

The Actuarial Profession
making financial sense of the future

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With-Profits in the New Decade

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Introduction

Threats and opportunities

- FSA Review
- Dear CEO letters to Mutuals
- Increasing focus on risk (and associated capital requirements)
- Customer demand for guarantees
- Change of business mix
- Uncertainty in longevity

Agenda

- Governance (Gerry)
- Treating Customers Fairly (Gerry)
- Risk Management (Richard)
- Products (Richard)
- Regulation (Andrew)
- Conclusions (Andrew)

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Governance

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Governance – The Past

- TCF consulted on in 2001
- Emphasis on board responsibility
- Appointed Actuary regime ceased at end 2004
- Two new statutory actuarial roles created:
 - Actuarial Function Holder
 - With-Profits Actuary
- Independent oversight (e.g. With-Profits Committee)



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What did Prudential do?

- Internal AFH, internal WPA
- Fully independent WPC
- WPA role – internal review/oversight
- No formal relationship between WPA and WPC

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Governance – The Present (1)

- Wide range of governance models
- With-Profits Actuaries in/out Actuarial
- With-Profits Actuaries producing/reviewing recommendations
- With-Profits Committees have range of membership profiles (or might be “independent person”)
- Actuarial advice sometimes provided to WPC

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Governance – The Present (2)

- FSA published results of a “thematic” review of with-profits business at the end of June
- “The majority of firms did not satisfactorily demonstrate that their practices were consistent with well-run with-profits businesses”
- Major concerns were governance and communications

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Why is governance still an issue?

- Operating new framework for more than five years, but
- FSA Handbook has limited description of role of WPA/WPC
- Subsequent FSA pronouncements (Dear CEO letters, thematic reviews, speeches) indicate wider and more pro-active roles than had been originally envisaged by companies (and FSA?)
- Uncertainty over policyholders' interests in inherited estate (Aviva Reattribution, Treasury Select Committee)



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Governance – The Future (1)

What do FSA want?

- WPA and WPC to be pro-active not reactive (A “Policyholder Advocate”?)
- Early input
- Taking a position rather than reviewing management proposal
- Challenge and evidence of challenge
- Companies must clearly explain their reasons if they don't follow advice

COBS rule changes should help clarify the position

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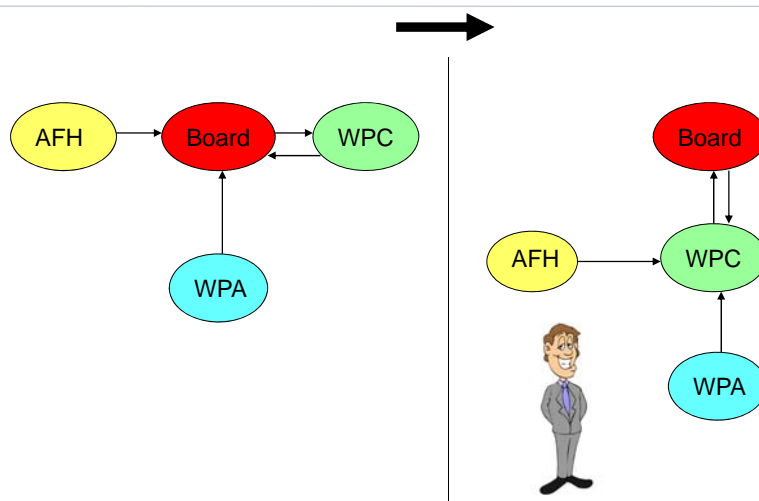
Governance – The Future (2)

Convergence of governance models

- WPA – surplus to requirements?
- WPA – part of Risk function?
- External WPA?
- Fully independent WPC (with actuarial advice?)
- WPC to make proposals?

