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With-Profits / Participating Business: An International Perspective

Rosalind Rossouw FFA

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With-Profits / Participating Business: An International Perspective

- **Kick-off:** Heritage
- **The Rules of the Game:** Regulatory Guidance Landscape
- **The Playing Field**
- **Schedule of Play:** Product offering
 - Surplus sharing
- **Commentary:** International Perspectives on Par Management
 - Investment strategy and Payouts
- **Final score:** Successful Par Management
 - Governance
 - Communication with policyholders
 - The reasonable expectations of policyholders
- **Case study: Germany**



Kick-off: Heritage

1800 and early 1900



1836⁽¹⁾

Girard Life Insurance, Annuity and Trust Company of Philadelphia was established

First dividends allotted to policyholders in 1844 to policies in force for 3 or more years

1847

Another of Canada's biggest three insurers begins operations in Canada

Distributed dividends to policyholders since 1848






1871

The Sun Life Mutual Insurance Company of Montreal begins operations in Canada





Distributed dividends to policyholders since 1877

(1) Actuarial Standards Board of the United States: ASOP 15

Regulatory Guidance Landscape

	Body	Par Management / Guidance	Professional
Canada 	Office of the Superintendent of Financial Institutions (OSFI) / Provincially regulated	<ul style="list-style-type: none"> Insurance Companies Act (ICA) Bill C-57 Policyholders Disclosure Regulations OSFI: E-16 	Canadian Institute of Actuaries (CIA): Standards of Practice and Education Note
United States 	Regulations differ by State and may not be Par specific	National Association of Insurance Commissioners (NAIC): Manual of Accounting Practices and Procedures	Actuarial Standards Board of the United States: ASOP 15
United Kingdom 	Financial Conduct Authority (FCA) and the Prudential Regulatory Authority (PRA)	Prudential Standards (PRU, INSPRU, and IPRU-INS), Business Standards (COBS), and Regulatory Processes (SUP)	Technical Actuarial Standards and Professional Standards
China 	China Insurance Regulatory Commission (CIRC)	<ul style="list-style-type: none"> Actuarial calculation method of personal with-profits insurance products 《个人分红保险精算规定》 Temporary management rule of with-profits insurance products 《分红保险管理暂行办法》 	
Hong Kong 	The Office of the Commissioner of Insurance (OCI)	Insurance Companies Ordinance, Chapter 41 and Chapter 41E of the Laws of Hong Kong (ICO)	Actuarial Society of Hong Kong: PS1

The Playing Field

	Y/E	Scope	Number of par policies	Claims payments	Par Assets under management
Canada 	2012	Dominated by three big players	Over 5m	2/3 players: \$CAD580m death claims	> \$CAD 55bn (US > \$52bn)
United States 	2012²	<i>ACLI 2013: 868 Life Insurers</i>	<i>\$13bn policyholder dividends</i>		<i>\$19trn</i>
	2012	Two biggest proprietary players		\$6m in benefits	\$108bn
United Kingdom 	2009³	82 insurers and friendly societies with 114 WP funds (53 open 61 closed)	25m (UK population 61.7m mid-2009 ⁴)	£7.2bn in benefits	~£330bn (US ~\$533bn)
	2012⁵	25 insurers with 50 WP funds (15 open 35 closed)			£265bn (US \$439bn)
China 	2011⁶	80% Market Share in China	Premium income of ~760bn RMB (US ~\$126bn)		

(2) American Council of Life Insurers Factbook 2013

(3) FSA With-Profits regime review report (June 2010) and FSA CP11/05 (February 2011)

(4) www.statistics.gov.uk





(5) Towers Watson Survey of With-Profit Funds December 2012

(6) Yearbook of China's Insurance 2012





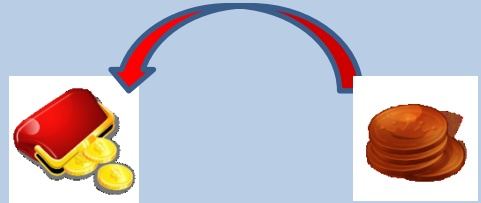
Schedule of Play: Product Offering

- Protection, savings or retirement products
- Core product foundation with a wide variety of features
- Key feature: Offer benefits which have the potential to grow over time by sharing in the surplus of the book
- Sharing could be via an element of surplus:
 - 1) distributed at each policy anniversary: *annual dividend or reversionary bonus*
 - 2) distributed at end of policy term (on death, maturity or surrender) for some contracts: *terminal dividend, special maturity dividend or terminal bonus*
 - 3) distributed to shareholders: *for example 90/10*
 - 4) retained for future distribution, to maintain the financial strength and to manage the stability of the par fund: *fund surplus, unallocated dividend liability, dividend stabilization reserve or inherited estate*

Surplus Sharing at a Policy Anniversary




	Method	Annual Dividends / Reversionary Bonus	Observation
Canada  & United States 	<ul style="list-style-type: none"> Contribution method: surplus distributed in proportion to policy's contribution Multi-factor approach Experience grouped across similar policies 3-factor: interest, mortality and expenses 	<ul style="list-style-type: none"> Not guaranteed (but cannot fall below zero) Can be added to plan benefit (and once added become guaranteed Paid-up additions or PUA) Can be taken as cash, held on deposit, or used to reduce future premiums 	<ul style="list-style-type: none"> Annual dividends vary and give an indication of the smoothed investment performance <i>Formulaic approach</i> <i>Managed to avoid a material tontine or deficiency</i>
United Kingdom 	<ul style="list-style-type: none"> Retrospective / Prospective Method Experience grouped across similar policies Generally maintained at a reasonably low level to minimise the future cost of guaranteed benefits 	<ul style="list-style-type: none"> Once declared, it is added to plan benefit at the policy anniversary, and once added becomes guaranteed on death or maturity May be guaranteed in some instances, and if so low (~ 0.1% to ~0.5%) 	<p>Not necessarily directly indicative of investment performance, but broadly reflects the difference between risk-free returns and the guaranteed interest implicit in the premium basis</p>

