The Actuarial Profession
making financial sense of the future

CURRENT ISSUES IN LIFE ASSURANCE SEMINAR

ROYAL COLLEGE OF PHYSICIANS, LONDON
30 MAY 2008

The Actuarial Profession
making financial sense of the future

Dear CEO Letter on With Profits

David Murray, Deloitte

Andrew Burke, Pearl Group

30 May 2008

Governance issues

The Actuarial Profession
making financial sense of the future

Governance issues

- *"We expect senior management to achieve an outcome which complies with our Principles of Business."* [This is not just about compliance]
- *"Governance arrangements should … involve some independent judgment in … how any competing or conflicting rights and interests of policyholders and, if applicable shareholders, have been addressed."*

The Actuarial Profession
making financial sense of the future

Governance issues: FSA concerns

- Too little independent review?
- Review arrangements focus on compliance, rather than "*the broader outcomes to be achieved*"
- Failure to invoke independent review early enough, so poor levels of challenge
- Potential conflicts of interest (e.g. some WPC members being executives, or independent reviewers doing other work for the firm)

The Actuarial Profession
making financial sense of the future

Governance discussion

- Generally, are WPCs working effectively?
- Are they considering conflicts and planning ahead to achieve good outcomes?
- Is there sufficient independence?
- What examples have we seen of a WPC working particularly well?
- Any examples of effective communication with policyholders re their prospects?

The Actuarial Profession
making financial sense of the future

Closure Issues

The Actuarial Profession
making financial sense of the future

When is a fund closed?

- How would one define an "open" fund?
  - Any benchmarks for required sales levels?
  - Is it just about current sales – what of the future?
- Efforts to rekindle WP sales – what is current experience and the future outlook?

The Actuarial Profession
making financial sense of the future

Should a WP fund be closed?

- Is it in the interests of existing policyholders to write new WP business?
  - It always has been!
  - Have the rules of the game changed?
  - Reqt to reserve fully for asset share, and pay out 100% of asset share changes the capital dynamic
  - Should new policyholders share in the estate?
  - Should they go into a new bonus series?
- What about the interests of the wider company (especially a mutual)?

The Actuarial Profession
making financial sense of the future

Distribution of working capital

- Should a fund reduce its risk and increase its distributable assets (e.g. by reducing EBR) as it gets more mature?
- Should a fund only commence distribution once it has excess capital above its ICA?
- Is the ICA before or after management actions?
- Should the run-off of the ICA be anticipated?
- Should a constant distribution be targeted or is it fair to build up capital where the ICA is not covered.

The Actuarial Profession
making financial sense of the future

Hedging guarantees

- Reducing capital needed to cover market shocks can increase the amount available for distribution now.
- Reduce capital by hedging guarantee costs with a tailored asset mix different from asset shares (if allowed)
- Consider physical short positions as an alternative to derivatives.

The Actuarial Profession
making financial sense of the future

Hypothecation

- Does fund structure and history allow?
- Lower EBR for policies with high guarantees?
- Focus the affordable equity backing on policies likely to benefit from it?
- Lower EBR for policies close to maturity and higher EBR for policies with longer to run?
- Term dependent fixed interest returns in asset shares can reduce both the overall fund risk and the volatility of maturity values.

The Actuarial Profession
making financial sense of the future

Unclaimed policies

- "Very conservative" £2bn estimate by ABI
- B Soc demutualisations have 12 year cut-off
- Nationwide campaign in 2007 aiming at reconnecting £42m of unclaimed accounts
- When should we write off unpaid reserves? What is legal position?
- IB policies – any examples people have seen?
- Is this a material issue or not?

When does run-off cease to make sense?

- Returns and risks to policyholders
  - If RIY is 1%pa above the norm (is there such a thing?) but returns are good because of distribution of working capital, is that good enough?
  - Same answer if 3%pa ?
- Is the ability to continue to offer the "expected" EBR and smoothing just as important?

When does run-off cease to make sense?

- What benchmark do we use to judge this?
- Is it about meeting TCF requirements and complying with PPFM?
- Or is the test to deliver the *best* value to policyholders by whatever means available?
- … so if you can deliver good performance, but a sale/transfer *might* offer better prospects, what do you do?

Converting a fund to another form

- Convert to non-profit - define future RB and a terminal bonus scale in a "scheme"
- Convert to unit linked with uplift
- Issues
  - Expense risk, operational risk: could be s/h underwritten, should p/h pay something?
  - Investment matching
  - Judging when to do it!

Non Profit Business in a WP Fund

- Long dated NP business may exceed the expected life of most WP business.
- Selling the NP business at a fair price can increase certainty of outcome for WP policyholders
- Agreements for future vesting annuities.

Fund size?

- When does a fund become uneconomic to run?
- Size of investment fund?
  - Other group funds can clearly help
  - Could move to passive management via equity index
  - Issues around lumpy or illiquid investments?
  - Should EBR be lower just because a fund is small?
  - When does a declining fund get into problems even with a fixed interest approach?
- Tax issues?
- Is there any experience of tontine effects?

Expenses

- Need to estimate diseconomies of scale effects
- Who suffers these – all generations?
- Recommend having a mechanism for charging expenses to asset share without any disproportionate effects
- Set up a reserve now to cover any expected costs beyond an agreed level of charge to asset shares?
- Outsourcing – very helpful in many ways, but what should we assume beyond contract renewal date?
- What techniques are people using to estimate future run-off costs (and the ICA stress?)

Different WP Types

- Some funds contain markedly different blocks of WP policy types
- Short dated low guarantee life endowments plus long dated high guarantee pension policies is a commonly found structure
- Capacity for management actions will tail off with the short dated policies
- Hypothecation may facilitate a fairer outcome.

Communicating the Run Off

- Pattern of distribution of working capital will depend on actual fund experience.
- Is it helpful to publish a central projection when the actual experience might differ from the assumptions.
- De-risking the fund might enable higher payouts now – how is this balance explained?