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Governance – The Future (3)



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TCF

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TCF – The Present

- Firms consider TCF in product developments and over a product's lifetime

But

- The FSA not satisfied that all firms were doing enough to provide comprehensive, timely and clear information to help customers understand their policies

Particular issues:

- Explain how the policy is performing and impact of changing asset mixes
- Quality of CFPPFM
- Firms often challenged as to why decisions are consistent with TCF

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TCF – The Future

More restrictions can be expected:

- Limits on strategic asset allocation (particularly if low yield environment continues)
- More transparency in communications (especially existing business) and also product design
- Limitation of discretion

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Risk Management

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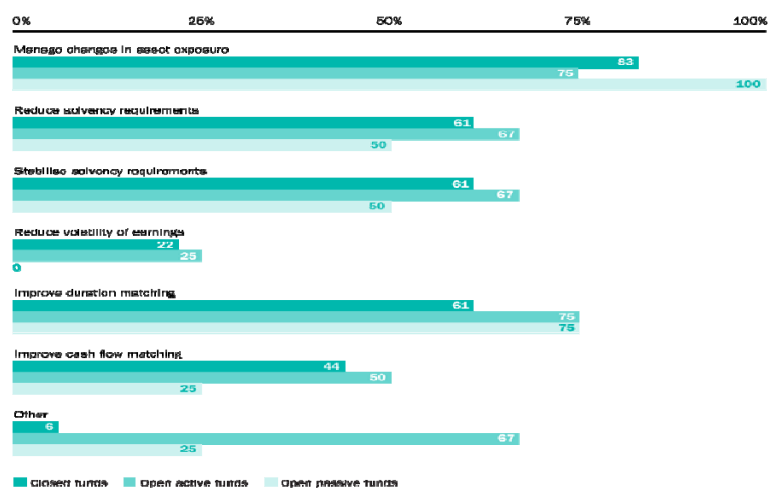
Risk Management – The Past

- Significant development over recent years (but further to go)
 - Management information (quantity; timeliness)
 - Embedding
- Various techniques employed to reduce risk
 - Derivative hedging
 - Segregation of assets to product classes
 - Variability of charges
 - GAR compromise schemes

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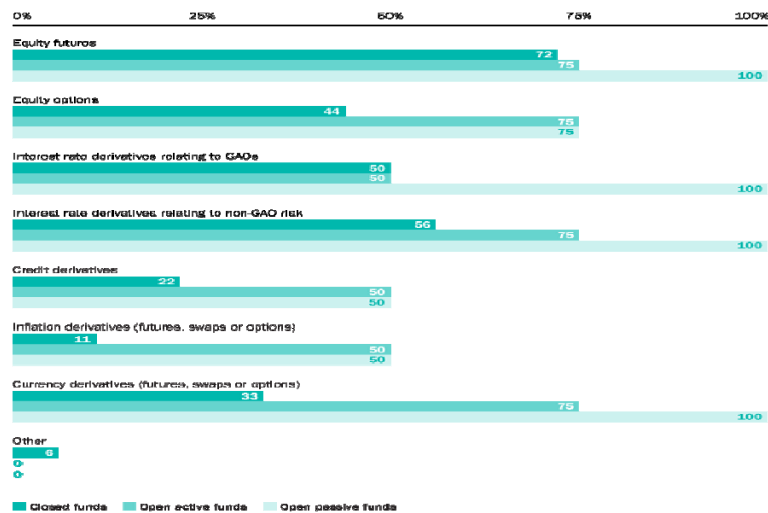
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Risk Management – The Present



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Risk Management – The Present



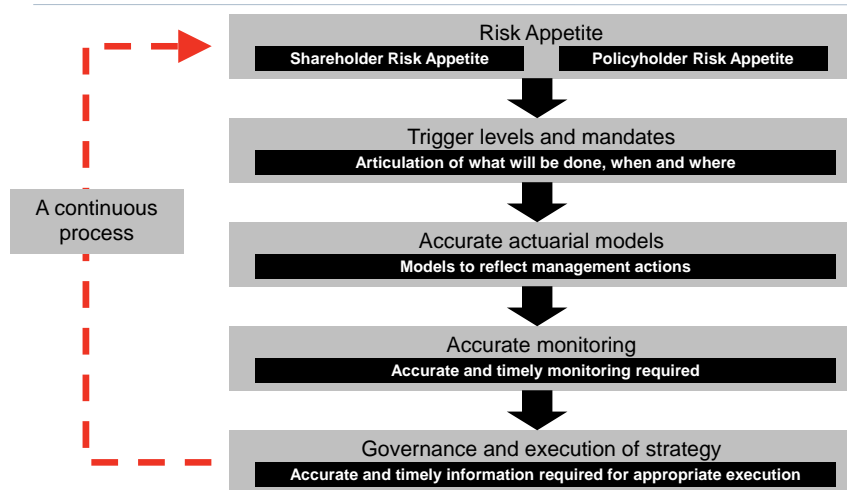
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Risk Management – The Future

