Insights from the UK

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Topics to be covered

Retail Distribution Review

With profits and the future of mutuals

Reverse stress testing

Technical Actuarial Standards

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Regulation of life insurance distribution in the UK

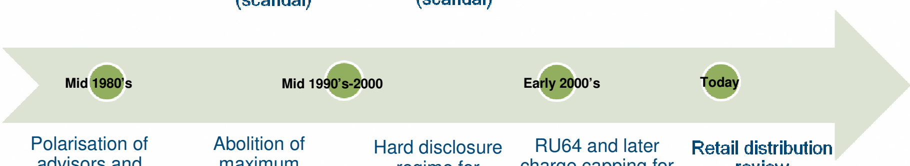
- The UK industry has undergone a number of distribution related initiatives during the last 20 years partly prompted by perceived shortcomings of the "advice" process

Industry issue

Mis-selling of unit linked products

Mis-selling of personal pensions (scandal)

Mis-selling of endowment assurances (scandal)



Polarisation of advisors and conduct of business rules "best advice"

Abolition of maximum commission agreement

Hard disclosure regime for commission

RU64 and later charge capping for pensions

Retail distribution review

Regulatory response

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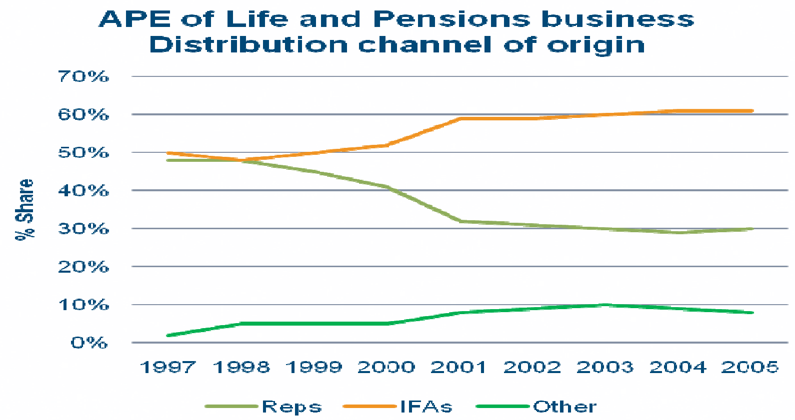
Distribution Channels – IFAs v Tied



Source : ABI

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Callum McCarthy – Speech September 2006
Is the present business model bust?

- Important to note that incentives work (commission per se is not bad)
- Focus is still on business volume rather than quality
- Persistency remains low (with substantial churn)
- Half of regular premium pension policyholders are no longer paying into them after 4 years
- Commission structures mean that one in 6 policies are in force for no more than 12 months
- Lots of activity in the pensions market – but is it in the customers' best interests?
- Reflects badly on the industry and the insurers' brand
- Product bias, provider bias and churn
- Unattractive to reputable providers
- Unattractive to customers
- Benefits to intermediaries are questionable

Source : FSA library : Gleneagles Savings and Pensions Industry Leaders Summit

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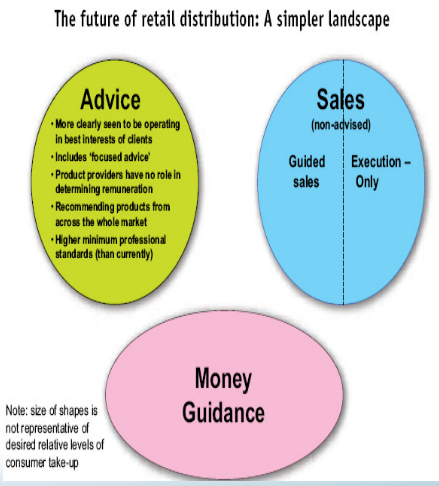
Retail Distribution Review

"A golden opportunity to re-build the confidence and trust of consumers at a crucial time"

Desired Outcomes

- An industry that engages with consumers in a way that delivers more clarity for them on products and services
- A market which allows more consumers to have their needs and wants addressed
- Standards of professionalism that inspire consumer confidence and build trust
- Remuneration arrangements that allow competitive forces to work in favour of the consumers



