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Value of with-profits to consumers

Phase 1 report

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With-profits environment and existing research from a consumer perspective

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Title

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1. Introduction

1.1 Background

With-profits business is often viewed as being opaque, complex and not providing a clear and simple product to the customer. Common criticisms are that with-profits products lack the apparent simplicity and transparency of many of the financial products sold to consumers in the current day.

Consumers, on the other hand, in surveys, state that they want products with guarantees so that they get their money back (or a high proportion of their money). They also place value on smoothed returns which provide some level of "buffer" against stock market volatility, and where some form of regular addition is given which cannot then be taken away. This sounds quite a lot like the with-profits concept in essence.

From another standpoint, the consumer press sees with-profits products as being (not to mince words) a "rip off". Articles reflect the reductions in payouts and that the outturn for consumers is in some cases considerably less than may have been estimated at the start. Adding fuel to the flames of this argument is the performance of certain closed funds (which the press often refer to as "Zombie funds") and the mortgage-related endowment mis-selling.

In light of this, the Life Board thought it would be worthwhile testing the view of consumers on with-profits products now and whether the current communications and disclosure is meeting their needs. Is the documentation they receive clear and do consumers understand what they are getting? Further do they value the product compared with other options? Are there things the Life Industry should now be doing to encourage better understanding via clearer or different communications?

The specific objectives for the Working Party were thus to consider:

1. Do consumers understand the value of their with-profits policies and, in particular, is the value of inherent guarantees and potential for real asset growth recognised by consumers?
2. What is the consumer's perspective on the run-off of with-profits funds? Are consumers getting what they signed up for and do they understand the potential "end games" of the run-off of the fund?

To this the Working Party, during the course of its work, has added a further objective:

3. To make recommendations and proposals to aid consumer understanding of with-profits business.

1.2 Limitations of this Report

Please note that this Report is focused on whether the consumer UNDERSTANDS the inherent value of with profits contracts . This Working Party has not considered customer value outcomes and how these might be assessed quantitatively to conclude what is the value to consumers.

Much of the focus of the Report in Section 2 is concerned with investment performance and payouts. From a consumer value viewpoint, there is another aspect to with-profits which is the downside protection. No research has been performed to consider whether with-profits policies 'perform' versus this expectation of downside protection (for example how often do guarantees bite given customers are paying for them?). If they do bite, is access to ongoing investment performance still provided at the level of customer expectations?

These are perhaps topics for another Working Party!

1.3 Our approach

Our work has been split into two phases focussing on UK with-profits business:

- Phase 1 (covered by this report) – desk-based research
- Phase 2 – consumer survey with questions informed by the Phase 1 output

Our summary Phase 1 report was presented at the Current Issues in Life Assurance meeting in May 2017. This report represents the formal conclusion of Phase 1 summarising the findings of the Working Party's research and its initial recommendations and proposals . Phase 2 is now largely completed and we provided an initial report on the results and conclusions to be drawn from the consumer survey at the Life Conference in November 2017. A final report on Phase 2 will be produced in due course.

Three distinct aspects of consumers' interaction with with-profits business were investigated in Phase 1:

1. **The with-profits landscape:** the background and context for with-profits business today, the features, options and guarantees that they contain now and how this has evolved over recent years. This section also considered recent investment performance against comparable alternative products.

2. **With-profits research from the consumer perspective:** the available research**,** considering insights into consumer views of their with profits policies. Given the scarcity of the information available here, we turned to other sources, notably provider-based customer research which a number of insurance companies generously shared.

3. **With-profits consumer communications:** The way the insurance industry communicates the value of with-profits business to its consumers. This took the form of a review of over 30 different companies benefit statements and illustrations to assess the extent of standardisation, emerging best practice or innovative ideas for these complex communications.

These three aspects were looked at by a different sub-group of the Working Party so the views expressed in this paper are not necessarily the views of all members of the Working Party. The members of the Working Party are listed at the beginning of this paper.

1.4 Support received

We would like to offer our sincere thanks to all the companies who have helped the Working Party through the contribution of information, sample documents and consumer survey results of their own policyholders.

Our thanks also go to Willis Towers Watson for allowing us to make use of the data on with-profits fund performance that they have collected for many years and which may be of even greater value going forwards with the removal of the PRA return from 2017.

2. The with-profits landscape

2.1 Product Overview

With-profits products are pooled insurance and savings products typically sold by insurance companies or mutual societies. They give individual customers the chance to share in the benefits of a diversified portfolio of investments with these returns "smoothed" to reduce volatility and often with an underlying guarantee that the payout received when the benefits are taken at certain key events will not be lower than a defined amount.

With-profits customers also share in the profits from the operation of the company or fund, such as mortality experience being better than expected, or the expenses incurred in running the company being lower than expected.

These contracts are sometimes variations on other types of life assurance, giving the protection of a life assurance contract with the chance of higher returns from investment profits. With added downside protection (through minimum value guarantees), they are also a means of saving for retirement income, paying off interest-only mortgages or funding future school tuition fees. Original with-profits products were "conventional", with a guaranteed minimum sum assured set up at the beginning with bonuses added throughout the lifetime of the policy. It is generally agreed that it may have been difficult for customers to understand how the value of their policy changed over time, or what level of charges they were paying for the contract.

A summary of the key features of traditional with-profits products can be found in the 2010 briefing note, "With-Profits Policies" produced by the Actuarial Profession[1].

With-profits products were extremely popular through the 1980's and early 1990's, but sales fell dramatically from the late 1990's into the 2000's.[2]

Unitised with-profits offer a more transparent arrangement, where customers can see how many units they own, what the value of those units is and what charges are taken from their fund. However, similar to conventional WP products, there remains discretion with unitised products, relating to smoothing and the setting of bonus rates in particular.

Whilst unitised business has become the standard format for new business, there remained (and still remains) significant amounts of money invested in conventional with profits and therefore concerns about transparency of the operation of with profits funds persisted.

