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PROMISES, PROMISES
THE MYTH AND REALITY OF LIFE OFFICE QUOTATIONS

by

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Presented to the
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PROMISES PROMISES

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"Sweet records, promises as sweet."
William Wordsworth

"95% is crap."
Terry Arthur

This is a topical paper, so topical that we had to defer committing pen to paper as long as printing deadlines permitted. These lines are being written on New Year's Day. Between today and the date the paper is presented there will have been further developments. In the circumstances the reader must not expect a theoretical treatise. Our aim is to generate a good discussion.

The views expressed in this paper are those of the authors and not necessarily those of their employers - a life insurance company and a financial newspaper. We are grateful to Sun Life for letting us use, as a starting point for this paper, an internal report prepared last spring by one of the authors; and to the Life Insurance Council for giving us permission to make reference to the report of their Working Party on Bonus Illustration.

We have found it necessary to show practical examples of different approaches adopted by various companies. Wherever possible we have used examples drawn from the employer of one of the authors. Where other companies' examples are used we have deleted their name.

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1. THE NEED FOR CHANGE

"Times they're a changin'"
Bob Dylan

The Government's success in reducing inflation to around 5% and the long term rate of interest to around 11% and the likelihood that the days of high interest rates are unlikely to return in the near future has put the current rates of bonus under severe strain. Inevitably, they must fall at some time as outlined by Mr. Locksley Smaller in his recent paper to the Institute (1) although companies may disguise it or use the estate to further postpone the day of reckoning. This poses an urgent problem because of the industrywide practice of providing quotations assuming that the current rates of reversionary and terminal bonuses will be maintained.

Section 73 of Insurance Companies Act 1982 makes it an offence for a company to make misleading statements when inducing people to enter into contracts of insurance. However, this piece of legislation has not been very effective.

The nature and urgency of this problem however has been appreciated not by the life assurance industry but by the actuarial profession. The initial public warning was made by Mr. Stewart Lyon the immediate past President of the Institute of Actuaries and repeated by the current president Professor Peter Moore.

At the first actuarial convention held in Birmingham last September, the subject of illustrations on both with profits and unit linked business was discussed at a meeting led by Mr. Stewart Lyon and Mr. Richard Wales.

But the most outspoken comment came a few months ago from Mr. Joe Macharg, in his recent Presidential address to the Faculty of Actuaries. He summed up the underlying problem of bonus illustrations - projecting the recent inflationary past into the not-so-inflationary future - and gave a warning of the consequences - that there were a lot of quotations around that if not fulfilled would constitute a series of time-bombs for the profession as well as for the industry. All that was missing in his address was the solution to the problem.

This problem has come at a time when the withdrawal of life assurance premium relief and the impending legislation opening up personal pensions to other financial institutions is forcing us into greater competition with a growing range of competitors.

Life companies have a duty to the consumer to provide quotations in a form that will not distort his judgement between one financial institution and another, between one life company and another and between one investment contract and another.

Proprietery life companies have the added complication in that their first duty is to make profits for their shareholders. Pursuit of propriety must not undermine the company's commercial viability relative to its competitors within and outside the life assurance industry.

Companies have a direct responsibility to potential clients when the approach is direct, through its own salesforce or by direct response advertising or by direct mailing. Some of the worst examples of irresponsible selling have regrettably been in off the page advertising.

The advent of cheap desk top and portable computors has meant that an office's own salesmen and intermediaries are able to provide quotations without reference to it. This is particularly a problem for unit linked business where projections may be provided in this way on optimistic growth rates.

But perhaps potentially the greatest problem is the development of the facility to provide via a VDU screen, a quotation direct to the intermediary. Two pilot schemes currently in operation. In both cases the barest minimum information is supplied. In the very near future networking will become very common.

In theory, companies can take a more relaxed attitude when there is an independent intermediary involved, since that intermediary should explain to a potential client the features and caveats of a quotation. In practice, however, many of the current problems stem from intermediaries using the bottom line figure in a quotation to select a life company, ignoring the small print.

A Working Party from the Life Insurance Council (LIC) of the Association of British Insurers (ABI) has been grappling with this problem of bonus illustrations for many months. We had hoped that by the time our paper appeared the Working Party would have come up with a solution that would have been acceptable to life companies within the LIC. This has turned out to be on the optimistic side in that consensus has been difficult to achieve - an indication of entrenched attitudes among some companies and the intermediaries through whom they market.

However, the problem has been taken out of the hands of the LIC. The moves on Financial Services, with the introduction of the Bill shortly before the Christmas recess has put the ball firmly in the hands of the Marketing of Investments Board Organising Committee (MIBOC). This board will be setting out its ideas on bonus illustrations and quotations as part of the overall supervision of life company marketing. The LIC Working Party's ultimate consensus will be submitted to MIBOC and we await the publication of its ideas.

In such a fast changing environment, the main purpose in presenting this paper is to provide actuaries with a framework for discussions of the problem and the likely solution from MIBOC. It is expected that MIBOC will be seeking views from as wide a range of opinion as possible. We hope this paper and the discussion will contribute to these debates.

2. THE PURPOSE OF A QUOTATION

"Though the Life Force supplies us with its own purpose, it has no other brains to work with other than those it has painfully and imperfectly evolved in our heads."

George Bernard Shaw

A number of life insurance policies provide a guaranteed benefit on the happening of a certain event, in return for the payment of a defined level of premium(s). A potential client is therefore clearly aware of what he is buying . There may be problems with exclusions, particularly with permanent health insurance. Perhaps offices should do more to highlight their exclusions but at least the client can always find out if he takes the trouble to ask.

There are other policies, with an investment bias, where the ultimate benefits cannot be determined precisely in advance. They depend either upon profits that have not yet been earned (with profits contracts) or directly upon the underlying value of a nominated pool of assets (unit linked contracts). In both cases, as only a limited guarantee is being provided by the life office, it can invest less cautiously and more remuneratively than it would be able to if the entire benefit was guaranteed. Thus the client can expect to obtain a better return than under a fully guaranteed contract. In the nature of things it is necessary to given him some idea of what benefit he can expect to receive.

A quotation, or an illustration or a projection, fulfills two specific functions:-

(i) To give an indication of the benefits that are likely to emerge from the contract if certain stated assumptions are borne out.

(ii) To help in the choice of savings contract, and to distinguish between different life companies and other savings institutions.

In our opinion, the first function should be all important. In practice far too much emphasis is given by intermediaries to the second function with the quotation operating as an instant selector of life companies.

There is a third function that is specific to pension schemes. Where the trustees have a liability to provide a pension (and other benefits) based upon earnings at a future date the quotation of a funding rate is the best estimate of a pattern of outlay that will be necessary to meet the emerging liabilities.

With only a few exceptions life assurance based products are sold rather than bought. Promising benefits is a integral part of the selling process. Indeed for traditional with profits business, quotations are very much a necessary exercise in the selling process, for they convert the reversionary bonus rate, which by itself means very little, and the terminal bonus rate, which often can mean nothing, into an investment return that the client can understand.

It is therefore necessary for the industry to ask in respect of each market sector just how crucial is the role of the quotation in the selling process. The more crucial the role, the greater the duty not to mislead the buyer.

Here is the nub of the problem. The quotation is given on certain stated assumptions. There is no implication given by the life company that these assumptions will be borne out in practice, but there is nevertheless a presumption by the client that they are not unreasonable, despite all the caveats and disclaimers in the quotation. Thus the position of equilibrium that currently exists is inherently unstable and dangerous.

There are two distinct circumstances a buyer can find himself:

* He may need to decide whether to invest in a life assurance product or a savings product offered by another financial institution.

* He may need to decide whether to take out one insurance company's product or another's.

In the next two parts of this paper we will consider each in turn.

3. COMPETITION FROM OTHER INDUSTRIES

3.1 Introduction

The quotation should be an aid to the buyer's judgement when he is considering whether a particular type of product suits his requirements in terms of value for money. He can make a valid judgement only if our quotation is based upon economic and investment assumptions that are compatible with those made by other financial institutions.

A survey of such institutions is shown in Appendix 1. There are several instances of reprehensible practice but the practice of projecting current achievement into the future in a personalised quotation is virtually unique to our industry.

3.2 Factors Affecting Choice of Product

In selecting a vehicle a prospective buyer will ascertain whether it meets his requirements regarding, e.g., monetary security or inflation protection or general growth potential; short term liquidity or long term return; tax efficiency; regular income or capital appreciation; etc. For any given buyer profile several investment alternatives will fall away. It is only when more than one remain that relative value for money becomes relevant.

Let us consider instances where an insurance based product has a non-insurance based competitor. Let us consider each market in turn.

3.3 The Investment Market

We shall use the term 'Investment' to refer to products that do not require regular commitment.

The primary insurance product is the unit linked bond. It is sold in one of two ways:

(i) At the asset backing a flexible trust designed to provide CTT mitigation.

(ii) As a straightforward 'asset-backed' investment vehicle.

In the former case there is very little alternative that is as tax efficient if the settlor requires income. In the latter case the alternatives are unit trusts and investment trusts.

Unit trusts are not sold on the basis of projections. Instead they rely upon past performance. Where possible they will use figures produced by an external publication. Such an approach tends to favour the sale of unit trusts that have done well in recent months, not those that are likely to do well in the future. The position is made worse by the proliferation of specialist trusts.

By comparison the standard practice on bonds of quoting on two alternative growth rates is more acceptable.

3.4 The Savings Market

There really is no direct competitor to a with profits endowment as a medium of long term savings with the prospect of a good consistent return. The nearest is the building society subscription term shares but there are essential differences.

Unit-linked plans are directly comparable with unit trust savings plans. Our literature gives sufficient information on charges for the buyer to compare it with unit trust charges. The past performance of the funds is readily ascertainable and comparable with those of the unit trusts. The buyer can therefore make a rational judgement.

One area of voluntary savings is that of additional voluntary pension contributions (AVCs). Building societies are very strong in this area. They do not often provide quotations but when they do, they have no hesitation in projecting current yields right up to retirement. Admittedly they have caveats. The with profits AVC schemes equally project current bonuses into the future (again with caveats). Unit linked schemes project on two alternative growth rates and are therefore the most commendable.

Building societies only show the accumulated fund. No one expresses the figures in real terms.

3.5 The Mortgage Market

An area where our practice should cause great concern is that of **endowment mortgages.** Where there is a free choice between taking out a repayment mortgage and an endowment mortgage we submit that it would be hard for the industry to find a reason why a first or second time buyer should opt for the latter. Such housebuyers, under initial financial pressure, can find much better use for the additional outlay required for an endowment mortgage.

The whole thrust of the sales patter focuses attention towards the surplus proceeds at maturity expressed in future pounds. Thus the use of the current rates of reversionary and terminal bonus is central to the selling process. The unstable equilibrium of the current practice is made worse by the gearing effect involved in calculating surplus.

Consider a 25 year mortgage of £25,000 at 12% taken out by a young man. A repayment mortgage would cost him £205 per month. An endowment mortgage (with interest at 12½%) would typically cost him £215 per month. For an extra £10 a month i.e. £3,000 in total, he could typically expect a surplus of £31,000 - a yield of 15¾% p.a. net! If on the other hand the terminal bonus were reduced so as to decrease the maturity proceeds by 30%, the surplus would be reduced by over 50%. The yield on the additional outlay would drop to under 11%. Given the choice a typical home-buyer would much rather spend the extra £10 a month on furniture etc. If he has no choice, he may consider a surplus of £31,000 worthwhile but a sum of £15,000 less so. In any event any voluntary saving over and above the minimum necessary to repay the mortgage is best carried out by means of an unencumbered vehicle.

The argument that if interest rates dropped to 8-9%, the endowment mortgage will involve negligible additional outlay is fallacious because the current bonus rates would then drop sharply. (In the example quoted, the maturity values currently being quoted imply a net yield of 13¾% **ignoring** the cost of life cover and expenses of administration.)

In summary, the industry's practice on endowment mortgages is an area of serious concern. The argument that it is the responsibility of the intermediary has considerable force but we cannot entirely absolve ourselves from responsibility.

A similar problem does not exist in the case of mortgages where the buyer cannot raise the loan himself. In such circumstances, if the lender, or the intermediary requires an endowment to be effected that is a cost inherent in obtaining the loan. We see nothing wrong in this but would expect the cost of the policy to be taken into account in calculating the APR.

The past five years have seen the growth of **pension mortgages.** This relies upon the fact that pension schemes or plans (exempt) approved under Section 20 Finance Act 1970 or Section 226 of the Income and Corporation Taxes Act 1970 give the individual the right to commute a part of his pension for a tax free cash sum. The borrower takes out a pension plan for a premium which, on quotation assumptions acceptable to the borrower, will give a tax free cash sum adequate to repay the loan at retirement date. As the policy cannot be assigned to the lender, there is no compulsion to use the proceeds to repay the loan.

The lender usually ignores the terminal bonus when determining the premium level although the life company is free to include it in its quotation once the premium has been determined. In the case considered earlier, a typical pension premium would be the same as for a repayment mortgage but would at age 60 give a surplus cash sum of £35,000 plus a pension of £25,000 p.a. The gross build up of pension funds introduces a major safety margin. Furthermore, most policies have the facility to increase premiums, something the client would be expected to do to build up an adequate pension.

We consider the position of pension mortgages much more defensible. The industry has not marketed pension mortgages too aggressively because the Revenue's attitude to them has not been one of whole hearted endorsement.

However, the greater public awareness of personal pensions and the growth of AVC's will, in our opinion, lead to a great growth in pension mortgages.