Source : Financial Services Authority – Retail Distribution Review – Interim Report

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RDR rules (implementation 31 December 2012)

- Advisers to be described as either 'independent' or 'restricted' with independent advisers expected to conduct a comprehensive and fair analysis of the wider range of retail investment products.
  - May still use panels but must justify exclusion of other market players
  - Restricted advisers (e.g. banks) must disclose orally that they provide restricted advice and the nature of that restriction
- Adviser charging to replace commission based remuneration
  - Agreed at outset between adviser and client
  - Payment from premiums permitted, but not factoring
  - Ongoing adviser charge may only be applied if there is ongoing advice
- Advisers to meet enhanced standards for CPD
  - All meet FPC level 4 (no grandfathering)
  - New overarching Code of Ethics
  - Enforced through new Professional Standards Board (PSB)

RDR – likely consequences

Topics to be covered

- Retail Distribution Review
- **With profits and the future of mutuals**
- Reverse stress testing
- Technical Actuarial Standards

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COBS rules

- If a with-profits fund has an excess surplus ... it should make a distribution or carry out a reattribution (COBS 20.2.22(1))
- If a firm proposes to effect new contracts in an existing with-profits fund, it must only do so on terms … unlikely to have a material adverse effect on the interests of existing with-profits policyholders (COBS 20.2.28)
- A fund ceasing to effect new business in a with-profits fund must submit a run-off plan demonstrating how it will ensure a fair distribution of the inherited estate (COBS 20.2.53(2), 20.2.56(1))
- If non-profit business is written in a with-profits fund, a firm should take reasonable steps to ensure that the economic value of future profits on this business is available for distribution during the lifetime of the with-profits business (COBS 20.2.60(1))

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Project Chrysalis – AMI/AFS

- Combination of the COBS rules and the lack of demand for with-profits business had the potential to damage the mutual sector
- Application of COBS rules may result in
  - transfer of ownership from members to with-profits policyholders
  - disproportionate “windfall” payments to current with-profits policyholders
- Proposal to create a clear definition of a with-profits sub-fund for mutuals and of “mutual capital”

FSA view – Dear CEO letter October 2009

- “As a general rule with-profits policyholders … are ultimately entitled to all or almost all of the surplus in the long-term fund”
- “Mutuals must consider the implication of ceasing to write new with-profits business and must adequately protect the interests of its existing with-profits policyholders as the business runs off”
- “With-profits policyholders will be adequately protected if the economic value of new non-profit business can be distributed over the run-off period”
- “Options which would redefine the interests that with-profits policyholders have in the mutual are likely to amount to a reattribution”

Mutual sector response

- Position of an individual mutual depends on its constitution
- Dear CEO letter did not recognise significance of membership relative to participation status
- Mutuals typically existed for many years before they started writing with-profits business
- …but some signs of acquiescence

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FSA view – Dear CEO letter September 2010

- "One of the feature of the mutual insurance sector is its diversity"
- "A number of firms evidently received legal advice to the effect that, in their own particular circumstances, the interests in their long-term funds were quite different from the general position described in my previous letter"
- "It would be ... surprising if the reasonable expectations of with-profits policyholders in a mutual firm were as fundamentally less extensive than those of similar policyholders in a proprietary company as some firms have effectively argued … "
- "If a firm suggests that its own particular circumstances warrant a different outcome, it must be able to point to clear and unambiguous factors to justify this"


Financial Services Authority

FSA

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To the Chief Executives of all UK Mutual Insurers — 28 September 2010

Our Ref:

Your Ref:

Dear Chief Executive

MUTUAL INSURERS OPERATING WITH-PROFITS FUNDS

I am writing to you to address some of the points that emerged from our consideration of firms' responses to my letter of 13 October 2009 to all chief executive officers (CEOs) of mutual insurers that provide with-profits business.

Background

The aim of the October 2009 letter was to explain the conclusions that we had reached on several questions put to us by mutual firms and by what is now called the Association of Financial Mutuals.

