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# Unlocking Customer Value: Reflections of the WPA and Independent Actuary on a GAR compromise scheme

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# Overview - The Royal London GAR Scheme

- Part 26 Scheme of Arrangement
- 33,000 Guaranteed Annuity Rate (GAR) pensions plans in **Scottish Life Fund**
- Opportunity to exchange
  - valuable (but inflexible) **GAR** for ...
  - ... actuarially equivalent **cash value**
- Two year process over 2017/18
- **Sanctioned by the High Court on 12 November**



# Context - Schemes of Arrangement

- Effective tool for restructuring and simplifying LifeCos
- Only a handful completed to date
- Gaining in popularity
  - as firms move beyond immediate demands of SII embedding and IMAP
- Non trivial process!
  - lots of challenges



# This Presentation - Aims

- Explains why we undertook the Scheme (and dismissed the alternatives)
- The various stages of the process
- How we interacted with the Independent Actuary
- What we learned – and the things we'll do differently next time!
- The thoughts of the IA and WPA





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1. Motivations - Why a Scheme?
2. RL GAR Scheme Process
3. Fairness - WPA Perspective
4. Fairness - IA Perspective
5. Q&A





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# Statement of the Problem (Part 1)

## GARs are very valuable

- Typically they double the annuity purchasing power
- BUT... The majority of customers don't exercise them

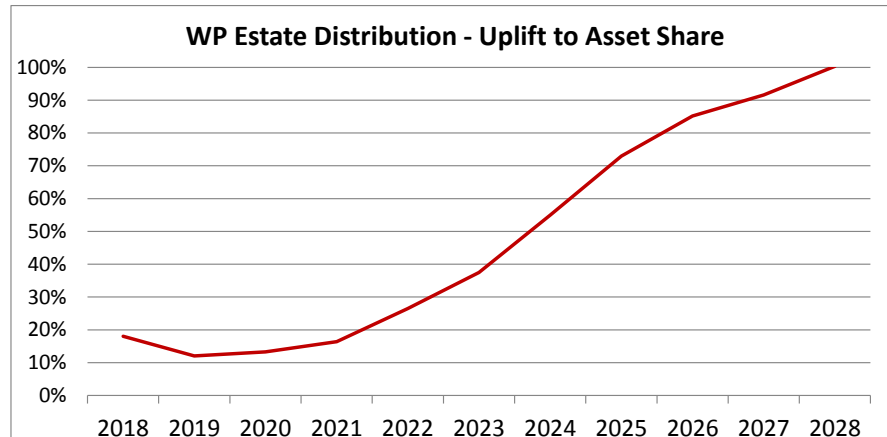
| Customer Choice | Proportion by Value | Proportion by Number |
|-----------------|---------------------|----------------------|
| 0% Cash         | 24%                 | 14%                  |
| 25% Cash        | 45%                 | 25%                  |
| 100% Cash       | 28%                 | <b>60%</b>           |
| Other           | 3%                  | 1%                   |



# Statement of the Problem (Part 2)

## GARs tie up capital

- Mainly longevity & GAR take-up risks that are difficult to hedge
- This hampers a fair distribution of the estate to WP policyholders







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# Scheme of Arrangement - Typical Timeline



# Stage 1: Design

- Early consideration - key questions:
  - Actuarial - do the numbers stack up? Can we fund an offer fairly?
  - Legal - any blockers/constraints, e.g. existing T&Cs, instruments of transfer?
- Process
  - Workshop sessions - actuaries, lawyers (internal and external)
  - Full legal due diligence
  - Actuarial modelling
  - Consider own view of fairness and fairness criteria
- Iterative process - work toward draft design



# Actuarial - Crafting an Offer

- Two key stakeholder groups – need to balance interests
  - GAR policyholders
  - Wider WP policyholders
- Starting Point – set offer equal to GAR reserve, but:
  - GAR reserve assumes GAR TUR (materially) less than 75%
  - Offer at this level unattractive to majority who take 25% TFC/75% GAR
  - Need to increase GAR TUR to 75% ideally but gives funding challenge
- How to fund?
  - ‘Gap’ funded from release of SCR (top-up to offer)
  - Remainder falls to WP policyholders
  - Is it enough?
  - In our case yes – gave material increase in estate distributions (roughly doubled)
- Both stakeholder groups satisfied – “win-win”