2.2 Regulatory Environment

In response to such concerns regarding transparency, the FSA implemented a new regulatory regime for the with-profits sector[3], with the overall objective of achieving greater protection of policyholders. As a result of this review, a number of documents became a regulatory requirement (including but not limited to the Principles and Practices of Financial Management ("PPFM") and a Consumer-Friendly version "CFPPFM"), though as the contents of these was heavily prescribed, there is still a danger that they are not well understood by customers on the whole.

[1] https://www.actuaries.org.uk/documents/briefing-note-profits-policies

[2] See for example: https://www.nottingham.ac.uk/business/businesscentres/crbfs/documents/cris-reports/cris-paper-2009-3a.pdf

[3] https://www.handbook.fca.org.uk/instrument/2003/2003_44.pdf

As well as these documents, a number of regulatory frameworks and disclosures were implemented, including, but not limited to:

- The realistic balance sheet – accounting for the volatility in future liability values
- Treating Customers Fairly – ensuring fair treatment of all customers
- Conduct of Business Sourcebook – a framework of standards and practices to be followed
- Annual reports to policyholders on the exercise of discretion
- Regulatory returns (sample payout values, investment returns etc)
- Annual statements and illustrations

Over time, a number of large providers of these contracts changed from being mutual companies (owned by their with-profits customers) to proprietary companies (owned by shareholders or another company). In so doing, they had to define which profits would be passed to customers in future, how and when this would be done and how customers would be compensated for the loss of any potential future profits they were no longer entitled to.

A number of large with-profits funds have also closed to new business, meaning the funds are in run-off. This could change the way the funds are administered as they should then be considering how to fairly run off the expected profits and avoid a "tontine" effect[4].

In 2016, the then regulator, the Financial Conduct Authority, removed requirements for a Consumer Friendly PPFM as it found that few consumers read or understood the document[5].

Also in 2016, the FCA published FG16/8, covering the fair treatment of legacy customers[6]. Amongst other issues, this sets out recommendations relating to the provision of policyholder communications throughout the lifecycle of the product. This included setting out expectations of the information that should be included on statements sent to legacy customers (including with-profits policyholders).

2.3 Negative Press

With-profits business has suffered from widespread criticism in the press for a number of years with practices and performance scrutinised for fairness and value for money:

"***Savers should plot their escape from zombie funds****" – The Times, 9 July 2016*

"Help! Why has my 'with profits' fund shrunk 11% in two years as stocks hit record highs?" *– Thisismoney.co.uk, 20 May 2015*

"Deal or No Deal – why deciding when to take 'with profits' benefits can be like playing the popular game show" – *Thisismoney.co.uk, 30 May 2015*

While performance may not have lived up to expectations set in original illustrations, have products delivered on their promises or have customers been locked in to high cost, poor quality investments? Could alternative products have delivered better outcomes for same or lower cost? In section 2.5 we address the performance of with-profits as a whole, and also consider what expectations customers may have.

[4] A tontine is, in simple terms, a scheme for life assurance in which the beneficiaries are those who survive and maintain a policy to the end of a given period
[5] https://www.fca.org.uk/publication/policy/ps16-23.pdf
[6] https://www.fca.org.uk/publications/finalised-guidance/fair-treatment-long-standing-customers-life-insurance-sector

2.4 Key features of with-profits

The key features of with-profits products do not differ widely between providers and have remained the same over many years, though how providers administer the funds may have changed. Key features include:

- Guaranteed minimum values –payable on a single specified date, or on a range of dates and give customers protection from poor investment returns
- Investment mix – providers define the level of investment risk for each product, and set the investment mix accordingly. Within this risk limit, funds look to achieve a diversified mix of holdings and maximise returns on those investments while retaining enough protection on the downside.
- Smoothing – The value of investments can suddenly change significantly, yet customers have bought these products to meet a specific purpose, and would not expect to see sudden large movements in the value of their policy. Smoothing is applied to try and even out sudden movements (both upside and down) to offer protection from sudden drops in value. This should be applied in a way that is neutral over the long term (i.e. smooth up as often as down).
- Charges / expenses – There are different charging structures which depend on the product – some are charged by a set annual management charge, others are charged a monetary amount based on the expenses of running the fund each year. Customers can also be charged a regular amount to pay for their guarantees.
- Surrender penalties / Market Value Reductions (MVR's) – these could be applied on all dates other than the original maturity date if customers look to take the current value of their policy. They can take the form of lower terminal bonus rates, explicit charges, reduced unit prices or factors acting to reduce terminal bonus rates, and would act to reduce the value compared to what they would get on their contractual date(s). These are applied to avoid customers leaving outwith their contractual terms with more than their fair share of the fund's assets in order to protect the interests of those customers staying in the fund. In addition, the impact of poor investment returns is passed on to the customer and there may be less smoothing protection offered on these claims.
- Bonuses – all funds have a defined mechanism to allocate profits to policy values, split between regular bonuses and terminal bonuses. The extent to which regular bonuses have been historically applied impacts on the terminal bonus paid. Once a regular bonus is declared, it increases the guaranteed minimum value of the policy and cannot be taken away (except on early surrender – see above). Funds which have historically applied large regular bonuses typically have less investment freedom (this is constrained by the need to back higher guarantees with less risky, lower return assets such as bonds) and thus less capacity to pay more through terminal bonuses. These policies would be more protected from sudden changes in value due to the high proportion of the payout being guaranteed, with a lower proportion being sensitive to market movements. Conversely, funds which have historically added smaller regular bonus may have more capacity to invest in higher risk/return assets, such as equities, and be able to declare larger terminal bonus, however this is sensitive to short term market movements, with less protection offered from the guarantees.
- Estate – this is a fund's excess assets over and above those liabilities expected to be incurred. Once funds stop writing new business, or new business volumes fall below a certain level, funds should look to define a mechanism to distribute these excess assets ('the estate') in a fair and reasonable manner. This is likely to be through additions to payout values, one-off cash payments, additional unit allocations, special bonuses or pre-funding future deductions for guarantees. The value of the estate depends on a number of factors, including:

- Age of the fund (e.g. older funds approaching run-off tend to have less prudence in future liabilities, whereas younger funds may look to retain the excess for protection).
- Whether a mutual or not, and whether there is shareholder/parent company support in place.
- Whether any distributions of the estate were made at demutualisation (i.e. some of the excess assets at that time were released as cash or shares in the new company).
- Past distribution practices.

