

Assessing the Need for Structural Change

The Mutual Perspective

Cameron Mills, Reliance Mutual

Stephen Wilson, Royal London Group

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Agenda

- Regulatory background for mutuals - Chrysalis and CP 12/38. (SW)
- The Royal London perspective. (SW)
- The Reliance Mutual story - a different approach. (CM)

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Project Chrysalis

- Project Chrysalis instigated by AFM in 2006.
- Key issues/problems:
 - (a) COBS rules do not recognise the dual purpose of the 'Main Fund' in a mutual;
 - (b) dwindling volumes of WP new business - no future generations to participate in surplus and COBS Rule 20.2.54;
 - (c) Lack of clarity between rights of WP policyholders and rights of members of mutuals, particularly in the event of run-off.

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Project Chrysalis (*continued*)

- Dialogue established with FSA on Chrysalis.
- Various FSA pronouncements over last few years, (*'Dear CEO' letters, CP11/5, PS 12/4*).
- Generally unhelpful to mutuals who are writing profitable non profit new business, but struggling to write new with profit business.
-until CP 12/38, (*December 2012*).

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CP 12/38

- Huge and very welcome change of tone from FSA - now seeking to allow mutuals that have a viable business plan to continue to provide other financial products alongside the run-off of their WP business, provided that at the same time the WP policyholders are treated fairly.
- Acknowledges that the current FSA rules do not recognise the legitimate interests of the members of the mutual, (*as opposed to the interests of the WP policyholders*).
- Expresses a desire to make membership of a mutual more meaningful.
- Acknowledges that all mutuals are different and that a 'one size fits all' solution is not possible.

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CP 12/38 (*continued*)




- Focuses on a process by which mutuals can identify a Mutual Members Fund ('MMF') which, (*by waiver*), would be exempt from COBS 20 Rules, and separate from the 'With Profit Fund' which **would** continue to be subject to COBS 20.
- Mutuals will then be able to use the MMF, inter alia, to finance the writing of profitable non profit new business.
- **Optional** process - still open to mutuals to retain a single main fund subject to COBS 20, but in particular such mutuals would need a material ongoing flow of new participating business for them to continue open to new business.

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About Royal London



- Estate circa £2bn.
 - Main Fund assets £20bn of which £7bn relate to WP.
 - Writing immaterial new WP business but substantial values of profitable NP new business, (*Pensions through Scottish Life, protection through Bright Grey and Scottish Provident*).
- 


- Roughly 50% of members do not hold with profits policies.
 - Aspirations to make membership and mutuality more meaningful.

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Royal London Reaction to MMF process set out in CP 12/38

- CP 12/38 is helpful in setting out a more streamlined process to establish an MMF, in comparison to a Scheme of Arrangement.
- Still a (very) complex process to establish a MMF, (*involving independent expert, PRA, FCA*).
- Considerable uncertainty over what level of MMF would result and whether it would be sufficiently large to further Royal London's aspirations going forward.
- A high level principle in CP 12/38 states that WP policyholders under the firms' MMF proposals will be "*no worse off than equivalent WP policyholders in a proprietary WP Fund*". What exactly does this mean in practice?
- Successful MMF application requires "*a strategy to ensure that the WP policyholders and members are appropriately engaged and informed*". Again, what will this entail?
- Waiver mechanism does not give permanence and hence creates ongoing uncertainty.
- Post establishment of MMF, most management actions will be in WPF, rather than in the MMF.

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New Forms of Participating Products

Hence, the Chrysalis solution currently favoured by Royal London is the creation of a new form of participating contract so that the 'material volumes of new business' test in COBS Rule 20.2.54 is successfully met.

If we can achieve that, whilst treating all policyholders fairly, then we are presently unconvinced that MMF would generate additional benefit commensurate with cost/effort of achieving it. This view may, of course, change as the proposed MMF process gets clearer.

FSA acknowledge the legitimacy of mutuals adopting the route of creating new forms of participating products to address Chrysalis and say, (CP 12/38, Section 2.40), "*we will encourage further developments in this area*".

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New Forms of Participating Products (continued)

Various ideas explored, (*e.g. making protection business participate*), and rejected because of lack of customer appetite/ FSA concerns over degree of participation/lack of fit with making mutuality relevant.