A recent development has been the introduction of **unit linked endowment mortgages.** Here the practice so to calculate the premium rate on the basis of a relatively cautious growth rate (typically around 7½% p.a.) and the premium is then projected on two alternative growth rates (7½% and 10%). Many offices also offer to apply annual corrections to the premium rate to make sure that the plan stays on course to fulfil its intended objective. This is a very reasonable approach. As an investment vehicle it may well turn out to be better than a corresponding with profits product for the same premium but the initial quotation would be much less attractive. Perhaps that is one reason why it has made so little headway.

3.6 The Individual Pensions Market

Currently there is no competition in the self-employed pensions market but this will change when Fowler opens up the market to other institutions. As a self employed pension plan is essentially a savings contract the arguments are the same as considered previously under the heading 'Savings Market'. As for individual pension arrangements (IPA) and small self-administered schemes (SSAS), the insurance based product may be in competition with self-administered arrangements that are available from consulting actuaries and pension consultants. Life companies provide packaged benefits covering administration documentation, actuarial services as well as investment management, within the rating structure. For certain products, such as hybrid SSAS's, they may make an explicit charge but it would be only a fraction of the total expense loadings within the contract.

In contrast to the insurance industry, the consultants unbundle the package and charge explicity and separately for each type of service. Investment management is treated completely separately. Often they give a limited range of investment advice. Even those consultants who give a performance measurement facility etc. give undue regard to short term performance.

A doctrinaire consumerist would argue that life companies ought to unbundle their charges so that a buyer could make a direct comparison. In our opinion, that would be missing the crucial difference between a (fairly) standardised off the peg product and a bespoke one. It would also focus undue attention to the relatively minor issue of charges when the two most important factors are the flexibility of rules and the quality of investment management.

As consulting actuaries and pension consultants seldom 'sell' on the basis of the quality of investment management selected by them, a life company's quotation is not the critical factor in a client deciding in favour of an insured scheme.

3.7 Early Leaver Market

This is a new market but is likely to be a major growth area of the future. The ex-employee is being seduced into forgoing the deferred pension he is entitled to from his former employer's pension scheme in favour of his own personal deferred annuity from an insurance company. The excitement of having a policy document in his hands apart, the attraction of such a Plan is the prospect of a substantially higher pension. At the small premium bread and butter end of the market, the member's entitlement under his former pension scheme is little more if at all, than the GMP he would be entitled to (if the scheme is contracted out). In such cases, whilst insurance companies may illustrate a higher level of pension by piling terminal bonuses on top reversionary bonuses, the likelihood of their paying significantly more than the GMP is not very high. A prospective buyer needs to take that into account in view of the fact that by taking out such a Plan he is forgoing the right to any retrospective improvement in benefits the employer might make in the future.

Fortunately, where there is a prospect of large volumes of bread and butter business, the trustees would have access to independent advice. Nevertheless, the industry's quotation basis for Early Leaver Plans is a major cause for concern as it is the single most important criterion in obtaining the business; the office's expertise in the pensions market and the quality of its service being a poor second and third; or is it third and second?

3.8 Group Pension Market

As the market is fairly static, the activity centres mainly around the switching of either schemes or investment management. The quality of advice is fairly sophisticated and the accent is on past performance. This is true of both the with profits and the managed fund vehicles. Investment business is never obtained on the back of a long term projection.

At the smaller end of the market, which is largely money purchase, quotations are frequently used. The consideration are the same as those outlined earlier for IPA's.

4. COMPETITION WITHIN THE INDUSTRY

"But Facts are chiels that winna ding
An' downa be disputed."
Robert Burns

4.1 Introduction

In this section we will consider the extent to which quotations influence a buyer in selecting one office in preference to another having already made his mind up to select an insurance based product.

As a generalisation we can say that the more price sensitive a market is the more crucial the role of quotations will be. Thus it would be vital to obtaining business in the with profits "back to back", the mortgage and early leaver markets. It is less vital but still very important in the markets of self employed pensions and individual pension arrangements.

As a further generalisation, quotations are much more important for with profits business than for unit-linked business. By quotation we do not necessarily mean a full printed quotation; it is the final answer, the bottom line, that is crucial. Before examining the role the quotation plays in the buying process, we will explore the current practice of companies.

4.2 With-Profits Products - Current Practice on Quotations

"Anything you can do, I can do better."
Irving Berlin

There was a time, not all that long ago, when life companies only showed the sum assured in the quotation. A terse footnote was added along the lines of:

"In addition a reversionary bonus will be payable at maturity or on earlier death. The current rate is £3:10:6d".

This practice started to change when the growth in investment earnings and capital values lead to substantial increases in bonus. However, what really transformed the attitude of caution to one of gay abandon was the rapid growth of unit linked business during the sixties and the seventies. In hindsight one has to admit that the traditional offices were wrong in trying to beat the unit linked companies at their own game.

The current position is quite varied although underlying it there is a tacit understanding on what is acceptable and what is not.

It is agreed that quotations should be based upon current bonus with no anticipation or indication of future bonus rates. It is also generally agreed that both basic reversionary bonus rate and terminal bonus rate may be used as they represent regular items in the bonus structure but that once-off or irregular items such as special reversionary bonuses should not be used.

Some companies do not total the terminal bonus with the sum assured and reversionary bonus but show it separately (Appendix 2, Exhibit 1); several others, recognising that intermediaries will add it in anyway, include it in the total (Appendix 2, Exhibit 2).

Some companies have now paid special bonuses for several successive years. The temptation is to regard them as regular items and bring them into quotations. By and large Companies have resisted this temptation but there are exceptions. (Appendix 2, Exhibit 3).

There is variation in the caveats explaining the assumptions made. (See Notes to Exhibits 1,2,3 and 4, Appendix 2). Some companies are quite emphatic on the volatility almost to the point of belittling their investment departments. With others the warnings are perfunctory.

There is the special case of quotations for low cost endowments to repay a mortgage. Here the aim of the quotation is to ascertain the premium required so that the projected maturity value on conservative assumptions equals the amount of the mortgage.

The usual practice is to calculate the projection on 80 per cent of current reversionary bonus rates and ignore terminal bonuses in order to obtain the required premium and then bring in the full reversionary bonus rate and terminal bonuses to illustrate the surplus left after repaying the mortgage.

This 80 per cent limit has been weakened in the past year or so since the ending of LAPR removed the competitive advantage of low cost endowments. First companies switched to operating on 80 per cent of the projected value on the full bonus rate - equivalent to around 84 per cent of current bonuses for 25 years. Now more companies are prepared to calculate on 100 per cent of the reversionary bonus.

4.3 Selection Between Companies - With Profits Product

The choice of life companies for a with-profits contract is often decided by the price - usually the bottom line figure, the projected benefit for a given premium, but in the case of low cost endowments for endowment mortgages a combination of the premium and projected benefits. Little attention is given to the bonus rate structure or the actual structure of the quotation. This can lead to situations where confusing, and sometimes contradictory, decisions are taken.

Consider two companies, **A** & **B**, who in a given market provide substantially similar products apart from price; or, to put it another way, apart from the projected benefit for a given premium.

A includes terminal bonus directly in its quotation whilst **B** shows it separately. Including TB, **A**'s projection is higher; excluding it, **B**'s is higher. Which one does the buyer choose? The answer is probably **A** although some would plump for **B** on the grounds that reversionary bonus is more predictable than terminal bonus.

Selling solely on the bottom line, the client would be recommended **A**.

But should the intermediary take into account the inherent volatility of terminal bonus and recommend **B** on the grounds that the reversionary bonus is more predictable and stable than terminal bonuses?

In reality both companies are giving quotations that are unlikely to be achieved unless interest rates were to rise significantly. The intermediary may not know this but if he did, how would he make his selection?

Again consider two life companies **A** and **B**. Both have similar past performance as measured by current maturity values. Both have similar premium and reversionary bonus rates. **A** distributes other surplus partly as a special reversionary bonus and the rest as terminal bonus; **B** distributes it all as terminal bonus.

As it would not incorporate its special bonus in its projection an intermediary who goes purely by the bottom line figure in the quotation would plump for **B**. Is that right? On the other hand, if he judged purely by past performance which office should he select?

4.4 With Profits Products - Defects in Current Practice

"I do not mind lying, but I hate inaccuracy."
Samuel Butler

The defect as far as with-profit quotations are concerned was summed by by Mr Macharg - companies are projecting the recent inflationary past into the not-so-inflationary future.

Investment conditions over the past decade have been exceptional, and it is regarded as imprudent to act on the asumption that these conditions will continue for the next decade, let alone the next 25 years.

Up to now, actual maturity values paid out have exceeded the original quoted amounts in money terms, even though in may cases, the real yield over price inflation has fallen steadily. But while benefits were discussed in money terms, this did not matter.

Now the industry is faced with the situation that bonus rates could be cut as interest rates fall so that maturity values could fall short of the original illustrations, while the real returns could well improve. Mr Macharg considers this feature somewhat ironical and sees the industry paying the penalty for having felt no necessity in the past to educate the public (and the intermediary) to think in terms other than monetary value.

One may question whether it is actuarially correct (as well as ethically correct) to add reversionary and terminal bonus together. Mr Macharg regards this in the category of adding apples and pears.

The other strong criticism of quotations in monetary form, which applies in any conditions other than very low inflation is that they give a misleading impression of the real value of the benefits. All the figures in the quotation are expressed in pounds sterling, but every single item has a different value. The pounds payable in 25 years are not the pounds of today. Yet little or no attempt has been made to even indicate values in real terms, another indictment of not using yields on quotations.

Pension Products

This is bad enough on endowment quotations where a client's savings are concerned. It is indefensible on pension contract quotations where one is dealing with a client's income in retirement. The numbers quoted on current pension quotations, which if dialled on a telephone would get a person in Australia, convey a false and cosy impression of an adequate income when the reverse could be the case.

Indeed, almost every defect in current practice on quotations is brought out when considering quotations for Section 32 Early Leaver Plans.

Here the quotation is fulfilling both functions - both competition between life companies and competition with another savings medium, the company pension scheme - see 3.7.

These quotations start by producing this "funny money" cash sum, often shown in bold print which implies that the investor will be able to pocket this amount. Next, the pension purchased, shown in smaller print, is usually based on a single person flat rate current annuity rate - which of course produces the highest pension value in money terms.

This is then used to compare with the deferred pension in the company scheme - an apples and pears comparison. The benefits that could be obtained from the new company scheme are not mentioned, let alone compared. Caveats on this aspect tell the employee to consult with the trustees of the pension scheme. Thus all too often, an employee changing jobs is left on his own to make the comparisons necessary to help him select his options.

The position of quotations in marketing pensions needs to be sorted out in time for the expected introduction of personal pensions which are intended to be available to all employees. They must be in a form that makes comparison between company and personal pensions straightforward - not an easy task.

4.5 Unit Linked Products - Current Practice on Quotations

Over the years a practice has developed of giving quotations on two standard growth rates - 7½% and 10% for a life product (Appendix 2, Exhibit 5) and 10% and 12% for a pension product. The quotation is therefore no more than a comparison of the respective charges. This is an ideal situation as a prospective buyer can make a rational judgement by taking both the comparative quotations and comparative past performance into account.

Unfortunately reality is not as pure as this. In markets where the quotation is important several methods of disguising the true charge have been developed. The principal one capitalises on the fact that the standard growth rates that quotations are based upon are net of the annual management charge. For example one office may have 1% p.a. charge but another only ½%. If both quote on 12% growth rate, the former is gaining an unfair advantage. There are other instances where the offices internal fund invests in its own unit trusts without completely eliminating double charging.

The practice adopted by magazines such as Planned Savings of using growth rates **prior** to the deduction of annual management charge is more informative. Ideally companies should move over to that basis.

There is evidence to suggest that intermediaries use quotations not merely to compare respective charges but to give an indication of prospective benefits. How else can one explain the steady upward drift in the assumed growth rate? The move on pension products from 10% and 12% to 10% and 14% or even 10% and 15%; the practice adopted by a few companies of projecting past performance into the future (Appendix 2, Exhibit 6).

To some extent companies have been forced to do this to make the figures look comparable with corresponding with profits projections; a particular problem if the company offers both alternatives under the same policy.

4.6 Alternatives to Quotations in Choosing Life Companies

"How happy could I be with either,
Were t'other dear charmer away!"
John Gay

Whatever the outcome of all the discussions on this subject by all those concerned, one thing appears certain. No longer will an intermediary rely solely on quotations in his selection of life companies for with-profits contracts. He will be expected to take into account certain other features in making his recommendation and to set out those reasons before his client. This should happen when selecting unit-linked life companies.

A few of these features are described below, together with a discussion of our reservations on the usefulness of the particular feature.

(A) Past Performance of Companies

The choice of unit-linked companies for investment products is based very much on the past performance record of its funds, the period over which performance is measured usually being selected to suit the case being made for a particular company.

There is a growing body of opinion within the life assurance industry that more attention should be given to past performance in with-profit recommendations - with those life companies in the top ten in past performance league tables being the strongest and most persistent advocates.

Interestingly, such tables concentrate upon life rather than pension products. Here selection cannot really be based on performance over the short term since 10 years is the minimum maturity period.

The argument behind this concept is simply that a company than has done well in the past will do well in the future. Such an argument needs to be treated with caution in a recommendation. We would put forward these considerations when looking at past performance:

* A company's investment policy may have changed significantly - one is considering very long time spans.

* A company may have consciously or otherwise overdistributed surplus in the past, thus leading to better past performance, but a weaker financial base for the future.

* A company may have expanded much faster than others and thereby accepted more business on unsupportable terms.

* A company may have done very little with profits business until the past decade or so. Thus the cost of providing very high terminal bonuses could be trivial, particularly for the longer term contracts. The company may therefore be deliberately overdeclaring terminal bonuses on longer term policies - see 6.4.

