

The Impact on the UK Savings Industry of the Sandler Review

Jackie Wells and David Gulland

2003 Life Convention  
9-11 November

---

---

---

---

---

---

---

**“HM Treasury...**

- Background  
...announces stakeholder price cap”

---

---

---

---

---

---

---

**Content**

- Background
- Consumer Issues
- Distribution
- Provider Issues
- Financial modelling
- Smoothing and Guarantees
- Market Impacts

---

---

---

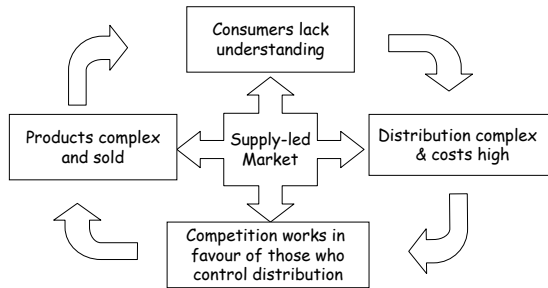
---

---

---

---

### Sandler Review




---

---

---

---

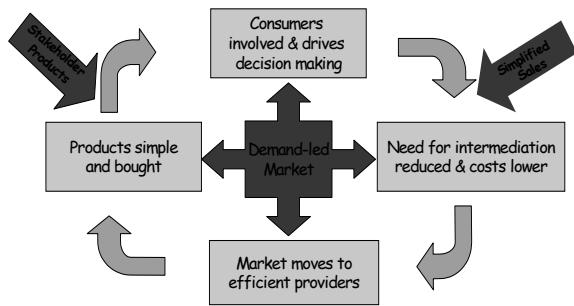
---

---

---

---

### Reversing the Market




---

---

---

---

---

---

---

---

### Stakeholder Suite 2005

#### Savings Plan

- Life assurance or mutual fund wrapper
- ISA or non-ISA
- 60:40 fund
- New smoothed 'WP' fund

#### Pension Plan

- Replaces current stakeholder
- Life assurance or mutual fund wrapper
- Lifestyling option
- New smoothed 'WP' fund

#### Child Trust Fund

- Life assurance or mutual fund wrapper
- Equity based with lifestyling
- Additional optional funds
- Government Endowment
- £1200pa max voluntary contributions

#### Cash ISA

- Rebranded for CAT-marked Cash ISA

---

---

---

---

---

---

---

---

### Price Cap Research

- Sandler suggested 1% as starting point, but...
- ... acknowledgement that might not be enough
- Two Deloitte market impact studies commissioned by Treasury
  - Comparative studies of different price caps structures and levels
  - Wide-ranging industry research
  - Analysis of cost structures and desired returns
  - Impact of simplified sales on distribution costs
  - Assessment of enthusiasm for market entry
  - Identification of distribution potential
  - Impact on consumers critical – accessibility and RIY
  - Research in June (Sept for CTF)
- Decision by end of year
- Strong dependency on FSA DP19 outcome

### Content

- Background
- Consumer Issues
- Distribution
- Provider Issues
- Financial modelling
- Smoothing and Guarantees
- Market Impacts

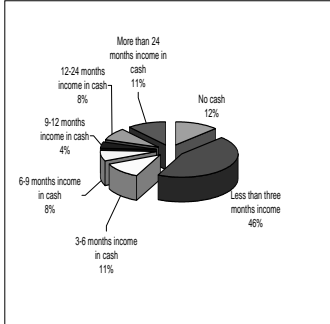
### Consumer Issues

- Started by modelling potential size and profile of market
- Strong influence from forthcoming FSA regulation
- DP19 lays out three options but only one being tested
- Expectation of 'guided' self-help
  - Series of questions designed to highlight when Stakeholder product may not be suitable
- Key 'suitability' themes likely to include:
  - Adequacy of cash holdings
  - Manageability of debt
  - Adequacy of life cover
  - Willingness to take investment risks
  - Interaction with state
- Investigation of impact of filters
- Starting point, adult population of approx 45 million