Over time, similar non-profit unitised products and funds have increased in popularity, offering a similar chance to invest in a diverse range of assets, but without the added profits (and potential losses) from the operation of the fund, and (generally) without guaranteed minimum values and smoothing of payout values.

With-profits policies differ from unit-linked policies in two key ways:

- The value of the underlying asset pool does not immediately flow through to the policyholder; payouts under the policy are subject to discretion (see figure 1 below) applied by the provider and to product features such as guarantees, which are not present in pure unit linked policies.
- In addition to returns on the invested assets, with-profits policies may also receive a share of wider business profits (and losses). This can include profits from other with-profits policies, profits from non-profit business written in the same fund and subsidiaries. In addition, some funds may be paying distributions from their estate.

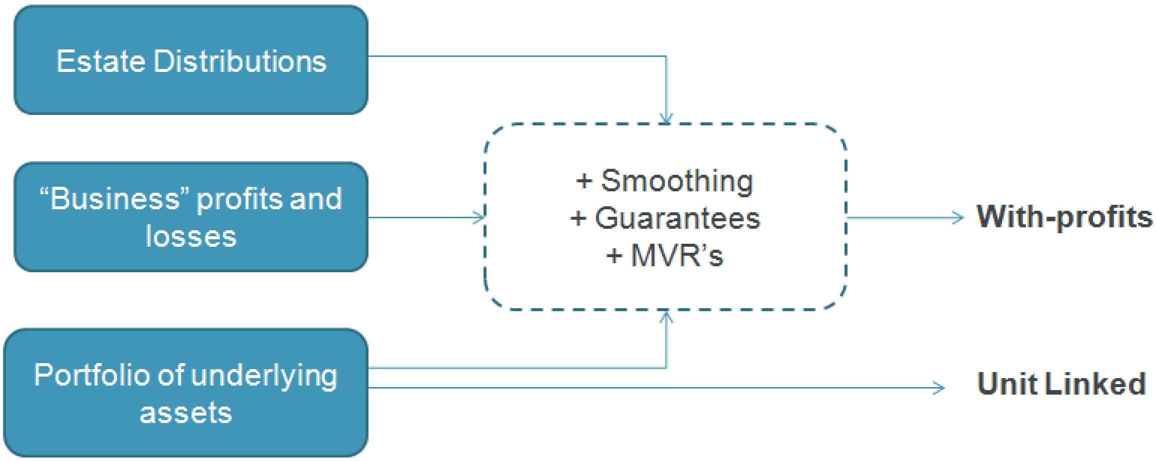

Figure 1: With-profits vs Unit Linked

The key features of with-profits policies can provide significant benefits to policyholders. However, the communication of these complex features is challenging because:

- Within any one fund there are additional, specific features that need to be communicated to policyholders. In particular, the underlying investment mix and bonus policies can vary widely by fund.
- Different providers will have different practices and methods of assessing value, distributing profits and calculating payouts.
- The relative importance of these features varies between funds so it is difficult to compare.
- Explaining to consumers the trade-off between the risk profile and potential rewards of the with-profits fund is difficult

- Consumers may not understand the cost of the downside protection particularly if that protection/guarantee is provided over a long duration
- There are different mechanisms and practices re MVRs and surrender penalties can be difficult for consumers to understand

This complexity can be managed in a number of ways and the onus is on providers to ensure their approach in terms of communication and their valuation and payout methodology lead to fair and transparent customer outcomes.

Typical approaches to achieving customer fairness include:

- Greater understanding of consumer needs including their appetite for risk and the likely duration of the product
- Stronger governance requirements within providers for with-profits policies to ensure that decisions are made in the best interests of with-profits policyholders.
- Stronger guidance around the advice process
- Analysing current and emerging cross subsidies to ensure no groups of policyholders are being treated unfairly compared to others.
- Clear communication with policyholders.

2.5 Performance of with-profits

A recent Willis Towers Watson survey[7] investigated the influence of a number of factors on with-profits payouts:

- Returns on the invested assets
- Charges and expenses
- Estate Distributions
- Impact of smoothing and guarantees
- “Other” factors

The clear conclusion drawn from this survey is that investment returns are, understandably, the biggest contributor to policy values. However, in low interest, low investment conditions, focus should be on returns *net of charges* – looking to maximise returns on investment but also to minimise the impact of charges and expenses – in order to deliver overall value for customers. While the same is true for other product types, such as unit-linked business, there is a tacit agreement that the provider will try to get the best outcomes for customers across all allowable asset classes, whereas unit-linked funds tend to operate across smaller ranges of assets and the investment choice is more in the policyholder’s control.

The survey highlights the sheer breadth of product offerings and performance, as well as investment mixes and provider/fund practices being considered under the “with-profits” umbrella. For all product, frequency and term combinations, there is a large range of payout values across providers. This is further evidenced by comparing the highest and lowest payout values from another survey, the annual Money Management survey[8], which shows that the payout on the top performing with-profits fund can be over three times that of the bottom with-profits fund[9].

[7] *With-Profits Expense and Pay-out Benchmarking Survey* – 14 November 2016
[8] *Money Management Personal Pensions Survey,* March 2016, values as at 1 March 2016
[9] Mixed investment, 40%-85% shares

The level of enhancements from the estate also varies quite significantly, both between providers and over time. It is unclear whether this is due to longer term policies receiving a greater share of the excess assets (in reward for longer participation) or simply by dint of having larger fund values, or a different methodology for distributing the estate. This also does not make reference to any past practices, such as shares/cash payments given to customers at demutualisation or previous special bonus payments made from the estate. Given the variability within this measure, and the histories and practices underlying it, there is extra onus on the provider to ensure it is trying to do the right thing for all customers at all times.

