

Challenges around PPFM and CFPPFM



Outline

- Background
- Some Pitfalls
- Triggers and Management Information
- Governance and Compliance
- Changing PPFM and CFPPFM

Conduct of Business Rules

6.10.5R(1) "A firm must establish and maintain the principles and practices of Financial Management according to which the business of its with-profits funds is conducted"

Conduct of Business Rules

6.11.4 R "... A firm should maintain governance arrangements designed to ensure that in the conduct of with-profits business it complies with applicable PPFM.

6.11.10 R "The annual report [to policyholders] must address all significant relevant issues, including the way in which the firm has exercised, or failed to exercise, any discretion that it has in the conduct of its with-profits business....."

Key Areas of Discretion

- Bonus rates, including the introduction of new bonus series
- Market Value Reductions
- Surrender terms
- Investment policy, including derivatives
- Expense charges
- New business volumes and terms
- Guarantee charges
- Accumulation of asset shares
- Application of tax
- Allocation of miscellaneous profits and losses
- Transfers to shareholders
- Inherited estate
- Application of 'scheme of transfer' provisions

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Possible Conflicts

With-profits brings some interesting conflicts:-

- Smoothing v. year to year payouts
- Policyholders v. shareholders
 - Investment risk
 - Charges for guarantees
 - Expense charges
- Policyholders v. policyholders
 - Cross-subsidies
 - Extent of risk

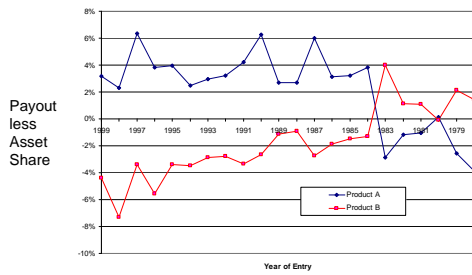
Discretion, Bonuses and Fairness

The way discretion is applied will affect the extent of cross-subsidies. They arise between:

- Different sizes of policy
- Different generations (e.g. smoothing, inherited estate)
- Different policy types (e.g. shared bonus series)

Management Information - Cross-subsidies

Graph showing cross-subsidies that may exist between 2 products



Do we understand how this may look in future?

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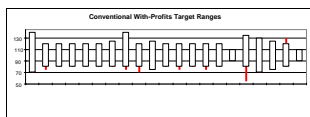
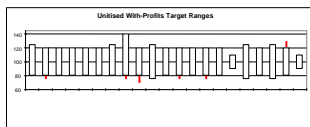
Target Ranges

'Target ranges' are a description of a firm's cross-subsidies

- Measure at policy level?
- Measure for sample policies?

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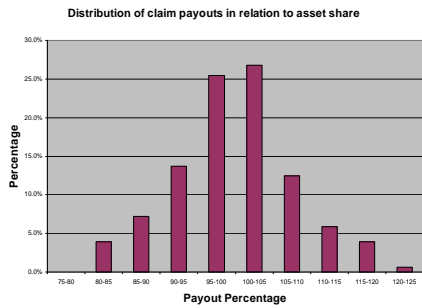
Target Ranges



White blocks : maturity ranges
Red lines : Surrender ranges, where wider

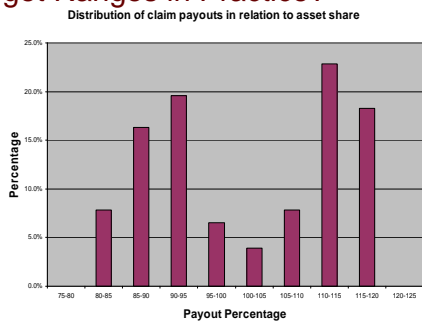
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Target Ranges in Practice?



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Target Ranges in Practice?



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Triggers for Action

Offices' PPFMs may include:

- Limits on smoothing
- Triggers for changes to asset mix
- Threshold levels for market value reductions
- Triggers for changing surrender scales
- Limits on allocation of losses to policyholders

Are we tracking these?

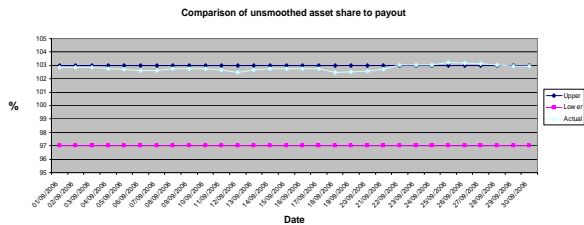
Can we react in time (early warning)?

When to Pull the Trigger?

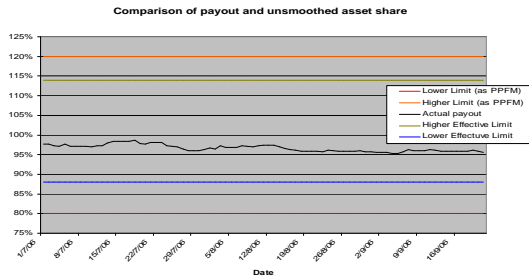
There's a big difference between:

- We will adjust market value reductions if surrender payments are 3% or more below asset share.
- We will consider an adjustment to market value reductions if surrender payments are 3% or more below asset share.

Management Information – Time to Change?



Effective and Published Triggers



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Governance & Compliance

- Clear delegation of discretion?
 - Delegated where?
 - Post-event reporting clear?
 - Application and/or method delegated?
- Exercise of discretion clearly linked to what PPFM says?
 - Rationale follows PPFM steps?
- Can we explain it in our annual report to policyholders?
 - Would a knowledgeable policyholder accept it as a reasonable thing to do?

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Controls

Effective controls are essential:

- Clear authorities & sign-offs
- Spreadsheets & black boxes
- Reconciliations
- Visibility to With-Profits Committee (and Board)
 - Key developments
 - Approximations
 - Methods
- Monitoring – markets, tax, law, regulations

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Evidence of Compliance

Did we do what we said?

- Frequency of reviews?
- Decision made by?
- Was it put into effect?

Did we do it how we said we would?

- Does the rationale match the PPFM process?
 - Internal notes?
 - Board and WPC papers?
- Good MI pays dividends
- Annual (half-yearly?) review to pull it together

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Changing PPFM and CFPPFM

FSA rules and practice need to be considered

- Changes are not allowed, unless the firm's governing body considers they are necessary to:
 - Respond to changes in environment
 - Protect policyholder interests
 - Change **practices** in order to follow **principles**
- Change principles – 3 months advance written notice
- Change practices – notify in writing (in advance or arrears)
- Management Actions Review Committee

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Changing PPFM and CFPPFM

Despite the effort consider changing PPFM if

- Practice is hard to apply (or will get harder)
- Rules change
- Internal or external change
 - close to new business
 - new product or bonus series
 - market conditions
 - new opportunities
- Regular (annual?) review

Do the CFPPFM still reflect the PPFM?

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