they may be amortised over a limited period, related to the period over which the benefits of the expenditure are expected to be obtained, and not normally exceeding five years. If amortisation of development costs is adopted, the amortisation, with interest, of prior years' costs should be brought into account.

9.4 There may be circumstances where certain expenses will be met from the estate or shareholders' funds.

Examples might include:

9.4.1 Large, one-off costs (e.g. the compensation payable in respect of the *FSA* Review on Pension Transfers and Opt Outs).

9.4.2 Support for exceptional new business expenses in a particular year.

9.4.3 Support for maintenance expenses whilst cost-reduction measures are being taken.

9.4.4 Shareholders’ tax and/or shareholders’ additional tax.

9.5 In the circumstances envisaged in Paragraph 9.4, the expenses in question may be excluded from appropriate charges, provided that all the following conditions are met:

9.5.1 Sufficient finance is or will be demonstratively available from the estate or from shareholders’ funds as appropriate to meet such expenses as they arise. Where the expenses which will be met from the estate or from shareholders’ funds are expected to persist for most or all of the policy duration, it is particularly important that the Actuary can demonstrate how, on realistic assumptions, those expenses will never fall upon policyholders’ asset shares.

9.5.2 A firm commitment should exist that the resultant expense assumptions will be used as the basis for determining asset shares for the relevant policies both immediately and in the future. A board minute to this effect would typically be appropriate evidence.

9.5.3 Any reductions in incurred costs anticipated in future years should be evidenced by definite business plans on, in the opinion of the Actuary, realistic assumptions.

9.6 It is permissible to ignore the investment management costs on the estate.

9.7 Except as provided for in Paragraphs 9.4 and 9.6 it would not normally be appropriate to ignore any expenses attributable to the with-profits business.

9.8 Where a product invests in other packaged products it will be necessary to “look through” to ensure that all charges and expenses, both implicit and explicit, which the investor will bear are included.

10 Initial Apportionment

10.1 In making an apportionment, the Actuary would be expected to consider that some expenses will not vary with the volume of business (and may be regarded as fixed costs in the short term) whilst other expenses may increase or decrease as the volume of business rises or falls (and may be regarded as variable costs). The relationship with volume is not necessarily direct or proportionate and changes in variable costs may lead or lag behind changes in volume. The allocation between fixed and variable costs is not an exact science and this is especially so where large development costs are being incurred or if the company is young and small.

10.2 The Actuary may find it helpful first to divide costs into different categories, each of which may be subdivided into fixed and variable elements. Such categories might include:

(i) New business or initial costs (including the costs of cancellations from outset and unsuccessful sales efforts);

(ii) Renewal, maintenance or discontinuance costs;

(iii) Claim costs;

(iv) Investment costs;

(v) Development costs;

(vi) Overheads (e.g. general management).

Judgement must be exercised in any subdivision, although a degree of objectivity is possible in most categories.

10.3 The Actuary would also be expected to consider that many expenses can be identified with particular product lines, both with-profits and non-profit. This can be done either explicitly, or by the use of techniques such as time-spent analysis. The actual expense loadings implicit in with-profits policies may not be relevant to this process particularly if they are out of date. The Actuary should ensure that the allocation of expenses to non-profit business is fair and not in excess of those which are sustainable by that class of business.

10.4 The apportionment of overhead costs, which can be a significant proportion of the total expenses, requires considerable judgement and can be carried out in a number of credible and equitable ways depending upon the type of overhead cost. For example, overhead costs could be added as a layer on top of some or all of the non-overhead costs listed in Paragraph 10.2. Overhead costs could also be allocated uniformly over all product lines or with a bias towards classes of business which benefit most from them (for example, those classes requiring most management attention).

10.5 It is crucial that costs are allocated consistently:

(i) across all product lines;

(ii) in the treatment of regular and single premiums, and increment policies;

(iii) across all companies within the same marketing group;

(iv) over various distribution channels;

(v) across all territories;

(vi) from one year to the next.

A major change in the basis should normally reflect a significant change in the way in which a firm apportions expenses for the purpose of determining bonuses.