When looking at payouts as a whole, with-profits are delivering returns in line with comparable unit-linked funds as can be seen in table 1 when comparing the returns in the columns WP return and Avg UL Pens. These returns are delivered on top of the downside protection afforded by minimum value guarantees.

Annualised returns on payouts at maturity from regular premium (RP), and single premium (SP) with-profits policies, compared with comparable unit-linked equivalents and total return on equivalent investment in FTSE All Share index are shown in Table 1.

Product	Freq	Term (years)	WP Return (WTW[1])	WP Return (MM[2])	Avg UL Pens (MM[3])	FTSE AllShare[4]
Pension	RP	10	5.70%	5.80%	5.90%	6.20%
Pension	RP	20	5.20%	5.00%	4.90%	6.00%
Pension	RP	30	8.40%			8.00%
Pension	SP	10	4.70%	5.20%	4.90%	5.60%
Pension	SP	20	6.40%	6.60%	5.30%	6.70%
Pension	SP	30	8.90%			9.50%
Endowment	SP	10	4.10%			6.40%
Endowment	SP	25	5.90%			7.00%
Bond	SP	15	4.50%			4.40%

Notes:

1. The WP Return (WTW) represents the return on with profits funds taken from the Willis Towers Watson "*With-Profits Expense and Pay-out Benchmarking Survey*", 14 November. The return represents mid-range of all returns quoted, excluding top and bottom 10th percentiles and is the return after the deduction of expenses.
2. The WP Return (MM) is taken from the 2016 Money Management Personal Pensions Survey, published March 2016. The quoted return is the average of the funds covered in that survey and represents the annualised return after all charges.
3. The Avg UL Pens return is also taken from the 2016 Money Management Personal Pensions Survey, published March 2016. This return represents the average return on mixed investment funds with 40%-85% invested in shares, after charges.
4. The FTSE All Share return is the Total return of the index over the period concerned. No allowance for expenses / charges has been deducted from these figures.

These benchmarks, in the view of the Working Party, facilitate a reasonable comparison between the returns for an "average" with-profits fund and an "average" unit linked fund with similar investment objectives.

The higher returns over longer terms (most notably 30-year pensions) reflect both higher historic returns and higher distributions from fund estates.

While this comparison suggests with-profits products are providing strong returns relative to comparable alternatives, does this actually mean they are performing well enough? Customers are unlikely to do a product-to-product comparison and are instead more likely to compare their payouts with their own expectations. These expectations are likely to have been influenced by:

- Marketing literature received at inception – illustrated values, possible returns, promises made.
- Marketing literature received throughout the lifetime of the policy – have expectations been re-set, are customers made aware of the performance of the fund and their policy? Are industry-wide issues and changes properly explained to customers to warn them of the possible impacts?
- The purpose of the investment – if a with-profits endowment is taken in order to pay off an interest-only mortgage then the payout itself is of less interest than any resulting shortfall in the mortgage payment.
- Policyholder's original and ongoing needs (including purpose above) eg risk appetite, ability to hold to maturity
- What they can do with the proceeds – for example if a with-profits pension leads on to an annuity income that is lower than they expected, do customers see these as two distinct factors? It is more likely that customers would focus on the end outcome – their retirement income. It is perfectly plausible that good performance of the pension is being overshadowed by a lower than expected annuity rate.
- Policyholders perception of value for money – is investment performance good enough for the charges paid (given these charges are difficult to disclose this could be hard for customers to assess) – if customers perceive with-profits as an expensive product, they have high expectations over what they should get for the cost.
- Press coverage.
- Policyholders' own research and analysis.

This means that, while there is a need for providers to assess investment performance against peer companies or indices, they should also pay due regard to the expectations of their policyholders and ensure these expectations are managed throughout the lifecycle of the product. This can be particularly challenging for with-profits products which were taken out in the 1980's when interest rates were a lot higher and when investment returns generally higher than current expectation given the low yield environment.

By comparing payouts against competitors', providers can assess how their own methods, approaches and performance compare, and may well highlight underperformance or concerns over fairness.

Providers should regularly reconsider their own methods for fairness, looking at the broad spectrum of factors:

- Consumers' changing needs and expectations, including how actual investment experience is evolving compared to the original expectations
- The level of risk being borne by the fund and the level of any shareholder support and how this influences investment approach.

- Allowing customer access to the value of their products in a fair manner – surrender penalties and MVR’s not presenting an unnecessary barrier to customers moving their money.
- Fairness of distributions of profits and surpluses – ensuring fairness between generations, geographies and product choices.
- Company/fund expenses charged to customers – providers should ensure the expenses levied to the fund, and reflected in payouts, are in line with the services they receive and not seen as a way of unfairly paying for company-wide expenses.
- Closing to new business and how the provider intends to ensure / monitor the fair treatment of those remaining customers.

A large part of customer satisfaction and confidence can be shaped and improved by regular, clear and concise communication. This should cover:

- Letting them know how their investment is doing, including against their original expectations,
- What value they are getting and for what cost,
- Whether the risk return characteristics of the fund have changed, and
- What alternative options there are now and in future.

3. With-profits research from consumer perspective

The Working Party considered existing consumer research in order to benefit from existing insight into the with-profits consumer and provide steer for the consumer survey, which would be commissioned under the second phase of our research.

This section considers existing consumer research from the profession, providers and industry bodies going back nearly a decade. The Institute and Faculty of Actuaries Library service provided assistance – identifying articles relating to with-profits or consumers including presentations from past Life Conferences and Exhibitions. These articles were reviewed and summarised by individual members with insights fed back to the wider Working Party for discussion.

Relevant materials are referred to within this section. Whilst there is much research around with-profits, very little has been undertaken on behalf of the Institute and Faculty of Actuaries from the perspective of the consumer in recent years. As such, the Working Party have referred to consumer research performed by providers and industry bodies in search of relevant themes and gaps.

3.1 Aviva policyholder advocate report

A number of relevant published articles were reviewed by the Working Party, we first consider the largest such article published in recent history.

