

The Actuarial Profession  
making financial sense of the future

Current Issues in Life Assurance 2011  
Kevin Arnott; Matt Lee



**With-profits**  
Balancing conflicts of interest

25 May 2011

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**With-profits - balancing conflicts of interest**

**Contents**

- Background and recent developments
- Detailed rules vs. better governance
- Proposed changes to:
  - the way funds are managed
  - corporate governance
- Next steps and wider implications

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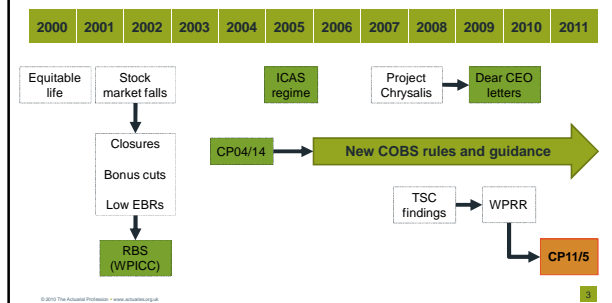
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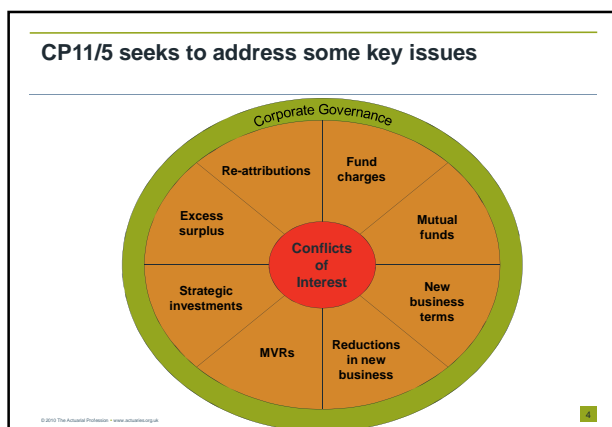
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### The treatment of with-profits policyholders has been of concern for some time



### CP11/5 seeks to address some key issues



### FSA believe the current arrangements do not work

"The with-profits market **suffers** from information symmetries ... stem from the **complexity** of the with-profits products and the **opacity** of their operation."

"... can result in **unfair outcomes** for with-profits policyholders."

"Many firms' **practices are inconsistent** with our rules and guidance."

"... most firms did **not satisfactorily** demonstrate how their practices were consistent with well-run with-profits businesses in one or more of the areas we assessed"

Source: FSA (CP11/5, February 2011)

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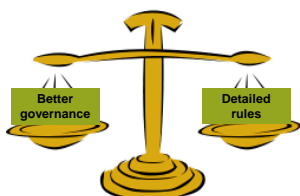
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## How might we improve the current arrangements?



- Common understanding
  - does one size fit all?
- Sharpen management's focus
  - can we foresee all possible outcomes?
- Implementation challenges

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## What do you think?

*Could the governance arrangements be enhanced to resolve these issues?*

*If not, how else might we improve the deal for with-profits policyholders?*



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## With-profits - balancing conflicts of interest

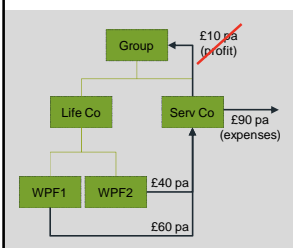
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## Remove profit charges to with-profits fund service agreements

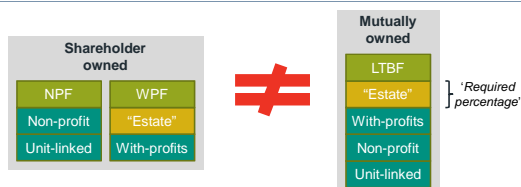


- Creates barriers to improving services
- Write-off historic investments
- Doesn't recognise risk transfer
- Scheme legal agreements?
- Practical challenges on look-through to multiple funds
- Renders mutual funds unsellable to proprietary firms
- Creates incentive to sell Serv Co

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## Attribute 'required percentage' of mutual fund estate to with-profits policyholders



- Mutuals are complex - one size does not fit all
- Mutuals existed before WP business, and should remain after
- FSA's legal opinion does not align with firms' legal opinions
- Poorer customer proposition if mutuals forced from the market

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### Firms must demonstrate that new business is likely to have 'no adverse' effect

- 'No adverse effect' applies to existing and potential customers?
- Potential conflict if sales defer estate distribution
- Comparison to marginal costing?
- Prohibition of loss leaders may leave gaps in the customer proposition



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### Onerous extensions to planning requirements



- Agree that more MI is needed, but will this proposal deliver?
- Distribution plans unnecessary for some funds
- SUP App 2.15 compliant closure plans inappropriate for some funds
  - 3 months timescale?
- Onerous costs borne by with-profits policyholders

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## Tougher criteria for with-profit committees

Fund size	Membership	Terms of reference
Large (Realistic reporters)	1. Wholly independent and external OR 2. Include internal, but with independent majority	<ul style="list-style-type: none"> <li>Guidance on what should be included</li> <li>Published on website</li> <li>Clear recording of decisions</li> <li>Access to external advice</li> <li>Proactively raise issues</li> </ul>
Small (Non realistic reporters)	Should involve independent judgement in relation to compliance with PPFM and conflicts of interest	

- Definition of independence could be tailored for WP funds
- In house knowledge is valuable

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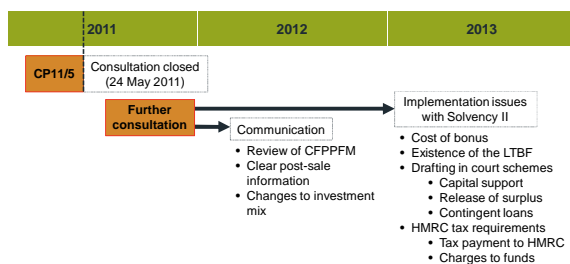
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## Where next for with-profits?



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### Potential implications for other products

- Trend towards less discretion and increased transparency
- Trend towards turning guidance into rules
- Will new rules be introduced for products where the same principals apply?

#### Income protection

- Policyholders locked in
- Can firms robustly link premium increase to experience?
- Technical vs. commercial pricing
- Are premium reviews bi-directional?

#### Unit linked pricing

- ABI guide to good practice
- ULPPFMs
- Guidance around bid/offer spreads and management charges

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### Open discussion



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