

## 2nd YOUNGER MEMBERS CONVENTION

1-2 December 2003  
Moat House, Glasgow

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## Developing a New Style With-Profits Product in the Post Sandler World

James Crispin

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## Introduction

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- q What is With Profits?
- q Sandler Review
- q HMT Stakeholder WP
- q Are these funds With profits
- q Things to consider when designing a new  
With Profits Fund

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## What is With Profits?

- q Brief History
- q Key Features

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## Brief History

- q Origins late 18th century
- q Initially Mortality Profits
- q Before moving onto other areas
  - q **Expenses**
  - q **Investments**
  - q **Other business**

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## Brief History

- q Now mainly Investments
- q Move started Post War
- q Equities - provide high returns but variable
- q Terminal Bonus introduced to allow for volatility
- q With Profits now savings with nominal protection

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## Key Features

- q Contractual Form of Life Policy
- q Smoothing of payouts
- q Guaranteed Benefits at various times/circumstances
- q Participate in profits

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## Key Structures

- q Either 90/10 or 100/0
- q Still common in original proprietary companies and mutual life companies
- q but, new form of 100/0 now being set up by several companies

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## Sandler Review Concerns

- q General Opacity of Product
  - q How Returns made up - investment/smoothing/costs
- q Terminology
- q Solvency

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## Sandler Review Concerns

- q Conflicts of interest current form raises
  - q Selection of Investment opportunities
  - q Lack of rights
  - q shareholder v policyholder
  - q Cost allocations
  - q Investment Objectives

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## Sandler Review Concerns

- q 90/10 Structure
  - q No incentives to cost efficiency
  - q Also opacity
  - q Provides capital to company which policyholders have little control over
  - q 90/10 split is arbitrary and does not allow for actual risks

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## Sandler Review Concerns

- q Inherited Estates
  - q How are they built up
  - q Who owns them
  - q They are a barrier to entry

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## Sandler Review Concerns

- q Competition
  - q Currently on wrong areas
  - q obscured by Opacity
  - q Focus on payouts/FAR rather than price/costs

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## Sandler Recommendations

- q With Profits to have
  - q Explicit Smoothing account
  - q Smoothing rules specified
  - q 100/0 structure
  - q Explicit management charge
  - q Paid to a separate co

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## Sandler Recommendations

- q With Profits to have
  - q Disclosure of smoothed and unsmoothed asset values
  - q Not to support other parts of business
  - q Payouts set annually
  - q MVAs in limited circumstances – must advise before introduction

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## HMT Stakeholder WP

- q A smoothed investment fund option will be available within the Sandler suite of Stakeholder products
- q It is unlikely to be named with-profits

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## HMT Stakeholder With Profits

- q This smoothed Investment Fund should
  - q Have a fund structure of 100/0
  - q Be unitised with the unit price published on a daily basis
  - q Have a separate smoothing account with the fund
  - q Have explicit charges
  - q Provide additional disclosure to customers

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## HMT Stakeholder With Profits

- q Other Features
  - q Aim for smoothing to be neutral over time
  - q If capital support needed then can be charged for subject to notifying policyholders
  - q Smoothing methods to be disclosed
  - q Less need for MVAs

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## HMT Stakeholder With Profits

### q Other Features

- q Changes to approach allowed in certain circumstances
- q Only guarantee is a mortality guarantee
- q Annual disclosure needed including an annual report
- q Also advise SAS and USAS post surrender.
- q Restrictions on Investments to apply as well

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## Are these funds with profits

- q Is the name an issue – some companies have used different names
- q Does smoothing make the product with profits?
- q If not, then only mutuals may be able to offer with profits

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## Are these funds with profits

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## Designing a new with profits fund

### q Things to consider

- q Fund Structure
- q Product Type
- q Capital
- q Guarantees
- q Investment Mix

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## Designing a new with profits fund

### q Things to consider

- q Smoothing Methods
- q Smoothing Accounts
- q Profits and Losses
- q Disclosure

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## Designing a new with profits fund

### q Fund Structure

- q Do you continue with current structure?
- q Do you move to 100/0 if not already doing so
- q If already doing so do you ring fence
  - q by hypothecation
  - q creating separate fund

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## Designing a new with profits fund

- q product type
  - q Pensions fund
  - q Unitised Annuity
  - q Growth Bond
  - q Income Bond

Influences design all the way through

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## Designing a new with profits fund

- q Capital
  - q How much is available?
  - q Whose is it?
  - q What rate of return is required on it?
  - q What other options are available?

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## Designing a new with profits fund

- q Guarantees
  - q Do you wish to offer them?
  - q If so, which ones?
  - q Guarantees cost so how will they be paid for?
  - q Explicitly or implicitly
  - q Will they be hedged?

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## Designing a new with profits fund

- q Smoothing Methods/MVR policy
  - q What level of smoothing do you wish to offer?
  - q Is it continuous or at a point in time?
  - q Smoothing over entry as well as exit?
  - q MVR policy are there any MVR free points?
  - q If not, is smoothing worth having?
- q Smooth when you don't want it and not when you do!

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## Designing a new with profits fund

- q Smoothing Accounts
  - q Do you have one?
  - q Where does it sit
    - q Policyholder's fund or
    - q shareholders' fund (conflict of interest)
  - q Can it go negative?

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## Designing a new with profits fund

- q Profits and Losses
  - q How much participation?
  - q Other parts of business?
  - q Other With Profits business?
  - q Smoothing in own class?
  - q Guarantees in own class?

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## Designing a new with profits fund

- q Disclosure
  - q How much should you disclose
  - q Investment Mixes + performance
  - q Smoothing methods + performance
  - q Guarantee costs + performance
  - q Smoothed/unsmoothed asset share

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## Does With Profits have a future?

- q My views

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## Does With Profits have a future?

What do you think?

Questions?

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