These reasons are set out not to decry past performance, but to inject a note of caution into their use. Past performance is not infallible, and we would refer to the investigations by one of the authors into the subject (2).

Nevertheless, if Company A has consistently delivered better performance than Company B, it is more likely then not to offer better results in the future.

There is no substitute for looking behind past performance just as there is the need to look behind the quotations.

Unit-linked life companies have always highlighted their past performance, but the claims need to be treated with caution. As described in the Appendix, where the linking is to unit trusts, there is a plethora of funds under management. A management group can usually point to a fund that is among the top performers over some priod. The fact that there are usually other funds in the bottom quartile is conveniently overlooked.

The financial magazines now show performance by each type of fund, with several subdivisions. One needs to investigate how the managemnt group has performed within each type of fund. This gives a good indication of investment management within the management group and leads on to the second feature.

(B) Quality of Investment Management and Investment Strategy

Certain unit linked life companies and unit-linked groups have over the years acquired a reputation for the quality of their investment management. This is very much tied in with past performance, together with a knowledge of the personalities of the investment manager and his investment team.

A company that has achieved an investment reputation is usually anxious to maintain it. It takes care in its selection of potential investment managers and has a good in-house system of training.

It is not easy for intermediaries to become closely acquainted with the investment department of a traditional life company handling just with profit business.

However, most traditional life companies are now in or about to enter the unit-linked field. As such their investment team is or will be getting much more exposure to intermediaries and discussing strategy as an integral part of marketing.

It needs to be remembered that as pointed out the time spans involved are very long. Investment teams do change and this is happening with much more frequency under current conditions of the supply of expert investment managers being far short of the growing demand. Head hunting and change of jobs has become the norm in investment management.

The effects of a loss of key investment personnel would take some time to show up with traditional business, but become very apparent in linked business and unit trusts, invariably with severe effects on sales.

In addition to looking at investment management, attention should be paid to the investment strategy of life companies. For traditional business, the proportion of assets held in fixed-interest and equity-type investments is of great significance for future performance. This subject is beyond the scope of this paper, nevertheless it needs much more attention given to it by actuaries and intermediaries than has been the wont to date.

This in turn leads on to another feature.

(C) Analysis of the Asset Strength of Life Companies

The distribution of assets and liabilities of a life company, combined with its investment strategy, should provide strong indications of the future bonus prospects of that company.

A certain amount of work on this subject has been done by some stockbroking firms with a strong actuarial backing. But their work has been confined to shareholders' dividend prospects in those few traditional life companies that are quoted on the stock exchange.

The work done on calculating mutualisation prices and profitability of life companies could be extended to assess bonus prospects. At least one pension consultancy firm does annually assess the bonus prospects for with-profit personal pension contracts giving life companies a prospect rating.

The main problem with all these is that a true assessment cannot be carried out without access to detailed information regarding the pattern of assets and liabilities that can only be obtained from the company itself.

*   *   *

4.7 Networks for Intermediaries

A significant development over the past twelve months has been the growth in the provision of quotations direct in the home or office of the salesman or intermediary. It started with electronic calculators on which simple unit linked quotations could be provided, occasionally at unacceptably high growth rates. It then progressed to microcomputers where the life company supplied the software.

However the greatest development is the two pilot schemes of BT and IBM to provide a network for intermediaries whereby they may be provided quotations, and in due course other facilities. Currently restrictions of screen design do not permit anything more than bare figures without caveats to be provided. This may change but the temptation to dispense with the small print will be too great. Life companies will have even less control over what is passed on to the client.

5. LEGISLATION

"I intend to make them grovel."
Tony Greig

5.1 Introduction

In section 1 of this paper we said that the intial concerns about the commercial malpractices of the life industry were sounded by the actuarial profession. The trade associations LOA & ASLO (now fused into ABI) picked up the gauntlet. At that stage the problem was however seen as an insular one. The imminence of Financial Services legislation has transformed it into an issue of wider importance. In this section of the paper we will therefore examine the implications for the subject of this paper, of the Financial Services Bill. But first we must consider existing legislation to put the matter in its proper context.

5.2 Existing Legislation

Concern about the selling methods used in unit linked business led to the Scott Report. That, against the background of insurance company failures led to the Insurance Companies Act 1974. That in turn was updated, particularly in the context of the harmonisation requirements of the EEC, into the Insurance Companies Act 1982.

Part III of that Act relates to the Conduct of Insurance Business, starting with Section 72 which deals with insurance advertisements. This section is an enabling section and the regulations pursuant to it have never been issued.

Section 73 dealing with statements inducing persons to enter into contracts of insurance states,

> "Any persons who, by any statement, promise or forecast which he knows to be misleading, false or deceptive, or by any dishonest concealment of material facts, or by the reckless making (dishonestly or otherwise) of any statement, promise or forecast which is misleading, false or deceptive, induces or attempts to induce another person to enter into or offer to enter into any contract of insurance with an insurance company shall be guilty of an offence."

The penalty upon conviction is imprisonment for up to two years, or a fine or both. Should a life company's quotation be found wanting under Section 73, it is the Directors who would be held responsible as it is they who in law, and in practice, run the Company.

However, it is widely believed that it would be very difficult to bring a successful action under it. It is not sufficient that a person has been misled. It must be proven that there was a deliberate intention to mislead. The Company does not have to prove that there was no such intention; the plaintiff needs to prove that there was. Even if it was alleged that the quotation was utterly unrealistic under current conditions, it is unlikely that the courts would convict until the end of the day, when the policy matures.

Under the Insurance Brokers (Registration) Act 1977, a registered insurance broker is not permitted to use any quotation or illustration other than those provided by the life company. Intermediaries who are not registered and tied salesmen are not subject to this restriction.

5.3 The Need for Further Legislation

In July 1981 Professor Gower was appointed by the then Secretary of State for Trade to undertake a review of the existing framework of legislation and to make recommendations on the statutory protection and controls required by private and business investors. His report 'Review of Investor Protection', produced after consultation, was published in January 1984. Its principal recommendation was that the Prevention of Frauds (Investment) Act 1958 should be replaced by a new Act providing for basic policy, overall surveillance and regulation of investment business to be undertaken by the Government or a new agency. Day-to-day regulation would need to be entrusted to self-regulatory agencies, initially based on existing professional bodies and organisations, specifically recognised by the Government or the new agency.

Parallel with this, and of even greater urgency, were the changes that were taking place in anticipation of the changes in the Stock Exchange - the abolition of fixed commission and the introduction of dual capacity at the end of 1986. This is leading to the creation of new integrated financial services. Massive realignments have already taken place in anticipation of the "Big Bang".

For all these reasons it was necessary to introduce fresh primary legislation (and accompanying regulations) to provide a framework of rules that are suited to the new environment and are enforceable with effective penalties for offence.

In January 1985, the Government published a White Paper on Financial Services in the United Kingdom. It stated that in designing a new framework for investor protection its objectives were to ensure an efficient and competitive financial services industry with a system or regulation that will inspire confidence in investors and issuers alike and is flexible enough to respond to change.

> "**Market forces** provide the best means of ensuring that an industry meets the needs of its customers. If market forces are to operate properly it is essential that:
>
> - as much **information** as possible is disclosed about the investments and services on offer to the customer; and
> - the forces of **competition** are brought to bear on practitioners and their institutions."

It goes on to say that

> "If the law and the regulatory system are to be clean and fair there must be so far as this is possible **equivalence of treatment** between products and services competing in the same market. The law should not create artificial distinctions."

Finally, in order to allay any fear that the investor will lose personal freedom, the White Paper says:

> "No regulatory system can, or should, relieve the investor of responsibility for exercising judgement and care in deciding how to invest his money. If he makes a foolish decision on the basis of adequate disclosure - venturing all his savings on an avowedly speculative and high-risk proposition which fails for straightforward commercial reasons - he cannot look to any regulator to make good the losses arising from his own misjudgement.

The regulatory framework outlined in this White Paper gives prominence to this time honoured **caveat emptor.** But it recognises that caveat emptor alone is not enough."

Two regulatory bodies were envisaged: one, the Securities & Investment Board (SIB) covering the regulation of securities and investments and the other, Marketing of Investments Board (MIB) covering the regulation of marketing of pre-packaged investments such as life assurance and unit trusts.

The Government invited Sir Kenneth Berrill to form the SIB and to act as its first Chairman and Mr. Mark Weinberg to be the Chairman of an Organising Committee for the MIB (MIBOC). This dichotomy came in for much criticism from people who felt that a single regulatory body would suffice.

5.4 The Financial Services Bill

On 18.12.1985, the Secretary of State for Trade and Industry Mr. Leon Brittan delivered himself of the Financial Services Bill (hereinafter referred to as the Bill). This is a very wide ranging bill covering the entire financial sector with the exception of the Lloyds Insurance market. We shall concentrate upon those passages that are relevant to the conduct of long term insurance and unit trust business, straying outside it only where it is necessary to do so to consider equivalence of treatment.

The first point to note is that, consistent with Gower's recommendations, the Bill does not regard bank and building society deposits as investments. It is difficult to see how equivalence of treatment can be ensured if certain types of investment fall within the scope of legislation whilst others do not. Unit trusts and single premium bonds are often marketed as a viable alternative to such deposits. Banks are of course covered by the Banking Act 1979 and a new Building Societies Bill was also issued just prior to Christmas but we see no reason why the marketing of their investment products should not be brought within the scope of the Financial Services Bill.

It is understood that when the Mr. Norman Fowler's proposals regarding personal pensions are legislated, the DHSS will regulate the manner of quotations. That White Paper gives no indications as to what form these may take other than to make stern pronouncements on the need to regulate charges.

5.5 Regulatory Framework - General

The Bill states that it will be a criminal offence for a firm - sole trader, partnership, or corporate body - to carry on investment business in the United Kingdom without authorisation. 'Investment business' will be defined widely and will include the giving of advice in relation to investments such as life assurance (which in turn includes pension policies) and unit trusts.

Authorisation may be granted -

(a) directly by the Secretary of State, or by a designated agency to which the Secretary of State's powers are transferred.

(b) by virtue of a firm's membership of a self-regulatory organisation (SRO) recognised by the agency.

The agency for this purpose is a single regulatory Board that will combine the roles previously envisaged for SIB and MIB, the Government having accepted the arguments against a two-tier board. SIB and MIBOC are expected to continue for a little while yet. We shall refer to the agency as the Board in the rest of this paper.

All authorised firms will have to comply with conduct of business rules laid down by the Board, or with rules offering at least equivalent standards of investor protection laid down by a relevant SRO or recognised professional body. There will be penalties for non-compliance with these rules.

Sections 44 and 45 of the Bill restate and expand sections 73 and 72 of the Insurance Companies Act 1982, now of course in a much wider context. The formation of the Board and the determination to introduce regulations promptly will give the new legislation much greater force. The penalty for an offence, if found guilty, can be imprisonment for up to **seven** years or a fine or both.

5.6 Regulatory Framework for Firms Marketing Life Assurance and Unit Trusts

Life companies will automatically be authorised for the purposes of the new legislation. They will, however, be subject to the conduct of business rules relating to marketing and pension fund management.

Unit trust managers (including those associated with life offices) will each require authorisation by the Board or by an SRO. They require authorisation in regard to a number of different activities.

In the context of this paper, the following self-regulatory authorities have been put forward:

1. The Life Assurance and Unit Trust Regulatory Organisation (**LAUTRO**) covering life companies and unit trust managers and trustees for the management and selling of insurance-linked investments or units in a collective investment scheme by themselves and their tied sales forces.

2. The Life and Unit Trust Intermediaries Regulatory Organisation (**LUTIRO**) covering insurance intermediaries, so far as their business is limited to life assurance and unit trust products.

5.7 Overview

We have found it necessary to describe at some length the legislative background and the Government's desire to create an orderly efficient competitive and well regulated market, the protection of the investor being a paramount consideration. Returning to the theme of the paper, we conclude from all this that what the Government would really like is for the buyer to be supplied with enough information to be able to assess

(i) the nature of the investment vehicle, in terms of its risk profile, the nature of the financial commitment, etc.;

(ii) its merits relative to other investment alternatives available to him ("equivalence of treatment"); and

(iii) if possible, the likely return from it.

For fixed premium/fixed benefit contracts this in effect means making the client clearly aware of any limitations and exclusions.

For contracts with an investment bias, we can see the need for (i) above whilst (ii) and (iii) correspond to the two purposes of a quotation that we identified in section 2 of this paper.

5.8 Intermediaries & Company Representatives

After an initial attempt to sidestep the issue, MIBOC appear determined to end the widely prevalent practice of salesmen/agents who are tied to a particular life office also acting as an 'intermediary'. It is envisaged that an individual placing insurance or unit trust business must fall in either of two mutually exclusive categories:

1. An independent intermediary who in law is the agent of the client. He has an overriding duty to exercise skill care and diligence to produce the deal which is to the client's best advantage.

2. A company representative who is contractually restricted to selling the products of one life office/unit trust manager. He must indisputably be recognised as acting for the company or group he represents.

An **intermediary** whose advice has been sought will be more concerned about comparative values for money than their absolute values. He might for example need to be able to justify the statement that, say, a single premium bond is better suited to the client's requirements and that company A's bond was the one that he would choose. These are two separate recommendations. Value for money is only one consideration, particularly in the first recommendation. Whatever its importance, it is comparative value for money that is being considered.

The position of a **company representative** is quite different. He will not be expected to compare his office's product with that of a competitor although an alert client might force him to do so. The office therefore has a greater duty to give a more realistic quotation of emerging benefits. It is possible that the representative's sales presentation involves a comparison of the product he is selling (say a bond) with alternative investment media (say building society deposits and unit trusts). The life office has a duty to ensure that a valid comparison is being made.