The policyholder advocate report (Spottiswoode, 2009), which was written for the Aviva estate reattribution in 2009. This article was the most focussed on consumer value from with-profits contracts. Spottiswoode notes that the House of Commons Treasury Select Committee's April 2008 inquiry into the inherited estates of with-profits funds concluded that the bargaining position of consumers is weak. This theme is also picked up within "Equity between with-profits policyholders and shareholders" (O'Brien, 2011), which emphasises the information asymmetries between providers and consumers. Both papers suggest that consumers lack sufficient knowledge to make informed decisions when faced with a choice of options affecting their with-profits policies.

3.2 Media coverage

Consumer views and understanding can also be influenced by media coverage. To understand the consumer perspective, opinions expressed on with-profits products within media articles have also been considered. A number of articles were identified and these tended to take a negative view of with-profits, which appears still tarnished by historic mortgage endowment mis-selling, the fall of Equitable Life and the decline in payouts this century.

Several headlines and articles paint the insurance provider as the villain and construe past illustrative projections to represent 'promises'. As policyholders read articles that include such negative language as 'toxic' or 'misery' could be forgiven for thinking they were mistaken in purchasing their with-profits product. A headline from July 2016 (thisismoney.co.uk, 2016) paints a picture of the insurer offering 'promises' at point of sale which were not achieved by with-profits policies.

It is not all doom and gloom; there are corners of the press where balanced considered views are painted. Some notable examples appear in the 'agony aunt' style columns where reporters identify policyholders' misconceptions and can independently verify that providers have acted in a responsible way. Complaints to these columns have typically arisen from less than perfect communication between the provider and policyholder. This highlights the importance of clear communication to policyholders, which is considered further in section 4 of this paper.

3.3 Company specific research

A number of with-profits providers have carried out their own research to determine the level of understanding for their own with-profits consumers and the relative value that they place on communications with respect to their policies. We have identified the key themes from this research below.

The research found that of all the information consumers receive, the greatest appreciation is for their benefit statement, followed by the accompanying covering letter. The least valued information seemed to be Q&A's or booklets, which were perceived to be sales literature.

Other research suggested it was not always clear to consumers why they have been contacted. This suggests that there was room for improvement in how providers contact their policyholders. Numerical data such as tables of numbers should be adequately explained. The policyholders of one provider expressed a preference for these additional explanations to appear within the margins of the document.

Consumers also expressed a preference for envelopes to include a company logo to signify its importance and improve the likelihood of it being reviewed and filed away safely. Members of the Working Party noted that this is at odds with a trend to move towards plain envelopes as this makes the post less likely to be a target for identity fraud. However, some consumers identified plain envelopes as unlikely to contain any important information. Whilst glossy envelopes were seen as likely to contain promotional or sales material, resulting in many of these being binned without opening.

The absence of any policy specific details can have the effect of making communications appear impersonal. The current value of a policy should be prominent, with supplementary information to follow; this increases the chance of policyholders at least glancing over the remainder of the document. However, too much complexity in the presentation may serve to alienate consumers and risk the entire pack being ignored. Customers may be innately distrustful of providers. In order to build trust transparency is encouraged, for example, charges and taxation should be explicitly mentioned. The Working Party's own consideration of these themes are considered further in Section 4.

In terms of understanding of their actual policies, the most common reason for consumers choosing a with-profits policy was upon receiving advice. Some consumers view with-profits as being a 'safer' way to invest in risky assets. However, the majority of consumers surveyed by providers were unable to articulate the features, benefits or drawbacks of a with-profits policy. This highlights their heavy reliance on financial advice to make decisions. Consumers were considered to have limited understanding of their with-profits policy and reliance is put on the appropriateness of advice received from the financial advisor. Providers should consider to what extent a lack of consumer understanding should be a concern. Comfort may be sought from the level of governance around with profit policies (with-profits actuary, with profits committees, etc.) to the extent that consumers value this. Despite the lack of understanding or appreciation of the inner workings of their policy, one company's research highlighted the majority of their consumers still intend to hold onto their policy until maturity or retirement. Consumers typically lack a full understanding of with-profits policies' key features, such as guarantees or the exercise of discretion. Indeed, the understanding of policy options appears weaker amongst with-profits consumers than for typical unit-linked pension consumers, such as the option to surrender or transfer the policy early.

Where consumers do have some understanding of the key features of their product this leads to a greater appreciation of the value of their policy, resulting in increased premiums and consolidation of smaller funds, which benefits provider and consumer alike. However, one provider found a negative correlation between the financial sophistication of consumers and their opinion of the quality of information provided. This may suggest financially literate policyholders have greater information needs, or possess incorrect preconceptions that are at odds with what they receive.

Part of the challenge in communicating with policyholders is explaining how discretion will be exercised. Consumers polled by one provider considered reducing the level of discretion or simplifying policy terms to make explanations easier and improve their understanding.

The regulation of with-profits disclosures has evolved greatly over recent years. The introduction of the Principles and Practices of Financial Management (PPFM) and Consumer Friendly PPFM (CFPPFM) were ultimately seen to be of little use to consumers with the majority having neither read nor received either of these documents, and those who have unlikely to gain much from doing so (O'Brien, 2011). Disclosure requirements have since been identified as too prescriptive ultimately with the removal of the requirement to produce a CFPPFM with effect from November 2016. The Financial Conduct Authority encourage life companies to consider customers' specific information needs when deciding how best to provide information to consumers.

Digital communication is an up and coming area with the majority of consumers now referring to price comparison sites as part of financial decision making. The engagement of digital communication, however, can drive a generation gap with low market penetration amongst the older generation. It is also difficult to articulate the value of product specific options and guarantees on a basic comparison of products and so with-profits may appear relatively expensive compared to unit-linked or conventional non-profit alternatives.

Consumers have little understanding of the implications of the run-off of with-profits funds or the likely conversion to non-profit. It may not be necessary to inform all consumers, for example policies that are paid-up or in the process of maturing. The lack of understanding presents a challenge to consumer decision making. Conversions have accelerated the run-off of some funds by triggering consumers to surrender their policies.