10.6 If the Actuary has reasonable grounds to believe that the costs for the period will be higher than those based on the most recent experience, then those higher costs should be used.

10.7 Costs lower than those based on the most recent experience should only be used if the Actuary has strong grounds for believing that the cost for the period will indeed be lower.

10.8 In making an assessment under Paragraphs 10.6 or 10.7 account would normally be taken of inflation and of any intended changes in commission or other forms of sales remuneration.

11 Translation to Policy Level

11.1 Each different category of expenses so obtained must be translated down to the policy level by dividing it by the measure of volume appropriate to that category of expense.

11.2 The normal basis for this translation would be the most recent experience. However, if the Actuary has reasonable grounds for believing that volumes will be lower than those indicated by the experience, those lower volumes should be used. Only if the Actuary has strong grounds for believing that volumes will be higher than those indicated by the experience should higher figures be used.

11.3 If intending to use volumes higher than those implied by the most recent experience, the Actuary should ensure that any volume assumptions are justifiable taking into account:

(i) Current volumes;

(ii) The firm's plans;

(iii) Expected market conditions (including levels of early terminations); and

(iii) Any other factors which the Actuary considers to be appropriate.

New business assumptions for future periods should be consistent with the assumptions made regarding acquisition expenditure for those periods, taking into account the firm's recent experience of the costs of expansion if necessary.

12 Consistency with Bonus Philosophy

12.1 For with-profits policies the apportionment of expenses for the purpose of projections and disclosure should be consistent with the current methods of apportionment expenses for the purpose of determining bonuses.

12.2 Reasonable adjustment should be made to the apportionment to ensure such consistency. Examples of when an adjustment might be reasonable are:

12.2.1 If the policy fee differs from the apportioned fixed expenses expressed on a per policy basis - in which case the policy fee could reasonably be regarded as the only fixed expense per policy and the excess spread onto the variable expenses. Inflation of renewal expenses should be allowed for in this context (see Section 11).

12.2.2 If no account is taken of known differences in expenses between different policy categories when determining bonuses - in which case the attributed expenses should not be differentiated.

12.2.3 If a policy is offered at more than one price to reflect different acquisition or renewal costs between or within different distribution channels - in which case there would normally be different attributed policy costs for each.

12.2.4 If the attributable expenses for accumulating with-profits business exceed the explicit charges - in which case the Actuary may consider it appropriate to express the excess as an additional fund-related charge particularly if, in profit testing the product, an implicit management charge is assumed.

12.3 The assumed split as between future annual bonuses and terminal bonuses may also affect projections and other features of disclosure. This split must be reasonable and justifiable, taking into account the current split and the assumed future investment return. In particular, if terminal bonus is currently being added, it would not normally be appropriate to assume that there would be no terminal bonus in the future at any of the assumed rates of investment return.

13 Transfers to Shareholders' or Other Funds

13.1 Where transfers are likely to be made to shareholders' funds out of profits arising from with-profits business then allowance should be made for the expected cost of those transfers.

13.1.1 Transfers should be assumed to take place with the same frequency and in the same manner as has been the case in the past, unless any specific change is intended.

13.1.2 Transfers should be assumed to be the same proportion of distributable surplus as has been the case in the past, unless any specific change is intended. Future emergence of surplus should be assumed to be at the level which would be supported by the investment return required to be assumed.

13.1.3 The bonus structure assumed should accord with that currently applying, unless there is a specific intention of a different structure applying in future.

13.1.4 In taking account of shareholders' transfers appropriate allowance should be made for the way in which those transfers are calculated. Where, for example, the shareholders' transfer entitlement is one-ninth of the valuation cost of with-profits bonuses, the transfers should be calculated using appropriate assumptions about the rate of future bonus supportable and the valuation basis. The current valuation basis would normally be assumed to continue unchanged, subject to adjustment as appropriate to ensure consistency with other future assumptions, notably the future investment return.