Firms were asked to consider the implications of that letter for them and to communicate their conclusions to us by the end of December 2009. Since then, we have been carefully considering firms' responses and, in some cases, have been in touch with firms to request further information and to clarify some of the issues they raised.

Diversity within the Mutual Sector

One of the features of the mutual insurance sector is its diversity. This was emphasised in a number of specific areas by firms' responses:

- the differences in mutual insurers' form and size and how their origins and development have had an impact on their fund structures;

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Retail Distribution Review

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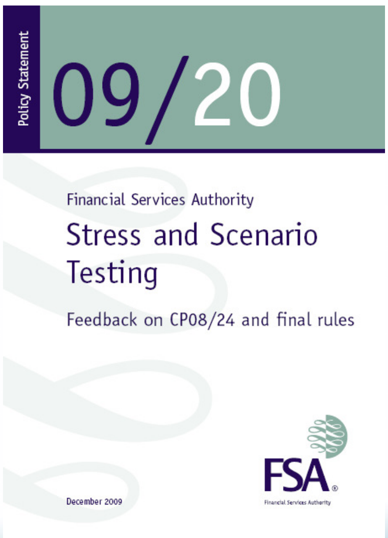
Reverse stress testing

Technical Actuarial Standards

Reverse Stress Testing

- Reverse stress-tests are stress tests that require a firm to assess scenarios and circumstances that would render its business model unviable
- Reverse stress-testing starts from an outcome of business failure and identifies circumstances where this might occur
- Business model failure defined by FSA as "the point when crystallising risks cause the market to lose confidence in the firm"
- Business model failure not just exhaustion of capital and/or liquidity


Policy Statement
09/20
Financial Services Authority
Stress and Scenario Testing
Feedback on CP08/24 and final rules
December 2009
FSA

Reverse Stress Testing

- Examples of business model failure could include:
  - All or a substantial portion of the firm's counterparties are unwilling to continue transacting with it
  - Mass lapse (which could itself be a cause of other forms of business model failure)
  - Severe reputational damage (affecting new business or market confidence)
  - Market refusal to provide or renew financial support
  - Sustained losses or inability to meet financial / commercial targets or expectations

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Technical Actuarial Standards

Technical Actuarial Standards (TASs)

- It is a strategic goal of the Financial Reporting Council (FRC) that:
  – Users of actuarial information can place a high degree of reliance on the information's relevance, transparency of assumptions, completeness and comprehensibility
- In pursuit of that goal, TASs will set out concepts, principles, rules and terminology from which those complying with standards will be able to determine the appropriate techniques, methodologies and assumptions to be applied to their work and the means of communicating the output

Source: BAS Conceptual Framework

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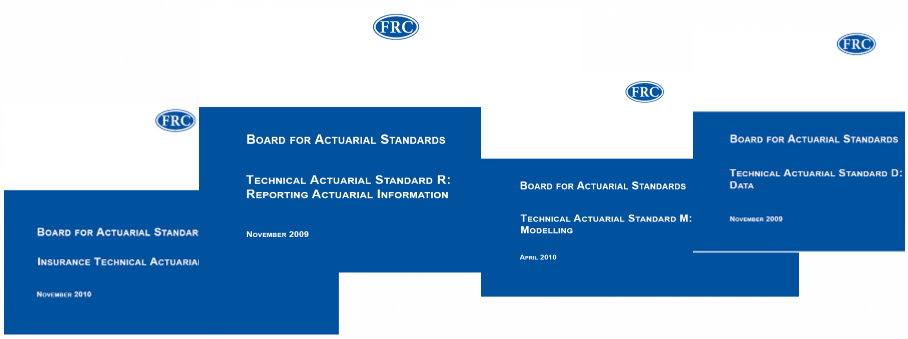
The standards



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Insurance TAS

- Effective 1 October 2011
- Covers all actuarial work relating to:
  - published financial statements
  - compliance with regulatory or tax-related obligations
  - embedded value reporting
  - audit support
  - product pricing
  - business transformations
  - mergers and acquisitions
  - exercise of discretion
- TASs D (data), M (modelling) and R (reporting) will automatically apply to all work covered by the Insurance TAS

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