With-profits transformation: Improving stakeholder outcomes through simplification

Trevor Fannin, Willis Towers Watson
Brian Murray, Royal London

Agenda

What is with-profits transformation?
What are the benefits to stakeholders?
Why now?
Case studies
- Case study 1: Conversion WP to NP
- Case study 2: GIR compromise
- Case study 3: GAR compromise
- Case study 4: Conversion WP to UWP/UL/NP

Summary of options

Disclaimer: Our comments and interpretations are based on implementation for life contracts; P&C and reinsurance contracts may differ. Comments should not be taken as advice, which will depend on the circumstances of the individual contracts or organisations. The views expressed are those of the authors.
A recap: with-profits issues

Contracting market
- Reducing new business sales
- Closed funds/run-off
- Consolidation
- Actuaries that understand the intricacies of with-profits

Nature of contracts has changed
- Guarantees
- Optionality
- Not understood by policyholders
- Fairness

Governance /costs
- Increased PRA/FCA requirements over recent years
- Management of with-profits business getting more onerous rather than less
- Capital

What is with-profits transformation?

With-profits outsourcing
GIR / GAR compromise
Convert to UWP

Current Position
Expense agreement
Communications exercise
Merge WP funds
Convert to UL/NP
Simplification is in all key stakeholders’ interests

**Shareholders/Members**
- Aligned interests in reducing opacity
- Aligned interests in simplifying TCF thereby reducing the potential for conflict between the company and the FCA/PRA

**Policyholders**
- Aligned interests in meeting TCF, although conflicts may exist between different groups of policyholders

**PRA/FCA**

Why a number of companies are considering simplification at the moment

1. Looming problems with shrinking funds and rising fixed costs mean simplification is a strategic imperative
2. Low interest rates mean policyholders are seeking alternative sources of return
3. Synergies available across projects
4. Likely more sympathetic response from regulator, given (1) and (2)

These factors present the industry with a window of opportunity
Potential with-profits transformation options

1. With-Profits outsourcing
2. GIR/ GAR compromise
3. Convert to UWP

Current Position  Expense agreement  Communications exercise  Merge WP funds  Convert to UL / NP

Case Study 1: conversion WP to NP

What is involved?
- Discretionary payments sacrificed for fully guaranteed benefits
- Policyholders compensated for loss of future upside-potential
- Compensation funded from previous capital support costs
- Shareholders may also contribute part of burn-through cost

How?
- Via Court Scheme – either scheme of transfer (Part VII of Financial Services and Markets Act 2000) or scheme of arrangement (Part 26 of Companies Act 2006)
- Often built in to Court Schemes (e.g. demutualisations) as a wind up provision when the fund reduces to a certain size
Case Study 1: conversion WP to NP

Part VII (Alico → Windsor Life); as part of transfer convert all WP to NP

Shareholder benefits:
- Reduced level of governance / cost
- Reduced level of administration

Policyholder benefits:
- Guaranteed benefit uplifts
- Participate in some expense savings

Characteristics of Alico WP fund:
- 90 / 10;
- closed;
- no inherited estate;
- Mix of guarantee business heavily in and out of the money

Asset-liability profile:
- pillar 1 liabilities = £70 million (regulatory peak)
- assets primarily invested in corporate bonds (EBR = 15%)

Approach

Determine pre-conversion RBS liabilities
Determine future bonus rates on central estimate assumptions
Uplift benefits to allow for expense savings
Value post-conversion liabilities
Final analysis to ensure policyholders not materially disadvantaged

Considerations:
- Risk Premium to use in central estimate assumptions
- Setting bonus rates for whole of life business
- Smoothing approach
- Fair allocation of expense savings
- Treatment of surrenders
Case Study 2: communications exercise

**Problem**

- Significant optionality in guarantees for pension policyholders
- Capital requirements
- Very difficult to hedge
- Also limited freedom for policyholders

**Solution**

- Apply a technique used successfully as part of de-risking exercises by defined benefits pension schemes
- Encourage (pension) policyholders to take benefits either through early retirement or transfer
- Reduces policyholder optionality
- Lower costs - no need for a court scheme

Strong communication plan key to achieve the maximum take up rate and to avoid anti-selection and potential mis-selling risks

Case study 2: GIR compromise

Positive for GIR policyholders

Positive for remaining policyholders or shareholders

<table>
<thead>
<tr>
<th>ETV take-up rate</th>
<th>5%</th>
<th>10%</th>
<th>15%</th>
<th>20%</th>
<th>25%</th>
<th>30%</th>
<th>35%</th>
<th>40%</th>
</tr>
</thead>
<tbody>
<tr>
<td>10%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>20%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>30%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>40%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>50%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>60%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>70%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>80%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>90%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>100%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Change in Own Funds following ETV exercise as a % of pre-ETV BEL
Case Study 3: considerations for a GAR compromise

Positive for GAR policyholders
• More flexibility
• Supports pensions freedoms
• Drawdown
• Cash Lump Sums
• More of it tax free
• Crystallise benefit when it’s valuable
• Give an option to keep their GAR

Positive for WP policyholders
• Release capital
• Reduce longevity risk
• Reduce interest rate risk
• Reduce take-up risk
• Achieve fairer, more stable distribution of estate
• Pave the way for further simplification

Case Study 4: before and after

Royal London case study
What it looks like from the firm’s perspective:

Before

After (in an ideal world)
Case Study 4: carrying out a feasibility study – a two staged approach

Royal London case study

**Phase 1**
High level feasibility assessment of a proposal to convert with-profits business to unit-linked and merge funds.

**Phase 2**
Assuming that Phase 1 produces a proposal that appears to have a high chance of success, Phase 2 would build a more detailed business case that could be put to the Board for approval.

We now have Board approval to proceed

---

Case Study 4: before and after

Royal London case study
What it looks like from the firm’s perspective:

**Before**
- CIS IB&OB
- RL Main
- SL

**After**
(in an ideal world)
- RL Main
Summary of simplification options

- With-Profits outsourcing
- GIR/ GAR compromise
- Convert to UWP

Current Position  Expense agreement  Communications exercise  Merge WP funds  Convert to UL / NP

Ease of legal implementation/cost
Tax complications
Level of simplification
Extent of precedents

Individual policy/fund characteristics will drive TCF & the overall attractiveness of different options

Key takeaways

- Potential policyholder and commercial benefits are significant
- Large project – begin with a feasibility study
- All with-profits funds should consider taking action
- A window of opportunity to achieve maximum benefits
Contact points

Trevor Fannin  
Director  
Willis Towers Watson  
Watson House  
London Road  
Reigate  
RH2 9PQ

T + 44 (0)1737 274640  
M + 44 (0)7802 957581

trevor.fannin@willistowerswatson.com

Brian Murray  
With-Profits Actuary  
Royal London  
St Andrew House  
1 Thistle Street  
Edinburgh  
EH2 1DG

T + 44 (0)131 456 7454

Brian.Murray@royallondon.com

Questions

The views expressed in this [publication/presentation] are those of invited contributors and not necessarily those of the IFoA. The IFoA do not endorse any of the views stated, nor any claims or representations made in this [publication/presentation] and accept no responsibility or liability to any person for loss or damage suffered as a consequence of their placing reliance upon any view, claim or representation made in this [publication/presentation].

The information and expressions of opinion contained in this publication are not intended to be a comprehensive study, nor to provide actuarial advice or advice of any nature and should not be treated as a substitute for specific advice concerning individual situations. On no account may any part of this [publication/presentation] be reproduced without the written permission of the IFoA [or authors, in the case of non-IFoA research].

Comments