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CURRENT ISSUES IN LIFE ASSURANCE SEMINAR

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Management Actions Working Party

The Management Actions Working Party was established by the Life Board to investigate and consider the use of management actions in with-profits funds:

- Within actuarial modelling
- As actually applied by firms
- As planned by firms in future scenarios (contingent actions)

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Membership

- Tim Bunch
- Iain Baker
- Gavin Coates
- Adrian Fuller
- Matthew Lee
- Jonathan Pears
- Martin Pike
- Ben Rowe

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Survey carried out

- 19 Actuarial Function Holders for 29 large with-profits funds
- A wide range of questions
- Some difficulty in interpreting the answers as the situation is complex and terms are not well defined
- Plenty of things to discuss!

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Agenda for today

- Some thoughts on governance
- Issues on specific management actions
- The state of modelling
- Future work

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Some thoughts on governance

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Reminder of history

- Mid 2002 first request by FSA for "realistic information"
- First published Realistic Balance Sheet as at 31 December 2004
- Market turbulence putting pressure on finances and actuarial teams
- First ICAs calculated as at 31 December 2004
- Systems development and bedding down of models
- Anecdotal evidence that this year end has been smoother for many firms
- Systems still evolving, but haven't we done well!

Thorough governance process

- Well developed plan for internal purposes
- Legal opinion obtained on legality and fairness
- Consultation within firm (WPA, AFH, Compliance, Executive, Board)
- Formal approval process including WPC and Board
- External audit (for RBS and RCM if actions are modelled)
- Care over contingent actions modelled
- Specific references in PPFM to contingent actions

Comments

- Discretion retained and plans kept vague
- Legal opinions taken on actual actions
- Few legal opinions sought on fairness (perhaps reliant on WPA and WPC)
- Unclear how management actions have been chosen
- Lack of disclosure in PPFMs

Process for thinking again about management actions

- Consider fund from perspective of with-profits policyholders (protection and treating fairly)
- Consider universe of management actions (type and timing)
- Residual risks affecting the estate
- Residual risks affecting the shareholders
- Risk appetite, capital management, and TCF need to be balanced
- Lots of work and potentially awkward to revisit established governance!

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Issues on specific management actions

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Charges to asset shares

- Firms are modelling variable charges
- Some allowed to increase without limit
- Need to limit charges?
- Need to assess degree to which charges are supported by actual and expected costs

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Charges to asset shares

- Difficulty in defining retrospective charges and prospective charges
- Annual management charge
- Operational loss
- Varying annual management charge
- Targeting less than asset share
- Categorisation less important than careful planning, but note impact of COB
- Which policyholders should be charged?

Equity backing ratios

- Many firms assume static EBR in RBS
- Of those that allow EBR to move, many allow EBR to fall to zero
- Is this fair?
- EBR currently towards top of allowable range
- Is this simply due to high solvency or is there a bias towards reducing risk?

Future bonuses

- Most firms are modelling dynamic future annual bonuses
- Different over triggers and measures adopted, perhaps reflecting practice
- Most of these seem comfortable with allowing bonuses to fall to zero
- Does this give a realistic measure of solvency?
- Does this really reflect reality (given marketing and retention considerations)?

De-risking

- Benefits to the firm are clear (reduced capital requirements in RCM and ICA)
- What about the impact on policyholders?
- If there is a (material) negative impact on policyholders should alternative risk be taken to increase policyholder expected payouts or should some other way of mitigating this negative impact be found?
- Need to review the risk appetite and governance process

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The state of modelling

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An idealised view

- All actions that would be taken in each scenario are modelled (survey suggests many/most do not do this)
- Consistency between RBS, RCM and ICA
- Allowance for reversal of actions and re-risking in good scenarios
- All models consistent with internal plan, PPFM and Board decisions
- Results would only differ as a result of genuine differences in the business written and the different financial strength of firms

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What is RBS for though?

- Demonstrating that firms remain solvent in current and adverse scenarios, or comparing the level of solvency?
- Note lack of rules on inclusion of actions (Firms may allow for management actions)
- Exclusion of new business means that the calculations are appropriate to a closed business, as management actions will be affected by new business
- What about ICA?
- Is there a risk we are overstating risk (and capital requirements)?

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Modelling issues

- Difficulty of modelling actions based on future levels of solvency
- Only need to model actions that generate enough free assets
- Time!
- Complexity of full model
- Practicality of seeking Board approval to a complex set of actions
- Models still developing

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Future work

- Further development of governance structure and establishment of more detailed internal plans
- More thorough assessment of universe of actions, by type and timing
- Further action to reduce risk (and volatility of returns) to policyholders, and to reduce dependence on radical contingent actions
- Further development of models
- Improved comparability

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