# Actuarial - Challenges

- Anti-selective opt outs - dilutes scheme capital benefit, imposes maximum tolerable opt out rate
  - We needed less than 30-35% opt outs
- Valuation of GAR heavily dependent on discount rates. Which basis to use?
  - valuation basis
  - market pricing basis
- Granularity of offer uplifts – balance simplicity vs avoiding excessive cross-subsidies
  - ultimately settled on split by contract, gender and age



# Legal Challenges

- **Voting classes**

- typical and preferable to have a single class - avoids 'veto risk'
- “*persons whose rights are not so dissimilar as to make it impossible for them to consult with a view to their common interest.*” (Sovereign Life Assurance Company v Dodd [1892]).

- **Gender Directive**

- Offer used gender-specific mortality assumptions (per GAR rates themselves)
- Policies pre-dated Gender Directive (2012) so believed to be OK
- Later challenged in court - but agreed that conversion under scheme did not constitute a new contract or review - so not caught by legislation

- **Deed poll**

- Some cases written under trust
- Exercise deed poll to allow individuals to vote on a 1:1 basis
- Common approach – not generally viewed as contentious

# Stage 2: Documentation

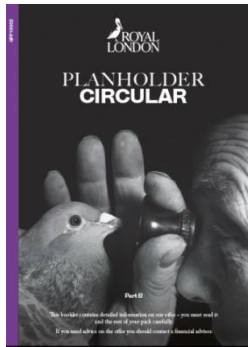
- **Legal Documents**
  - Scheme document
  - Circular - contains formal legal notices, serves as guide to scheme
- **Actuarial Reports**
  - Independent Actuary
  - With Profits Actuary
  - Chief Actuary
- **Policyholder Communications**
  - Formal offer pack
  - Also interim 'appetite mailing'



# Formal Offer Pack

## Contents

- Cover Letter
- Scheme
- Circular
- Personalised Illustration
- Decision Form



## Challenges

- Customer friendly vs compliant
  - customer testing employed
- Multiple variants
  - LTA, trustee, safeguarded benefits etc
- Review process
  - highly iterative
  - multiple, conflicting feedback
  - version control
- Personalised Illustration
  - COB compliance
  - waivers sought



# Stage 3: Regulatory Review

- FCA led (PRA kept informed)
- Engaged informally with FCA for ~6 months
- Then submitted all court (convening) documentation for formal review
  - Scheme
  - Actuarial reports (IA, WPA, Chief Actuary)
  - Guidance/Advice documentation
  - Policyholder communications
- Process took ~6 months (vs 3 months anticipated)
- Very large volume of detailed feedback provided
- Key Areas of Focus
  - Scheme fairness
  - Waiver applications
  - Gone-aways
  - Guidance/Advice
  - Vulnerable Customers



# Gone-Aways

- Started with 20% gone-aways
- Legal Requirement
  - Gone-aways default into scheme - but may or may not be their desire
  - must minimise number on 'best endeavours' basis
- FCA Requirement
  - find everyone!
  - anyone you can't trace must be given **Retrospective Opt Out**
- Extensive tracing programme
  - Capita, LexisNexis, DWP
  - Gone-aways reduced to ~10%
  - Remainder successfully traced and sent Circular
  - Only ~0.5% untraceable



# Stage 4: Execution & Voting

## Convening Hearing (June)

- One day hearing
- Focus on voting classes
  - Fairly constituted?
  - Correct number?
- Fairness issues reserved until later Sanction Hearing
- Main challenge was around Gender Directive
- FCA provided non-objection notice and court report. Attended as observers.
- Go-ahead given to proceed to scheme meeting



# Formal Offer - Voting (July-October)

- Process
  - 3 month voting window – per “*Code of Good Practice for Incentive Exercises*”
  - Votes could be submitted online or by post (postal approx twice as popular)
  - Reminders issued mid-way through
- Response
  - Slow start initially
  - Reminder mailings important in driving returns
  - Late ‘surge’ in final weeks
  - Significant minority left it until very last minute
  - Opt out spike at very end – panic voting?