Led to the concept of 'Member Accounts'.

Two in-depth meetings with FSA have not as yet revealed any insuperable hurdles with this concept.

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What is a Member Account?

- A Member Account is an additional account which will be granted to policyholders as an integral part of our existing core product offerings, alongside normal policy benefits.
- Adding Member Accounts provides participation to **all** new business - making **all** new policyholders members.
- A distribution from Operating Profits is paid into each Member Account annually, subject to Board discretion.
- The value of those distributions builds up over time.

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What is a Member Account? (*continued*)

- Member Accounts give policyholders higher core benefits from their policies:
 - additional payouts on pensions and savings policies, (*UL and WP*).
 - additional life cover or critical illness sums assured (*or alternatively a reduction in premium*) on protection policies.
- The full value of the Member Account is available on policy maturity/claim.
- A reduced value may be available on voluntary exit/surrender.
- Member Accounts reward loyalty - improving persistency.

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Positives for Member Accounts

- Attractive to customers/policyholders - consumer research favourable.
- Makes membership of a mutual more relevant and provides tangible benefit of membership, (*fit with CP 12/38*).
- No need to change Articles or membership rules.
- Represents an evolution from 'old style' with profits to a new form of participation.
- Solves the Chrysalis issue!

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Member Accounts - Challenges to Overcome

- Material participation?
- Fairness to existing with profits members.
- Methodology to set fair allocations to different types of policies.
- Methodology to disburse amounts accumulated in member accounts without falling foul of any legislation.
- IT implications.
- Making FSA comfortable.

Not solved all challenges yet, but we are confident we can overcome them.

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Member Accounts

Our current assessment, given the unresolved aspects of MMF, is that Member Accounts represent a 'better' solution for Royal London, given its particular circumstances.

Aspect	Member Accounts	MMF
Sustainable solution to Chrysalis	✓	✓
Maximises membership into future	✓	✓
Possible without changing FSA Rules	✓	✓ (waiver)
Mutual capital moved outside COBS constraints	X	✓
Possible without changing Articles of Association	✓	X
Possible without member vote	✓	X
Possible without complex costly structural change	✓	X
Confidence in an acceptable outcome	Medium/High	Unknown

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The Reliance Mutual Story

History of Reliance Mutual

The 2010 Review

Developing the Proposition

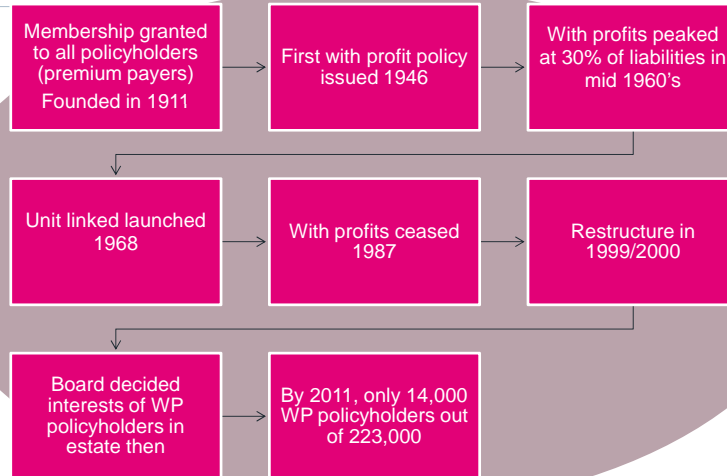
The Final Scheme

Member Reaction

Where we are Today

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History of Reliance Mutual



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Restructure in 2000

Facts

- With profits business had a much shorter tail
 - by 2010, 65% of with profits liabilities would have disappeared
 - By 2020, 94%
- Non – profits business had a much longer tail
- Board was responsible for **all members**
- Net realistic surplus of £46.2m

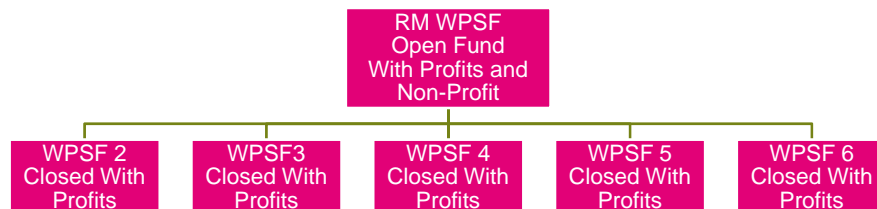
Solution

- Notionally split the surplus
 - £16.2m to support non-profit business
 - £30.0m to be distributed to with profits business
- Distribute surplus as a percentage of asset shares