We warmly welcome the fact that MIBOC intend to deal with the tied agency sham and would urge them not to permit the exception sought for professional firms and smaller building societies and estate agents. Smaller building societies control more insurance business than several full-time intermediaries. Professional firms (accountants and solicitors) are often regarded as being experts in financial matters and it is of great public importance to ensure that the client is under no misapprehension regarding the quality of advice being tendered.

We would suggest that any individual or firm who does not have the resources or expertise to exercise the skill care and diligence required of an independent intermediary should either have a link with such an intermediary or become a company representative.

5.9 Licensing

All future salesmen, whether company representative or independent intermediary will require a license to sell life assurance and unit trusts. In order to obtain the license it is necessary to demonstrate a degree of competence, probably by examination.

6. THE ROLE OF THE APPOINTED ACTUARY

"He never said a foolish thing
Nor ever did a wise one."

Epitaph on Charles II
(by J. Wilmot)

6.1 Introduction

Up to now, our paper is one that would be presented to the St. Andrew Square/Staple Inn Life and Pensions Society. We have been considering a vital aspect of life assurance operations, but it primarily involves the life company marketing department and life intermediaries - independent, tied and company employees.

We now consider where the appointed actuary stands in relation to quotations and illustrations and the involvement of the Institute and Faculty in handling the current problems.

6.2 Duties & Obligations

Under section 19 of the Insurance Companies Act 1982, a company transacting long-term insurance business must have an Appointed Actuary to carry out, from time to time, and to report on an investigation into the financial condition of the office, including a valuation of its liabilities.

The Institute of Actuaries have issued Guidance Notes to Appointed Actuaries. The following extracts from GN1 are relevant to this paper:

> ".....every actuary acting in his professional capacity ..... has a duty to his profession and his responsibility to his principal must be consistent with this." However,
>
> "The appointed actuary, as such, has no executive authority within the Company (even though he may also, in another capacity, have an executive position and authority). The responsibility for Company decisions must, both in law and in practice, rest with the Board of Directors." Besides, whilst
>
> "A prime responsibility must be with the appointed actuary to satisfy himself that the premium rates being charged for business are appropriate", it goes on to say that
>
> "It may be that a practicable premium basis, whilst commercially justifiable, will involve significant new business strain. The actuary must be satisfied that the Company will be able to set up the necessary reserve, and must indicate any limits to the volume of business that may be prudently accepted."

Thus the Appointed Actuary's duties are largely of an advisory nature. It is the Board of Directors who run the Company. It is their responsibility to determine the terms upon which to carry out business. If the terms are unprofitable, the Appointed Actuary's duty is to advise them of its financial consequences and not necessarily to dissuade them.

It follows that the use of bonus illustrations in new business quotations is primarily a matter for the directors of the Company. If the illustrations are unrealistic in his opinion, the Appointed Actuary ought to draw the Directors' attention to section 73 of the Insurance Companies Act 1982.

Consequently the following note was added in May 1985 to GN8

> "It is the appointed actuary's professional duty to report in writing to the company, at an appropriate level of authority, on the results and implications of any valuation which he carries out for statutory purposes, whether or not a distribution of surplus is involved. **If there are policies which participate in profits he should advise on the conditions in whch the company could reasonably expect to be able to maintain its current rates of bonus, allowing for any changes in such rates that may be envisaged as a result of the valuation.**

6.3 Commentary

In our opinion an Appointed Actuary advising the Directors in accordance with the amendment to GN8 referred to will need to take into account the features specific to the Company such as:

1. The composition of its likely new business and the terms upon which it will be procured. Under current conditions the volume of unit linked business is particularly relevant.

2. If the company is a proprietery company, the cost of financing the transfers to the proprietors' funds.

It is not clear to us the extent to which the Company's free estate should be taken into account. In our opinion it should be ignored when determining the future rate of interest implicit in the current rates of bonus. However, his advice would be more constructive if the Actuary went on to explain the amount of the estate that would be dissipated if a further tranche of new business were transacted on the current bonus rate and such rate was in fact maintained. For this purpose he must make a **realistic** assumption regarding future rates of interest and this assumption must be clearly spelt out. (We use the term 'interest' loosely to denote investment return.)

If this were carried out then, in our opinion, the Directors will be in a position to assess their culpability under Sections 44 and 45 of the Financial Services Bill.

6.4 Equity in Bonus Distribution

"It aint necessarily so."
George & Ira Gershwin

Coe and Ogborn, Cox and Storr-Best, Fisher and Young (strange how they always came in pairs) inculcated in us the importance of equity in bonus distribution. All participating policyholders paid substantial bonus loadings but all the money went into the same pot. There was an implicit belief that the actuary would be as fair to all policyholders as is practicable and is consistent with the smoothing and pooling inherent in a with profits system.

And yet the only reference to bonus distribution in the guidance notes is an en passant statement in GN1 in the context of insolvency.

This would not matter so much were it not for the fact that there is prima facie evidence to suggest that in recent years companies have used terminal bonuses specifically to inflate new business quotations. This was particularly evident when, following the withdrawal of life assurance relief, several companies (a) further increased the terminal bonus on lowcost endowment and (b) suddenly discovered that they had underdistributed on pension plans to which the focus of new business was bound to shift. Some companies are projecting, on 5 years pension plans benefits that imply a yield of 19-20% on the gross premium, ignoring commission and expenses. How do their Directors reconcile this with their obligations under section 73?

Although we are likely to move away from projecting current bonus rates into the future, the problem of terminal bonus and its uses will not disappear. If the emphasis in marketing were to shift to past performance it is very cost effective to declare large terminal bonuses which will cost very little, particularly if they are duration related. (This is because the rapid inflationary increases in new business that life companies have enjoyed for the best part of three decades means that the liabilities on policies maturing now are a very small proportion of the total reserves).

This action has been adopted by several life companies over the past few years as competition has become keener among traditional life companies. These companies have declared massive increases in their terminal bonus rates in order to get into or hold on to the top positions in the past performance tables. Now we are seeing maturity values being paid where terminal bonuses account for more than half the payout.

Commercially, the extra cost of providing a more than equitable terminal bonus may be more than justified in terms of the extra business written. For example it may have cost the office even more to get the same amount of business if instead it had paid extra commission or engaged in heavy advertising or promotion.

Nor is the exclusion of terminal bonus the answer. Different companies have different bonus structures and one needs to look at the total bonus policy. Indeed it can be argued that an office that declares only terminal bonus must, other factors being equal, give the best return because it has the greatest freedom of investment.

Perhaps the only solution is to make equity in bonus distribution a specific item in the Guidance Notes. The addition to GN8 made in May, 1985 does not go far enough. It takes only a prospective look. It does not ask the actuary to state that in his opinion the achieved results are reasonable.

If the Directors choose to demand a higher than equitable bonus for a specific class of business, for purely commercial reasons, then the theoretically elegant solution would be to discard the excess from past performance tables and treat it as an expense item. Elegant but regrettably impractical.

6.5 Wider Role of the Actuary

The statutory duties and Guidance notes tend to portray the Appointed Actuary as a mixture of a Jeremiah and a devil's advocate, warning the Directors as to what they ought not to do. Indeed in many organisations the actuary does carry such an image - hence the quotation at the beginning of this section.

We consider this most unfortunate. His professional training may not necessarily equip turn to be a good businessman. Nevertheless, we feel that the actuary, as an important member of the top management team of the company should take a more positive role in shaping policy. He should be more forthcoming in stating what is possible. In this he should work closely with his Marketing Director. A good rapport between them is vital.

7. SOLVING THE PROBLEM - THE WORK OF LIC

"Life is the art of drawing sufficient conclusions from insufficient premises."
Samuel Butler

7.1 Working Party's Objectives and Criteria

The life assurance industry as represented by the Life Insurance Council (LIC) of the Association of British Insurers (ABI) has been grappling with the task undertaken by its predecessors, the LOA and ASLO, whose work it has taken over. In this it has liaised with the Institute and the Faculty.

The following objectives and criteria were put by the LIC to its Working Party on Bonus Illustrations:

Objectives

(i) To convey to the potential policyholder an indication of the benefits that will emerge.

(ii) To facilitate a choice as beween one office and another.

(iii) To achieve equivalence of treatment with other investment institutions.

The Institute and Faculty in its review of the initial proposals felt that the third objective was not necessary, so the Working Party dropped this objective from its aim in attempting to devise a solution. But it had to be reinstated following representations from MIBOC after the publication of the Bill.

Criteria

(i) The illustrated figures should not be such as to create unreasonable expectations in the minds of potential policyholders; and should be seen to be responsible at the time the illustrations are given.

(ii) The bonus illustation system would need to be acceptable to, and easily understandable by, potential policyholders and intermediaries.

(iii) At least in part, the system should be based on factual information so as not wholly to neutralise the competitive differences between offices.

(iv) Subject to there being no conflict with the requirement in (i) above, the system should not be so stringent as unjustifiably to weaken the competive position of life offices relative to other savings media.

These objectives and criteria apply equally to unit-linked and to with profits business. It can be seen that (iii) & (iv) can come into conflict with (i) & (ii).

7.2 Advice from the Actuarial Profession

Early last year the Institute and Faculty of Actuaries were approached for their views on various actuarial considerations involved in this complex issue. Their recommendations will be submitted to MIBOC.

The Institute and Faculty whilst pointing out that the use of bonus illustrations in new business quotations is primarily a matter for the directors of the company, went on to say that

"Nevertheless, the profession's reputation and standing was so inextricably interwoven with this issue that it would wish to support any industry-led development of a code of good practice."

As regards the more detailed aspects, it was suggested by the Institute and Faculty that:-

1. The approach to projections should be even-handed as between with profit and unit-linked quotations. This criterion is reinforced by the recent development of combined contracts.

2. Comparisons between offices should not depend on projections but on verifiable facts about their achieved performance. The latter should be qualified so as to set them in the context of the financial conditions which gave rise to them.

3. Projections should be made solely for the purpose of indicating a reasonable range of magnitude of the policy proceeds and should be on stated assumptions about future financial conditions.

4. Projections should not be limited to single-point estimates, because these convey an unwarranted degree of precision however strong the caveats associated with them.

5. Projections should be made in real terms where relevant and practicable.

* * *

Taking these views into account, the Working Party made the following recommendations:

7.3 Linked Business

It is proposed that benefits be illustrated upon two alternative rates of return as follows:

Pension Business	12% and 8% gross
Assurance Business	10% and 7% net

These rates of return are prior to the deduction of the annual management charge. Where the charges are not guaranteed, it is sufficient to use the current rate provided that this is stated in the quotation. Allowance must be made for the bid-offer spread, but it is sufficient to use the standard spread of 5% notwithstanding that in extreme cases it could be more.

7.4 With Profits Business

Three solutions were suggested:

A. Accumulation of the gross premiums on standard growth rates. These rates would be lower than the corresponding rates used for unit linked business in order to make a somewhat crude allowance for expenses and life cover.

B. Accumulation of net premiums at the standard growth rates agreed for unit linked business. The adjustments for expenses and life cover to arrive at the net premium would be standardised.

C. As a variation to B, the deduction from gross premium to allow for life cover and expenses may be made on a basis which, in the opinion of the Appointed Actuary is reasonable and appropriate in relation to the office's business.

The Working Party ruled out the first alternative and suggested that the choice should lie between the other two. It went on to suggest that Companies should be permitted to illustrate in terms of bonus rates so long as the final answers did not exceed that brought out on the agreed basis.

7.5 Personal Pensions

This description was used by the Working Party to cover all individual approved pension arrangements including self employed pensions and section 32 early leavers pension plans.

It is suggested that the accumulated fund should be shown in real terms in some way. Price inflation is considered to be more practicable and the yields on index linked gilts a useful yardstick.

In converting the cash fund into pension it is suggested that the rate of interest to be used is no higher than the real rate used in building up the fund.

It is suggested that offices should be free to show projection in nominal terms if it also showed figures in real terms (assuming a real rate of no more than 3½% p.a.).

7.6 Past Performance

The Working Party recognised that a more standardised approach to quotations would focus greater attention upon past performance, the life company itself taking the lead in this. They also recognised the concern expressed in 4.6(A) and 6.3 of companies unduly boosting past performance. However it felt that the additional guidance issued to Appointed Actuaries in May 1985 when coupled with an extended code of industry practice would be sufficient.

In connection with the latter it was suggested that as part of the cooling off process each company should voluntarily issue a booklet as to the nature of the contract. This could include a "scene-setting" statement as to the source of surplus for bonus distributions, the dependance on investment returns from a variety of assets and the tendency for such returns to move in line with inflation.

7.7 Commentary

The LIC's views are still evolving. By taking a snapshot of it we are perhaps being unfair to them. We have included it to give the reader an indication of the lines along which our trade body is thinking.

We are happy with the principles proposed for quotations although, as can be seen from section 8 of this paper we disagree in several items of detail.

Our main criticisms are that it makes no attempt to deal with the requirements of equivalence of treatment and that it does not offer any suggestions as to the interpretation of past performance.

8 POSSIBLE SOLUTION

"You cannot be serious."
John McEnroe

8.1 Introduction

It is just as well that a deadline is being forced upon us by the Government's Financial Services Bill. It is unlikely that an industry as disparate as ours would ever reach an enforceable consensus out of free choice. Every solution put forward by the LIC has met with opposition from at least one group of life companies.

So far in this paper we have endeavoured to set the scene, describe the problem and refer to the current line of thinking of the LIC. In this section we will endeavour to set out our own views on how to tackle the problem. In the final analysis there isn't a solution that is theoretically credible and can be applied universally. There are too many factors that need to be taken into account. All we can do is present a series of relevant information that either are factual or are effective discriminators. It is up to the buyer or his advisor to decide what weight to attach to each.