13.2 Where the firm, whether proprietary or mutual, has the practice or intention of permanently withholding a proportion of surplus from with-profits policyholders, this retention should be treated in a similar manner to a transfer

of surplus to shareholders. An example would be when an office has traditionally withheld surplus to expand its estate with no intention to return it to policyholders, even as terminal bonus, and has no intention to change this practice. Contributions to a bonus smoothing account which are not systematic and where contributions to and from the account should average out over the longer term are not ‘equivalent retentions’.

13.3 *FSA* COB Rules allow amounts of transfers or retentions determined as above to be offset by ‘any sustainable rate of transfer of surplus from non-profit business’. The starting point for assessing this offset should be a best estimate of the current level of surplus from non-profit business attributable to the with-profits fund. This amount could then be expressed as a proportion of the surplus transferred to shareholders and/or withheld. A similar proportion of future transferred or retained surplus, adjusted as necessary for any changes in the mix or profitability of business reasonably anticipated, could then be offset. The offset should be determined using assumptions consistent with Part II of this Guidance Note. The offset cannot, however, be greater than the cost of transfer or retention and therefore must be nil if there is no such transfer or retention.

14 Mortality and Other Costs

14.1 Both projections of future benefits and the disclosure of cumulative deductions are required by *FSA* to include mortality and morbidity on either the current rate or scale (where explicit charges are made) or on a basis appropriate to the class of investor (where no explicit charge is made).

14.2 In the latter case, the mortality (including allowance for AIDS) or morbidity assumed should be a best estimate of the rates expected to apply in the period of use of the figures. No improvements should be anticipated for the future periods for insurances, although this may be appropriate for annuities.

15 Taxation

15.1 For proprietary companies, where it is the current practice for shareholders’ tax and/or shareholders’ additional tax to be charged to with-profits policyholders’ asset shares, allowance for such tax should be incorporated into the appropriate charges. Examples of such tax are shareholders’ tax in relation to pensions business profits, and shareholders’ additional tax (i.e. tax, net of relief on expenses, in addition to that payable by a mutual company) in relation to non-pensions business taxable income. An approach where such tax is not charged to asset shares is set out in Paragraphs 9.4 and 9.5 above.

15.2 In applying Paragraph 15.1 current practice should be assumed to continue unless any specific change is intended. It would not be appropriate to assume that a change to current practice would be instigated if investment returns were to satisfy (or fail to satisfy) certain conditions.

15.3 Where tax legislation specifies that tax relief on expenses shall be automatically deferred (e.g. the spreading of acquisition expense relief) allowance should be made for this deferment. No allowance should, however, be made for the effect of any other tax losses or unrelieved expenses being carried forward. This will

ensure consistency with the net investment return regardless of the firm's tax position.

16 Inflation

16.1 Any expenses which are expected to be incurred other than at the inception of a policy should be adjusted for the effect of future inflation.

16.2 The rates of inflation assumed are required by *FSA* to be as specified in COB Rules section 6.6.47. It should be noted that different assumptions are required for projections at different rates of investment return.

16.3 The paragraph in section 6.6.47 which refers to administration charges reviewable by the firm not intended by *FSA* to be used for with-profits policies or unit-linked policies with implicit charges. The rates of inflation assumed should therefore lie at or between that specified for National Average Earnings and that for Retail Prices Index inflation, according to the Actuary's view of the appropriate mix for the policies in question.

16.4 Expenses expressed at policy level as a percentage of funds will, of course, automatically include an implicit allowance for inflation.

17 General

17.1 In the case of a brand new product, the Actuary should be guided by the expenses attributable to the existing product that most closely corresponds to it, but with proper regard to what the Actuary regards as material differences in cost.

17.2 Some of the smaller friendly societies may not have the data for the Actuary to carry out the detailed analysis set out in this Guidance Note. In this circumstance, or in the more general circumstance of lack of up-to-date data, the Actuary may make appropriate approximations. In doing so the Actuary should be conscious of the requirement of Section 8.

17.3 Expense disclosure must be maintained up-to-date. Whenever the Actuary believes that it is appropriate to review the apportionment of expenses such a review should be conducted. This should not be less frequently than annually. If the Actuary believes that the current projection basis and expense disclosure are no longer appropriate then the firm should be advised.

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