- Developments to process
 - Embedding
 - Industrialisation of MI
- Risk exposure – continuing to reduce?
- More **management** of risk
 - Greater use of ALM, M&A and reinsurance
- Emerging issues to deal with

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Risk Management – Control Cycle



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Products

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Products – The Past

- Born out of uncertainty in late 18th and early 19th centuries
- Originally mostly protection policies – typically whole of life
- Grew into endowments
- Pensions followed
- Not seen as a specific savings choice until latter half of the 20th century

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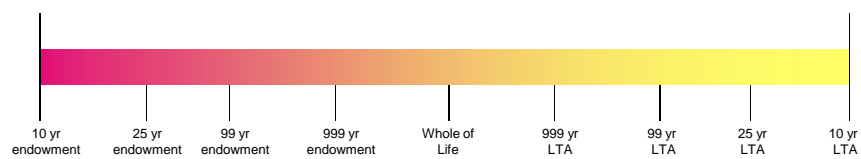
Products – The Present

- Out of favour – customers, media, financial advisors, (FSA)
- With-profits “brand” discredited – anyone for a mortgage endowment?
- Limited new product innovation
- New products / rebrand – return to with-profits’ roots

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Products – The Future

- Term assurance
- Critical illness
- Annuities
- Unit-linked



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Products – Why Bother

- Lower capital requirements
- Lower competition
- To exist
- Marginal cost
- **Customer need**

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Products – Issues to consider

- Asset share?
- Equity between new/existing policyholders
- Same fund or new fund?
- Regulations

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Regulation

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FSA

- Is supposed to think about consumers
- Consumers can benefit in many areas from better products if they share the risks
- With-profits can benefit consumers
- So why narrow the definition?
- Do not confuse **amount** and **basis** of distribution with **entitlement**
- Risk/reward balance should be on loss potential, not inherent risk in the policy (c.f. whole of life mortality risk)

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Dear CEO letters – the new legislation?

- FSA are defining requirements through letters, speeches and newsletters
- FSA also provide their views via “close and continuous” meetings, private letters and risk mitigation plans
- Letters from Jon Pain to Mutual Chief Executives
 - 13 October 2009
 - What rights do with-profits policyholders have?
 - What new WP business is being written?
 - What constitutes new with-profits business?
 - “Sister mutual” or new funds
 - 28 September 2010
 - We are right and you are wrong!
 - Nothing on “new product” space

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Ownership of Surplus – Mutuals

- Direct comparison with proprietary offices
 - Not unreasonable?
 - “Rules of the club”
 - c.f. Australian and Canadian demutualisations of 1990s
 - Have some mutuals mis-described their structure, and is it too late to change?

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New Products

- A lawyer is only as good as their brief
- “Features and pricing of traditional non-profit policies”
- “Entitlement to share in profit does not extend beyond membership only, or where the participation in surplus is illusory, or not of a material kind”

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Conclusion

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Risk sharing

- Wherever there is uncertainty, risk must be borne by someone
- Where the risk is hard to quantify, then with-profits is a solution
- With-profits shares the upside and the downside and on balance is attractive to many customers
- It is a **good thing**

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The New Decade

- We can expect governance models to converge, with a larger and more active role for WPCs
- It is inevitable that more restrictions will be placed on with-profits business
- Regulators will focus on policyholders' "rights"
- Increasing focus on the management of risk
- Further consolidation and fewer new business franchises
- With-profits to return to its roots? Move from investment products to risk products

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