The industry needs to be responsible but the principle of caveat emptor must always apply.

In 5.7 we said that in our opinion, the Financial Services Bill required us to supply the buyer with enough information to be able to assess

- (i) the nature of the vehicle in terms of risk profile etc
- (ii) its merits relative to other comparable investment vehicles (equivalence of treatment)
- (iii) the likely return from it

To that we must add the ability to discriminate between different life companies.

We entirely agree with the broad advice given by the actuarial profession to the LIC (see 7.2). However, it does not tackle the problem of equivalence of treatment, nor does it actually give any solution.

We are very concerned about the provision of quotations through computer terminals in intermediaries offices. Life Companies must not let their standards slip. Equally, it is hoped that MIBOC, through its system of licensing will ensure that intermediaries use the information responsibly.

8.2 Risk Classification

It is a truism that greater the potential reward the greater generally speaking the risk. Some investment options that offer the greatest scope for profit also show the greatest scope for loss - traded options, commodity futures, mining stock etc. Conversely those that offer the least scope for spectacular profit also show the least scope for loss - bank and building society deposits, National Savings Certificate etc.

We consider it essential that investors should be given an indication of the risk and reward ratings of the product. For example we could have ratings from 1 to 10 for each, 1 being the safest and least remunerative, 10 the most speculative and potentially the most remunerative. It would be necessary to decide whether the criterion is in money terms or in real terms. Perhaps, a dual scale could be considered.

We can almost hear the reader sniggering with contempt, a thousand practical difficulties crossing his mind. We do not disagree. Equally, we cannot see how an investor can be truly protected without some such guideline. After all it is conceptually similar to tar rating on cigarettes.

In any event, in order to get a debate started we set out below our own factor ratings for various investment media.

Investment Medium	Risk Ratings	Reward Ratings
Bank/Building Society Deposits	1	1
Cash Fund	1	1
Gilts or Gilt Fund or Unit Trust	2	2
With Profits	2	4
Managed Fund, Managed Unit Trust	4	5
UK Equity Fund or Unit Trust	5	6
F. Eastern or N. American Fund or Unit Trust	6	7
Commodities	9	9
Traded Options	9	9

We would envisage either LAUTRO or IMRO (the investment managers regulatory organisation) determining the risk and reward ratings of different types of investment, such ratings being updated periodically. The idea is not new. Unit trust management companies have occasionally risk-categorised their trusts. One or two life companies have done the same during the past year. We feel that a formal basis should be adopted.

8.3 Equivalence of Treatment

We do not know what equivalence of treatment means other than that it does not mean identical treatment. Whatever it is, the biggest bar to attaining it is the fact that the list of investments defined in Schedule 1 of the Bill is not wide enough. It does not include bank and building society deposits, nor does it include retailing of stock exchange securities. We will endeavour to take the first two into account but the last named remains a problem. It seems not to be generally recognised that stockbrokers at the retail end are as much salesmen as insurance brokers. Indeed Sir Nicholas Goodison is understood to be unhappy that equivalence of treatment does not extend to commission - stockbrokerage after diregulation being less than on say unit linked bonds. He ignores the lack of 'cooling off' on security transactions.

As we saw in section 3 of this paper, the life insurance industry is the only industry that gives illustrations of future benefits. The only exception to this generalisation, pension funding, is considered separately. If there is some common theme to all of them it is that they talk in terms of **current** yield. We feel that meaningful comparisons can only be made if we talk of yields. The design of many of our products make this difficult but it must be our starting point. If a long term yield is being shown and such yield is dependent upon future rate of inflation, the rate assumed must be shown.

8.4 Estimating Likely Return

8.1 (iii) states that wherever possible we must give a realistic indication of the likely return. For contracts with an investment bias we do not consider it possible to do so. The future returns are too uncertain. Our suggestions in 8.2 and 8.3. will go a long way towards giving the investor an indication of the nature of the product.

If in addition, a quotation is required we agree with the advice given by the profession to the LIC. Rather than give a single point estimate we should show two or three values. This illustrates the inherent uncertainty and the big difference a seemingly small increase in yield will make to the final answer. The assumptions made regarding yield in arriving at the values must be shown. Ideally the value must give an indication of the bounds within which the final answer might lie.

8.5 Allowance For Inflation

We cannot ignore inflation because it has a material bearing on future investment returns. Looked at another way, the investor is more concerned about the real value of his investment. This is particularly true of a pension plan.

For normal investments price inflation, as measured by the Index of Retail Prices (RPI) is the appropriate measure; for pension arrangements, earnings inflation, as measured by the National Average Earnings Index (NAE). Generally NAE has increased at a faster rate than RPI (currently the gap is around 3 - 4%) but there have been exceptions.

We talk generally of a positive yield gap between gross investment returns and price inflation. Indeed historically this has been broadly true ((3) and (4)) but there have been major aberrations. For example, in the mid-seventies the gap was substantially negative; in recent years it has been substantially positive.

It seems to us that the generally held assumption that yield is likely to be price-inflation plus 'something' is too simplistic. Other factors being equal an investor would expect inflation plus 'something' but other factors are not equal. Supply and demand of money and expectation of **future** price inflation, and returns available in overseas markets (which are influenced by local inflation) all come into it. In particular, when inflation is as low as 5 - 6%, investors appear reluctant to accept a gross yield below 11 - 12% p.a. Are they simply being cautious, not believing that inflation will always be too low? Or it is the international nature of the investment market that is causing this?

Neither of us is an economist or an investment manager. We would however question the overreliance on the assumption of a constant yield gap. For example, if we assume an investment return of 12% (gross), that could be associated with price inflation is low as 6% or as high as, say 10%. On the other hand a long term return of 15% (gross) will probably be unlikely to be associated with price inflation of under 10%.

8.6 Distribution Method

We stated in Section 1 of this paper that the life companies have a greater duty to their clients when they are not dealing through intermediaries. The distinction drawn by MIBOC between intermediaries and company representatives underscores this point. We argued in 5.8 that comparative values are more important than absolute values when selling through intermediaries but when selling through company representatives it is important to give a realistic assessment of emerging benefits. As companies would wish to use the same basis in both cases they are in effect obliged to provide realistic quotations in a form that facilitates meaningful comparison.

It is hoped that the same high standards will be employed in direct response advertising - both by life companies and unit trust managers. Some of the worst examples of inadequate quotations are in this field - see Appendix 2, Exhibits 4 and 8.

8.7 Preferred Basis for Unit Linked and Unit Trust Business Past performance

Let us consider first of all bonds and unit trust. The use of quotations is incidental to the sale of the former (except in CTT-vehicles) and unknown to the latter. It is past performance that is of importance. This has led to a new breed of salesmen who do not really understand investments but have picked up the lingua. They have elevated to a verbal art form the explanation of mediocre performance.

What skills and attributes contribute to good fund performance can be the subject of a paper in its own right. Quality of fund management, the effectiveness of price management, the ebb and flow of funds all have a part to play. Furthermore given the recent trend towards more active turnover of fund managers how relevant is past performance anyway? Perhaps an analogy can be drawn with football clubs. Is the investment department of the life company or unit trust like Liverpool where a continuity of style and attitude has enabled standards to be maintained through four managerial reigns; or are they like Leeds or Derby?

It is not easy to encapsulate all these considerations into a single criterion. The client or his intermediary will need to take them into account. For all its limitation past performance remains the best guide. We would suggest the following guidelines:

1. The average annual growth in unit price must be shown and by way of comparison the average annual rate of price inflation over the same period. The period must be as long as possible, but in any event, not less than three years. There is no objection in showing average annual growth rate over a series of periods.

2. The risk classification must be shown.

3. Any comparison between different funds must compare like with like, regarding risk classification and the period over which performance is being assessed.

4. Where a new Fund is being launched and there is no track record the average or median yield achieved as comparable Funds must be shown together with an explanation of why the Company feels that it can do better. Where the tract record is of less than three years, it must be heavily qualified.

5. There must be an accompanying note along the lines of "Any increase in the value of the unit price arises from the future growth in the value of investments and income from investments. The rates of growth achieved in the past must be studied in the context of the inflation over the same period. Future rates of growth cannot be predicted in any way and indeed the value of the unit can fall as well as rise."

Where the Managed Fund or a Managed Unit Trust is being marketed we believe that this is sufficient. For other specialist funds, any statement as to past performance must be supplemented by a realistic prognosis. This is particularly true of unit trusts. One of the unfortunate features of the past four years has been the uncontrolled growth of specialist trusts following every ephemeral trend.

In the case of overseas funds, it must be clearly explained that performance was achieved partly by stock selection and partly from currency movements. The results are therefore highly volatile - hence the high risk profile.

In general, the marketing of unit trusts needs to be cleaned up. We have no objection to a management company boasting of the number of successes it has had as a measure of its investment credentials but it must be done in a statistically valid way. For example a common theme is of the type 'we had three trusts in the top twenty performers over the past year'. However a quick glance at the full top twenty will reveal that most of them have a similar investment philosophy, the one that, in hindsight, was the most popular - Europe one year, Far East another and so on. A large management company with a wide range of trusts will stand a good chance of having a good representation in the top twenty but this will probably be matched by a similar presence in the bottom twenty.

We would suggest that any comparison made should be by sector. If a company must boast of presence in an aggregate league table they should say something like "Three out of our 30 trusts were in the top twenty." And of course whenever possible they must use externally published comparisons. The magazines Planned Savings and Money Management and its sister publications Unit Management and Pension Management provide such comparisons.

Future Projections

Projections are used in regular premium unit linked plans and may well be used in unit trust savings plans some time in the future. We believe that the only practical basis is that of showing figures on two alternative growth rates. We would suggest

(i) $7\frac{1}{2}$% and 15% for a gross fund with reinvested income.
(ii) 5% and 11% for a gross fund with no reinvested income.
(iii) 5% and 10% for a net fund with reinvested income.

(i) and (iii) apply to internal pension and life funds, (ii) to unit trust. These growth rates are prior to the deduction of fund management charge. If the office has an open ended charge, it is sufficient to use the current charge provided that it is clearly stated that the charges are open-ended.

Such a wide range is intended to give an indication of the variability of results. When set side by side with past performance recorded as suggested earlier and the risk classification, the client can make a choice to suit his requirement and temperament. We see no reason why a third intermediate projection cannot also be provided.

Where a quotation in real terms is being provided, the two rates we would suggest corresponding to the lower and higher growth assumptions are:

3% and 10% for price inflation
5% and 12% for earnings inflation.

8.8 Preferred Basis for With Profits Business
Past Performance

There is no objection to the Company using an externally published league table of past performance as a part of its general investment credentials. If however it is being used as an integral part of a quotation, it must relate to a comparable product. The return must be expressed as an overall yield on the gross premiums invested and the corresponding average annual rate of price inflation must be shown. We do not mind the Company saying that 'valuable life cover' is 'on top'.

We would suggest to the profession that specific guidance be given to appointed actuaries not to 'overdistribute' simply to inflate the league table position (see 6.3). We would also expect the Company to add a note along the following lines to the quotations whenever reference is made to past performance:

"Although past performance is no guide to the future, the Company has been advised by its Actuary that given similar investment conditions, a similar can be achieved for the current generation of new policyholders."

In giving such advice, the Actuary would need to take into account the current rate of new business. We agree with the suggestion of the Working Party that a booklet on the With Profits product should be prepared. We would issue it with the quotation. It will inter alia, talk of the product's risk profile. We accept that this suggestion is contentious but we feel very strongly that the profession must get to grips with this problem.

A caveat along the following lines must be added to the illustration:

> "Future reversionary or accumulation (Appendix 3) bonus rates depend upon profits earned in the future. That in turn depends crucially upon future growth in the value of investments and income from investments. The high rates bonus declared in recent years reflect the exceptionally high investment returns achieved in recent years and must be studied in the context of inflation over the same period. Future rates of bonus cannot be predicted in any way other than to say that a continuation of low inflation if coupled with low investment earnings could lead to a fall in the rate. The rate of terminal bonus depends critically upon financial conditions at the time of claim and may be expected to fluctuate."

We consider it essential that the pension be shown in real terms, as a proportion of salary or earnings. We would use the assumptions set out in 8.7 for this purpose. It does not matter whether the figures are shown as a percentage of final earnings (Appendix 2, Exhibit 7) or in terms of current purchasing power.

Future Projections

Our preference is for basis C outlined in 7.3. We would provide two quotations using the alternative rates of return outlined in 8.7. These returns would be adjusted for renewal expenses and proprietors share of surplus. The cost of mortality or other risk would be determined by the Actuary. Where an office transacts unit linked business, the starting point must be the assumptions made in respect of it. The Actuary must have good reasons for departing from it.

8.9 Pensions

Where a funding rate is being determined for final salary pension schemes the actuary has to have regard to a wide variety of considerations that are embodied in a separate set of Guidance Notes. For Individual Pension Arrangements, the maximum contribution rates are laid down by the SFO on a standard basis involving, inter alia, a rate of salary inflation of $8\frac{1}{2}\%$ p.a.

For other money purchase schemes and self employed pensions no established standard exists.

It would of course be reasonable to assume that where contributions are paid regularly, they shall increase in line with NAE. In converting the accumulated cash sum into pension we should use the same underlying assumptions.

8.10 Personal Pensions

The White Paper on Reform of Social Security warned against the issue of misleading quotations. We are talking about selling pensions to low income earners who are not familiar with any concept other than money building up in a building society. Contributions will be a percentage of earnings and it is important that information be supplied in a meaningful way. This applies not just to life companies but also to other underwriters of personal pensions. It is hoped that the Occupational Pensions Board (who are an 'SRO' for the DHSS) will ensure this.