Surplus Sharing at the end of a Policy Term

	Method	Terminal Dividends / Bonus	Observation
Canada & United States  	Used to allocate any surplus not distributed via an annual dividend	<ul style="list-style-type: none"> • Not common • Not guaranteed 	Change to Canadian valuation methodology in 1990's required terminal dividends to be held as a liability
United Kingdom 	 <p>Retrospective Method: Accumulation of cashflows = asset share (AS)</p>  <ul style="list-style-type: none"> • Prospective Method: Present value (PV) of future cashflows = distributable assets (A) 	<ul style="list-style-type: none"> • Experience grouped across similar policies • Used to enhance guaranteed benefits (GB) so that $GB + TB = AS$ • Used to allocate balance of surplus which is not distributed via reversionary bonus so that $PV \text{ of } (GB + TB) = A$ • Not guaranteed • Lower scale on surrender 	<ul style="list-style-type: none"> • Terminal bonus cushion is desirable <p><i>Balance between passing on good experience in the form of:</i></p> <ul style="list-style-type: none"> • <i>a proportionately lower reversionary bonus and a (potentially) higher terminal bonus</i> <p><i>or</i></p> <ul style="list-style-type: none"> • <i>a regular dividend / bonus (increasing guarantees)</i>

Surplus Sharing in Asia

分红保险




	Method	Bonus type	Observation
Asia   	Either a Contribution (a 2- or 3-factor formula is used, with specific reflection of experience on interest and expenses) or UK-style method (either retrospective or prospective)	Annual Dividend / Reversionary Bonus: <ul style="list-style-type: none"> • Not usually guaranteed • For both the contribution and UK-style methods: Can be added to plan benefit (and once added are guaranteed / PUA) • Can be taken as cash, held on deposit, or used to reduce future premiums Terminal Dividend / Bonus: <ul style="list-style-type: none"> • Not usually guaranteed • Depend on territory 	<ul style="list-style-type: none"> • Also give an indication of the smoothed investment performance • Managed to avoid a material tontine or deficiency • Not common for contribution firms
Unique feature	<ul style="list-style-type: none"> • Regulation in China⁷: Total policyholder dividends must be at least 70% of the profit • Vietnam also has an at least 70% rule • India and Malaysia have a stricter at least 90% rule 		

(7) Temporary management rule of with-profits insurance products 《分红保险管理暂行办法》

Surplus Distributed to Shareholders

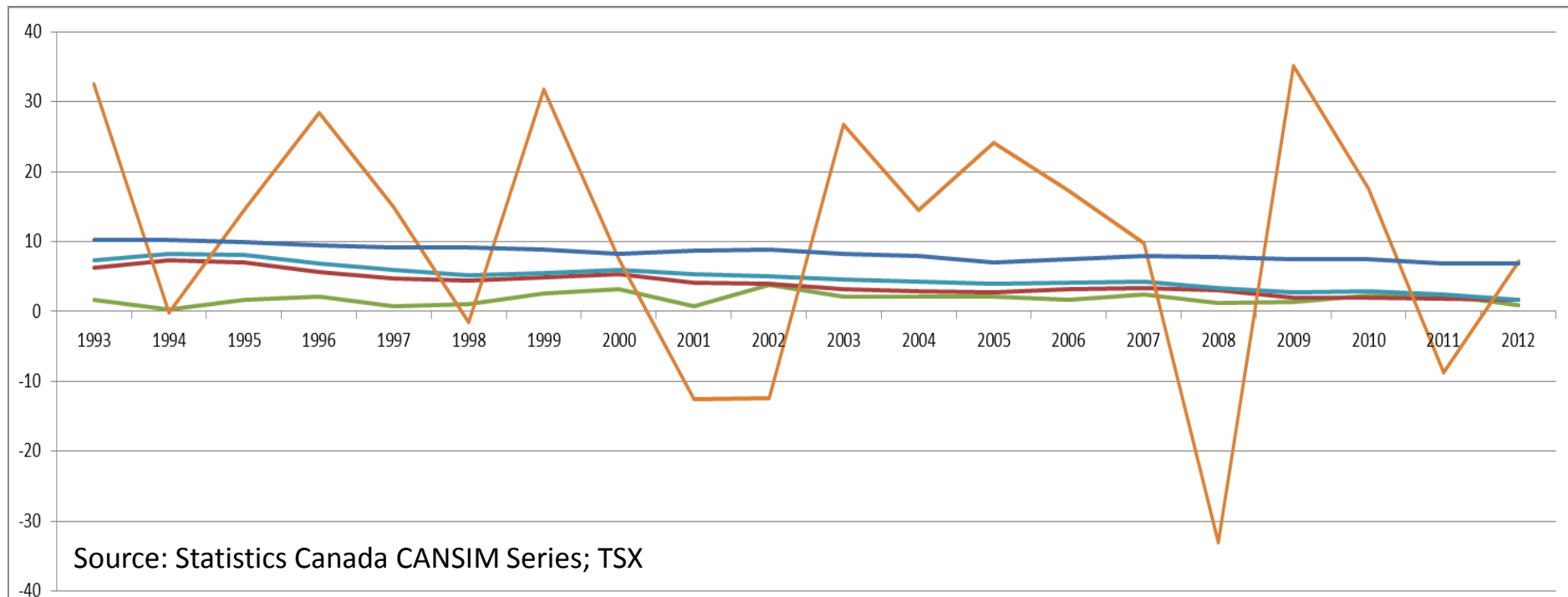
- Proportion of all dividends may be paid to shareholders, typically 90/10
- Shareholder interest may change the character of the fund and its operation
- Potential conflict of interest
- Example: Section 461 of the ICA of Canada prescribes the maximum amount of shareholder distribution