# Guidance / Advice (1)

## Overview

- We decided to offer free guidance and subsidised advice to policyholders throughout the ~3 month voting period

## Why?

- Complex decision with material consequences
- Offer fair at an overall level
- But attractiveness of the offer **for each individual** depended on a number of factors
  - Preference for cash – e.g. those taking < 25% TFC may want to opt out
  - Health, e.g. those in very good health may opt-out; ill health opt in
  - Attitude to risk and desire for certainty of income
  - Desire to leave inheritance



# Guidance / Advice (2)

## Process Overview

- “Triage” approach



## Guidance

- Conceptually similar to PensionsWise
- 45 minute telephone call
- Followed agreed script
- Not a personalised recommendation but **free service**



# Guidance / Advice (3)

## Advice

- JLT appointed as scheme default adviser
  - Capacity
  - Qualifications (pension transfer permissions)
  - Track record
- Cost-effective approach
  - Bulk deal, telephone-based
  - Customers asked to pay nominal fee of £100
  - Waived for safeguarded benefit cases and vulnerable customers
- Own Advisers - customers could also use their own adviser if they wanted to / had one
  - Equivalent subsidy provided



# Guidance / Advice (4)

## Key Learnings

- **Helpline** very popular (~6,000 calls; ~15% take-up)
  - Policyholders often had just one or two key questions
  - But then happy to get on and vote
- **Guidance** didn't prove popular (~3% take-up; 30% assumed)
  - time and effort involved appeared to be a deterrent (45 minute conversation)
  - no personalised recommendation at end / unfamiliar concept ?
  - though 95% who took it felt able to vote immediately (without requiring further advice)
- **Advice** was more popular (~5% take-up; 10% assumed)
  - People liked using their existing adviser where they had one
  - Take-up amongst safeguarded benefit cases was relatively high (~50%). JLT default well utilised.
  - Those taking advice voted similarly to population as a whole





# Scheme Meeting (October)

- Formal meeting of ‘creditors’ to discuss scheme
- 23 policyholders attended
- Led by Royal London’s Chairman
- Overview of scheme provided
- Q&A
  - panel of CFO, Chief Actuary, WPA, IA and Legal Advisers
  - Q&A session was lengthy and vibrant!
- Votes then cast
  - Chair casts as proxy for c 15,000 online/postal votes.



# Voting Results

- Results

- Response rate: 49% by count; 59% by value (far higher than expectations)
- Opt out rate: 16% by count; 22% by value (needed < 30%)
- Phoenix 2009 scheme comparator: response rate 33%, opt out 17%
- Offer most popular with smaller pots; opt outs higher on larger pots
- Vote result (excl. opt outs) – 98% in favour by count, 99% by value (comfortably in excess of 50% and 75% hurdles)

- “Second Chance” mailing

- Wrote to 170 ‘against’ voters post-vote to check if they wished to change to an opt out



# Sanction Hearing (November)

- Relatively short 1.5 hour hearing to sanction scheme
- FCA represented by counsel. Non-objection provided.
- Judge explored
  - underlying scheme requirements ("intelligent person" test, 'blots' on scheme etc)
  - approach to communications - demo of mailing pack in court
  - levels of customer engagement
  - objections/complaints - key themes and mitigations
  - protections in place, e.g. opt out, advice provision, uplift final recalculation mechanism
  - IA's views
  - FCA non-objection





