Unlocking Customer Value:
Reflections of the WPA and Independent Actuary on a GAR compromise scheme

Andrew Valentine (Royal London)
Brian Murray (Royal London)
Paul Coulthard (Deloitte)

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Overview - The Royal London GAR Scheme

• Part 26 Scheme of Arrangement

• 33,000 Guaranteed Annuity Rate (GAR) pensions plans in Scottish Life Fund

• Opportunity to exchange
  – valuable (but inflexible) GAR for ...
  – ... actuarially equivalent cash value

• Two year process over 2017/18

• Sanctioned by the High Court on 12 November
Context - Schemes of Arrangement

- Effective tool for restructuring and simplifying LifeCos
- Only a handful completed to date
- Gaining in popularity
  - as firms move beyond immediate demands of SII embedding and IMAP
- Non trivial process!
  - lots of challenges
This Presentation - Aims

• Explains why we undertook the Scheme (and dismissed the alternatives)
• The various stages of the process
• How we interacted with the Independent Actuary
• What we learned – and the things we’ll do differently next time!
• The thoughts of the IA and WPA
Contents

1. Motivations - Why a Scheme?
2. RL GAR Scheme Process
3. Fairness - WPA Perspective
4. Fairness - IA Perspective
5. Q&A
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Statement of the Problem (Part 1)

GARs are very valuable

- Typically they double the annuity purchasing power
- BUT… The majority of customers don’t exercise them

<table>
<thead>
<tr>
<th>Customer Choice</th>
<th>Proportion by Value</th>
<th>Proportion by Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>0% Cash</td>
<td>24%</td>
<td>14%</td>
</tr>
<tr>
<td>25% Cash</td>
<td>45%</td>
<td>25%</td>
</tr>
<tr>
<td>100% Cash</td>
<td>28%</td>
<td>60%</td>
</tr>
<tr>
<td>Other</td>
<td>3%</td>
<td>1%</td>
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Statement of the Problem (Part 2)

GARs tie up capital

- Mainly longevity & GAR take-up risks that are difficult to hedge
- This hampers a fair distribution of the estate to WP policyholders
Contents

1. Motivations - Why a Scheme?
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4. Fairness - IA Perspective
5. Q&A
Scheme of Arrangement - Typical Timeline

Stage 1: Design
- Q1: Legal DD
- Q2: Actuarial Design

Stage 2: Documentation
- Q3: IA Review
- Q4: Draft Actuarial Reports

Stage 3: Regulatory Review
- Q5: Draft Legal Scheme
- Q6: Draft Policyholder Comms

Stage 4: Execution & Voting
- Q7: Appetite Mailing
- Q8: Convening Hearing

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Stage 1: Design

• Early consideration - key questions:
  – Actuarial - do the numbers stack up? Can we fund an offer fairly?
  – Legal - any blockers/constraints, e.g. existing T&Cs, instruments of transfer?

• Process
  – Workshop sessions - actuaries, lawyers (internal and external)
  – Full legal due diligence
  – Actuarial modelling
  – Consider own view of fairness and fairness criteria

• Iterative process - work toward draft design
Actuarial - Crafting an Offer

- Two key stakeholder groups – need to balance interests
  - GAR policyholders
  - Wider WP policyholders
- Starting Point – set offer equal to GAR reserve, but:
  - GAR reserve assumes GAR TUR (materially) less than 75%
  - Offer at this level unattractive to majority who take 25% TFC/75% GAR
  - Need to increase GAR TUR to 75% ideally but gives funding challenge
- How to fund?
  - ‘Gap’ funded from release of SCR (top-up to offer)
  - Remainder falls to WP policyholders
  - Is it enough?
    - In our case yes – gave material increase in estate distributions (roughly doubled)
- Both stakeholder groups satisfied – “win-win”
Actuarial - Challenges

• Anti-selective opt outs - dilutes scheme capital benefit, imposes maximum tolerable opt out rate
  – We needed less than 30-35% opt outs

• Valuation of GAR heavily dependent on discount rates. Which basis to use?
  – valuation basis
  – market pricing basis

• Granularity of offer uplifts – balance simplicity vs avoiding excessive cross-subsidies
  – ultimately settled on split by contract, gender and age
Legal Challenges

• Voting classes
  – typical and preferable to have a single class - avoids 'veto risk'
  – “persons whose rights are not so dissimilar as to make it impossible for them to consult with a view to their common interest.” (Sovereign Life Assurance Company v Dodd [1892]).

