



Institute  
and Faculty  
of Actuaries

## With-profits reborn

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## With-profits reborn

What are firms doing to meet the needs  
of customers?

Expertise  
Sponsorship  
Thought leadership  
Progress  
Community  
Sessional Meetings  
Education  
Working parties  
Volunteering  
Research  
Shaping the future  
Networking  
Professional support  
Enterprise and risk  
Learned society  
Opportunity  
International profile  
Journals  
Support

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## Caveats

- Experience for this talk is based on AFH and WPA roles for smaller mutuals and friendly societies
- Firms have faced a number of issues:
  - Regulation – COBS20; Solvency II
  - Falling new business volumes and viability
  - Access to capital
  - Governance
- For the purposes of this talk I will assume these have been isolated and “dealt with” enabling the firm a free hand to develop its business.

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## Origins of with-profits

- Late 18<sup>th</sup> century
- Distributions to members arising from accumulated surplus reflecting better than expected mortality experience
- Holloway concepts developed in late 19<sup>th</sup> century moving towards combined savings and protection
- Concept of security and stability

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## Origins of with-profits (cont)

- Principles of distribution were simple:
  - Premiums > benefits + expenses
  - Investments were predominantly cash and fixed interest
  - Triennial valuations and distributions
  - Allocated through a uniform reversionary bonus
  - Use of net premium methodology prevalent
- Second half of 20<sup>th</sup> century began to see:
  - Increased equity and property investment
  - Introduction of final (or terminal) bonuses
  - Increased use of bonus reserve valuation methodologies

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## Origins of with-profits

- And of course in the 1980s and early 1990s we saw huge growth in with-profits as companies developed unitised with-profits products
- The practice of using asset shares became more established
- Payouts to policyholders looked highly favourable reflecting the historic very high investment returns over the period of investment

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## Storm clouds looming

- The 1990s saw:
  - Lower inflationary environment
  - Lower prospective investment returns
  - Lower prospective bonus affordability
  - Increase costs constraints within the insurance industry
  - Overhaul of sales and distribution
  - Increased regulatory scrutiny
  - Increased consumer anxiety over the apparent opacity of with-profits
  - Mis-selling reviews

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## Where are we now?

- Terminal decline?
  - Product mis-selling: personal pensions and mortgage endowments
  - Lack of transparency
  - Lack of confidence that TCF is at the heart of the management of with-profits
  - Poor value?
  - Capital requirements vs alternative business opportunities
  - Regulatory interventions
  - Governance overheads
  - Closure of with-profits offices

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## The opportunity

- Firms have faced challenges:
  - Declining business volumes
  - Increased expense base
  - Lower inflationary environment
  - Volatile investment markets
  - Erosion of traditional routes to market
- The threat to established ways of doing business helps innovation

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## What have firms done?

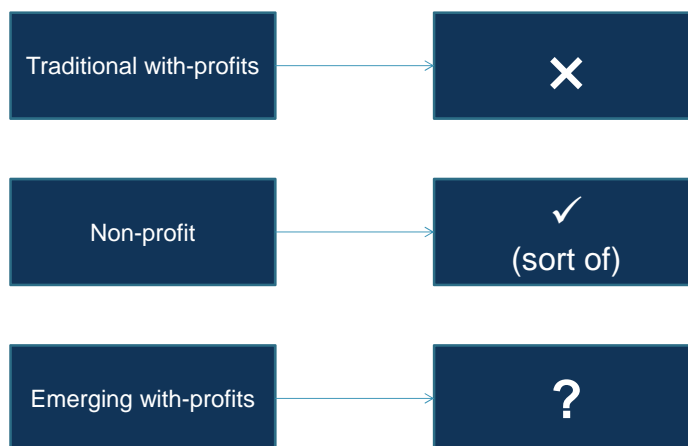
- Improved governance
- Clarified strategic objectives
- Sought new routes to market
- Use developing technologies
- Rethought what customers want from their products
- Seen what doesn't work and adapt

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## Various approaches explored



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## With-profits variants

- Going back to first principles
- Low inflation
- Lower exposures to equity and property
- Distribute surplus based on demographic experience rather than economic experience
- Sharing of risk helps keep capital requirements low
- But benefits customers from favourable experience

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## Examples

- Over 50s
  - Non-profit whole of life, guaranteed acceptance
  - Fixed sum assured
  - No surrender value – so if premiums cease get no benefit – even if paid premiums for 20 years
  - Can be characterised by high commissions
  - Uncertain mortality experience
  - Indirect support to sales of funeral plans
  - Great success in some quarters
  - But is this really a product that has the customer at heart?

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## Over 50s alternative

- What if:
  - Sum assured increases each year – say target 2.50%pa
  - Surrender value payable based on accumulated premiums less expenses and cost of life cover
  - Premiums limited so that not payable over age 90
  - Sold direct with limited acquisition costs
- Done by:
  - Cautious mortality assumption and fixed benefits
  - Determine bonus earning power of business
  - Allow to emerge as enhancements to sums assured

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## Better?

- Cons:
  - More expensive than pure Over 50s approach – but not as much as you might think
  - Difficulty of direct marketing and avoiding heavy initial acquisition costs
  - Doesn't eliminate with-profits governance overheads
  - Regulatory issues over PRIIPS and necessary disclosures

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## Better?

- Pros:
  - Sharing of risk between insurer and customer
  - More aligned with the needs of the customer:
    - Benefits give some inflationary protection
    - Get better value for money on surrender

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## Examples (cont)

- Income protection
  - Mutuels sell pure IP on profitable terms
  - Who owns the surplus arising? What is fair?
  - Some redistribution back to members?
    - Discounted premiums?
    - Establishment of account reflecting accumulated distributions?
    - Is this really that far removed from the original Holloway concepts?

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## Examples (cont)

- Sharia type contracts
  - Concept of defined “pool” of contributors
  - Legitimate costs of doing business may be taken from the fund
  - Where one individual “suffers” then the group covers the cost of that
  - Complications with compliance aspects, prospective regulation under Solvency II, and the terminology used, but.....
  - is this really so different to with-profits?

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## Conclusion

- With-profits has had a hard time
- Concept of sharing protection risk now dominating sharing investment risk – rather akin to the origins of with-profits business
- Too early to see if a success
- But do need to find a way of making products relevant for the customer base to which they are aimed
- The with-profits concept seems the perfect way of achieving that

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## Questions

## Comments

Expressions of individual views by members of the Institute and Faculty of Actuaries and its staff are encouraged.

The views expressed in this presentation are those of the presenter.

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