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With-profits transformation: Improving stakeholder outcomes through simplification

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Brian Murray, Royal London

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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.



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A recap: with-profits issues

Contracting market	<ul style="list-style-type: none"> • Reducing new business sales • Closed funds/run-off • Consolidation • Actuaries that understand the intricacies of with-profits
Nature of contracts has changed	<ul style="list-style-type: none"> • Guarantees • Optionality • Not understood by policyholders • Fairness
Governance /costs	<ul style="list-style-type: none"> • Increased PRA/FCA requirements over recent years • Management of with-profits business getting more onerous rather than less • Capital

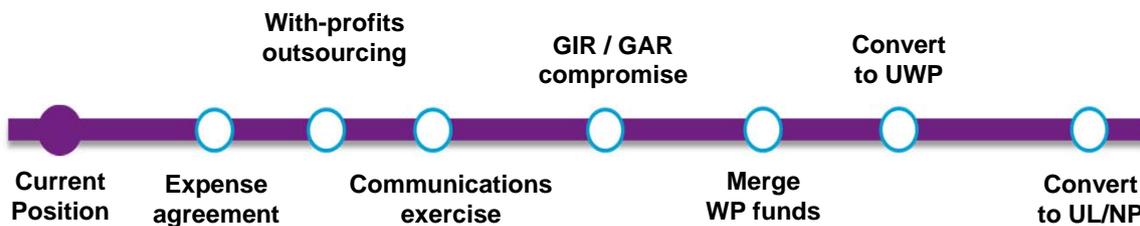


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What is with-profits transformation?

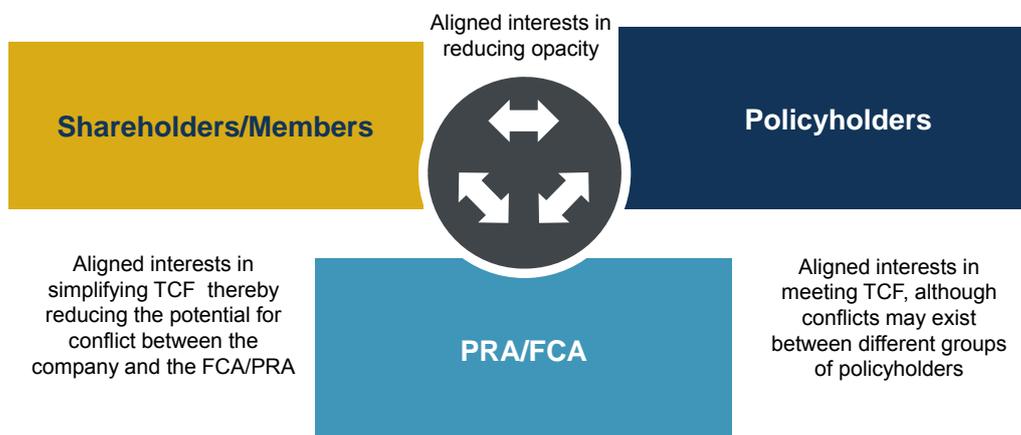


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Simplification is in all key stakeholders' interests



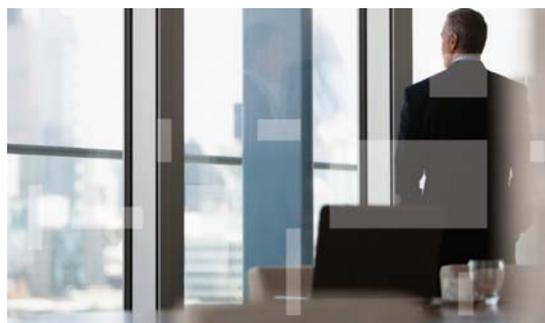
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Why a number of companies are considering simplification at the moment

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

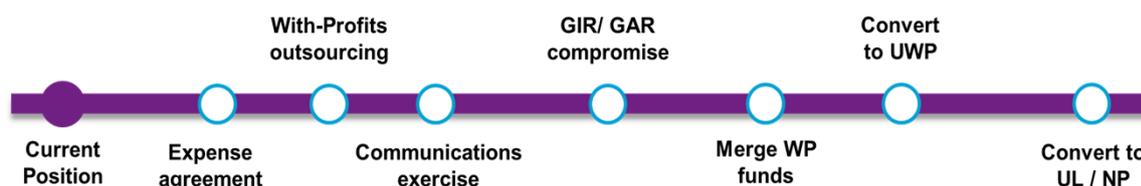


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Potential with-profits transformation options