A personal pension quotation requires the employee to be able to judge his contribution rate in order to target for an adequate pension. Thus the variables must be realistic. Too optimistic assumptions will lead to inadequate pensions; too conservative assumptions will result in overcommitment to the detriment of current consumption.

Conceptually, it is very similar to funding for a final salary pension - see 8.9.

8.11 Pension Consultant

We referred in 5.8 to MIBOC's proposals for independent intermediaries and company representatives. One category of intermediary/salesmen/advisor that needs to be closely investigated is the breed of pension consultants. Many of them provide an excellent service to their clients almost as independent as consulting actuaries'. However there is a large body of consultants who are in an ambiguous position. They purport to give independent advice but are in fact selling their own small self administered schemes if their fees can be justified, or an insurance company's product, if it is easier to receive commission instead. In the former case they are a supplier or underwriter in the latter an intermediary. We doubt if this is made clear to the client.

We believe the two roles must be kept completely distinct and that all consultants who offer their own self administered schemes should be regulated.

8.12 Spurious Accuracy

It would help to convey the illustrative nature of all our quotations if

A. We cease calling them quotations and refer to them merely as illustrations; and

B. We round down the figures so as not to have more than, at most, three significant figures.

9. EPILOGUE

"Man must pursue things which are just in present, and leave the future to the divine Providence."

Francis Bacon

9.1 Introduction

Winston Churchill once wrote a long letter to a friend explaining that he did not have the time to write a brief one. Had we allowed ourselves more time we could have delivered a more tightly drafted paper; but then the paper could not have taken into account the Bill, the latest MIBOC proposals etc.

We would like to round off the paper with a few thoughts regarding the future.

9.2 Future of Annual Premium Business

Prior to the demise of LAPR, one of the main line products of the industry was the Maximum Allocation Plans. Current levels of sale are very low. Another annual premium investment contract is the low cost endowment. If our recommendations are implemented, its sales too will be badly hit. Mr. Norman Fowler's proposals on personal pensions are likely to force us towards a no explicit charge, low commission, variable premium product.

Are we seeing the end of the annual premium investment contract? We believe that this could well be the case. Actuaries and Chief Executives are advised to take this into account as it has profound implications upon business and pricing strategy. We would need to more over to the approach adopted by other industries, banks and building societies and that is to take a much larger turn from all monies.

For too long we have concentrated upon selling investment based products on the basis of tax relief and tax efficiency, using commission as a tool. We now have to consider ways of identifying customer needs, by a process of education and skilful marketing converting them to wants and in that way expand demand and reduce acquisition costs.

We are not the only party involved. There is also the salesman to consider, be he an independent intermediary or a company representative. If this were to come about, and bearing in mind the pressure to talk in terms of real returns, we are likely to see a move away from fixed premiums to variable or index linked premiums.

9.3 Universal Life

A spate of Universal Life Plans has come onto the market. They allow total flexibility of premium payment and benefit choice. They pay commission at the whole life rate. It is essentially a protection contract which can also provide investment benefits.

Regrettably it is often sold as an investment vehicle. Companies who are overtly or otherwise permitting it are taking a very short sighted view. Either the level of cover must not be permitted to fall below a sensible level or the commission rate must be severely curtailed when there is little life cover.

9.4 Future of With Profits Business

The principle of equivalence of treatment, the need to be able to talk in terms of yields has all made the traditional reversionary bonus contract an anachronism. Has it outlived its usefulness? The mutual insurance business has been one of the major success stories in the social history of this country. With Profits business will never die. However, it does need modern presentation and vocabulary. Expressions like reversionary bonus have little relevance to the public.

We believe that the future with profits product is the unitised With Profits Fund. It's time was already coming but the introduction of the Financial Services Bill and Personal Pensions makes it even more relevant. As there is no reference to it in actuarial literature, a brief description is given in Appendix 3.

9.5 Final Thoughts

Our final thoughts on the problems are that the industry can already do much to alleviate the situation by educating the salesmen and intermediaries on the whole subject of illustrations and how they should be used. We would urge that the training requirements for obtaining a license should cover the subject in detail. There is much that can be done now without waiting for MIBOC and legislation.

REFERENCES

The following papers have been referred to in the text.

(1) Bonus Declaration After a Fall in Interest Rates - S.L. Smaller (JIA112,2)

(2) Personal Life Assurance, What the Past Tells Us - E. Short (Paper presented to the Institute of Actuaries Student Society on 2.2.1982).

(3) Long Term Rates of Interest In the Valuation of a Pension Fund - C.D. Daykin (JSS21,3)

(4) Equity & Fixed Interest Investment from 1919 - a de Zoete & Bevan publication.

(5) Deposit Administration - M. Iqbal (JSS23)

APPENDIX 1

QUOTATION PRACTICE OF OTHER FINANCIAL INSTITUTIONS

We are concerned only with institutions that offer a pooling of tasks. Thus direct investment in the stockmarket are ignored. We will consider only building societies, banks and unit trusts.

Building Societies

Building Societies do not sell upon the basis of projected benefits. They sell on the basis of the interest rate they offer. A wide variety of investment and savings plans are offered of varying investment terms and notice of withdrawal.

The vast majority of the investors and a majority of the moneys they invest are on 'instant call' or 'sevendays notice'.

The vast majority of the advertisement is for cream business where money is invested for 3 or 5 years at a premium rate of interest - typically 2% over the normal investor rate from time to time. The advertising copy highlights the current rate. One has to read the small print, often obscure, to learn that the rate is in fact variable.

The one area where they will provide a long term projection, if requested, is on AVC schemes. Here they will project current yield in to the future.

Banks

The clearing banks have not in the past competed aggressively with the building societies - which probably accounts for the decline of their share of personal savings from 28% to 6% over 15 years.

There are signs that this will change now that banks are being forced to deduct composite rate tax on interest. In the past they use to advertise the rate and the fact that it was gross. In the future the accent will still be on rate.

Unit Trusts

Unit trusts sell on the basis of their performance. Most management companies have several trusts in their stable and, at any one time can boast of one that is successful. But these are specialist trusts and past is a dangerous guide to the future. For example M&G have 30 trusts and proudly boast that they usually figure in the top five performing trusts. But it is usually a different one each time and a potential investor is no wise as to the future.

As head hunting amongst investment managers is quite common, past performance may in any event be totally irrelevant.

The decision by Department of Trade to permit management companies to increase and 'open-end' annual management charge has meant that new trusts are viable at much smaller levels. This has led to a spate of new specialist trusts being launched.

APPENDIX 2

EXHIBIT 1

13th January 1986

Illustration for Flexible Mortgage Plan (With Profits basis)
Designed to repay a mortgage of £25,000
at the end of its term of 25 years

Male life aged 30 next birthday.

A. BENEFITS ON SURVIVAL OF THE TERM
(on current bonus rates - see notes)

	£
Cash value of benefits including Accumulation Bonus	31,294
Amount required to repay mortgage	25,000
Balance cash remaining after the repayment of the mortgage	6,294
Additional Terminal Bonus	16,030

B. BENEFIT ON DEATH DURING THE TERM

	£
The guaranteed sum payable on death (or value of fund if greater)	25,000

C. THE MONTHLY COST

	£
Premium payable to SUN LIFE	38.67

* The policy does not provide an unconditional guaranteed benefit at the end of the mortgage term. However, if the recommendations made at periodic Plan Reviews are fully complied with, Sun Life will guarantee that the cash available at the end of the term will not be less than the amount of the mortgage. Such recommendations could include an increase in the amount of future premiums payable after Plan Reviews. Full details of the Plan Reviews are available on request.

The illustration of the cash values has been made on the assumption that the Plan remains invested in the With Profits Fund throughout its duration and that, during the term, our current accumulation bonus rate of 9.00% per annum of the total fund and our current assumed scales of terminal bonus are maintained.

See notes attached

Notes

DEATH BENEFIT

The sum payable on death will be the greater of the mortgage sum assured and the bid value of the units as at the day following the date of notification of death.

CASH VALUES

The illustrations of the cash values have been prepared on the following assumptions:

(a) Level of benefits and premiums – that your Plan is maintained in full force for the level of gross premiums and guaranteed death benefit shown, that no previous cash withdrawals have taken place and that no premiums are overdue when the Plan is to be cashed.

(b) Mortality – that rates of mortality currently assumed remain unaltered.

(c) Future rates of bonus (with profits benefits only) – that our present rate of accumulation bonus and scale of terminal bonus payable on death or on encashment at the end of the mortgage term are maintained throughout the duration of the assurance. The current rate of accumulation bonus reflects the investment returns obtained in recent years when high interest levels have been associated with high rates of inflation. Lower rates of inflation would normally imply lower interest levels and in these conditions the rate of accumulation bonus could be reduced. The rates of terminal bonus are influenced by financial conditions at the time when a claim arises and can be expected to fluctuate.

NO GUARANTEE OF FUTURE BONUS RATES CAN BE GIVEN AS THESE WILL DEPEND UPON PROFITS YET TO BE EARNED

(d) Future growth in the value of units (Unit-linked benefits only) – that the value of units increases at one of the rates illustrated. Any increase in the value of units arises from future growth in the value of investments and income from these investments. No one can guarantee the future rate of growth; unit prices can grow at a faster or slower rate than the rates illustrated and can go down as well as up.

TAX RELIEF IN RESPECT OF MORTGAGE INTEREST

Mortgage interest on a loan to purchase your main residence in the United Kingdom is normally eligible for income tax relief within the statutory limits (at present related to a loan up to £30,000). The figures have been calculated to reflect this limit. From April 1983 relief at the basic rate may be deducted at source from the interest payable to your lender.

However, most Building Societies will not operate the new arrangements when the loan exceeds the £30,000 limit. In these circumstances, tax relief will be obtained through PAYE codings and assessments.

If any part of your income is taxable at a rate in excess of the basic rate, relief in respect of such excess will be obtainable through PAYE codings and assessments. The net mortgage interest shown in this quotation has been calculated on the assumption that you will qualify for tax relief at the rate shown.

Further information is available on request.

FURTHER DETAILS OF ALL ASPECTS OF THIS CONTRACT ARE CONTAINED IN THE TECHNICAL GUIDE

EXHIBIT 2

For a life, age not exceeding

This illustration is dated

You invest

For a period of 10 years

A investment of £

Life cover

Your life will be assured during the first years for £

This sum will increase each year over the balance of the 10 year investment period.

Increase your investment

If you are under 54 when you start your you may double your rate of investment at the end of the 5th year (or at the anniversary of the Plan immediately preceding your 55th birthday if sooner) by effecting a further Plan without evidence of continuing good health (see Option 5 overleaf).

Your benefits at the end of 10 years

You may decide

1 **to realise your total investment**
which *assuming maintenance* of our current rates of bonus could amount to:

Guaranteed Minimum Sum	+	Projected Ordinary Bonus	+	Projected Terminal Bonus	Total Projected Return
£		£		£	£

representing the following approximate yields:

net yield % p.a. equivalent gross yield % p.a. *assuming tax at* %

OR

2 **to take a tax-free 'income'**. This 'income' may be taken in a variety of ways (see booklet) but if Growth Bonuses are declared at 7½% p.a., a tax-free 'income' of £ for example may be taken at the *end of each year* whilst leaving intact your investment of £

OR

3 **to leave the Total Projected Return invested** for as long as you wish to earn Growth Bonuses of, for example:

		Total Projected Amount
5% p.a. producing at the end of, say	years	£
OR		
7½% p.a. producing at the end of, say	years	£

OR

4 **to leave the Total Projected Return invested** and continue investing for 10 more years. You can then take cash or Options 2 or 3 above.

5 **to start a new investment** if you are then under age 55 (see Option 5 overleaf).
Bonus rates (important – see note overleaf) assumed in part 1 above:

NOTE: If Option 2 or 3 is selected, a yearly premium of £5 is payable.

THE NOTES OVERLEAF AND OUR BOOKLET SHOULD BE READ AS PART OF THIS ILLUSTRATION.

M 31 4.84

Please note

This illustration and notes give only a brief description of the standard policy terms. It is not practicable to set out every detail of the contract but further information and/or a copy of the policy will be supplied on request.

Although the terms described are those which are intended normally to apply, they may be varied by at its discretion before the policy comes into force if, in its opinion, underwriting considerations make this necessary. The information given below relating to tax is a summary of understanding of current law and practice.

Please remember that . is designed to give you an excellent return after 10 years and your premiums are invested to achieve this. You should appreciate that if the Plan is surrendered in the early years of that period, the return is unlikely to match the premiums you have already paid.

The bonuses

All profits distributed by are shared among the with profit policyholders *in the form of* bonuses and under are added to the Guaranteed Minimum Sum. However, as future bonuses depend on profits yet to be earned, **they cannot be guaranteed.** Terminal bonus is allocated only at the end of the policy term and reflects conditions then applying; hence the rate may be reduced or increased at any time. It is currently calculated as a percentage of all ordinary bonuses and the rate shown overleaf applies only on the maturity of the policy.

The Terminal Bonuses currently being paid result mainly from the high rates of investment return achieved in the past in periods when inflation was significantly higher than at present. If lower interest rates associated with lower rates of capital growth apply over the next few years, then such levels of Terminal Bonus are unlikely to be maintained. However, if correspondingly lower rates of inflation apply then this will be reflected in the real value of the total benefits paid to policyholders.

See page 6 of the booklet.

Benefits on death of the life assured

are detailed in the Moneymax 10 booklet.

The options

Option 1 – the 'Total Projected Return' is the projected cash available to you at the end of the first 10 years. If you wish you may leave it invested under Options 2 or 3.