3.3 Wider consumer research of relevance

In 2016, the Money Advice Service (MAS) performed research by a combination of focus groups and in depth interviews on retirement language (Money Advice Service, 2016), across a range of ages, financial sophistications and pension pot sizes. While the research was not with-profits specific, many of the findings are applicable to with-profits consumers as well as wider pensions consumers.

Overall understanding and confidence around pensions is low. Individuals rarely understand personal control over pensions and tend to think of pensions as something that "happens to them" rather than a process in which they can be involved. Engaging consumers in pension decisions is a challenge to the industry and companies may wish to consider alternative communication styles and strategies. Communication should be early and often to build both a trusted relationship and consumers' understanding.

The use of appropriate language and identification consumers' information requirements should continue to be developed by providers.

3.4 Summary

Consumers may not have sufficient knowledge or understanding to make informed decisions when it comes to financial products. This is particularly true in of with-profits, where a lack of consistency in approach between providers or funds, coupled with arguably more complicated products and jargon is leaving some consumers bewildered. Engaging consumers in the lifecycle of their with-profits policy and reassuring them of governance in place to protect their interests would be positive steps to remedy this.

More could be done to tackle misleading negative press coverage, individual providers and the profession as a whole should consider all avenues of communication through which consumers' access information about their policyholders and ensure these are fit for purpose.Error! AutoText entry not defined.

4. With-profits consumer communications

The Working Party was asked to consider relevant with-profits marketing literature and benefit statements with a view to identifying improved/simpler explanations of the concepts underlying with-profits and whether or not sophisticated technical explanations should be used. In this section we review and share the Working Party's views in respect of the example with-profits communications provided directly to the Working Party by providers. These might not apply to all of the communications reviewed.

4.1 Material reviewed

The Working Party asked providers to provide examples of their with-profits communications with any personal information removed. Requests were sent to as many providers as possible, and their response was voluntary, rather than compulsory. Over 40 contributions were received and after review, 36 with-profits communications were analysed further. Due to the different structure of conventional and unitised with-profits products and the differing regulatory requirements for Pension and Investment (Life) products, our analysis has been presented below in these categories. We received healthy mix of with-profits communications in each of these product types. Whilst analysing each of these, we observed natural similarities and key comparable aspects in each of these product categories. This resulted in a natural split for comparison and analysis, particularly as the key comparable aspects within each of the communications could be easily identified. Items such as sum assured, regular and final bonus, and market value reductions were analysed further. In addition, the elements included in Outcome 2 of the FCA's Fair treatment of long-standing customers guidance, FG16/8, were also examined and detailed comparative findings are included in Section 4.2 below.

Although the review was not informed by consumer insight, the Working Party endeavoured to provide a consumer perspective, with the aim being to see whether a communications allows a consumer to have a clear understanding of their product, how it has performed, and the benefits, risks and costs associated with their product. More specifically, the review placed a particular focus on the value a consumer would draw from the communication.

4.2 Practices observed

Our review of the current communications has shown how each provider has sought to provide useful information to policyholders against the framework of the current FCA guidance and principles. Of particular relevance is Principle 7 of the FCA's Principles for Businesses which requires providers to pay due regard to the information needs of its customers and to ensure that their communications are fair, clear and not misleading. This has led to each provider coming to its own conclusions and producing something bespoke and often very detailed. Hence comparing the communications is far from easy and as knowledgeable reviewers we can see that the diversity may be confusing for anyone who has more than one with-profits policy.

All the communications received were of a good standard in the opinion of the reviewers, and the findings contained in this report provide some examples which the reviewers found to be particularly helpful. It is recognised that providers who submitted their communications to the Working Party for review would not have had an opportunity to update these for the outcomes of FG16/8. In addition, it is important to note that the list provided in FG16/8 is not prescribed, and given that the guidance makes it clear that it is for providers to decide what information their customers need, the contents of this report should be seen as an initial opportunity for the Working Party to present their findings. The table presented below summarises the comparative results of the communications reviewed:

	The Current Value of the Policy[10]	Surrender Value of the Policy	The Value of the Policy at the previous communication	Premiums paid in the last year	Informing customer benefit is not guaranteed	Indicative level of charges (in £ terms) applicable to the policy	Where a policy has a guarantee	Where a policy has (additional) life cover
Conventional	100%	8%	Not directly applicable	25% showed monthly premium	58%	33% made mention of charges	100%	67%
Pensions	100%	77%	31%	38%	77%	33% made mention of charges	62%	38%
Investment / Savings	100%	100%	88%	38%	50%	50%	63%	88%
Total	100%	58%	52%	24%	64%	30%	76%	61%

	Sum Assured	Regular Bonus	Final Bonus	Market Value Reduction	Details of a customer's options are provided	Contact details
Conventional	92%	92%	25% stated one might be payable but didn't specify the value	8%	Not directly applicable	100%
Pensions	15%	54%	54%	54%	46%	100%
Investment / Savings	Not applicable	63%	88%	63%	50%	100%
Total	39%	70%	42%	39%	48%	100%

Table 2: With-profits communications review output

All areas highlighted in green represent good practices observed, with yellow areas representing areas where a majority of good practices were observed. The amber and red representing areas where we believe improvements to these aspects of with-profits communications could be made, and this is particularly relevant for providers that do not currently include this information in their communications. Section 4.3 provides examples for improving consumer communications. In particular, further comments on the good practices observed include:

- The majority of the communications included the current value of the policy.
- In contrast to conventional communications, almost all of the communications in the Pensions and Investments category included a transfer value, and where this was different to the plan value, an explanation was provided.
- Just over half of the communications in the Pensions and Investments category included the plan value at the previous communication, and in line with FG16/8, we support its inclusion.
- The majority of communications included details of which benefits were guaranteed and were not guaranteed, although this was not always immediately obvious to a reader. We have proposed examples below with suggestions for making this distinction clearer.