### Cash Holdings

Concern to ensure have some cash to see through difficulty

Applying 3 month threshold reduces market by 60%




---

---

---

---

---

---

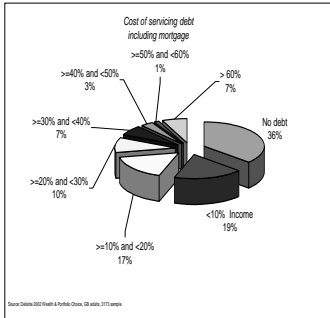
---

---

### Debt management

60% consumers do not have sustained non-mortgage debt

For majority, debt servicing accounts for less than 30% income




---

---

---

---

---

---

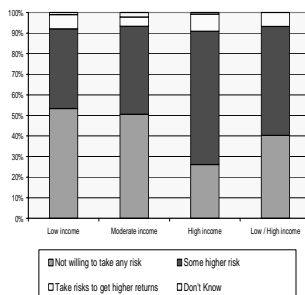
---

---

### Appetite for Risk

Removing those not prepared to take risk reduces market by 50%

However, many not willing to take risks do have risky products in their portfolio




---

---

---

---

---

---

---

---

### Consumer Issues

- Starting point, adult population of approx 45 million
- Market narrower but potential pool of buyers identified
- Pool segmented by income segment
- For each segment:
  - Average contributions
  - % likely to buy / sold to each year
- Market level new business measured
- Sensitivities assessed

---

---

---

---

---

---

---

### Content

- Background
- Consumer Issues
- Distribution
- Provider Issues
- Financial modelling
- Smoothing and Guarantees
- Market Impacts

---

---

---

---

---

---

---

### Distribution

- Hypothesis at start of the project that:  
*"demand for Stakeholder products will be driven largely by the distribution channels that can be supported at different charging levels and by the nature of those channels – the more 'persuasive' the channel and the wider the market reach, the greater the influence on savings behaviour"*
- Analysis of distribution driven by:
  - Current customer preferences
  - Market reach to low and middle income consumers
  - DP19 and depolarisation considerations

---

---

---

---

---

---

---

**Distribution**

	Single Company Tie	Multiple Company / Limited Market	Independent / Whole Market
Introducer			
Execution Only / Financial Promotion			
Simplified Sales Process			
Full Advice			

- ☐ Current regulatory / distribution positions – life, pensions and investments
- ☐ Future additional regulatory / distribution positions – life, pensions and investments

---

---

---

---

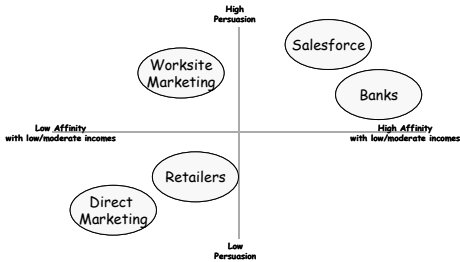
---

---

---

---

**Distribution**



---

---

---

---

---

---

---

---

**Content**

- Background
- Consumer Issues
- Distribution
- Provider issues
- Financial modelling
- Smoothing and Guarantees
- Market Impacts