Surplus Retained

	Mechanism	Purpose	Objective
Canada  &  United States	Held as a Dividend Stabilization Reserve (DSR) or as an Unallocated Dividend Liability (UDL)	<ul style="list-style-type: none"> Provides a margin to allow changes to the dividend scale to be made in a smoother manner 	<ul style="list-style-type: none"> Usually managed close to zero
 United Kingdom	<ul style="list-style-type: none"> May not all distribute all surplus to policyholders / shareholders via bonuses Fund surplus assets or Inherited Estate 	<ul style="list-style-type: none"> Strengthen the regulatory capital position of the par fund Provide increased investment freedom Provide general working capital Support policyholders reasonable expectations (PRE) Help cover the cost of smoothing Cannot be used to fund new business 	Open funds: <ul style="list-style-type: none"> Longer-term view Generally not distributed Closed funds: <ul style="list-style-type: none"> Distributed in a fair manner over time Amount distributed depends on the plan's contribution to the fund's risk-bearing ability. Cautious investment view



Investment Strategy and Payouts

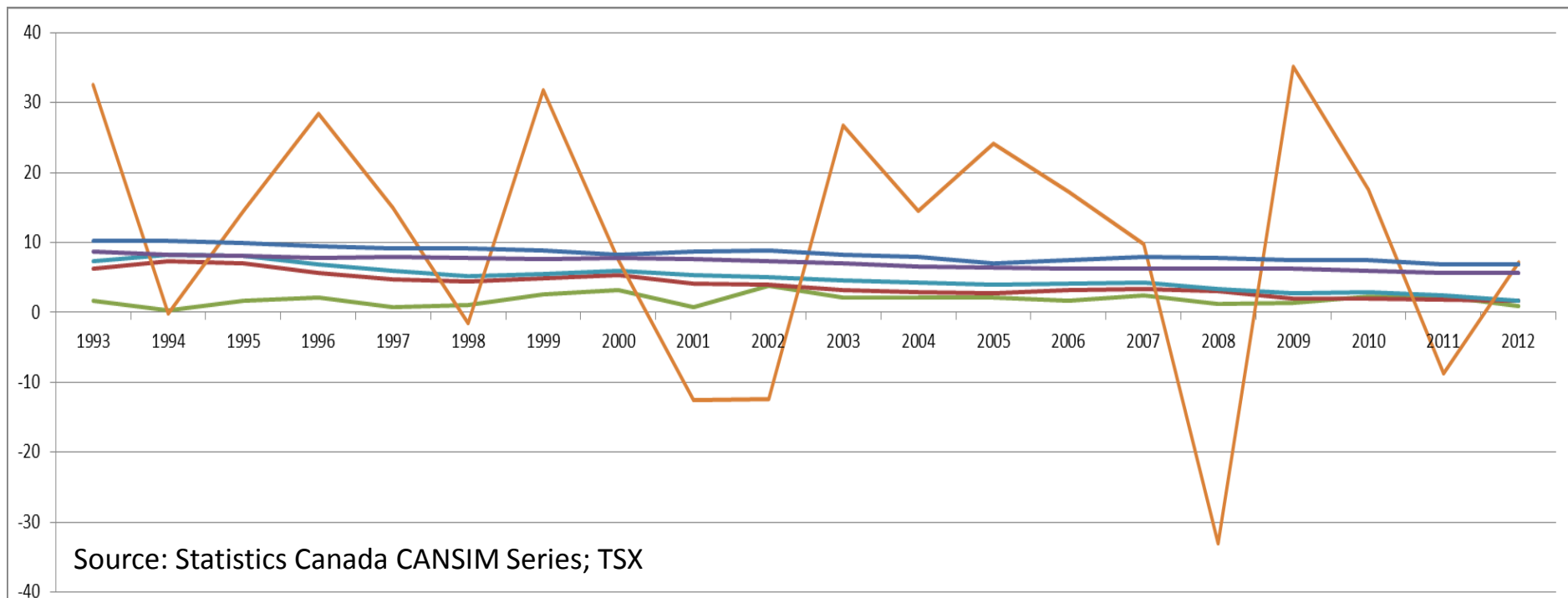
31 Dec 2012		Bonds	Equities / Stocks	Real Estate	Cash & Short-term	Policy loans	Mortgages	Other
Canada 🇨🇦	4	50%	13%	11%	2%	7%	15%	1%



- CPI
- Government of Canada marketable bonds, average yield, average of Wednesdays: 5-10 year
- Average dividend scale interest rate
- Chartered bank - Guaranteed Investment Certificates: 5 year
- S&P/TSX Composite



Investment Strategy and Payouts

31 Dec 2012		Bonds	Equities / Stocks	Real Estate	Cash & Short-term	Policy loans	Mortgages	Other
Canada 	4	50%	13%	11%	2%	7%	15%	1%
United States 	9	70%	4%	1%	2%	7%	12%	4%



-  CPI
-  Government of Canada marketable bonds, average yield, average of Wednesdays: 5-10 year
-  Average dividend scale interest rate
-  Chartered bank - Guaranteed Investment Certificates: 5 year
-  S&P/TSX Composite
-  WoL US average dividend scale interest rate