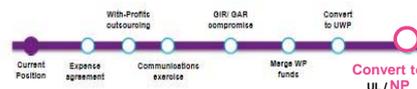


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Case Study 1: conversion WP to NP



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 (eg demutualisations) as a wind up provision when the fund reduces to a certain size

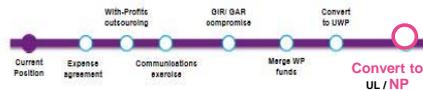


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Case Study 1: conversion WP to NP



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



Shareholder benefits:

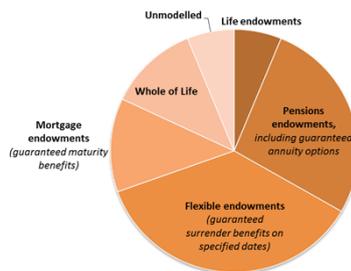
- Reduced level of governance / cost
- Reduced level of administration



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%)

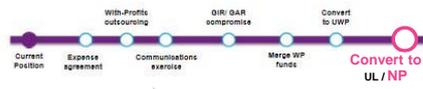


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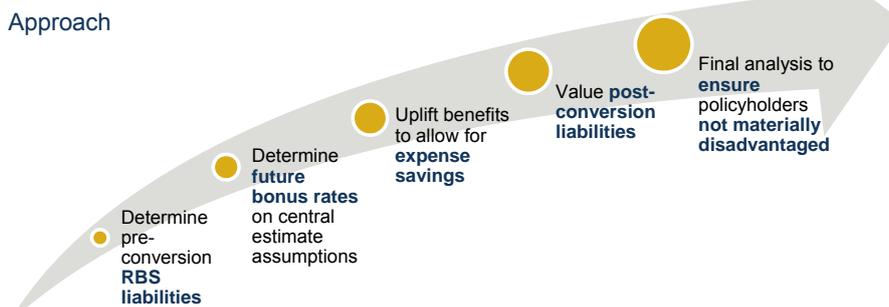


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Case Study 1: conversion WP to NP



Approach



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



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Case Study 2: communications exercise

Problem	<ul style="list-style-type: none"> • Significant optionality in guarantees for pension policyholders • Capital requirements • Very difficult to hedge • Also limited freedom for policyholders
Solution	<ul style="list-style-type: none"> • 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



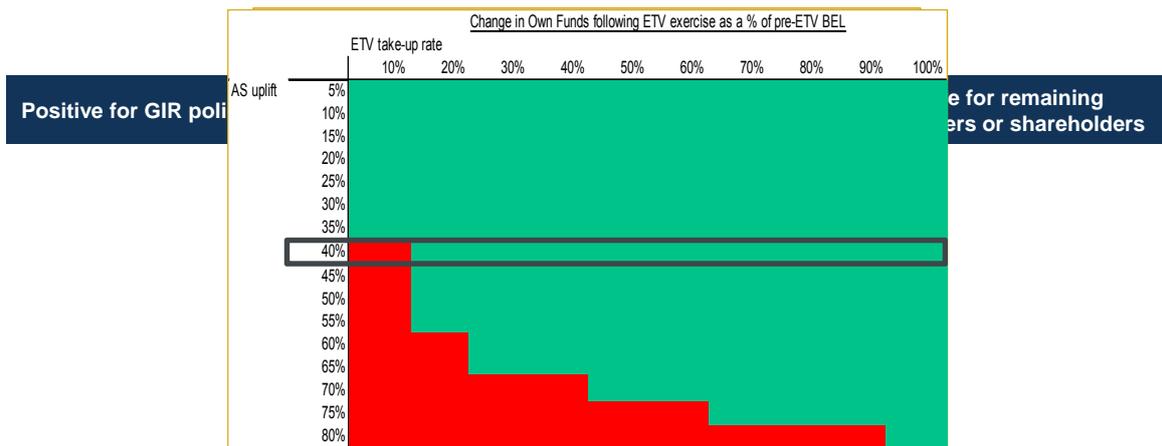
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Case study 2: GIR compromise