[10] Taken to be guaranteed minimum policy benefit for Conventional with-profits plans

4.3 Examples for improving consumer communications

The Working Party thought the following areas of consumer communications could be improved:

- The value of any premiums paid since the last regular communication: Less than a third of the communications reviewed included the monthly premium. It is good practice for the first figure which appears in a statement to be something a consumer is familiar with, namely, the amount they pay an insurer for their policy, and if included at the start of a statement, this value then sets the context for the figures that follow[11].
- Many communications seemed to place a focus on the fact that benefits were only payable as long as you had paid all of your premiums. In a few communications, this statement was included multiple times within the guaranteed value section of a statement, and doing this might detract from the importance and value of the guarantees. We suggest a statement be included at the start of a communication, such as ‘The guaranteed benefits amounts which follow are only payable if you we have received all of your premiums due’. This statement, in conjunction with the value of premiums paid since the last regular communication (as above), then sets the context for any figures which follow.
- FG16/8 suggests that an explanation of the charges being deducted – for example, the guarantees that incur a charge and policy fees – and an indicative level of charge (in monetary terms) applicable to the policy are included in a communication. Although this might be challenging to ascertain for conventional plans, this information was included in half of the investments communications reviewed, and although we acknowledge the inclusion of this information could be widely interpreted by a consumer, we would encourage the inclusion of this information in conventional and pensions communications.

Proposals for further improvement: Conventional With-Profits

Date of Statement	30 June 2017	
Policy Start Date	DD MMMM YYYY	
The date your policy is due to mature	DD MMMM YYYY	
Premiums paid over the last statement year	£420	
Basic guaranteed value (sum assured) [A]	£100,000	**Your guaranteed benefits**
Existing bonuses (the value of bonuses we've added to your policy in previous years) [B]	£20,000	
Annual bonus for 2017 [C]	£500	
Total guaranteed value [A + B + C]	**£120,500**	
Final bonus [D]	£6,500	**Your benefits which are not guaranteed**
Surrender value	£105,000	
Guaranteed minimum death benefit	£250,000	**Other benefits**

[11] This is only applicable for premium paying plans.

Premiums paid over the last year: This is the total payment you've made in the past year. It's important to pay your premiums. The guaranteed benefit amounts quoted below are only payable if we have received all of your premiums due.

Basic guaranteed value (sum assured) [A]: This is the minimum amount that we guarantee to pay at the maturity date or when a life assured dies (if this is earlier), before we add bonuses.

Regular bonus [B + C]: Regular annual bonuses increase the minimum amount that we guarantee to pay at the maturity date or when a life assured dies (if this is earlier).

Total guaranteed value [A + B + C]: This is the total amount that we guarantee to pay at the maturity date or when a life assured dies (if this is earlier).

Table 3: Conventional With-profits communications review example

- The review highlighted that it was not always obviously clear to a reader what was guaranteed and what was not. In the proposed example in Table 3 we have clearly distinguished the guaranteed benefits from the non-guaranteed benefits.
- Some communications only used the term minimum, and did not use the term guaranteed, even though it was applicable, and vice versa. The review also highlighted that it was not necessarily clear in some instances that a reader had to add two or three numbers together, in order to arrive at the total guaranteed value. Where this was included, this was either by using the word ‘plus’ or a by using ‘+’ symbol. The example in Table 3 supports the continued use of this, and the wording proposed clearly indicates the regular bonus is payable in addition to the basic sum assured.
- The example in Table 3 then distinguishes the non-guaranteed elements of the policy, and where possible, includes their associated value. FG16/8 suggests providers should explain the impact of any likely terminal bonus on the current value and any reductions in asset share that will reduce the current value on surrender. A quarter of communications in this category stated a final bonus might be payable, but none provided a value.
- Only 8% of the conventional communications included a surrender value, although a few referred to policy documentation, or included a slip request for a surrender value form. Given both terminal bonus and surrender value are important contributors to the value of a with-profits policy, we have included these in our proposed example, and we believe these should be included in a statement.
- It is also important for communications to clearly indicate, as well as distinguish, whether a value shown in the communication is at the maturity date or is an illustrative surrender value at the statement date.
- The example in Table 3 includes a final placeholder for plans which had a guaranteed minimum death benefit floor. More generally FG16/8 suggests customers should be given a reminder of any specific options and benefits associated with their policy.

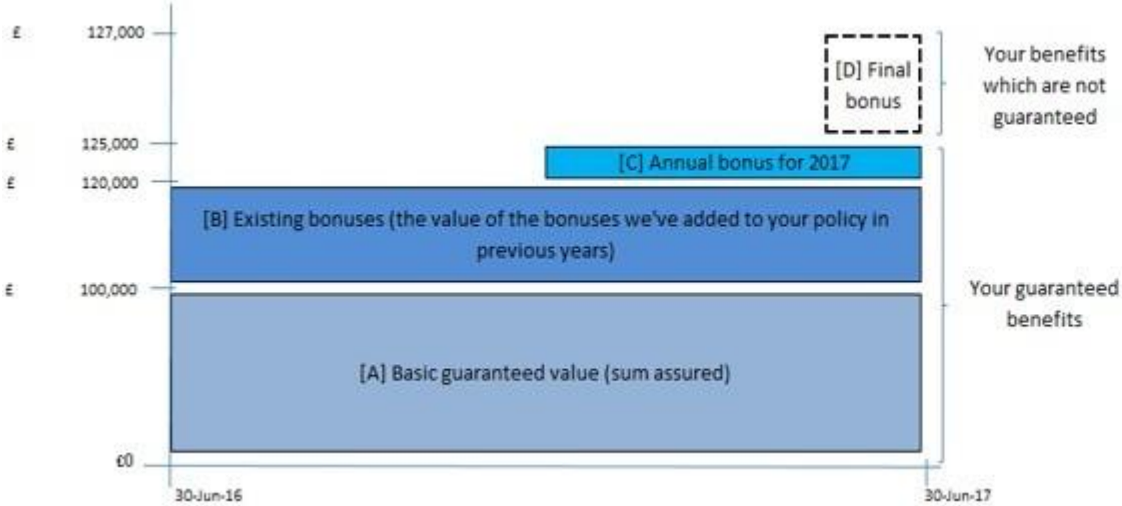

Figure 2: Conventional With-profits communications review graphic

Figure 2 represents a simple graphic inspired by a more detailed graphic included in one of the communications reviewed. It visually demonstrated plan value to a reader, linking the figures included in Table 3 above. Note the vertical axis is deliberately not to scale, in order to illustrate the component building blocks.