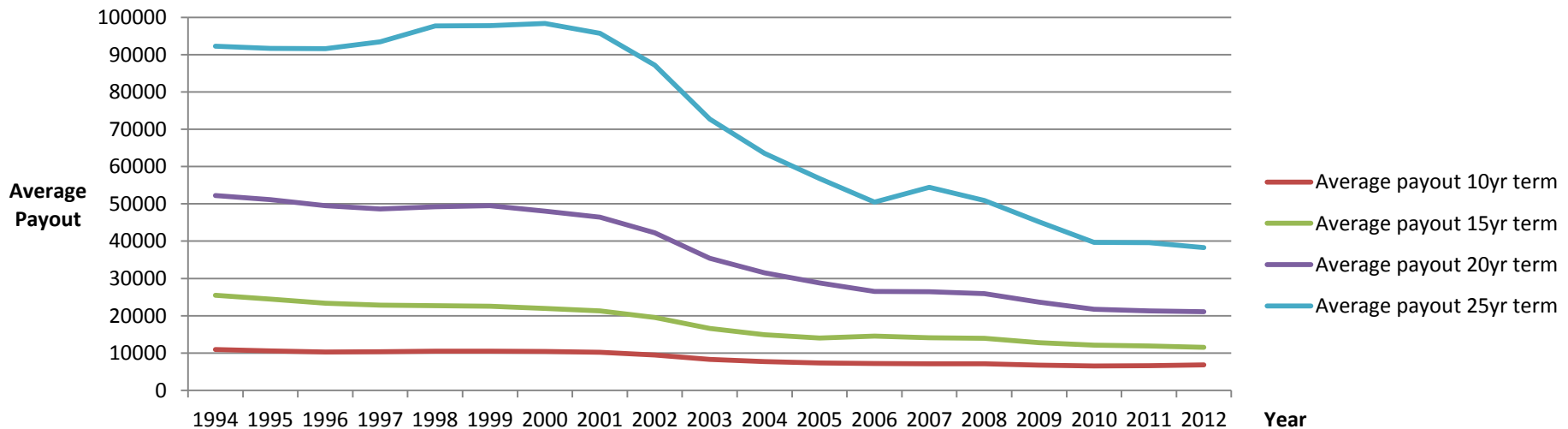
Investment Strategy and Payouts

31 Dec 2012		Bonds	Equities / Stocks	Real Estate	Cash & Short-term	Policy loans	Mortgages	Other
Canada 	4	50%	13%	11%	2%	7%	15%	1%
United States 	9	70%	4%	1%	2%	7%	12%	4%
United Kingdom ⁸	41	45.7%	34.2%	14.6%	3.8%	4.5%		

(8) Money Management With-Profits Endowment Survey results December 2012








Average payout for a male age 30 years next birthday with a premium of £50 per month⁹



(9) Money Management With-Profits Endowment Survey results December 2011

Investment Strategy and Payouts

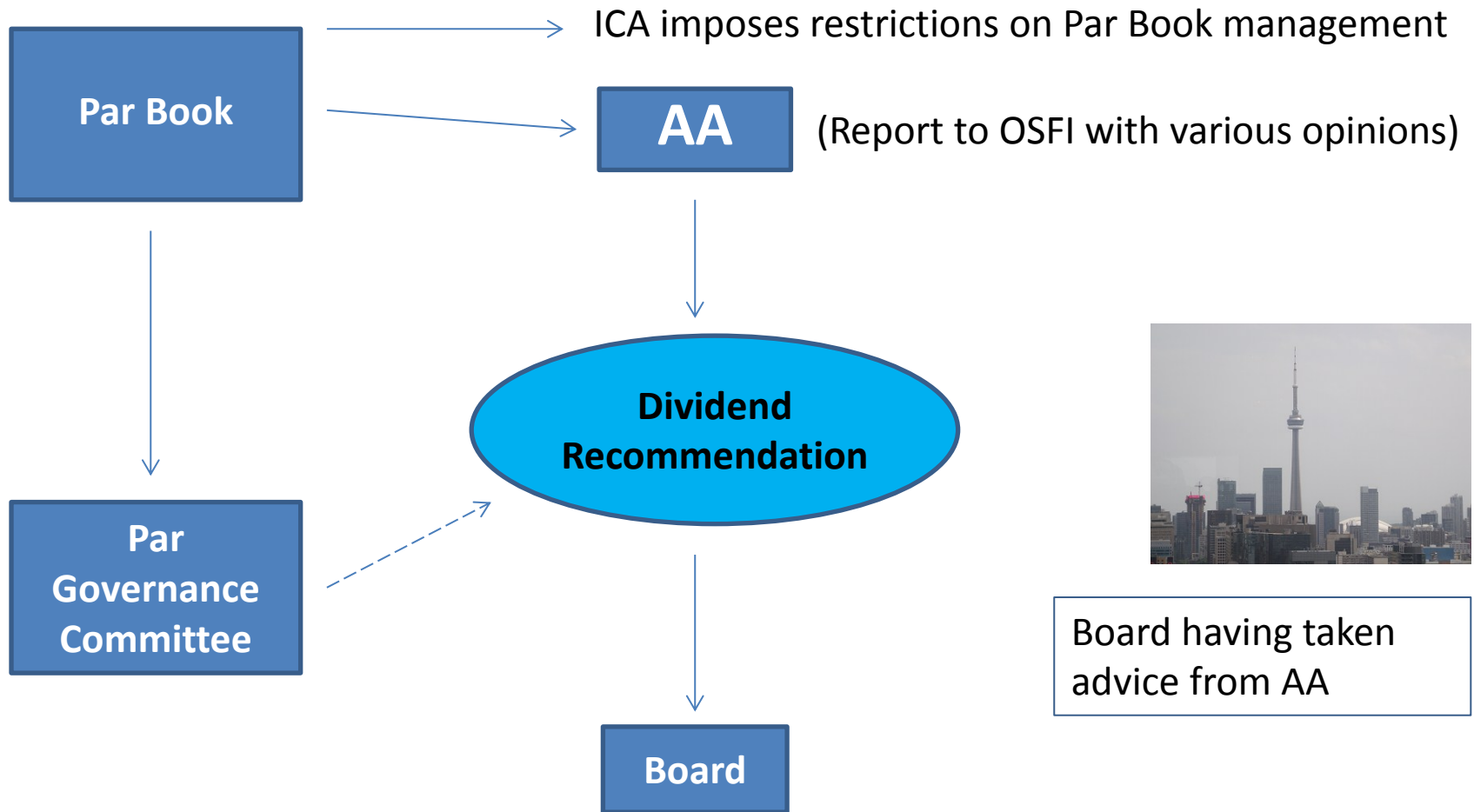
31 Dec 2012 (31 Dec 2011)		Bonds	Equities / Stocks	Real Estate	Cash & Short-term	Policy loans	Mortgages	Other
Canada 	4	50%	13%	11%	2%	7%	15%	1%
United States 	9	70%	4%	1%	2%	7%	12%	4%
United Kingdom	41	45.7%	34.2%	14.6%	3.8%	4.5%		
<i>UK Asset Share - Open funds</i> ¹⁰ 	17	39%	38%	14%	5%	4%		
<i>UK Asset Share - Closed funds</i> ¹⁰	15	63%	30%	4%	2%	1%		
<i>UK Estate - Open funds</i> ¹⁰	15	87%	-7%	-1%	10%	12%		
<i>UK Estate - Closed funds</i> ¹⁰	16	51%	5%	0%	33%	11%		
SL Asia  	2	81%	8%	0%	4%	4%	2%	2%