• Gender Directive
  – Offer used gender-specific mortality assumptions (per GAR rates themselves)
  – Policies pre-dated Gender Directive (2012) so believed to be OK
  – Later challenged in court - but agreed that conversion under scheme did not constitute a new contract or review - so not caught by legislation

• Deed poll
  – Some cases written under trust
  – Exercise deed poll to allow individuals to vote on a 1:1 basis
  – Common approach – not generally viewed as contentious
Stage 2: Documentation

- **Legal Documents**
  - Scheme document
  - Circular - contains formal legal notices, serves as guide to scheme

- **Actuarial Reports**
  - Independent Actuary
  - With Profits Actuary
  - Chief Actuary

- **Policyholder Communications**
  - Formal offer pack
  - Also interim 'appetite mailing'
Formal Offer Pack

Contents

• Cover Letter
• Scheme
• Circular
• Personalised Illustration
• Decision Form

Challenges

• Customer friendly vs compliant
  – customer testing employed
• Multiple variants
  – LTA, trustee, safeguarded benefits etc
• Review process
  – highly iterative
  – multiple, conflicting feedback
  – version control
• Personalised Illustration
  – COB compliance
  – waivers sought
Stage 3: Regulatory Review

• FCA led (PRA kept informed)
• Engaged informally with FCA for ~6 months
• Then submitted all court (convening) documentation for formal review
  – Scheme
  – Actuarial reports (IA, WPA, Chief Actuary)
  – Guidance/Advice documentation
  – Policyholder communications
• Process took ~6 months (vs 3 months anticipated)
• Very large volume of detailed feedback provided

• Key Areas of Focus
  – Scheme fairness
  – Waiver applications
  – Gone-aways
  – Guidance/Advice
  – Vulnerable Customers
Gone-Aways

• Started with 20% gone-aways
• Legal Requirement
  – Gone-aways default into scheme - but may or may not be their desire
  – must minimise number on 'best endeavours' basis
• FCA Requirement
  – find everyone!
  – anyone you can't trace must be given Retrospective Opt Out
• Extensive tracing programme
  – Capita, LexisNexis, DWP
  – Gone-aways reduced to ~10%
  – Remainder successfully traced and sent Circular
  – Only ~0.5% untraceable
Stage 4: Execution & Voting
Convening Hearing (June)

• One day hearing

• Focus on voting classes
  – Fairly constituted?
  – Correct number?

• Fairness issues reserved until later Sanction Hearing

• Main challenge was around Gender Directive

• FCA provided non-objection notice and court report. Attended as observers.

• Go-ahead given to proceed to scheme meeting
Formal Offer - Voting (July-October)

• Process
  – 3 month voting window – per “Code of Good Practice for Incentive Exercises”
  – Votes could be submitted online or by post (postal approx twice as popular)
  – Reminders issued mid-way through

• Response
  – Slow start initially
  – Reminder mailings important in driving returns
  – Late ‘surge’ in final weeks
  – Significant minority left it until very last minute
  – Opt out spike at very end – panic voting?
Guidance / Advice (1)

Overview
• We decided to offer free guidance and subsidised advice to policyholders throughout the ~3 month voting period

Why?
• Complex decision with material consequences
• Offer fair at an overall level
• But attractiveness of the offer for each individual depended on a number of factors
  – Preference for cash – e.g. those taking < 25% TFC may want to opt out
  – Health, e.g. those in very good health may opt-out; ill health opt in
  – Attitude to risk and desire for certainty of income
  – Desire to leave inheritance
Guidance / Advice (2)

Process Overview
- “Triage” approach

Guidance
- Conceptually similar to PensionsWise
- 45 minute telephone call
- Followed agreed script
- Not a personalised recommendation but free service

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Guidance / Advice (3)

Advice

• JLT appointed as scheme default adviser
  – Capacity
  – Qualifications (pension transfer permissions)
  – Track record

• Cost-effective approach
  – Bulk deal, telephone-based
  – Customers asked to pay nominal fee of £100
  – Waived for safeguarded benefit cases and vulnerable customers