These recommendations are the views of the working party and are not informed by customer insight. The research was used to inform the questions contained in the consumer survey (please see our Phase 2 Report for further details).

Proposals for further improvement: Pensions and Investments

Date of Statement			30 June 2017
Policy Start Date			DD MMMM YYYY
Premiums paid over the last statement year			£3,000
Fund based charges over the last statement year			£69

	Fund Name	Number of Units held [A]	Unit Price (£) [B]	Fund Value [A x B]	% of Plan
	Global Property	100,000	1.1	£110,000	63%
+	With-Profits	50,000	1.2	£60,000	34%
+	Growth Bonus	5,000	1.2	£6,000	3%
=	**Total Fund Value**			**£176,000**	**100%**

	Date of Statement	30 June 2017
	Total Fund Value	**£176,000**
+	Interim Bonus	£250
+	Final Bonus	£30,000
-	Market Value Reduction	£0
=	**Plan Value as at 30 June 2017**	**£206,250**
	Transfer Value as at 30 June 2017	**£205,500**
	Plan Value as at 30 June 2016	**£195,000**
	Guaranteed Minimum Death Benefit	**£250,000**

Table 4: With-Profits Pensions and Investments communications review example

- It was challenging to distinguish the guaranteed elements from the non-guaranteed elements, as some with-profits funds were structured with the ability to invest in other funds, so we've proposed an example in Table 4 above which should fit the majority of with-profits Pensions and Investment statements, and distinguished any bonus units from fund units
- The example in Table 4 supports the continued use of a multiplication sign to ensure a consumer understands they need to multiply the number of units by the unit price, as this wasn't necessarily obvious to a reader. The example in Table 4 also supports the continued use of a plus sign, as sometimes it wasn't clear a reader had to add three fund values together to obtain their total fund value.
- The example in Table 4 includes a placeholder for interim bonus and final bonus (in contrast to conventional communications, the majority of pensions and investment communications included a value of final bonus).
- Some statements clearly explained a market value reduction and showed how this might be applied, even where the current value was zero, and the example in Table 4 supports the continued use of this. Other statements defined a market value reduction and explained to a customer that they would receive a lower payment when one is applied.

- The example in Table 4 includes a placeholder for any other options or guarantees associated, given here as a guaranteed minimum benefit on death.
- As previously mentioned, it is also important for communications to clearly indicate, as well as distinguish, whether a value shown in the communication is at the maturity or retirement date or is an illustrative transfer value at the statement date.

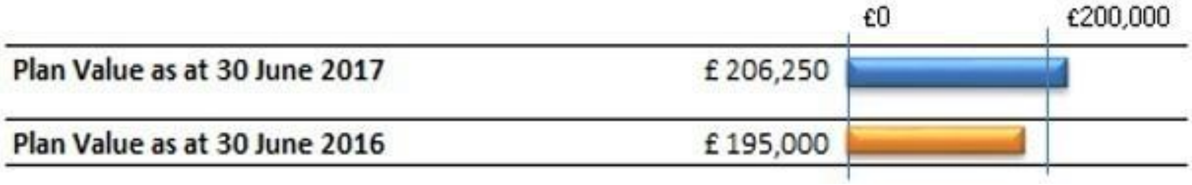

Figure 3: With-Profits Pensions and Investments communications review graphic

The sample graphic in Figure 3 above was inspired by one of the communications reviewed. Its simplicity visually demonstrates the plan value to a reader, linking the figures included in Table 4 above.

4.4 Summary

Findings: All the communications received were of a good standard in the opinion of the reviewers, and the findings contained in this report provide some examples which the reviewers found to be particularly helpful.

Recommendations: We have suggested a few examples in a standardised format which we believe would help them improve the consistency of with-profits communications from different providers. Providers are encouraged to ensure their communications continue to meet the needs of customers and we trust the examples provided will allow providers to question the value a consumer would draw from their communication. Focus should be placed on encouraging better, more helpful communications with consumers.

5. Conclusions

Our objectives at the inception of the Working Party, as set out in Section 1, were to consider:

1. Do consumers understand the value of their with-profits policies and, in particular, is the value of inherent guarantees and potential for real asset growth recognised by consumers?
2. What is the consumer's perspective on the run-off of with-profits funds? Are consumers getting what they signed up for and do they understand the potential "end games" of the run-off of the fund?
3. To make recommendations and proposals to aid consumer understanding of with-profits business.

Findings

There is not much existing consumer-specific with-profits research.

The performance of with-profits has been comparable to Unit Linked products and the FTSE All Share, but has provided the additional security offered by guarantees

However, performance in terms of payouts is very variable and highly dependent upon the with-profits fund chosen

With-profits funds can change markedly over the consumers' investment lifetime, and the consumer's needs can change also, so ongoing communication is particularly important.

Recommendations

Providers should ensure benefit statements continue to meet the needs of consumers.

As a profession we should focus on encouraging better, more helpful communication with consumers

As an industry we could do more to counter unjust negative commentary in the press of with-profits products.

5.2 Next Steps – Further Consumer Surveys

A consumer survey was commissioned by the Institute and Faculty of Actuaries in October 2017. The next Phase of the research of the Working Party was to work with the survey provider to develop appropriate questions for consumers to evaluate the level of engagement consumers have with their with-profits products. We reported back on the initial results of the survey at the Life Conference in Birmingham in November 2017.

In July 2018 we sent out a request to providers to assist with a survey exclusively for with-profits consumers. We aim to provide an initial report at a Sessional Meeting in early 2019.

Acknowledgements

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