(10) Towers Watson Survey of With-Profit Funds December 2011

Investment Strategy and Payouts

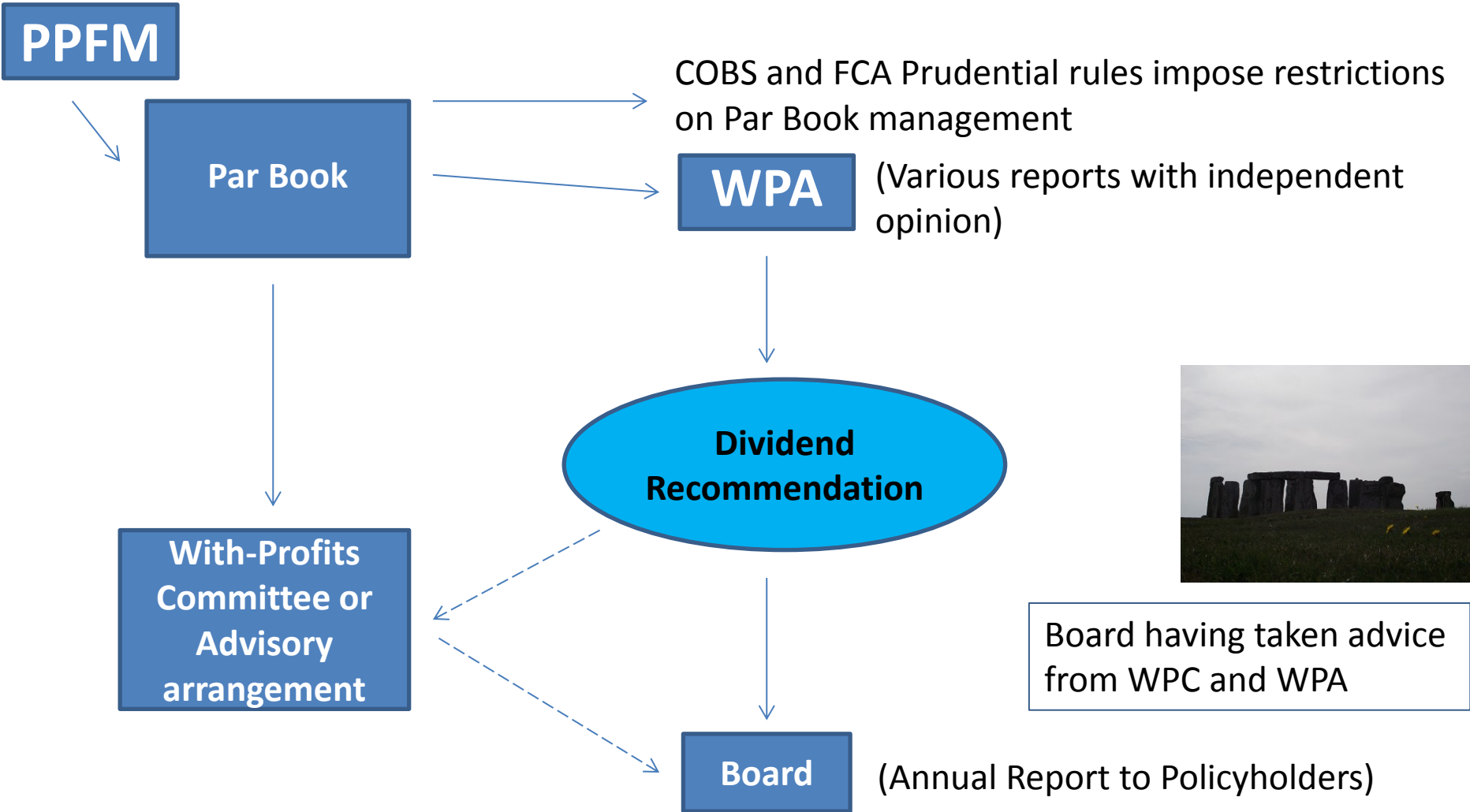
- To support and meet guarantees (and to minimise the risk of the par fund running out of money)
- To add value, for example, by holding a diversified mix of assets
- To minimise market risk
 - Reduction in equity backing ratio trend or adopting a hedging strategy
 - Different investment strategies for assets backing liabilities and surplus, and for open and closed par funds
- To provide good and equitable benefits to policyholders (and an appropriate return to shareholders)
- To meet the reasonable expectation of policyholders