• Own Advisers - customers could also use their own adviser if they wanted to / had one
  – Equivalent subsidy provided

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Guidance / Advice (4)

Key Learnings

• **Helpline** very popular (~6,000 calls; ~15% take-up)
  – Policyholders often had just one or two key questions
  – But then happy to get on and vote

• **Guidance** didn’t prove popular (~3% take-up; 30% assumed)
  – time and effort involved appeared to be a deterrent (45 minute conversation)
  – no personalised recommendation at end / unfamiliar concept?
  – though 95% who took it felt able to vote immediately (without requiring further advice)

• **Advice** was more popular (~5% take-up; 10% assumed)
  – People liked using their existing adviser where they had one
  – Take-up amongst safeguarded benefit cases was relatively high (~50%). JLT default well utilised
  – Those taking advice voted similarly to population as a whole
Scheme Meeting (October)

- Formal meeting of ‘creditors’ to discuss scheme
- 23 policyholders attended
- Led by Royal London’s Chairman
- Overview of scheme provided
- Q&A
  - panel of CFO, Chief Actuary, WPA, IA and Legal Advisers
  - Q&A session was lengthy and vibrant!
- Votes then cast
  - Chair casts as proxy for c 15,000 online/postal votes.
Voting Results

• Results
  – Response rate: 49% by count; 59% by value (far higher than expectations)
  – Opt out rate: 16% by count; 22% by value (needed < 30%)
  – Phoenix 2009 scheme comparator: response rate 33%, opt out 17%
  – Offer most popular with smaller pots; opt outs higher on larger pots
  – Vote result (excl. opt outs) – 98% in favour by count, 99% by value (comfortably in excess of 50% and 75% hurdles)

• “Second Chance” mailing
  – Wrote to 170 ‘against’ voters post-vote to check if they wished to change to an opt out
Sanction Hearing (November)

- Relatively short 1.5 hour hearing to sanction scheme
- FCA represented by counsel. Non-objection provided.
- Judge explored
  - underlying scheme requirements ("intelligent person" test, 'blots' on scheme etc)
  - approach to communications - demo of mailing pack in court
  - levels of customer engagement
  - objections/complaints - key themes and mitigations
  - protections in place, e.g. opt out, advice provision, uplift final recalculation mechanism
  - IA's views
  - FCA non-objection
Fairness from a WP policyholder perspective

Pre-Scheme – Capital Tied Up

• Not only is the shape of the distribution unappealing
• The risk in the fund makes it very uncertain
Fairness from a WP policyholder perspective

Post-Scheme – More certain future

- Part of the Inherited Estate forgone to make offer
- Future Estate distribution much more stable
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Background

• Independent Expert (Actuary) – statutory requirement for Part VII
• No equivalent requirement for Part 26 Schemes of Arrangement
  – But considered good practice
  – Precedent through previous SoAs
• Provides assessment of fairness of scheme
• Assessment centred around **Fairness Criteria**
• Report provided to Convening Hearing
  – Plus Supplementary Report for Sanction Hearing
• **Duty to court (not company)**
Considerations

• Purpose of Scheme

• Legal test: Scheme is one that an intelligent and honest person might approve
  – Not “no materially adverse impact”
  – Individuals for whom the compromise is not favourable due to individual circumstances

• Choice offered to planholders: opt-out or vote for / against

• Implications: vote / communications / gone-aways / retrospective opt-out / advice

• Uplift values – methodology / assumptions and calculation timing
## Fairness Criteria

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<th>Description</th>
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<td>Fair Value Test</td>
<td>The increase to policy values should be broadly consistent with the “economic value” (fair value) of the GAR being compromised.</td>
</tr>
<tr>
<td>Adverse Scenario Test</td>
<td>The extent to which policyholders could be materially worse off if they take the offer but financial conditions change (“capacity for regret”) should be limited.</td>
</tr>
<tr>
<td>Ongoing Feasibility Test</td>
<td>The reasonable benefit expectations of the non-GAR (with profits) policies should not be lower following the scheme.</td>
</tr>
<tr>
<td>Estate Value Test</td>
<td>Other funds (e.g. RL Main Fund) should not inadvertently receive any benefit from the Scheme.</td>
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