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Development During the Noughties

Twin strategy of new business and acquisitions



With profits members in RM WPSF saw estate distribution increase over the decade from expense savings

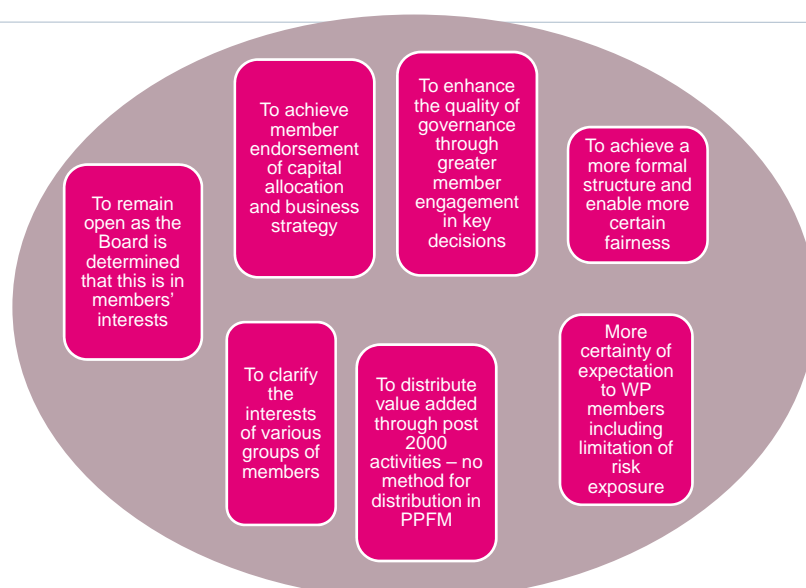
BUT

No distribution from acquisition profits or from new business

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The Board objectives in its 2010 strategic review



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Grouping the Members

Grouped policyholders with similar interests – a fairness issue



Acquired policyholders in ringfenced subfunds
Non profit policyholders in open subfund
With profits policyholders in open subfund

Policyholder tracing, adverts to get register as up to date as possible
(Note – large back book of IB business)

External assistance to make policyholder communications as straightforward as possible

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Developing the proposition

Legal and actuarial review of actions since 2000

Mem. and Arts. give WP p'hrs 100% of surplus on wind up but silent on going concern

Seek clarity over future strategy and endorsement from members

Committed to a member vote

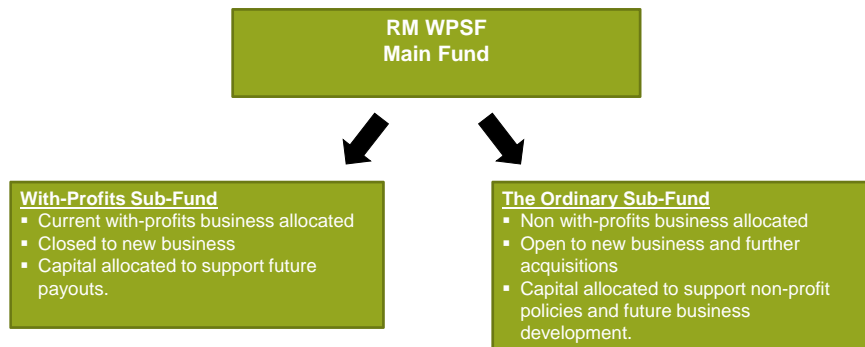
Member vote should be decisive and binding



Chose to use scheme of arrangement

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The Board's proposition



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Developing the proposition

- The strategy needs to meet the Board's objectives of:
 - Distributing the value that has built up to members equitably and over a suitable timeframe.
 - Obtaining an endorsement of strategy.
 - Remaining open to new business.
 - Controlling unit costs.
 - Maintain or enhance benefit security for members.
 - Maintain or enhance benefit expectations for members.
- Also need to be able to recommend to policyholders as 'better' than the alternative.
- Therefore we need to establish:
 - What is the alternative?
 - What is the definition of better?
 - How do we show it is better?