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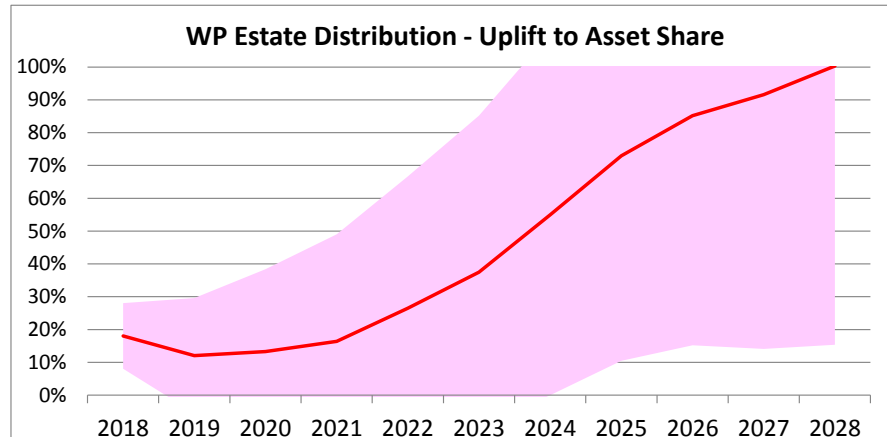
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# Fairness from a WP policyholder perspective

## Pre-Scheme – Capital Tied Up

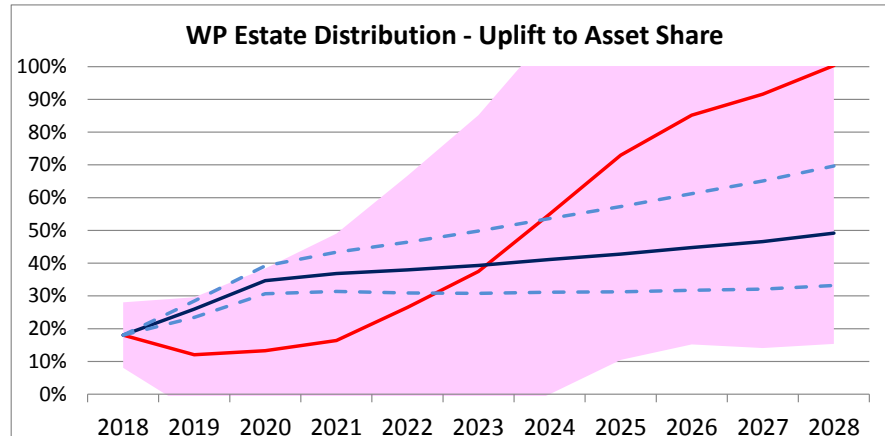
- Not only is the shape of the distribution unappealing
- The risk in the fund makes it very uncertain



# Fairness from a WP policyholder perspective

## Post-Scheme – More certain future

- Part of the Inherited Estate forgone to make offer
- Future Estate distribution much more stable





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# Background

- Independent Expert (Actuary) – statutory requirement for Part VII
- No equivalent requirement for Part 26 Schemes of Arrangement
  - But considered good practice
  - Precedent through previous SoAs
- Provides assessment of fairness of scheme
- Assessment centred around **Fairness Criteria**
- Report provided to Convening Hearing
  - Plus Supplementary Report for Sanction Hearing
- **Duty to court (not company)**





# Considerations

- Purpose of Scheme
- Legal test: Scheme is one that an intelligent and honest person might approve
  - Not “no materially adverse impact”
  - Individuals for whom the compromise is not favourable due to individual circumstances
- Choice offered to planholders: opt-out **or** vote for / against
- Implications: vote / communications / gone-aways / retrospective opt-out / advice
- Uplift values – methodology / assumptions and calculation timing



# Fairness Criteria

| Test                            | Description   |
|---------------------------------|---|
| <b>Fair Value Test</b>          | The increase to policy values should be broadly consistent with the “economic value” (fair value) of the GAR being compromised.                                   |
| <b>Adverse Scenario Test</b>    | The extent to which policyholders could be materially worse off if they take the offer but financial conditions change (“capacity for regret”) should be limited. |
| <b>Ongoing Feasibility Test</b> | The reasonable benefit expectations of the non-GAR (with profits) policies should not be lower following the scheme.  |
| <b>Estate Value Test</b>        | Other funds (e.g. RL Main Fund) should not inadvertently receive any benefit from the Scheme.   |





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# Questions

# Comments

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