

# GUERNSEY FINANCIAL SERVICES COMMISSION

## GUIDANCE NOTE FOR LICENCED INSURERS ON UNIT LINKED PRICING

### 1. Introduction

This Guidance Note sets out standards of conduct for the pricing of Life Assurance Unit Linked Funds and when the Commission considers action and/or compensation is required in respect of errors. The Commission's general intention is to require licensed insurers to exercise due diligence over pricing and to ensure that different policyholders are treated fairly. Licensed insurers should compensate policyholders unless the error is of minimal significance (see section 4). This Guidance Note is designed to ensure consistency but is not intended to be exhaustive.

This Guidance Note introduces a reasonable de minimis figure but at the same time indicates to licensed insurers the need for tight controls over pricing routines to reduce the likelihood of errors arising. It is intended to ensure that there is universally tight control over pricing throughout the industry to the benefit of policyholders generally, whilst minimising the need for costly investigation into the consequences of very minor cases of incorrect prices.

### 2. Pricing Controls

The Actuary should be satisfied that all discretionary elements of unit pricing are applied consistently with policyholders' reasonable expectations. In particular, the Actuary should be satisfied that:

- the prices at which units are allocated to or de-allocated from policies are equitable to the policyholders involved;
- the prices at which units are created or cancelled are equitable to the continuing unit holders;
- the compensation payable where errors in unit pricing have occurred is equitable to any policyholders affected, both directly and indirectly; and
- the fund pricing basis, i.e bid or offer, is appropriate with regard to projected fund cashflows.

The actuary should confirm that unit pricing procedures have been reviewed during the preceding 12 months as part of the annual report.

The following sets out the minimum checks which the Commission expects the licensed insurer to carry out:

- a) Prices and currency rates used should be consistent with company policy and from a reputable source. The reliability of the source of prices and rates should be kept under regular review and abnormal prices or rates questioned.
- b) If a third party is used to carry out the pricing function, the licensed insurer still remains responsible for correct pricing and should ensure that the third party acknowledges the

licensed insurer's responsibilities in this respect.

- c) Where the pricing function is delegated, the licensed insurer must satisfy itself that the delegate's system will produce accurate results. The licensed insurer should review the outputs from the system at least annually and on any significant system change.
- d) Unless the valuation and record keeping systems are integrated, the valuation output should be agreed with the licensed insurer's records of the fund at each valuation point. In addition, the licensed insurer's records, including debtors and creditors, should be agreed with the Custodian's record of stocks, capital and income cash at least monthly. Any reconciling items should be followed up promptly and debtors reviewed for recoverability.
- e) Systems should be in place whereby deals in securities are confirmed in writing as quickly as possible to the licensed insurer (or delegate). All deals to which the fund is committed must be included in the valuation. A cut-off procedure should be in place to guard against omissions or duplications.
- f) Where prices are obtained other than from the main pricing source (e.g. unquoted, suspended or illiquid stocks), the licensed insurer should maintain a record of the source and basis for the value placed on the stock. This should be frequently reviewed and approved by the Actuary.
- g) A system should be in place to ensure that investment and borrowing powers are not breached and that, if breaches occur, they are identified and rectified promptly.
- h) A system should be in place to ensure that dividends are accounted for as soon as stocks are quoted ex-dividend unless (as with some stocks) it is more prudent to account for them on receipt. Unless a longer interval is more appropriate for reasons of materiality, fixed interest dividends and interest should be accrued at each valuation point. Similar considerations apply to the expenses of the fund.
- i) A justification for the figures included for dealing expenses and commissions included in the price should be reviewed at least quarterly for each market. In addition, adjustments should be made when substantive changes in a market's costs occur (e.g. changes in the rate of stamp duty).
- j) Licensed insurers should fix a limit for certain key elements of a valuation such that any movement beyond that limit is investigated and the investigation and evidence of the outcome should be evidenced by signature of the Actuary. Such key elements include: share/unit price; stock prices; exchange rates; income accruals and expenses. If a price has remained unchanged for a fixed period, it should be investigated to ensure that movement in the price has not been overlooked.
- k) Cash should be reconciled to the bank account at every valuation point. Outstanding items should be followed up.
- l) Controls should be in place to ensure the correct number of units in issue is recorded at each valuation point.
- m) A copy of the valuation should be sent to any external investment adviser/manager at least monthly. They should check that the correct securities are recorded.

### **3. Regulatory Position**

The licensed insurer must be able to demonstrate that it has complied with the minimum control requirements set out in this Guidance Note. Evidence of persistent/repetitive errors consistently in the licensed insurer's favour is likely to make this more difficult to demonstrate. Compensation may be required where the licensed insurer would otherwise derive material benefit from the use of incorrect prices.

### **4. Guidance on Incorrect Pricing**

All instances of incorrect pricing amounting to 0.5% or more of the unit price must be reported to the Commission. Details of all such instances must also be recorded in a register and made available to the Commission on request. The paragraphs below cover action to be taken with regard to compensation for incorrect pricing.

*Prices found to be incorrect by less than 0.5%:*

Where a dealing, creation or cancellation price of any unit is found to be incorrect by less than 0.5% of the price of that unit, compensation to policyholders or to or from the fund will not normally be required.

*Prices found to be incorrect by 0.5% or more:*

Where the dealing price of any unit is found to be incorrect by 0.5% or more of the price of that unit, compensation to policyholders will be required unless, exceptionally, compensation is inappropriate.

Where a creation or cancellation has taken place at a price which is incorrect by 0.5% or more of the unit price, the transaction will normally be corrected and money paid into or out of the fund. Where the factor leading to an incorrect unit price continues (or has continued) in existence over a period of time, compensation will normally be required only on days where the price is incorrect by 0.5% of the unit price. Where there is more than one factor at any one time which causes an incorrect price to be calculated, compensation will normally be required whenever, and so long as, the combined effect on any one day is greater than 0.5% of the unit price.

In all cases where compensation is otherwise required, amounts due to reimburse policyholders for individual sums under £10 (or currency equivalent at the rate taken at the valuation point) will not normally need to be paid, although licensed insurers are free to pay such smaller amounts, or to make such smaller amounts up to a higher figure (e.g. £10).

The Commission should be informed of pricing errors greater than 0.5% as and when they occur and a summary of pricing errors greater than 0.5% must be submitted to the Commission on an annual basis together with the annual return.