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Developing the proposition – the alternative scenario

What is the alternative scenario against which the Board's proposition will be tested?

- The 'base case' or 'closed scenario'
- Board: clear rejection of the proposition by members will lead to closure and run-off.
- FSA: set out in 'Dear CEO' letter.



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Developing the proposition – the alternative scenario

Not straight-forward:

- Sell all or part of the company.
- Transfer out part of the business
- Out-source part or all of the administration.
- Securitization.

Difficult to set realistic assumptions for hypothetical situations.

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Developing the proposition – comparing strategies

- Security of benefits for all members.
- Returns on with-profits policies:
 - Benefit expectations.
 - Certainty of returns.
 - Fairness.
- Service standards.
- Additional returns on with-profits policies provided by the global augmentation rate.



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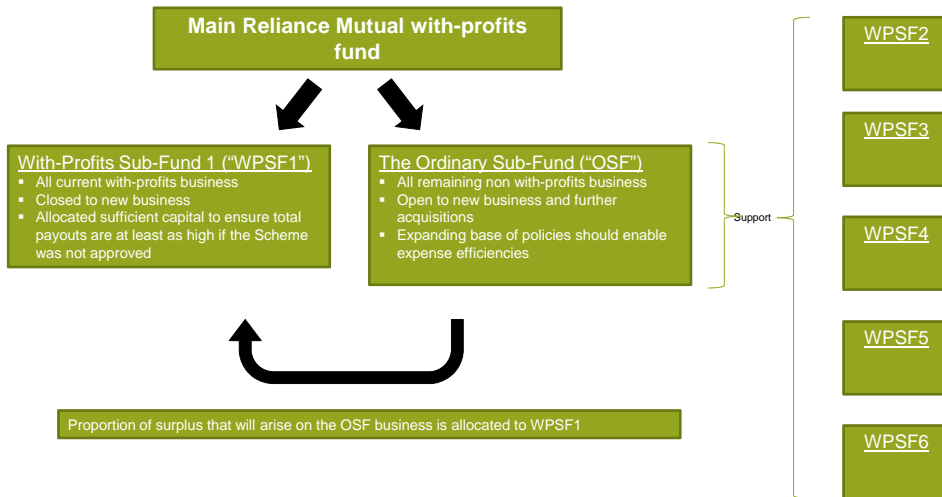
The final scheme

- Capital divided between WPSF1 and OSF.
- Proportion of surplus that will arise on the business initially allocated to the OSF will be allocated to WPSF1.
- Mechanism set up to transfer this to WPSF1 as surplus arises.
- Support arrangements formalised for existing with-profits funds as well as OSF and WPSF1.
- With-profits policies remain but a 'non-profit mutual' going forward.
- Mandate provided by the members for Board strategy.
- OSF used for business development subject to a system of controls, checks and balances.

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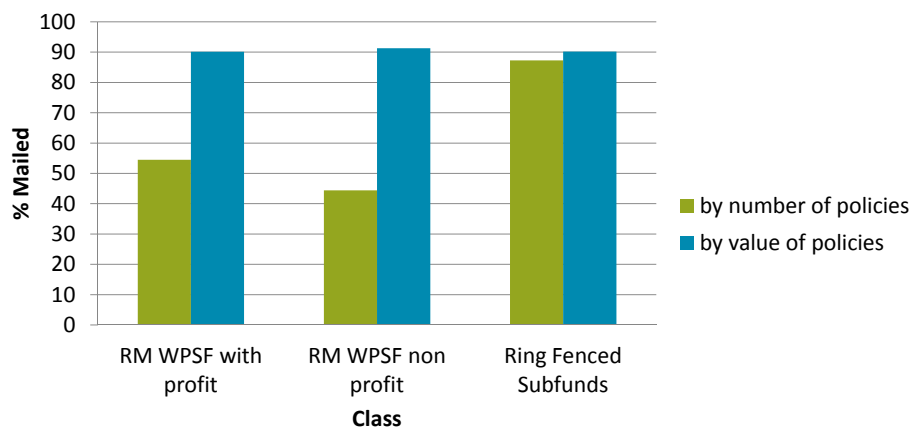
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The final scheme



