Institute and Faculty of Actuaries

Irish Life Closed With-Profits Fund

Example of a successful conversion
from With-Profits to Non-Profit policies

Simon Hogley
John Paul Noonan

04 November 2013

Views expressed in this presentation are those of the presenters.

Institute and Faculty of Actuaries

Overview

This presentation will cover:

- Industry context
- Conversion of Irish Life Closed Fund to non-profit
- Lessons to draw

Institute and Faculty of Actuaries

Industry context

- Recent experience
- Commercial drivers
- Conversions in the public domain

Institute and Faculty of Actuaries

Recent experience

- Recent increased interest in firms exploring a transformation of their with-profits funds
- Solutions covering:
  - NP conversion
    - NP contract with similar benefits to WP guaranteed benefits
  - Unitisation
    - Offer to customers, or formal conversion
  - Transfers out of non-profit blocks (particularly annuities)
  - Reinsurance solutions.

Institute and Faculty of Actuaries

Commercial drivers

- Rapid run off of with-profits funds
  - Particularly endowments
- Make management easier, and reduce cost of management
  - Firms are keen to reduce the management burden from with-profits
- Knowledge and expertise
- Put business onto platforms
  - Provide scale
  - Provide with-profits customers with greater choice
  - Generate additional shareholder profit (possibly).

Institute and Faculty of Actuaries

Conversions in the public domain

- Examples of conversions in the public domain
  - Alico
    - July 2012, conversion to non-profit as component of Part VII transfer to ReAssure
  - Reliance Mutual
    - Society declared its intention to wind up two funds in 2013
    - Scheme of Arrangement specifies criteria for wind up based on size of assets
- There are a number of schemes with similar types of thresholds which will soon be reached
- Consider also Phoenix GAR compromise.

Institute and Faculty of Actuaries

04 November 2013 7

Conversion of Irish Life Closed Fund to non-profit

- Background, principles, process and peer review
- Technical and operational aspects
- Post conversion experience

Institute and Faculty of Actuaries

04 November 2013 8

Overview of Irish Life Closed Fund

Fund History:

- Closed to new business from 1990
- Scheme of Transfer set out how the fund would operate
- Assets ring-fenced, no shareholder participation
- Target maturity payments of 125% of asset share
- Special Bonus declared in 1990.

Institute and Faculty of Actuaries

Criteria for wind-up

- Scheme specified wind-up criteria to avoid a tontine effect:
  - Number of in-force policies falling below 1000
  - Threshold met in late 2011, and ILA Board proposed the wind-up
- Specific Scheme requirements relating to the wind-up:
  - Distribute all assets, no benefit to the Continuing Fund
  - Use a realistic bonus reserve valuation
  - An option for policyholders to convert to unit-linked without loss
- Other Scheme provisions set out regular operating requirements.

Institute and Faculty of Actuaries

Principles applied to conversion

- Fair and equitable distribution of Closed Fund assets
- Comply with provisions of Scheme
- Minimal disruption to service levels
- Transparent and independently verifiable.

Institute and Faculty of Actuaries

General considerations

- Governance
- Ability to demonstrate equitable treatment
- Costs
  - Minimise administration system changes
  - Difficult to achieve neutral outcome
  - Lower operating costs post conversion?
- Data clean up pre-conversion
- Capital impact
- Communication with policyholders.

Institute and Faculty of Actuaries

Governance process

- Report from Appointed Actuary
- Actuarial peer review
- Signoff by Board
- Regulator informed
  - Central Bank of Ireland (CBI)
  - Authorisation not required in advance, as Scheme had already provided for the wind-up
- Policyholder communication.

Institute and Faculty of Actuaries

Role of Peer reviewer

- Peer review covers the review of actuarial work by a suitably qualified actuary
- Reasons to undertake peer review:
  - Actuaries make material decisions
    - eg that directly affect policyholders
  - Actuaries may lack necessary knowledge or expertise
  - Actuaries can disagree
  - Actuaries are fallible
  - Demonstrates independence.

Institute and Faculty of Actuaries

Peer reviewer – Irish Life fund

The Peer Reviewer's remit for the Irish Life fund conversion included:

- Review terms of conversion and raise queries
- Report findings to the Appointed Actuary
- Input to policyholder communication:

"Are the proposed conversion terms in accordance with the Scheme of Transfer and fair and reasonable to the with-profits policyholders?"

Institute and Faculty of Actuaries

Technical aspects

- Policy details
- Approach to bonus rates
- Investment return assumption
- Expenses / mortality / surrender assumptions
- Tax
- Capital charge
- GAOs and other options
- Conversion to unit-linked

Institute and Faculty of Actuaries

Policy details

At time of wind-up:

- €25m of assets; less than 1,000 policies
- Over 80% of the policies were UK Low Cost Mortgage endowments – relatively short term to maturity
- Small number of pension policies – high asset shares
- Simple bonus structure
- GAOs attaching to pension policies, few other policy options.

