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CURRENT ISSUES IN LIFE ASSURANCE

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A one-day seminar was held at Staple Inn Hall jointly by the Institute of Actuaries and the Faculty of Actuaries, on 'Current Issues in Life Assurance'. The target audience was Appointed Actuaries and their immediate deputies.

The first session, which set the theme for the day, was led by the President of the Institute of Actuaries, Mr H. H. Scurfield. In a reiteration of the theme of his Presidential Address he reminded the audience of the need to give a lead to not only our profession but also the life insurance industry in which the target audience worked. He mentioned suggestions that Appointed Actuaries should act as trustees for the policyholders, as they best understand the make-up of the constituent parts of life assurance. Active professionalism was essential, given challenges from other forms of long-term savings, our unique method of supervision being under European scrutiny, the trend towards better-informed and better-read financial commentators and the irritation of the Financial Services Act.

He expressed concern at the illogicality of some of the bonus decisions made by Appointed Actuaries. In particular, in the last two years 3 offices have made significant leaps in the payout league table. He wondered if this was intellectually credible given the uncertain economic environment in which the decisions were made, particularly at the year end 1990. He accepted that a change of Appointed Actuary might cause a reassessment of the distribution philosophy of the office, but if this were to lead to a marked discontinuity he wondered if there was a case for retrospective adjustment to immediate past payouts. He warned Appointed Actuaries against being seduced by the low cost (relative to, say, a promotion or advertising budget) of increasing the payouts over the 'correct' level in order to obtain more new business. He drew an analogy with the general insurance companies which grew in the 1960s on the back of consistent under-reserving, which eventually caught up with them. He then went on to repeat his presidential address concern about the inequity of low surrender values. His concern was on two fronts. First, he felt it was unprofessional to give an outgoing policyholder a surrender value materially lower than the relevant asset share. Second, he was concerned that it could lead to a consumer revolt calling for guaranteed surrender values, with the consequential loss of investment freedom.

Mr Scurfield talked briefly about disclosure, mismatching reserves, and life profit recognition, three topics which were the subject of talks later on during the day. He then referred to the European dimension in the context of supervision and control, and pointed out that Ireland and the United Kingdom were unique, if not in the World then certainly in Europe, in the form of supervision that they currently employed. It was interesting to note that Americans expected soon to introduce the Appointed Actuary system, and that in Europe the Germans were beginning to show interest. He pointed out that our system of partnership between the supervisor and the Appointed Actuary produced, in his opinion, the best method of supervision, but only given a high degree of professionalism from all Appointed Actuaries.

Finally Mr Scurfield expressed some concern regarding advice given to distribution companies. He suggested that owners of any business, and especially when it is a mutual building society, should be concerned about the value for money which its consumers (and especially its members) receive from associated life assurance.

Mr P. O'Keeffe took a session on 'Life Profit Recognition: Recent Developments and E.C. Life Accounts Directive'. He gave a brief description of the origin of the E.C. Insurance Accounts Directive, the structure of the balance sheet, profit and loss account and the concept of true and fair accounting. Under present U.K. legislation there is an exemption from the requirement for the accounts of life assurance companies to give a true and fair view. The Fourth Directive will require accounts, including insurance company accounts, to be produced on a true and fair basis. European accountants, notably in Germany, have no difficulty in signing life company accounts prepared on a statutory basis as being true and fair, and consequently the E.C. Accounts Directive will present no difficulties to them. U.K. and Irish accountants have to find what they regard as a true and fair method of demonstrating the profits of a life insurance company, whilst at the same time complying with the restrictions of the draft directive that the only items of income which may be recognised are premiums and investment income. As things stood this made it difficult for them to recognise profits higher than statutory profits which, in the past, they have not regarded as true and fair. Mr O'Keeffe then went on to give a brief history of the Association of British Insurers Steering Group and Working Party on Life Profit Recognition and the genesis of the accruals method.

