The Actuarial Profession
making financial sense of the future

CP207 – Treating With-profits Customers Fairly

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Coverage of CP207

The purpose of this session is to run through CP207, considering its:

- Aims
- Subjects covered
- Implications

FSA's Aims

FSA "consider there are specific areas of potential unfairness in with-profits products where consumers' interests would be better protected by new rules and guidance" (1.2)

These "can be largely regarded as a codification of principles that have traditionally underpinned good practice………The fact that a firm's current approach is not consistent with our proposed rules and guidance does not necessarily mean that it has not been treating its policyholders fairly in the past." (3.9)

Main Areas Covered in the CP

- Controlling the determination of amounts payable under with-profits policies
- Achieving a better balance between the interests of departing and remaining policyholders
- Restricting the charges than can be made to with-profits funds
- Specifying the basis on which new business must be written
- Reattribution of Inherited Estates
- Consumer-friendly PPFM

Are Asset Shares the Answer?

An underlying assumption of CP207 is that asset shares provide a fundamental “truth” against which policyholder payments can be measured.

How easy is it to calculate “the” asset share for “each” policy?

(6.12.12R)

What is Fair?

Does “fair” mean giving everyone a payout value close to some underlying benchmark value (such as asset share) – FSA view?

Or does “fair” mean giving everyone a payout value close to that which they might have expected based upon everything the firm has told them about the operation of their policy?

Smoothing of Payouts

The rules propose that:

- Payouts should fall within a specified range of the unsmoothed asset share (6.12.12(1))
- Payouts do not change by more than a specified amount from year to year (6.12.12(2))
- Over the long term the aggregate payouts fall within a specified range (smaller than that specified above) with a minimum of 100% of the unsmoothed asset share. (6.12.13)

Smoothing of Payouts

FSA appear to assume that what policyholders want most is smooth payouts – i.e. changes in payouts from year to year are restricted.

Even if this forces a change in asset mix.

(Annex 4, 30-39)

Smoothing of Payouts

"We recognise that our proposals on target ranges might cause some firms to switch to a higher ratio of less volatile assets in their portfolios to improve their ability to meet their targets. This could have the effect of reducing overall returns to policyholders. However, this would be in exchange for less volatile assets in with-profits funds and an increased likelihood of policyholders receiving consistent payouts" (4.19)

Fairness vs. PRE – Surrender Values

The proposal “benefits existing and surrendering policyholders at the expense of maturing policyholders….However, the majority of policyholders fail to keep their premium payments going until maturity. So, our proposals would benefit the majority at the expense of the minority.” (Annex 4, 47)

Fairness vs. PRE – surrender values

Some firms have had a long-standing practice of paying less than asset share on early surrender.

Some policyholders expect this to continue.

Is it fair to change this practice?

Are more rules necessary?

Could much of the additional material proposed in CP207 be avoided by a little more disclosure in PPFM?

- Surrender values vs. Maturity payouts
- Smoothing process vs. Asset mix

Distributions

- No distribution can be made unless it can be met from the Regulatory Surplus (6.12.27)
- No distribution to shareholders can be made unless the whole cost of the distribution can be met from the Realistic Surplus (6.12.27)
- Additional distribution should be made if the firm determines it has a Relevant Surplus (6.12.23/24)

Distribution of Excess Estate

Intention is to prevent build-up of orphan estates

If a firm considers "that the surplus in the fund ….exceeds what is necessary to support its current and future business" then "fairness to policyholders points….towards distribution." (4.26)

Would this have worked if it had been in place in the 1990's?

Small Funds Exemption

Under CP195 small funds are exempt from the RBS calculations – but the rules on distributions require the calculation of a realistic surplus (6.12.27R)

Management of New Business Volumes and Closure to New Business

New business should not be detrimental to existing policyholders (4.42)

On closure a plan should be submitted showing how the free estate will be distributed (4.49)

How can any new business be justified?

Charges to/ Compensation from With-profit Funds

- Only “costs directly attributable to the operation of the fund” may be charged to the fund (4.33)

- Compensation or redress costs must be paid:
  - First from any inherited estate
  - Second, from assets attributable to shareholders
  - Finally, (as a last resort) to asset shares (4.37/38)

Charges to/ Compensation from With-profit Funds

- 6.12.33R lists acceptable deductions from asset share when calculating a surrender value
  - "financing costs" can include the cost of any capital used to back the policy
  - The same deductions should be acceptable when calculating maturity values

Charges to/ Compensation from With-profit Funds - Tax

- Maximum charge for tax equal to that which would be payable if the with-profits fund were taxed as a “separate corporate entity” (6.12.43R).

- But any “tax synergies” should be shared. (4.39, 6.12.45G)

Charges to/ Compensation from With-profit Funds

However:

> “Nor is it our intention to unpick existing arrangements formally sanctioned by us or by the Court” (3.9)

Communications with Policyholders

“Customer friendly” PPFM document (Ch 6)

- What to leave out?

Point of sale disclosure of “special features” (6.12.86R)

- How comprehensive does this have to be?

Re-attribution of Inherited Estates

Proposals follow lines previously trailed by FSA.

Role of the Policyholder Advocate –

- How will agreement ever be reached? When can the advocate negotiate/ compromise? What protection does he have?

Timetable from here

- Consumer-friendly PPFM available by 30 November 2004
- With Profit Guides withdrawn form the same date

- Rules and Guidance on Treating With-Profits Policyholders Fairly effective from 31 March 2005 (to allow for potential for changes to PPFM)

- Feedback on CP170 and proposals for Point of Sale information (including illustrations) (?) Summer 2004

Conclusions

- Avoid prescriptive rules by making more use of PPFM and individual scrutiny by FSA
- Clarify exclusion of small funds
- Clarify precedence of existing Schemes
- Clarify interpretation of draft rules and guidance to ensure their application matches high level aims

Profession’s Formal Response

Can be found at:

http://www.actuaries.org.uk/files/pdf/life_insurance/fsa_cp207_resp.pdf