Governance: Canada



Board having taken advice from AA

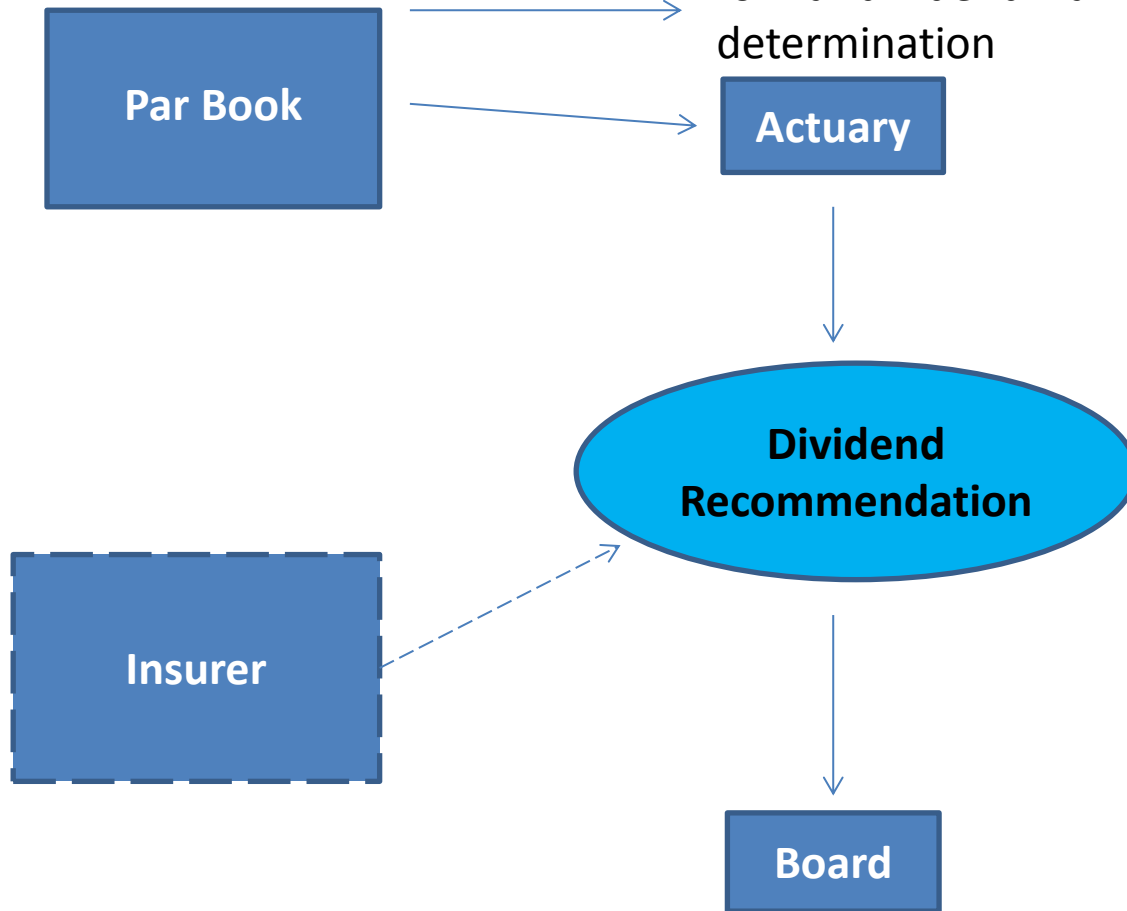
Governance: United Kingdom



Board having taken advice from WPC and WPA

Governance: United States of America

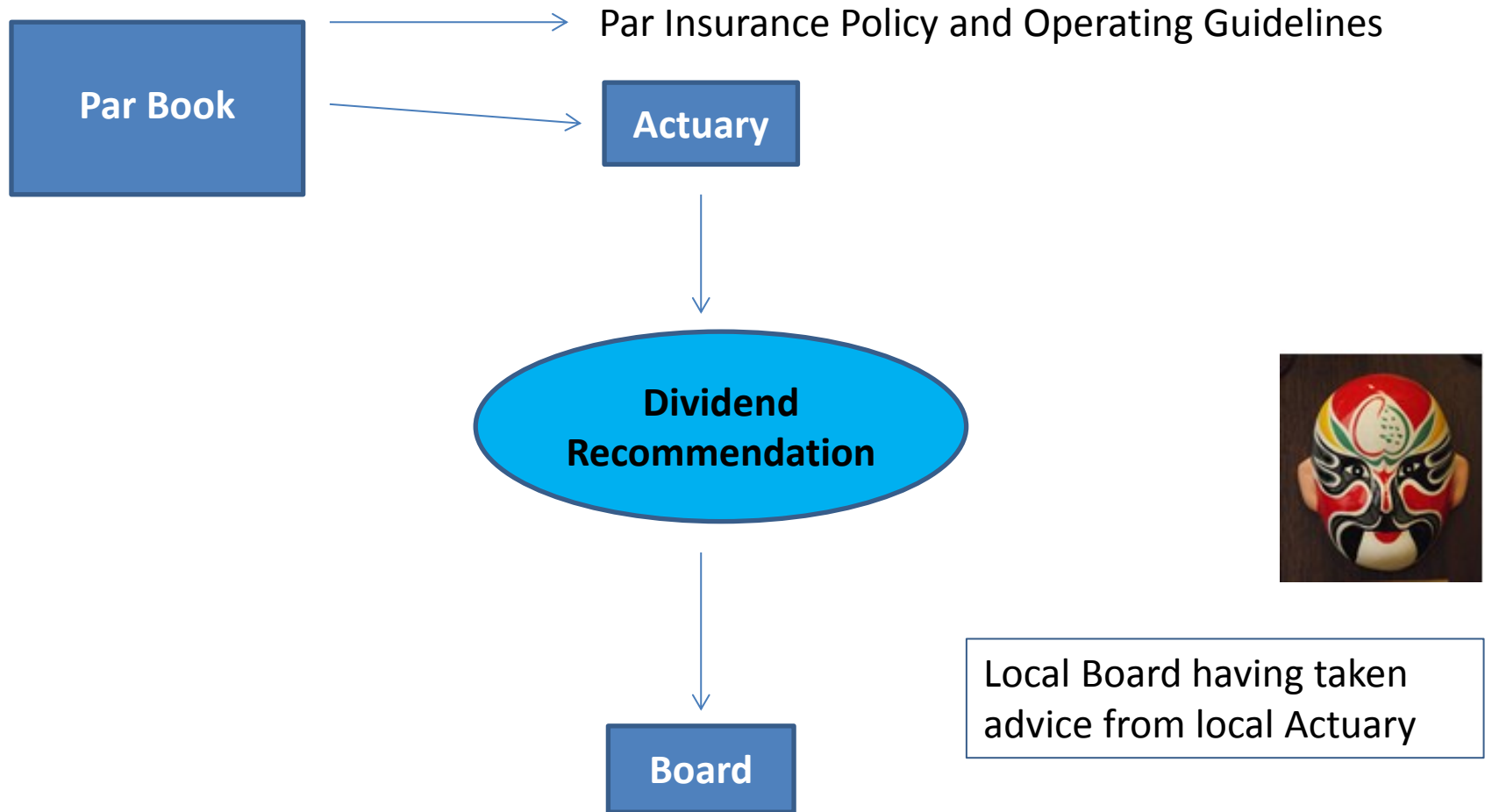
ASB US: ASOP 15 provide Professional Guidance for Par dividend framework modification and determination