---

---

---

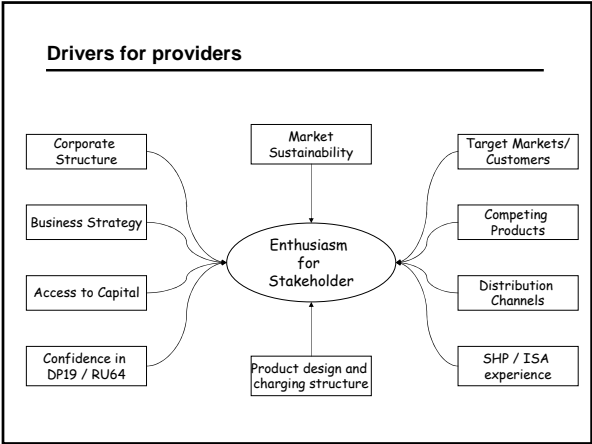
---

---

---

---

---



---

---

---

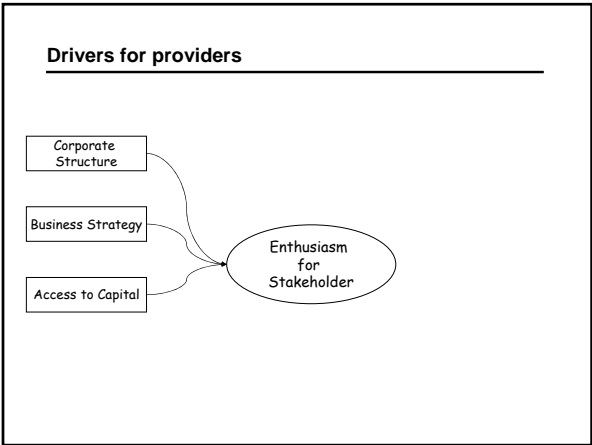
---

---

---

---

---



---

---

---

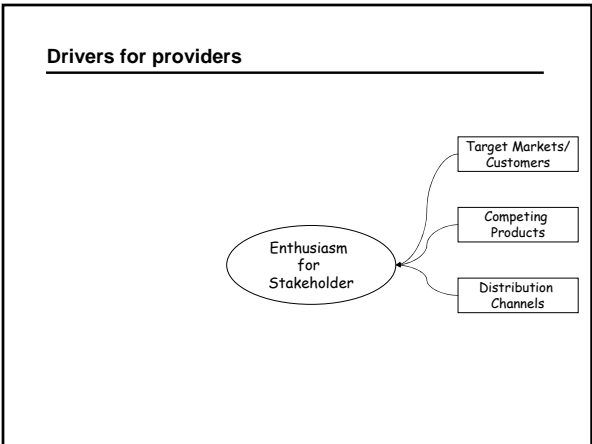
---

---

---

---

---



---

---

---

---

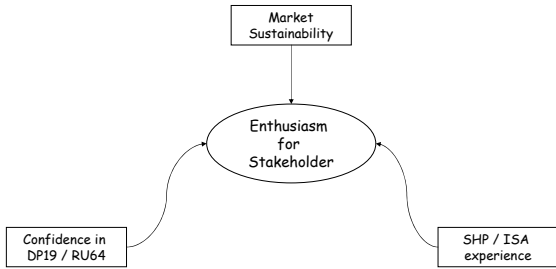
---

---

---

---

**Drivers for providers**



---

---

---

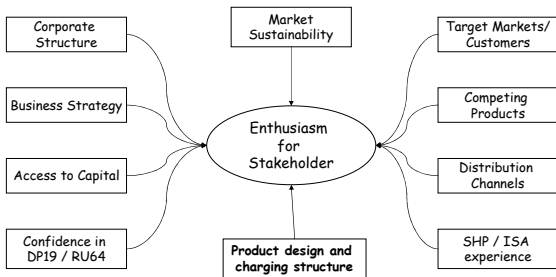
---

---

---

---

**Drivers for providers**



---

---

---

---

---

---

---

**Content**

- Background
- Consumer Issues
- Distribution
- Provider Issues
- Financial modelling
- Smoothing and Guarantees
- Market Impacts

---

---

---

---

---

---

---



### Financial Modelling - overview

- Different methodologies used in market by different providers/distributors
- "Project" base approach to measuring IRR, Payback
  - Recognising ABI and other public work on "minimum case size"
  - Also illustrative results on single cohort and marginal expenses
  - Agreed to be "structure-neutral" rather than specifically considering life insurance firms or product
- RIY used to illustrate impact on customer
  - Impact at different durations
  - For different persistency etc

---

---

---

---

---

---

---

### Financial Modelling - details

- "Bottom-up" approach to expenses
  - Inclusion of fixed and marginal expenses
  - Brief was to consider "efficient firms"
  - Lack of data on "DP19" costs
- Different distribution channels all based on "DP19" or direct response (no full advise)
  - Banking, DR, "worksite", DP19 salesforce, retail/brandassurer
  - Contribution levels varying by channel
  - Persistency varying by channel
- Various customer segments
- Two products – pension and savings
  - Both with RP and SP

---

---

---

---

---

---

---

### Financial Modelling - sensitivities

- 11 different charge cap structures
- Alternative expenses
- 5 different distribution mixes
- Volumes
- Persistency
- Case size
- Reserving requirements
- Investment returns

---

---

---

---

---

---

---

**Content**

- Background
- Consumer Issues
- Provider Issues
- Distribution
- Financial modelling
- Smoothing and Guarantees
- Market Impacts

---

---

---

---

---

---

---

---

**Smoothing - scope**

- Difficulties with achieving what Sandler originally proposed...
- Explanation of current products' mechanics
- Stochastic simulations of alternative smoothing rules
  - Sledgehammer for a nut but in line with current techniques...

