The Inherited Estate

ACA Life Assurance Meeting, April 24 2008

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Agenda

- Background to TSC Inquiry
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- ACA Submission
- Recent Events

Background to TSC Inquiry

- Some Insurers looking to attribute Inherited Estate (IE)
- Some discussion on the previous Axa attribution
- The appointment of the first Policyholder Advocates (PHA)
- Press coverage of attributions – not all positive
- Public discussion between Norwich Union ("NU") PHA and the Financial Services Authority ("FSA")

TSC Inquiry

- 26 February 2008 announced inquiry into the IEs, held by life assurance companies' with-profit ("WP") funds
- Asked for written evidence by 14 April 2008
- Oral evidence at a later date
- General inquiry into the appropriate use of IEs, their ownership and the attribution process, including the role of the policyholder advocate
- TSC raised 11 particular issues it welcomed evidence on

TSC's 11 issues (1)

1. The regulatory definition of the IE in a WP fund
2. The extent to which life insurance companies should be permitted to diminish the IE in order to subsidise corporate activity, including financing new business, making strategic investments, paying shareholder tax and paying the costs of compensation for misspelling
3. Whether allowing life insurance companies to use the IE to subsidise corporate activity has any adverse effects on competition
4. The principles that should guide the division of inherited estates in 90:10 funds between policyholders and shareholders upon attribution of the estate

TSC’s 11 issues (2)

5. The appropriate sharing of the IE between the current and future policyholders
6. Whether policyholders’ reasonable expectations (“PRE”) of distributions from the IE should be zero or have a positive value
7. Whether any distribution of benefits from the IE should be made in a single payment or phased over several years
8. The role and responsibility of the PHA
9. The framework for negotiation between the PHA and life assurance companies
10. The role of with-profits committees of life assurance companies
11. The approach of the FSA to the issues of IE

ACA Submission

- Drafted by ACA life insurance committee
- After discussion chose to focus on five of the TSC's points where it was felt that the ACA's members had specific views
- Other points were more generic and the ACA did not feel it had anything new or different to add
- Also a desire to keep the response concise and relevant

PRE of Distribution (1)

- Whether PRE of distributions should zero or have a positive value?
  - ACA accepted FSA’s legal argument that the IE is owned by the firm as part of its assets and that policyholders have a contingent claim on it
  - PRE is determined by the level of the IE.
  - Where IE is fully used to support the running of the business and there is no excess surplus then PRE of a distribution is at that time is zero
  - If fund has excess assets (more assets needed to run the business based on the level of its risk appetite) then the PRE of a distribution may be greater than zero

PRE of Distribution (2)

- There are many factors governing how PRE will apply in this case including
  - How the company assesses the level of excess assets
  - Which in turn depends on business plans and risk appetite (which may change over time)
  - Past practices, including policyholder communications, PPFMs, derivation of past benefits and smoothing policies
  - How the excess had arisen and how much the current generation had contributed to it
  - How much of the excess could be distributed and over what period and to whom
- All of the above are unique to each situation and thus the PRE of a distribution is determined by the merit of each individual case and not set by a general expectation of a distribution

Role of PHA (1)

- The role and responsibilities of the PHA
  - Clear need for interests of WP policyholders to be put forward by an independent voice during the attribution process
  - Not the role of either the company or WP committee
  - ACA agreed there is a need for a PHA
  - One possible shortcoming of present structure is that policyholders do not have recourse to the Financial Ombudsman Scheme
  - Attributions generally a court based process where individual policyholders can make representations
  - To be too prescriptive on PHA role and responsibilities would risk not recognising the unique circumstances of each IE attribution

Role of PHA (2)

- Current system does have its risks
  - In the absence of clear guidance on roles and responsibilities there is a risk that the PHA may have a wider vision of the role than was originally anticipated and the attribution process may take a long time
  - Currently the reattribution and transfer costs are met by the shareholders, but only a reasonable proportion of the PHA's costs are met by the policyholders
  - ACA would like to see further clarification on the definition of reasonable
  - It would not be unreasonable for all PHA costs to be met by shareholders
  - ACA considers it reasonable that if an attribution fails it is the initiator pays the costs

Negotiation Framework

- Framework for negotiation between PHA and insurers
  - Currently potential for significant overlap, and costs, between the various parties involved
  - ACA seeks greater clarity in the roles of each of the IE, FSA and PHA
  - ACA seek greater clarity in how the PHA should balance the interests of different groups of policyholders when negotiating with life insurance companies
  - There is the risk that the PHA and insurer may take different views on the appropriate use of the IE and its consequent capital implications and costs
  - ACA acknowledges that this is part of negotiation process but would look for a consistent approach between the FSA and PHAs

With Profits Committees (1)

- The role of WP Committees
  - Role laid out in COBS to independently review compliance with PPFM and to address conflicting interests of policyholders and if necessary shareholders
  - WP committees no explicit remit to negotiate on behalf of WP policyholders in an attribution
  - That is the role of PHA
  - WP committee does act in interest of WP policyholders and much of what is does is not in the public domain and potentially unrecognised
  - There is a trade off between the transparency of the actions of the WP committee and the effectiveness of these actions

With Profits Committees (2)

- ACA believes WP committees are an effective protective element in WP governance and would not seek to extend their role in the negotiation of IE attributions as this is currently best performed by the PHA

FSA and IE

- The approach of the FSA to the IE issue
  - ACA generally supportive of the 90:10 approach
  - We note that not all funds are 90:10 funds
  - The 90:10 approach appears to be interpreted differently by different parties
  - Supportive of FSA's stance on use of IE
  - In particular to look again at use of IE to pay for misselling costs
  - ACA acknowledges that there are two sides to the argument, but on balance the shareholders picking up the costs is probably the stronger argument

Final Plea

- The ACA pointed out that many of the WP companies are small and often mutual organisations
- Much of the discussion on the IE has been in the context of a proprietary company making an attribution
- If the rules and guidance on the uses of IE are changed the new rules must allow me equally applicable for small firms

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Recent events

- TSC now taking oral evidence
- April 22
  - Peter Vicary-Smith & Dominic Lindley, Which
  - Claire Spottiswoode, PHA for NU
  - Hector Sants and Sara Wilson, FSA
- April 30
  - Mark Hodges, NU
  - Nick Prettejohn, Prudential