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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

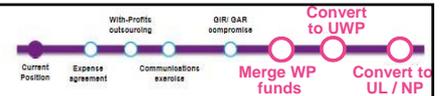


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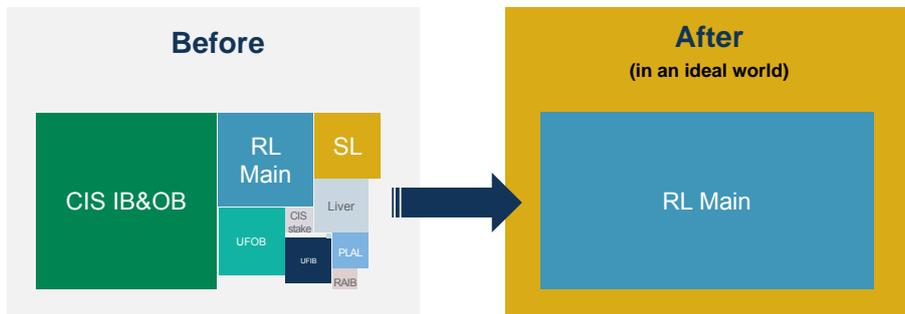
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Case Study 4: before and after



Royal London case study

What it looks like from the firm's perspective:

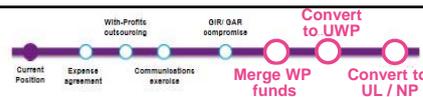


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Case Study 4: carrying out a feasibility study – a two staged approach



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

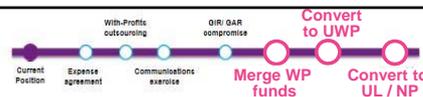


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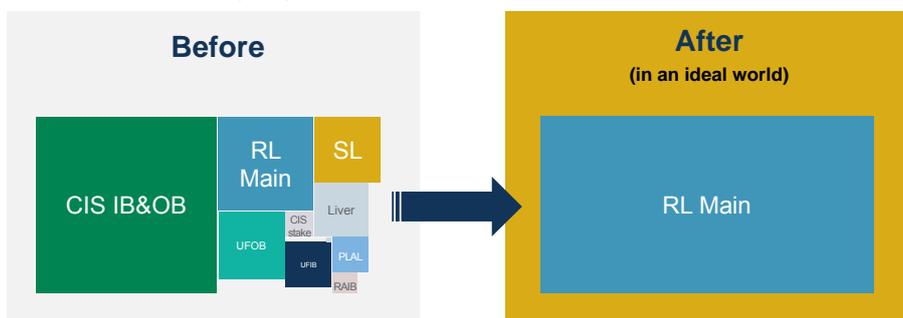
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Case Study 4: before and after



Royal London case study

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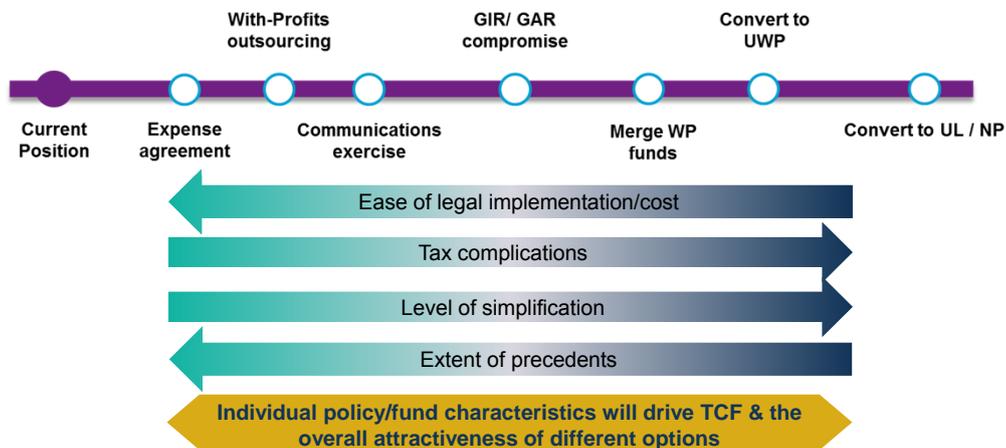


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Summary of simplification options



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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



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Questions

Comments

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