

The Actuarial Profession
making financial sense of the future

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With-profits mutuals
The fight for survival

7-9 November 2010

With-profits mutuals – the fight for survival

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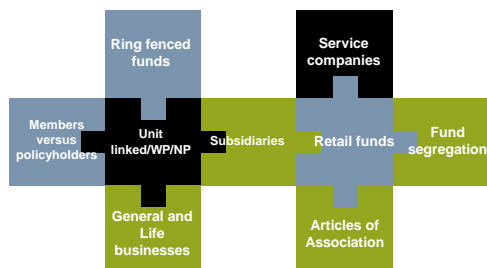
Mutuals have evolved in many shapes and sizes

- Established for the benefit of members before with-profits business came into existence
- Many started to assist self-help for the poorest in the community
- Owned by the ever-changing group of policyholders who happen to be its members
- Initial business was non-profit but profits returned to members as they arose
 - formalised in the creation of with-profits business

Source: Memorandum from the Association of Mutual Insurers, 28 May 2008

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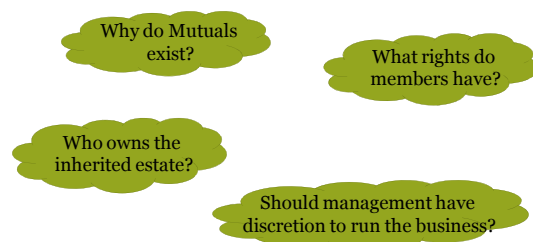
Mutuals can be complex organisations which present significant challenges



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Some questions to think about...



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Current challenges with with-profits business

With-profits products have fallen out of favour

- Claim and surrender values lack transparency
- Too much discretion, e.g. charges, investment strategy
- Large cross-subsidies to support onerous guarantees
- Poor public perception around solvency and the implications of closure

...this has led to substantial reduction in new business sales and closure for many funds

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COBS rules (TWPPF) sought to improve this

- A fund with an excess surplus should make a distribution or carry out a reattribution
COBS 20.2.22 (1)
- New contracts to be effected on terms unlikely to have a material adverse effect on existing with-profits policyholders
COBS 20.2.28
- A fund ceasing to effect new business must demonstrate a fair distribution of the inherited estate
COBS 20.2.53 (2), 20.2.56 (1)
- Economic value of future profits on non-profit business should emerge during the lifetime of the with-profits business
COBS 20.2.60 (1)

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Project Chrysalis started to gain momentum

- Combination of the COBS rules and the current challenges had the potential to inflict damage on the Mutual sector
- Application of COBS rules may result in
 - transfer of ownership from members to with-profits policyholders
 - disproportionate windfall payments to current with-profits policyholders
- Helpful to create a clear definition of a with-profits sub-fund for Mutuals and of mutual capital

Source: Memorandum from the Association of Mutual Insurers, 28 May 2008

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FSA responded with a strongly worded letter

... with-profits policyholders, in their capacities as policyholders and as members of a mutual, will be **entitled ultimately to all or almost all of the assets** in a mutual's long-term fund...

...options which would redefine the interests that with-profits policyholders have in the mutual are **likely to amount to a reattribution**...

...consider the **implications of ceasing to write new with-profits business** and must adequately protect the interests of its existing with-profits policyholders...

...the **economic value of the new non-profit business**, and the profits to be realised on it, **can be distributed** to the with-profits policyholders...

Dear CEO letter, 13 October 2009

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...and most Mutuals challenged the FSA letter

- Each Mutual is different
- FSA letter did not acknowledge some relevant complexity
 - not adequately addressing membership generally versus a with-profits policyholder
 - broadly assumes that, if the Mutual had non-profit policyholders previously, the NP interest in the estate is now small
- Some argue that the estate is capable of being used by non-profit members

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FSA has just published a follow up response

One of the **features of the mutual insurance sector is its diversity**

...firms evidently received legal advice to the effect that, in their own particular circumstances, the **interests in their long-term funds were quite different** from the general position....

...surprising if the reasonable expectations of with-profits policyholders in a mutual firm were as fundamentally **less extensive than those of similar policyholders in a proprietary company...**

...own particular circumstances warrant a different outcome, it must be able to **point to clear and unambiguous factors** to justify this...

Dear CEO letter, 28 September 2010

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...how will Mutuals respond this time?

Any views from the audience?



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Where do we go from here?

Improve new business sales

- With-profits products still have a lot to offer
- Can respond to the criticisms;
 - transparency and discretion
- Popular features in conventional non profit, unit-linked and variable annuity products can be replicated in with-profits
- Inherited estates can be used to provide benefits
 - more efficiently than non profit policies
 - not found in non profit policies

...but this only defers the problem

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Should we change direction if we expect new business sales to dry up?

Continue with
existing
operation model



Establish sub-
funds to clarify
ownership

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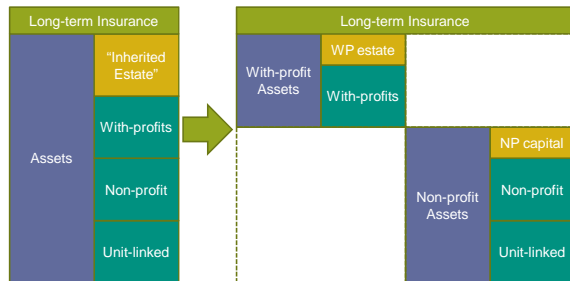
Continue with existing operating model



* Diagram removes complexity relating to other insurance funds and other companies within the Mutual

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Establish sub-funds to clarify ownership



* Diagram removes complexity relating to other insurance funds and other companies within the Mutual

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Allocating the inherited estate has some key challenges

- How do you allocate capital between with-profit and non profit policyholders?
- What capital was available to the fund before the first with-profits policy was written?
- What expectations do with-profits policyholders have to the estate?
 - How might this be valued?
- What expectations do other policyholders and members have to the estate?

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Clarify ownership has clear benefits but substantial costs



- Clear ownership
- Can distribute with-profit estate
- Can use member's funds to write new NP business



- High implementation costs
 - Potential for proportional response?
- Loss of discretion and flexibility

...but balance of costs and benefits will vary by stakeholder

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Winners and losers

- Policyholders
 - With-profits vs. non-profit
 - Current vs. future
- Members
- Regulators
- Management

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Open discussion

Who owns the inherited estate?

What rights do members have?

Should management have discretion to run the business?

How should Mutuals respond to the latest FSA letter?

Why do Mutuals exist?



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