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With-Profits Bonds Best Practice Guide

Note of Industry Best Practice drawn up by a Working Group of Life Offices for With-Profit Bonds Promotional Material (revised December 2002)

Objective

To set out prevailing good industry practice in respect of aspects of promotional material for with-profit bonds (including bonds offering both with-profits and unit linked funds i.e. all pre-sale literature and website information) so that investors might better understand the product and make better informed choices.

To enhance investor understanding by ensuring that the terms, advantages and disadvantages of the with-profit bond are promoted in a clear and unambiguous manner.
To reflect the impact of a shift in the economy to a low inflation environment and at times of relative stock market under performance, by promoting with-profit bonds to investors in a balanced manner allowing reasonable policyholder expectations to be set.

Implementation

All providers of with-profits promotional material are encouraged to have reviewed their material against these standards, and where necessary improved their material so that it meets these industry standards as revised in October 2002 as soon as is practical.
Nothing in this document prevents providers of promotional material exceeding the standards set out in it. The standards will be reviewed in the light of developments in the market and operational experience of them, and changes and additions made if necessary.

Relationship of industry standards with existing regulation

These standards are intended to complement and supplement as appropriate the Regulator's existing rules and guidance.

Principles

All investor materials will be expressed in plain, consistent language. Jargon will be minimised and explained where used. The content will not mislead investors.
All points made will be expressed as clearly and concisely as possible.
Figures will be kept to the minimum necessary.
There will be a logical order, structure and format to all consumer materials.
Small print will not be used.

The Proposed Standards of Best Practice

1. High "Headline" First Year Returns

Few participants in the with-profit bonds market still use advertisements quoting a rate of return in the first year designed to attract attention. Those that do will give equal prominence to the fact that there are charges/expenses to be deducted from the return, and what is and what is not guaranteed both in respect of the first year and thereafter.

There are many ways of creating the headline rates. An explanation should be given to investors as to how exactly the rate is comprised and how likely it is to be sustained throughout the duration of the contract.

Promotional material should make explicitly clear which part of the bonus is:

the regular (reversionary) bonus;

a "one-off" bonus applicable for a limited period of the contract - an early declaration of terminal bonus.

For example, where first year bonus rates are achieved through a combination of reversionary bonus rates and an increased allocation rate this should be spelt out clearly for investors.

The exact nature of any "special offer" rates should also be made clear and include an explanation of what happens to the bonus rate after the offer period.

Where the level of bonus to be applied is dependent on the size of the initial investment, promotional material should explain to investors the level of investment required and state clearly the level of bonus available for smaller investments.

2. The Impact of Charges

All charges that could apply throughout the term of the contract should be made clear to consumers.

Where a contract contains a bid-offer spread the promotional material should explain, where applicable, that it applies both to the whole fund value and to the first year rate.

Similarly, where set up, early surrender or other charges apply, promotional material must clearly explain the nature and impact of these charges on the investor's investment.

The promotional material will sign-post from its general information about yield and charges to the specific key features/illustration that will give detailed figures and explanation.

3. Term of the Investment

The promotional material will make clear to investors that with-profit bonds should be viewed as long-term investments, not usually for less than five years. Where early surrender penalties apply these must be spelt out to investors.

Reductions that can be made to the policy pay-out

Investors should be told clearly if a market value reduction (MVR) or any other type of adjustment may be applied to the contract. The reasons for each of the possible adjustments should be explained with a description given of the circumstances when each might be applied. These explanations should be given due prominence in the literature.

Product Positioning

Care must be taken to ensure promotional material gives a balanced description of the “risk and return” relationship within the contract. It should also be made clear that with-profit bonds are a stock-market related investment.

Promotional material should not describe a with-profit bond as “the best of both worlds” implying that investors will benefit from all of the security of a deposit account combined with all the growth potential of stock market investments. Clearly, full equivalent benefits cannot be offered in both respects.

The security of an investor’s capital should be made clear to the investor.

In explaining the concept of smoothed returns promotional material should cover the relationship between the performance of underlying assets and the declared bonus rate.

Presentation of Tax Benefits

Promotional literature must make clear the differences in tax benefit for higher rate and lower rate taxpayers. Tax benefits should not be presented as being equally applicable regardless of the rate the investor pays. Promotional literature should not focus on tax at the expense of the overall suitability of the product to meet the investor’s needs.

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