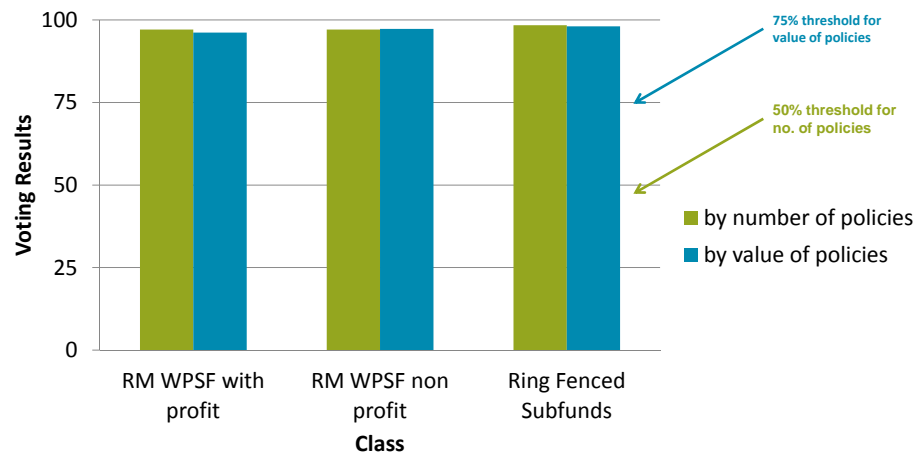
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Member Analysis



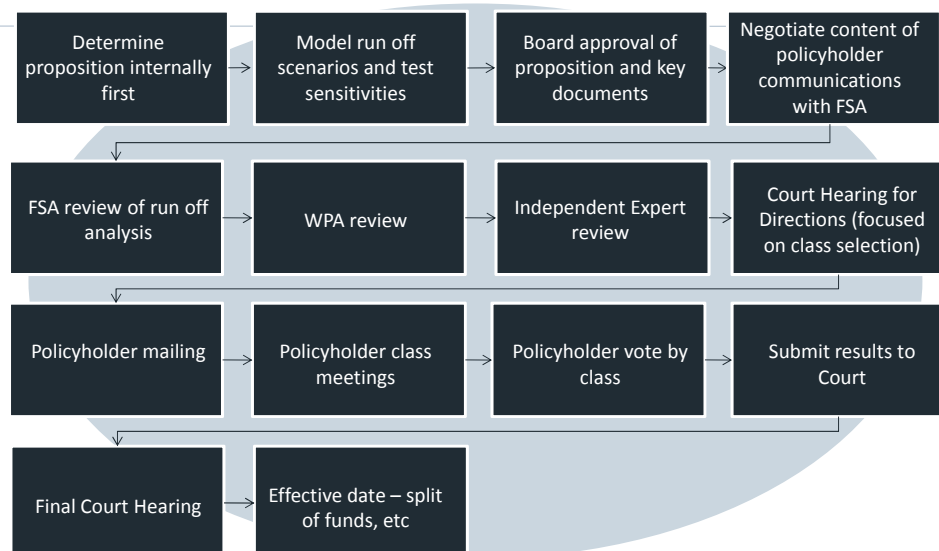
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Voting Results



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Approval Process



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Where we are today

- Now a non-profit mutual
- Finishing off implementation
- Do not underestimate the challenge of implementation
- Developing strategy for Reliance Mutual
- Clarity of capital ownership makes life so much easier
- We have found more of our members
- We are closer to many of our members
- Our members endorse what we are doing with their Society

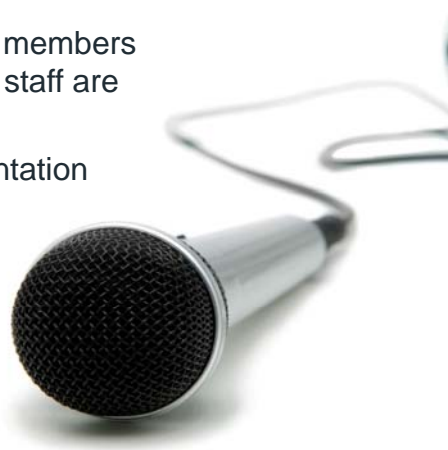
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