Board having taken advice from Actuary



Governance: Asian Territories



Communication with Policyholders





- Always needs to be considered from the viewpoint of the par policyholder
- Be clear and transparent
- Frequency and timing
- Regulatory requirements for Illustrations
- Reasonable expectations of policyholders

Communication with Policyholders

General Principles	Examples
<p>Always needs to be considered from the viewpoint of the par policyholder</p>	<p>E-16 states various expected characteristics of par and adjustable product disclosures: “The description should be understandable by a person with a rudimentary understanding of life insurance concepts and vocabulary. Expert technical knowledge should not be required to understand the descriptions”</p>
<p>Be clear and be transparent</p>	<p>OSFI expects companies “to provide the information necessary for the policyholder to have an understanding of the operations of par accounts”, enabling them:</p> <ul style="list-style-type: none"> - to form reasonable expectations with respect to dividends, and - to obtain and reasonable knowledge of the nature of participation, the operation of participating accounts and the methods used in dividend declarations. <p>E-16: “The goal should be clear and straightforward communication that is informative and transparent and leads to an understanding of the company’s participating accounts and adjustable policies”</p> <p>United Kingdom: Communicating with clients, including financial promotions (COBS 4): COBS 4.2.1R: “A firm must ensure that a communication or a financial promotion is fair, clear and not misleading.”</p>
<p>Frequency and timing</p>	<p>Canada: A firms par policies should be disclosed</p> <p>United Kingdom: Communications with with-profits policyholders (COBS 20.4): PPFM (COBS 20.3 and COBS 20.4.1R); CFPPFM (COBS 20.4.5R); Annual report to WP policyholders including statement by WPA (COBS 20.4.7R, 20.4.8R, 20.4.9R)</p>

Policyholder Illustrations

Regulations													
United States 	<ul style="list-style-type: none"> Regulatory guidance: NAIC Life Illustrations Model Regulation (2001) Professional guidance: ASOP 24: Compliance with NAIC Life Insurance Illustrations Model Regulation (Actuarial Standards Board – US February 2007, document #142) 												
United Kingdom 	<ul style="list-style-type: none"> Regulators recently reviewed this aspect (<i>following “significant weaknesses in what firms are doing to ensure that policyholders receive sufficiently comprehensive, timely and clear information”</i>) Illustration rates: PS12/17 effective 6 April 2014: A projection must be calculated using rates that accurately reflect the investment potential of the product and do not exceed the following maximum rates of return: <table border="1"> <thead> <tr> <th></th> <th>Low</th> <th>Intermediate</th> <th>High</th> </tr> </thead> <tbody> <tr> <td>Life</td> <td>1.5%</td> <td>4.5%</td> <td>7.5%</td> </tr> <tr> <td>Pensions</td> <td>2.0%</td> <td>5.0%</td> <td>8.0%</td> </tr> </tbody> </table>		Low	Intermediate	High	Life	1.5%	4.5%	7.5%	Pensions	2.0%	5.0%	8.0%
	Low	Intermediate	High										
Life	1.5%	4.5%	7.5%										
Pensions	2.0%	5.0%	8.0%										

The Reasonable Expectations of Policyholders

Regulations

Canada



- CIA Standards of Practice definition: “the reasonable expectations by policyholders of the company’s exercise of discretion in matters concerning their policies. PRE arises from the company’s communications in marketing materials, from information provided at the point of sale (such as policyholder dividend and investment performance illustrations), from its past and continuing administrations practices and from general standards of market conduct.”
- Practice-Specific Standards for Insurance (paragraphs 2320.28 to 2320.34)
- AA opinions with respect to PRE
- Annual reports in support of the dividend fairness opinions
- A Company’s practices with respect to dividends and its communications related to dividend declarations

United Kingdom



- The phrase PRE has technically been superseded. However, the concept now resides within the obligations imposed upon firms by FCA Principle 6 ('...a firm must pay due regard to the interests of its customers and treat them fairly...')
- COBS 20.4.7 Annual Report to WP policyholders needs to address any competing or conflicting rights, interest or expectations of its policyholders
- COBS 20.2 Treating with-profits policyholders fairly

Thank You

- My colleagues at Sun Life Financial: Lesley Thomson, Cathy Cheoros, Marilyn Brown, Clement Lam, Michael Conwill, Steve Jones, Xu Pei, James Banks, Franziska Dennis, Brennan Kennedy, and Steve Lipkowski
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- Morgan Stanley: Jon Hocking
- Money Management: Jon Cudby
- KPMG LLP: John Jenkins, Francis de Regnaucourt, and Jeffrey Klanderma
- ACLI: Jiangmei Wang