Option 2 – allows you to extend the term of your Plan to run, if you wish, for the rest of your life and provide an 'income' monthly, quarterly or annually.

Option 3 – allows you to leave your capital growing in the Plan with tax-free Growth Bonuses.

Option 4 – allows you to extend your Plan and continue investing in your or ten years *more, provided* at least £2,000 of your Total Projected Return remains in the extended Plan will consider a further alteration to your Plan during the extended term to permit Options 2 or 3 to be exercised.

Option 5 – allows a new 10 or a 10 year endowment assurance with profits to be effected (if you are then under 55) subject to rates, terms and conditions in force at the end of 10 years but without proof of continued good health.

In addition, if you are under age 54 when your begins you may double your original investment by effecting a further Plan at the end of the 5th year or at the Plan anniversary immediately preceding your 55th birthday, if earlier.

Options 2, 3, 4 and 5 and the right to double your investment are available only if your is in full force at the option date.

Neither of the policies available under these *replacement and increasing options will themselves* contain these options and the right to replace or increase will be included in your only if your application *is accepted on first class terms* without restriction as to residence, occupation or other additional risks.

This illustration contains only a brief description of the options which are described in full in the policy document. A copy of this or the booklet (which contains a fuller description of the options) will be supplied on request.

For technical reasons the policy proceeds will be expressed to be payable on the DAY FOLLOWING THE TENTH POLICY ANNIVERSARY.

M 31

EXHIBIT 3

Buy-out Illustration for Ms Catherine Riley

a married woman aged 28 next birthday

RETIREMENT BENEFIT
A transfer value of £10000.00 paid by the 26th. August 1985 could provide a cash sum at pension age (60) of £719741.89.

BONUSES

This cash is made up of a guaranteed sum of	£117753.06	
plus annual bonuses	£314636.29)	see
plus special bonuses	£187021.24)	note
plus terminal bonus	£100331.30)	1
	£719741.89	

USING THE CASH SUM
If the cash sum is used to buy pension from GRE (the Guaranteed Minimum Pension - GMP - must be bought from GRE anyway) not only will up-to-date terms be used, but a further bonus of 2.5% will be added.

For illustration, on today's terms the above cash sum would buy a pension of £39132.25 p.a. (including the GMP of £273.00 p.a.) plus a widower's pension of £9783.06 p.a.

The policy will guarantee that, whatever happens, a pension of £3584.30 p.a. plus a widower's pension of £896.06 p.a. can be obtained. This ignores bonuses completely.

PAYMENT OF PENSION
Pensions will be paid half-yearly and will increase each year by 8.5%. These increases will not, however, apply to the member's GMP.

The member's pension will continue until she dies. If this happens before 5 years' payments of her pension have been made the discounted value of the instalments for the rest of that period will be paid as one lump sum.

DEATH BEFORE PENSION AGE
Should the member's death occur before pension age GRE will pay a widower's pension of £1075.28 p.a. . . also a lump sum of £10000.00 with compound interest at 2.5% p.a.

FURTHER DETAILS
The age of the member's husband when she reaches pension age has been taken as 48.

The terms of this illustration may be altered if the member is not in good health at the outset. Please also read the notes attached.

NOTES

1. Bonuses
   If bonuses are illustrated, part or all of the benefits will participate in the profits of Life Fund.

   Future rates of bonus depend on the level of future profits and therefore cannot be guaranteed. They are added to with-profit benefits as follows.

   An annual bonus is declared each year. The annual bonus figure illustrated will be achieved unless future profitability is materially reduced as a result of lower investment earnings or other adverse experience. The latest declared rate is 8.35% of the basic with-profit benefit.

   A special bonus is declared as a percentage of attaching bonuses in years of high investment earnings and generally favourable experience. declared special bonuses of 10% in 1978, 10% in 1981, 15% in 1982 and 7½% in 1983.

   Once declared, annual and special bonuses cannot be cancelled or reduced.

   A terminal bonus is currently added at the rate of 30% of bonuses attaching when the member reaches pension age. This bonus is designed to ensure that each member receives an equitable share of profits including capital appreciation. The rate is liable to fluctuate.

   The figures illustrated are based on the latest declared rate of annual bonus, a special bonus every fifth year at an assumed rate of 15% of attaching bonuses and a terminal bonus at a rate of 20%.

   If the policy provides an increasing pension (see 3 below) but the increases do not apply to the GMP, then bonus pension added to the GMP will not increase either. However, at pension age the total pension can start at a lower level, and then *all* the pension excluding the GMP will increase. This adjustment has been made in the illustration so that it can be compared with benefits in the transferring scheme.

2. Using the Cash Sum
   If the pension has a cash equivalent, any cash not required to buy a Guaranteed Minimum Pension may be used as follows (but see note 4).

   To provide a tax-free lump sum.

   To buy a pension from or from any other suitable insurance company.

   To produce a different type of pension from that provided by the transferring scheme.

   The illustration on today's terms cannot be guaranteed. Financial conditions will vary from time to time, so the terms available on retirement may be better or worse than those illustrated.

3. Payment of Pension
   The first instalment of the member's pension will fall due when he reaches pension age. If the member dies before his pension has started, the first instalment of any widow(er)'s pension will be payable immediately. Otherwise, it will fall due when the next instalment of the member's pension would have been payable.

   Any pension increases shown in the illustration will take place on each anniversary of the commencement of pension payments. If the rate of increase exceeds 3% the increase in any year may need to be limited if the total of these increases is not justified by the rise in the cost of living since the pension commenced.

4. Limits
   The amounts of lump sum and pension benefits are subject to conditions laid down by the Inland Revenue.

   The extent to which the type of pension may be altered at pension age will depend on how the scheme rules were drawn up and what the Inland Revenue would allow. The limitations will be described in the policy.

5. Guaranteed Minimum Pension
   If the policy includes a guaranteed minimum pension (GMP), it will show the amount when contracted-out service ended. This amount will be revalued as time goes on. The illustration shows the maximum figure to which it will have grown by the time the member reaches state pensionable age. If a male member dies the GMP for his widow is half the amount to which his own has grown.

EXHIBIT 4

Self-Employed Pensions.

Invest £600 a year and retire with £129,791 tax-free and £43,263 a year for life.*

If you're self-employed there is no better way of saving tax and saving for your retirement than through a pension plan.

But which one?

Of course the past cannot guarantee the future. However, since 1977, Planned Savings magazine has surveyed pensions produced by regular premium with profits policies over 10 years and 20 years.

In 16 tables, has been top in eight and second in four more, a record not approached by any other company.

For those who would prefer to have retirement benefit linked directly to funds invested in the U.K. and various other parts of the world we can offer attractive plans.

One reason we do so well is that we do not pay commission to brokers or other middlemen. So please approach us direct.

Just telephone 01-606 6611 or send this coupon FREEPOST.

*Figures for man aged 34 retiring at 65. Gross premium £1,000 p.a.; assuming tax at 40%, only £600 p.a. net outlay.

Figures also suppose that current immediate annuity rates apply at the time, and that our current bonus rates, including terminal bonus, are maintained throughout. Future bonuses depend on future profits and cannot be guaranteed.

EXHIBIT 5

13th January 1986

Illustration for Flexible Mortgage Plan (Unit Linked basis)
Designed to repay a mortgage of £25,000
at the end of its term of 25 years

Male life aged 30 next birthday.

A. BENEFITS ON SURVIVAL OF THE TERM

	Assumed rate of growth p.a. 7.50% £	10.00% £
Cash value of units	28,430	40,431
Amount required to repay mortgage	25,000	25,000
Balance cash remaining after the repayment of the mortgage	3,430	15,431

B. BENEFIT ON DEATH DURING THE TERM

	£
The guaranteed sum payable on death (or bid value of units if greater)	25,000

C. THE MONTHLY COST

	£
Premium payable to SUN LIFE	38.67

* The policy does not provide an unconditional guaranteed benefit at the end of the mortgage term. However, if the recommendations made at periodic Plan Reviews are fully complied with, Sun Life will guarantee that the cash available at the end of the term will not be less than the amount of the mortgage. Such recommendations could include an increase in the amount of future premiums payable after Plan Reviews. Full details of the Plan Reviews are available on request.

The illustration of the cash values has been made on the assumption that the Plan remains invested in the unit linked funds throughout the term. For the guarantee to apply, it will however, be necessary to switch into the With Profits Fund five years before the end of the term.

NOTES (Policy)

* For the purpose of this illustration it has been assumed that you are assurable at our ordinary rate of premium.

* This illustration has been made on the assumption that the life to be assured has not smoked cigarettes for the past 12 months and has no intention of doing so in the future.

* The offer price of Accumulation Units in the Managed Fund has increased at an average rate of 15.7% per annum compound from the date unit prices were first published (February 1977) until the end of December 1985.

Notes

DEATH BENEFIT

The sum payable on death will be the greater of the guaranteed death benefit and the bid value of the units as at the day following the date of notification of death. The amount of the guaranteed death benefit can be varied, within certain limits; for the purposes of this illustration, it has been assumed that its value remains constant at the amount shown.

CASH VALUES

The illustrations of the cash values have been prepared on the following assumptions:

(a) Level of benefits and premiums – that your Plan is maintained in full force for the level of gross premiums and guaranteed death benefit shown (see above), that no previous cash withdrawals have taken place and that no premiums are overdue when the Plan is to be cashed;

(b) Mortality – that rates of mortality currently assumed remain unaltered;

(c) Future growth in the value of units (unit-linked benefits only) – that the value of units increase at the rate(s) illustrated. Any increase in the value of units arises from future growth in the value of investments and income from these investments. No one can guarantee the future rate of growth; unit prices can grow at a faster or slower rate than the rates(s) illustrated and can go down as well as up;

(d) Future rates of bonus (with profits benefits only) – the accompanying illustration has been made on the assumption that our present rate of accumulation bonus and scale of terminal bonus payable on death are maintained throughout the duration of the assurance and that, when a Plan is cashed, the scale of terminal bonus now appropriate will then be applicable. (It is our current intention to pay, on encashment after ten or more years in force, a terminal bonus at one-half of the rate applicable on death.) The current rate of accumulation bonus reflects the investment returns obtained in recent years when high interest levels have been associated with high rates of inflation. Lower rates of inflation would normally imply lower interest levels and in these conditions the rate of accumulation bonus could be reduced. The rates of terminal bonus are influenced by financial conditions at the time when a claim arises and can be expected to fluctuate.

NO GUARANTEE OF FUTURE BONUS RATES CAN BE GIVEN AS THESE WILL DEPEND UPON PROFITS YET TO BE EARNED.

COST-OF-LIVING INCREASES

This illustration shows potential benefits based on the levels of premium shown, and does not include benefits derived from any cost-of-living increase options which may be taken up in the future, nor does it allow for the effect of inflation on the monthly administration charge whilst such options are available.

FURTHER DETAILS OF ALL ASPECTS OF THIS CONTRACT ARE CONTAINED IN THE PROSPECTUS.

EXHIBIT 6

A PLAN FOR YOU

Age 65

ient Bond

THE BENEFITS

Investmen in unit-linked funds is firmly established as an outstandingly effective method of accumulating capital. Life was a pioneer in this field in the sixties and ever since has consistently been a market leader in performance and stability

The Investment Bond is a whole life insurance plan which is invested in the unit-linked funds you select. It combines the flexibility of being able to cash the Bond at any time with the security of life insurance. In the event of death, the greater of the original investment or the accumulated fund is payable. Example fund values at the growth rates indicated are shown below

Compound Growth Rate	Net Monthly Income	Total Income	Fund Remaining
Accumulated fund after 10 years	£83-33	£10,000	£16,247
Accumulated fund after 15 years	£83-33	£15,000	£25,186
Accumulated fund after 20 years	£83-33	£20,000	£42,979

Your Investment: £10,000

*The annual compound growth rate shown is that achieved by our Managed Fund since January 1974.

Actual results of our funds may be higher or lower in the future. For financial planning purposes a conservative 7½ % p.a. growth should be assumed.

EXHIBIT 7

IPA WITH PROFITS
ILLUSTRATION PREPARED FOR CLIENTS OF
B. ROKER LTD.

EMPLOYER : ABC Ltd.

MEMBER : I.P. Alexander (20% Director)

Date: 26 November 1984
Valid Until: 26 December 1984

Male	
Date of Birth	04/04/1950
Selected Retirement Age	60
Date of Joining Service	01/07/1972

EARNINGS ASSUMED

Current	Final
£20000	£142005

assuming 8.5% p.a. increases

CONTRIBUTIONS

£3000.00 payable yearly for 26 years plus a Single Contribution of £5000.00.

PROJECTED RETIREMENT FUNDS are based on assumed future yields on the gross contributions allowing for the cost of death in service benefits. If the current levels of bonus rates are continued the equivalent annual yields on gross annual contributions up to age 60 are 12.0% (excl. terminal bonus) and 15% (incl. terminal bonus). Bonus rates and future yields are not guaranteed.

	Assuming future yields of		
	10% p.a.	12.5% p.a.	15% p.a.
	£	£	£
RETIREMENT FUND AT AGE 60	367984	573246	898856
Providing MEMBER'S INCOME p.a.	27569 (19%)	42953 (30%)	67358 (47%)
or JOINT LIFE INCOME p.a.	21939 (15%)	34183 (24%)	53605 (37%)
OR			
MAXIMUM TAX FREE CASH of (from all sources)	213007 (150%)	213007 (150%)	213007 (150%)
plus MEMBER'S INCOME p.a.	11604 (8%)	26989 (19%)	51393 (36%)
or JOINT LIFE INCOME p.a.	9233 (6%)	21477 (15%)	40900 (28%)

Individual Pension contracts vesting now with terms of 5, 10 and 13 years have achieved average annual yields of 15.2%, 14.9% and 14.3% respectively.