Institute and Faculty of Actuaries

Approach to bonus rates

- Early decision to maintain bonus structure but freeze future bonus rates
  - Minimise change for policyholders
  - Minimise changes required to administration systems
- Reversionary bonus rates unchanged from recent past
- Terminal bonus rates were the balancing item to ensure the appropriate distribution

Institute and Faculty of Actuaries

Investment return assumption

- No allowance for future equity risk premium (ERP)
  - ERP not consistent with fixed future benefits
- Assumption based on yield of sovereign fixed interest assets and cash – consistent with intended investment approach post conversion
  - Consider allowance for credit risk
- Consideration given to alternative investment strategy:
  - What if choose to invest in more risky corporate bond assets?
  - Challenge from peer reviewer
  - Concluded no net gain to Continuing Fund due to associated higher capital cost

Institute and Faculty of Actuaries

04 November 2013 19

Expense, mortality, and surrender assumptions

- Expense: Realistic
  - EV assumptions, or 3rd party administration, treatment of fixed costs
- Mortality: Realistic
  - Conversion calculation largely insensitive to this
- Surrender: Zero surrenders
  - Expectation that lapse experience would materially change post wind-up
  - Wanted to avoid unintended shareholder profits emerging post wind-up due to changes in lapse experience
  - Surrender value basis set equal to realistic reserves, hence shareholder immune to lapse experience
  - Change from previous practice.

Institute and Faculty of Actuaries

04 November 2013 20

Tax

- Approach taken to setting taxation assumptions differed for Irish and UK components of the Closed Fund.

Taxation Assumption setting	Irish component	UK component
Were there carried forward tax losses?	Significant	Significant
Could these be used to relieve future investment returns?	Yes	No Could only be used for equity and property, which were no longer held.
Taxation basis	Projected 'I' and 'E' both gross of tax. No value placed on any projected unused deferred tax asset.	'I' and 'E' both net of tax.

Institute and Faculty of Actuaries

Capital charge

- Post wind-up the Continuing Fund would provide capital support to cover the prudence in the reserves and required Solvency Margin for these policies
- No charge was levied on the projected asset shares for this capital support. This reflected the specifics of the fund and requirements of the wind-up:
  - Capital support only required because of wind-up – fair to charge?
  - Historical precedent / provisions of Scheme
  - Transparency, fair treatment

Institute and Faculty of Actuaries

Guaranteed annuity options

- Small number of policies, but high asset share
- Very little experience to derive assumptions
- Key assumptions:
  - GAO take-up rate
  - Age at retirement
  - Annuity costs (future yields, longevity assumptions)
- Varying assumptions meant +/-10% to total liabilities.

Institute and Faculty of Actuaries

Conversion to unit-linked

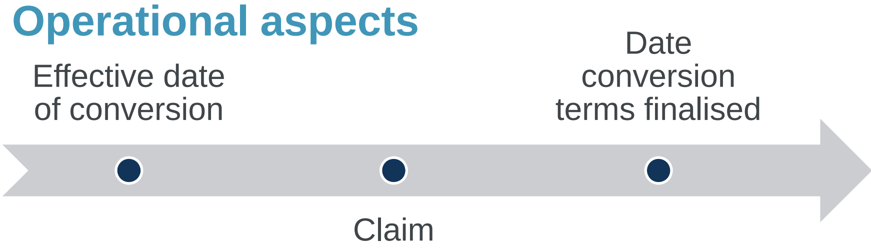
- Scheme allowed for policyholders to be given the option to convert their policy to a UL policy at wind-up. Intention was to allow policyholders to continue to invest in equity type assets
  - Considerable time and effort invested here to reach a solution.
- Approach taken differed for Irish and UK components:
  - Irish Life policies were given the option to take out an Irish Life UL policy:

Tax status?	GAOs?	Initial charge?	Commission?

  - UK policies not given this option (Irish Life no longer offers new business in the UK. Instead, able to surrender and take out new policy with different provider
- Other policyholder options considered.

Institute and Faculty of Actuaries

Operational aspects



- 2 months between effective date and date conversion terms finalised and communicated
  - Consider: Deaths | Maturities | Surrenders
- Also consider claims on policies post maturity date
  - Appropriate interest.

Institute and Faculty of Actuaries

Policyholder communication

- Letter and Q+A document sent to participating policyholders
- No letter to paid-up policies or policies past / near maturity
- Explained conversion and impact on policy benefits; showed maturity value; quoted current surrender value
- Limited explanations of technical options (tax difference for unit-linked fund option) – planned to explain further if necessary.

Institute and Faculty of Actuaries

Post conversion experience

- Small number of additional complaints, none relating to the wind-up per se
- High level of early surrenders (surrender values look attractive due to low interest rate environment)
  - Monitored closely in months post conversion to ensure asset liability matching still appropriate
- Continuing to experience a higher level of surrenders post conversion than pre-conversion.

Institute and Faculty of Actuaries

Lessons to draw

- Task made easier as...
  - Conversion terms explicitly defined
  - Long planning lead time, dry-run completed
  - Well capitalised fund
  - Small fund
  - Peer reviewer engaged at early stage
- Task made harder as...
  - Time and effort spent on policyholder options
  - Time invested at outset cleaning all legacy data issues
  - A lot of thought given to projection assumptions – no ready reference material
- Any advantages in implementing sooner?
- What about for larger funds?

Institute and Faculty of Actuaries

Questions / Comments?

Institute and Faculty of Actuaries