There was lively discussion, during which it was pointed out that, although members of the Institute and the Faculty were participating in the ABI Working Party, that did not mean that either professional body agreed to the ABI proposals. This was particularly so since the terms of reference of the Working Party and the Steering Group were not permitted to be challenged. Much discussion centred round the question of how the accruals method would actually fit in with the E.C. legislation, particularly for unit-linked products. It appeared that comparability was impossible between different countries. This was illustrated by the fact that, for a sample set of accounts for a standard company provided to different companies in different countries, the range of profits produced was quite large, from 70% to 170% of those of the standard model.

The first two afternoon sessions related to the guidance notes GN1 and GN8 and Practising Certificates. They were chaired by Mr A. Neill, President of the Faculty of Actuaries.

The first session was led by Mr D. Kerr who was a member of the Working Party reviewing GN1 and GN8. An amended draft was put before the audience. The amendments were largely of a tidying-up nature as a precursor to the introduction of Practising Certificates in 1992. The importance of clarity and precision in the guidance notes was noted, as Appointed Actuaries will be required to certify that they have complied with them. Concern was expressed that the prescriptive nature of some of the guidance notes might eventually reduce the role of the Appointed Actuary to that of a mere technician, and a plea was made to rethink the proposals to permit Appointed Actuaries from a wider background.

Mr M. Shelley led the session on 'Practising Certificates'. He reminded the audience that in 1990, followed the review of the Appointed Actuary system, the Department of Trade & Industry concluded that there was a case for reinforcing it and giving it further statutory backing. This led to the proposal (which was accepted by the profession) to introduce measures to:

(1) require the Appointed Actuary to certify in the DTI returns that professional guidance notes had been observed or to disclose any departures from them; and
(2) make possession of a Practising Certificate issued by a relevant professional body a pre-requisite for eligibility to act as an Appointed Actuary.

The intention was to make the necessary changes to the guidance notes by the end of 1991 to enable them to be used for returns submitted in June 1992.

The general criteria for issue of Practicing Certificates were proposed to be the following:

(a) FIA or FFA (and affiliates who require an Appointed Actuary certificate),
(b) age 30 minimum,
(c) appropriate Continuing Professional Education (CPE),
(d) appropriate practical experience,
(e) professionalism course for recent qualifiers,
(f) no adverse tribunal finding, and
(g) Form 'B' satisfactory, i.e. 'fit and proper'.

The intention is that existing Appointed Actuaries will receive a certificate automatically on application. That application will include an undertaking to notify changes in circumstances; for example CPE not up-to-date or changes affecting Form 'B'. Thereafter a certificate would be issued to an actuary who has been invited to become an Appointed Actuary only if he meets the above criteria. He then went on to outline the issues relevant to the CPE and practical experience criteria. The position of overseas actuaries was then considered. Mr Shelley hoped that the criteria could apply without amendment to overseas actuaries. If the practical requirements specify practical experience of life assurance practice in the U.K. it would be regarded as discriminating unfairly against actuaries from other E.C. countries. The requirements are likely to be phrased in terms of dealing with the financial aspects of the relevant types of life assurance. The timetable for the introduction of certificates was originally January 1993, following one year's CPE. However, this was likely to be delayed, as CPE may not now commence for the 1991/92 year. Rather than delay practising certificates, it is now proposed to see if it is possible to use these from January 1992, the full CPE requirement becoming a criterion at the earliest opportunity.

There was a lively discussion, largely concentrated on whether the proposed changes would strengthen the position of the Appointed Actuary within the life office. Many felt that it would not, but that he would nevertheless be put under more pressure. As increasingly the Appointed Actuary is only in the second tier of management, he has limited power. Even though most of the power in the office often lies outside his hands, the revised guidance notes and Practising Certificate impose no restraint on, for example, the Chief Executive and no sanctions on the office as such. For instance, they do not force companies to give the Actuary full access to the Board of Directors, as envisaged by GN1. It was suggested that it is too much to expect the Appointed Actuary to refuse to sign a certificate if he is not given complete access to information and to the decision-making process, as set out in GN1.