The bracketed figures represent percentages of assumed final earnings.

The illustrated incomes escalate at 8.5% p.a. and the joint life incomes reduce by 1/3 on the member's death. Current annuity rates have been assumed; these are not guaranteed.

This illustration should be read with the accompanying notes.

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EARNINGS ASSUMED

Current	Final
£20000	£142005

assuming 8.5% p.a. increases

DEATH IN SERVICE BENEFITS

Before age 60 a Sum Assured of £100000 PLUS The Accumulated Fund.

	Assuming future yields of 10% p.a. £	12.5% p.a. £	15% p.a. £
Total death benefit after 8 years	147158	153684	161097
after 16 years	235544	276433	330336

ANALYSIS OF CONTRIBUTIONS

£3000.00 payable yearly for 26 years plus a Single Contribution of £5000.00.

	GROSS £	TAX RELIEF £	NET £	AMOUNT INVESTED £
EMPLOYER	2000.00	@50% 1000.00	1000.00	
MEMBER	1000.00	@30% 300.00	700.00	
TOTAL YEARLY	3000.00	1300.00	1700.00	3129.00
SINGLE	5000.00	@50% 2500.00	2500.00	5000.00

TOTAL NET OUTLAY to Selected Retirement Age £46700.00

This illustration should be read with the accompanying notes.

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EXHIBIT 8

Send your child to public school for only 34% of the fees

You could hardly give your child a better start than by looking tc

Because our new School Fee Trust Plans make providing for your child's education realistic.

For example, eight annual premiums totalling £16,667 could, at the end of that period, provide £50,301 worth of school fees* over the following ten years

That's a saving to you of 66%.

You'll find that a plan with us is as flexible as you want it to be, with 3 different methods of payment to choose from.

So, if you'd like further details about the scheme that makes a private education possible just telephone 01-606 6611 or send this coupon FREEPOST

*If current annuity rates and current bonus levels [illegible] are maintained throughout. Future bonuses depend on future profits and cannot be guaranteed.

Recommended by National [illegible]

To: The FREEPOST, 4 Coleman Street, London [illegible]
I'd welcome further details on your school fee plans. [illegible]
☐ A capital sum ☐ Spreading the cost over a period.

Name (Mr/Mrs/Miss)

Add

Postcode

Date of Birth

Tel. (Office)

Tel. (Home)

Founded 1762

SKD 8D

APPENDIX 3

THE UNITISED WITH PROFITS FUND

A. Reversionary Bonus System

Consider a typical 10 year with profits endowment assurance for an annual premium of £110 securing a sum assured of £1000. Let us assume that the current rate of reversionary bonus is £4.50% compound and terminal bonus 50% of attaching bonus.

At the end of the first year, one premium of £110 having been paid, a bonus of £45 is added to the sum assured. The surrender value on the other hand is nil because the office has to recover initial commission of around £30 and initial expenses of around £100.

From the client's point of view the reversionary bonus suffers from being inexplicable jargon. It merely shows the build up of benefit he cannot obtain except on death or maturity. It gives him no insight into how the value of his policy builds up.

From the actuary's point of view it suffers from the disadvantage that bonuses are of an annual premium nature. In the early years he is granting a much higher bonus than is being earned by the policy. At a time when bonus rates are unsupportable generally, this is a serious strain.

On certain group pension contract the irregularity of size and unpredictability of the timing of premium payment has led to the development of single premium reversionary bonuses. This eliminates the train of annual premium bonuses but the lack of user friendliness remains.

B. Deposit Administration

A further variation was the development of Deposit Administration Plans. Here, instead of focussing on a guaranteed minimum sum at maturity, a build up of Account basis is adopted. The bonuses are single premium bonuses and technically it is very similar to a single premium reversionary bonus contract. The technique is described in a paper by one of the authors (5) - Alternative Two is the relevant example.

C. Unitised With Profits Fund

If we forget for the moment the expression "unitised", the With Profits Fund is essentially a Deposit Administration vehicle. The premium income less charges is invested in an Account created in respect of the policy. This Account forms part of a notional Fund. Bonuses are added to the Account periodically - some companies grant a minimum yield and top it up with a bonus, others give no minimum guarantee but declare a higher bonus.

All companies appear to reserve the right to treat different tranches of business differently, an essential precaution against widely fluctuating yields, and variable premium input. However, their intention in the main is to keep the annual, or accumulation bonus uniform across all tranches, in so far as possible and use the terminal bonus as the instrument of justice.

The attraction to the client is that the build up of an Account is a concept that he can readily understand. With the modern flexible contracts, where benefits are charged to the client on a risk premium basis, it is essential to have an Account so that the client may see what is going on. By making the plan unitised it is also possible to introduce it as another Fund to sit alongside a range of unitlinked Funds to give the client a wide range of investment choice.

In practice all that unitising means is that the with profits product wears an outer garment of unit linking. Instead of saying that 95% of each premium will be credited to the Account, we say that 100% will be invested in the With Profits Fund at offer price, there being a 5% bid offer spread. Some companies keep the unit price constant and declare bonuses in the form of additional units; others increase the unit price to reflect bonuses. It is entirely a question of which of the two is more convenient.

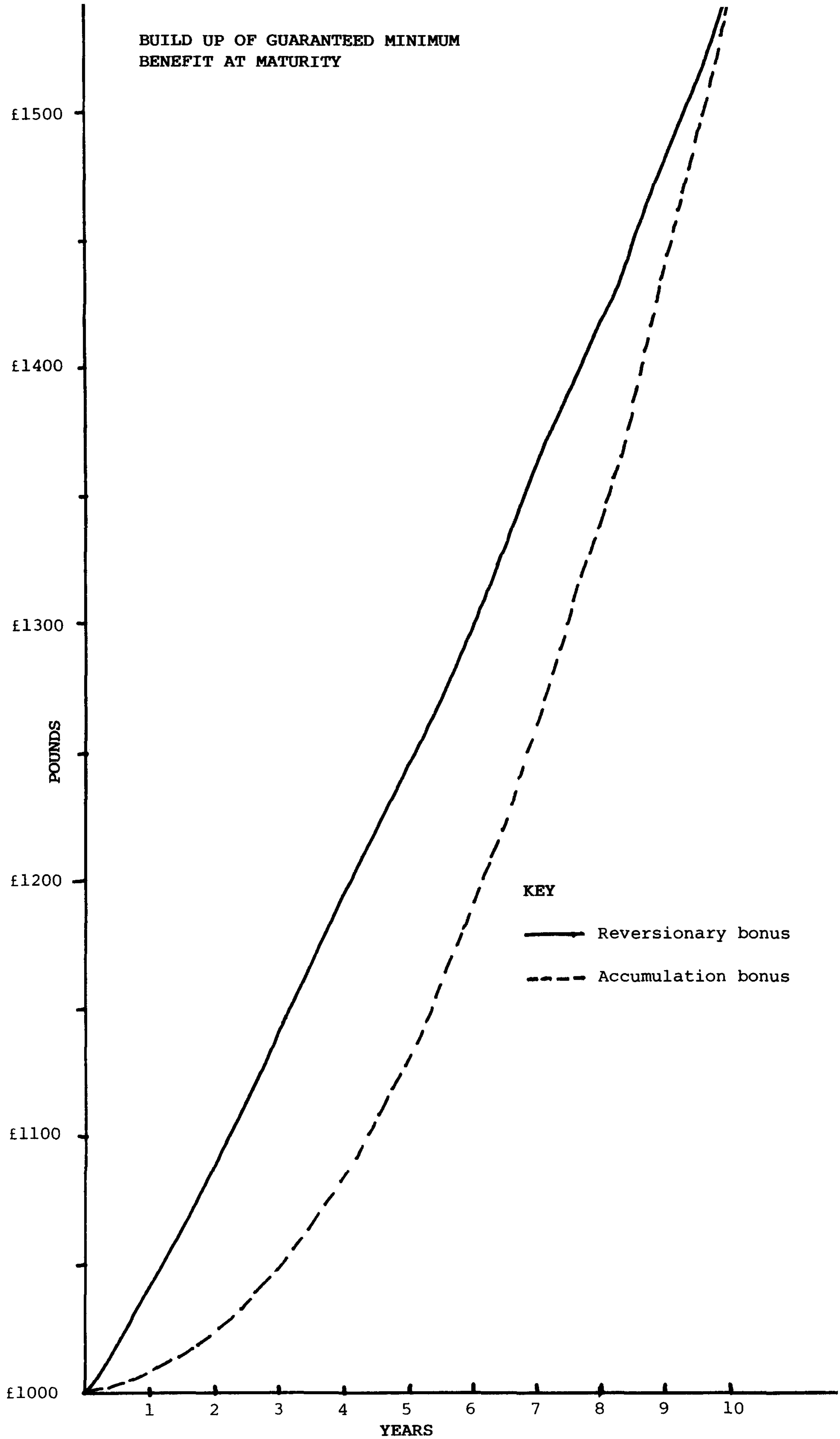
From the actuary's point of view, the attraction is that of single premium bonuses. The graph on the next page compares on both bases a 10 year endowment with a net premium of £100. A reversionary bonus of £4.50% will give a maturity value of £1552. On a With Profits Fund basis, with single premium bonuses credited to the accumulated fund, a bonus rate of £7.85% is required to arrive at the maturity value. The graph shows the year by year progress of the actuary's commitment - on reversionary bonus, the sum assured plus bonuses declared to date; on the With Profits Fund, the accumulated fund plus future net premiums.

It can be seen that right up to maturity, the With Profits Fund is always less onerous. This gives the actuary greater flexibility and the investment manager greater flexibility, to the greater benefit of all.

There is of course a snag. The price of greater investment flexibility is that in certain circumstances, the underlying market value of the assets could be lower than the total face value of the Fund. In such cases it will be necessary to apply a 'market value adjuster' to the Fund, on optional withdrawals.

This is not a popular feature but a necessary one. If it is to be used only sparingly the investment policy will need to take that into account; if it is used fairly frequently, a much more flexible policy can be followed. Each company will have its own policy.

The terminal bonus should, in our opinion be the first line of defence.


BUILD UP OF GUARANTEED MINIMUM
BENEFIT AT MATURITY
£1500
£1400
£1300
£1200
£1100
£1000
POUNDS
1
2
3
4
5
6
7
8
9
10
YEARS
KEY
Reversionary bonus
Accumulation bonus

PROMISES PROMISES - EXHIBIT 9

ASSUMED GROWTH			10%		10%	12.5%		12.5%	15%		15%	17.5%		17.5%	20%		20%
	TERM	SUM ASSURED	EARLY RE-PAYMENT		CASH	EARLY RE-PAYMENT		CASH	EARLY RE-PAYMENT		CASH	EARLY RE-PAYMENT		CASH	EARLY RE-PAYMENT		CASH
			Yrs.	Mths.		Yrs.	Mths.		Yrs.	Mths.		Yrs.	Mths.		Yrs.	Mths.	
HOMEBUILDER	10	£10,000	9	3	1354	8	7	2907	8	1	4688	7	7	6730	7	2	9068
	15	"	13	7	2198	12	5	4940	11	6	8364	10	9	12637	10	1	17966
	20	"	17	8	3207	15	11	7572	14	7	13535	13	6	21678	12	7	32789
	25	"	21	8	4386	19	4	10935	17	6	20755	16	1	35477	14	11	57535
JOINT HOMEBUILDER	10	£10,000	9	2	1361	8	7	2923	8	1	4715	7	7	6771	7	2	9126
	15	"	13	6	2204	12	5	4940	11	6	8397	10	9	12693	10	1	18053
	20	"	17	8	3213	15	11	7591	14	7	13574	13	6	21749	12	7	32910
	25	"	21	8	4319	19	4	10954	17	6	20798	16	1	35563	14	11	57695
HOMEBUILDER PLUS	10	£10,000	8	5	2890	7	11	4665	7	5	6701	7	1	9037	6	8	11713
	15	"	12	2	4826	11	2	8172	10	5	12354	9	8	17577	9	2	24095
	20	"	15	6	7288	14	1	13024	12	11	20859	12	1	31565	11	4	46185
	25	"	18	8	10403	16	9	19705	15	4	33663	14	2	54603	13	2	85995
JOINT HOMEBUILDER PLUS	10	£10,000	8	5	2907	7	11	4694	7	5	6746	7	0	9102	6	8	11802
	15	"	12	2	4846	11	2	8172	10	5	12413	9	8	17577	9	1	24234
	20	"	15	6	7313	14	1	13065	12	11	20934	12	1	31693	11	3	46394
	25	"	18	7	10419	16	9	19749	15	3	33752	14	2	54770	13	2	86297
HOMEBUILDER PLUS (LOW START)	10	£10,000	8	9	2555	8	3	4105	7	11	5865	7	6	7864	7	2	10135
	15	"	12	6	4348	11	10	7317	11	6	10965	10	4	15462	9	9	21005
	20	"	15	11	6685	14	7	11837	13	6	18755	12	8	28065	12	0	40598
	25	"	19	1	9641	17	3	18101	15	11	30546	14	9	48917	13	10	76043
JOINT HOMEBUILDER PLUS (LOW START)	10	£10,000	8	9	2569	8	3	4128	7	10	5899	7	6	7913	7	2	10203
	15	"	12	6	4365	11	10	7317	11	1	11007	10	4	15462	9	9	21102
	20	"	15	11	6694	14	7	11865	13	6	18805	12	8	28151	12	0	40738
	25	"	19	1	9654	17	3	18129	15	10	30603	14	9	49026	13	10	76239