---

---

---

---

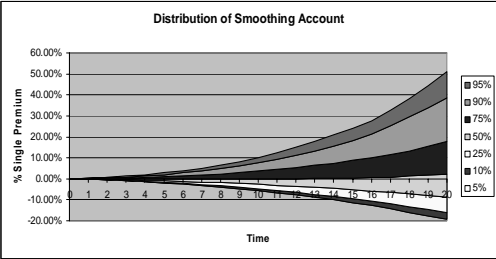
---

---

---

---

**Smoothing calculations – example output**



Economic Value of smoothing is 4% of single premium. Equivalent additional annual fund management charge would be 0.3% pa

---

---

---

---

---

---

---

---

### **Smoothing - comments**

- Difficulties in specifying a universal and acceptable smoothing charge that:
  - will be appropriate in all cases and
  - will lead to a zero balance for the smoothing account in the long-term.
- The smoothing charge will need to reflect:
  - changes in economic conditions over time
  - the definition of the smoothing rule and parameters used
  - the use or otherwise of MVAs
  - the extent to which the profits and losses from smoothing are recycled into the asset shares of continuing policyholders.
- Smoothing charge should be seen as just one part of overall management of the smoothing account – link to PPFM

---

---

---

---

---

---

---

---

### **Smoothing – Treasury conclusions in July**

- Treasury conclusions in July paper reflect previous comments and are more pragmatic than original Sandler proposals
- Very similar to PPFM proposals – ie set out what you are doing, but no prescription
- Explicit use of smoothing account, aim to be neutral over disclosed period
- Need for target neutrality will require regular changes to smoothing rules
- Can use external capital to fund shortfall, charges for which are outside the cap
- MVAs allowed
- Disclosure of smoothed and unsmoothed asset share at point of exit

---

---

---

---

---

---

---

---

### **Guarantees**

- Desire to try and include some guarantee in suite
- Standard stochastic modelling using TSM to illustrate costs under different volatilities
- Deliberately no investigation into impact of alternative legal structures or hedging mechanisms into cost
- Treasury paper in July dropped concept of including guarantees within suite (other than mortality for life contracts)

---

---

---

---

---

---

---

---

### **Content**

---

- Background
- Consumer Issues
- Provider Issues
- Distribution
- Financial modelling
- Smoothing and Guarantees
- Market Impacts

---

---

---

---

---

---

---

### **Market Impacts**

---

- For consumers
- For providers
- For distributors
- For government

---

---

---

---

---

---

---

### **Consumer / Distribution Impacts**

---

- Impact of structure of cap on value for money
  - For those who stay the course
  - For those who take money / transfer early
  - Particularly for moderate income consumers
- Impact of profitability on ability of distribution to reach moderate income consumers

---

---

---

---

---

---

---

**Provider Impacts**

- Capital requirements – adequate capital to support?
- Pay back period – different structures / fully costed, marginal costing
- Return on capital – different thresholds for different providers
- Number of providers supported / consolidation effect

---

---

---

---

---

---

---

**Market Impacts**

- Impact on size of savings and pensions markets
- Ability to draw in moderate income consumers
- Enthusiasm among providers, distributors and consumers

---

---

---

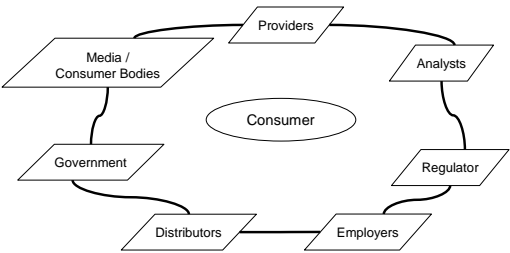
---

---

---

---

**For markets to succeed all stakeholders must be engaged**



---

---

---

---

---

---

---



---

---

---

---

---

---

---