Rosalind Rossouw FFA

rosalind.rossouw@sloc.co.uk

Case Study: With-Profits in Germany¹¹



- Regulator: BaFin and Largest Industry Association: Gesamtverband der Deutschen Versicherungswirtschaft (GDV)
- Assets: high proportion of fixed interest and policy loans with a low EBR
- Endowments purchased privately are paid for out of after tax earnings, and the gains made from investment returns receive favourable tax treatment:
 - Only 50% of a lump sum payment is taxed (on exit) and an annuity is taxed at 18% rather than the marginal tax rate
 - For private savings products, 85% of policyholders choose to take their benefits in the form of a lump sum on maturity rather than in the form of an annuity
- Contracts priced using a guaranteed minimum rate of interest regulated by German legislation:

	01/1942 – 06/1986	07/1986 – 06/1994	07/1994 – 06/2000	07/2000 – 12/2003	01/2004 – 12/2006	01/2007 – 12/2011	01/2012 -
Höchstrechnungszins	3,00%	3,50%	4,00%	3,25%	2,75%	2,25%	1,75%

- Bonuses differ for Endowment, Whole of Life and Term Assurance plans

(11) Morgan Stanley, Fat Tail Friday, “How German Life Works”

With-Profits in Germany

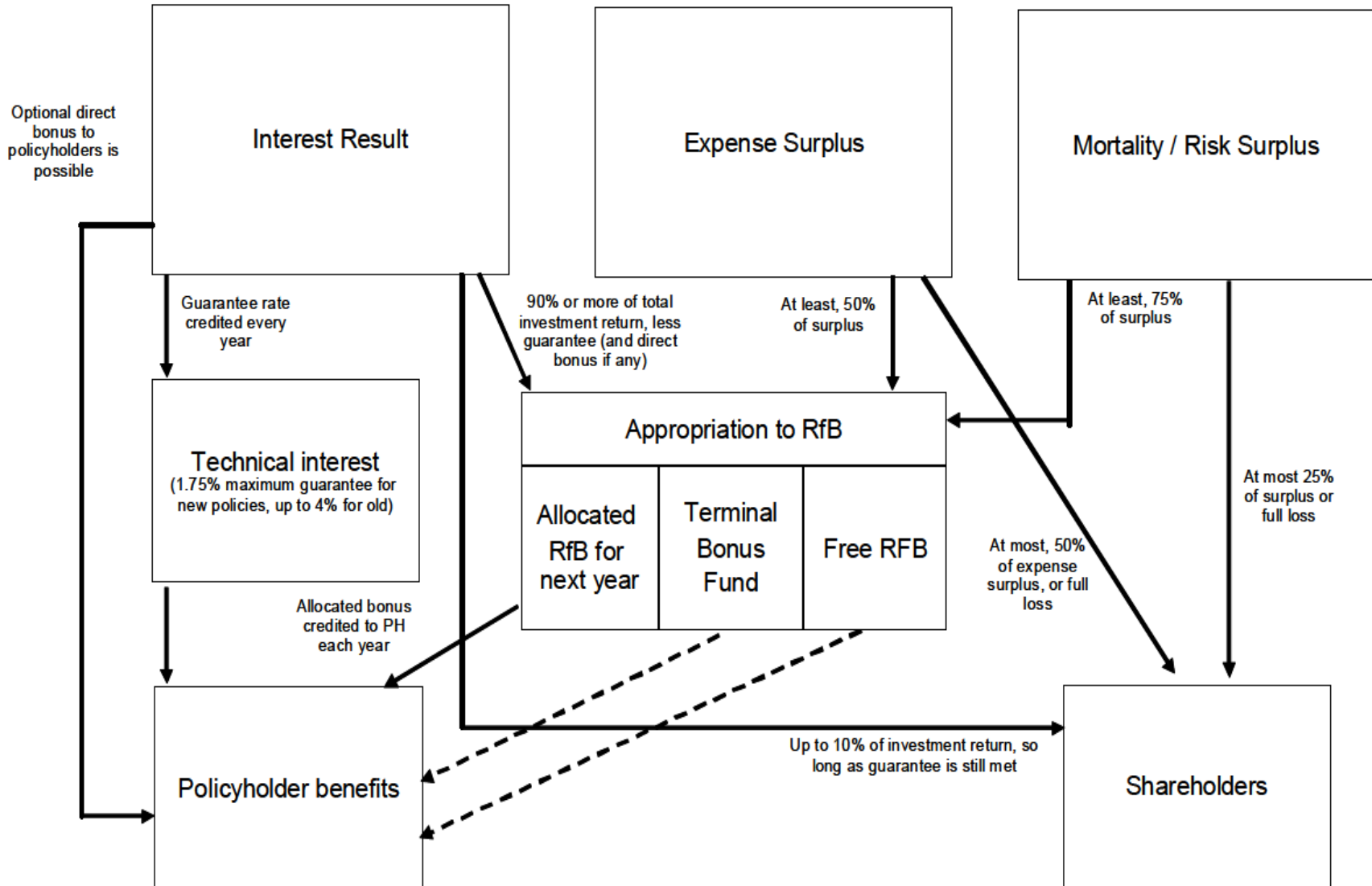


- Endowment plans:
 - annual bonus is guaranteed
 - primarily reflects investment experience above the guarantee rate as priced
 - expense, loading or additional experience surplus can be allocated
 - terminal bonus used to allocate balance of surplus not distributed via interest
 - terminal bonus tends to be small for Endowment plans
- Whole of Life and Term Assurance plans:
 - not strictly an annual / terminal bonus allocation
 - For example:
 - surplus allocated by a reduction to premiums with no increase to benefit, or
 - surplus allocated via single bonus paid only on death (expressed as a % increase to benefit paid)
 - percentage allocated much larger in magnitude (around 20% - 50%)

German With-Profits Model



German profit-sharing model – only limited pools of profits can be directed towards shareholders



With-Profits Germany: Audience Participation

- What is the main benefit of the complex Rules?
- What are Germany's three biggest challenges when it comes to with-profits?
- What safeguards could be used?