In response, it was stated that the new Appointed Actuary certificate was designed to show that the office had given him access to the information he requires. Setting out the regulations more clearly would strengthen his position in discussions with management. The Government Actuary's Department had also recently started to increase its contacts with life offices, partly in order to research the position of their Appointed Actuaries. It was pointed out that the DTI should enforce Form 'B', as it would be difficult for the Institute or the Faculty to do so.

The next session was on 'Disclosure', and was led by Mr C. Hairs. This was essentially a review 12 months on from a similar session he took at the corresponding seminar held in 1990 in Birmingham. He showed the results of a questionnaire he had circulated prior to the meeting. This showed the 1990 reduction in yield reported by the responding offices on 25-year and 10-year endowments as well as 25-year and 10-year personal pension products. Compared to the corresponding figures supplied for the same year 12 months previously there was a lower dispersion in the reductions in yield. Most responding offices indicated that the reductions in yield method was a reasonable method of expense disclosure. He then went on to review the 1990 With Profits Guide. Most of the respondents had expressed the view that LAUTRO rules were not a constraint in the production of the report and most were content with its content.

Mr Hairs pointed out that SIB was presently reviewing the shape of the disclosure package for the future, and that this review needed to cover content, timeliness and whether disclosure should be compulsory or optional.

The final session was led by Mr G. Aslet, and the subject was 'Valuation Regulations and Mismatching: Living in the Current Environment.' Mr Aslet talked about the problems of operating within the valuation regulations requirements and the Government Actuary's working rule on mismatching in an environment of varying investment conditions. The problem was that a company, that, on reasonable long-term assumptions, is capable of maintaining its bonuses and has no immediate cashflow problems, may nevertheless not be able to demonstrate solvency. This was a concern in September 1990, but the subsequent improvement in stock market levels eased the situation at the year end. The Valuation Regulations Working Party was looking into this, and it was desirable to come up with a workable solution before a potential problem arose.

He then went on to outline some results on unitised with-profits business, which seemed to suggest that resilience reserves required by a unitised contract were substantially greater than those expected under similar conventional contracts. Further work was being carried out on this.

He referred to work carried out by Mr M. Ross with Mr M. McWhirter into the effects of the restriction on equity yields on solvency and policyholder returns. By the use of stochastic models they demonstrated that an office may fail the statutory minimum solvency test based on a snapshot at a particular valuation date, when its long-term capacity to meet its liabilities was not at risk. If, in order to avoid this, the office was forced to switch from equities to fixed-interest stock to obtain a higher valuation yield, then, after a period, it would have an adverse impact on the size of the office's free assets and on its payout to policyholders.

Mr Aslet then referred to the 7·5% margin taken in the calculation of the maximum rate of interest as stipulated in Regulation 59 of the Insurance Companies Regulations 1981. Although the margin has little effect on the presentation of an office's published valuation, it does have an effect on the calculation of the resilience reserve. The Working Party believed that this presented unnecessary financing problems to many offices, especially as the rapid development of pensions business in recent years has led to increasing volumes of immediate annuity business being written. In view of other margins, the Working Party supported the recommendations of its predecessor that the 25% fall in equity prices required by the Working Rules should be regarded as arising partly from a 7·5% fall in income corresponding to the 7·5% margin required by Regulation 59.

Some speakers expressed surprise at the finding on unitised with-profits contracts, and felt that this was because the basic reserve was taken to be the face value of units rather than a discounted value. It was suggested that the DTI returns should disclose the basis used for the mismatching test and for establishing contingent capital gains tax reserves. A member of the Working Party commented that, although there had been some cuts in bonus rates for unitised contracts, there had so far been little signs of reductions in reversionary bonus rates for conventional contracts. He hoped to see such reductions, even if payouts were maintained by higher terminal bonuses.

Mr H. Scurfield then rounded off a very useful day with a short closing speech.

M. Iqbal