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A REVIEW OF POLICYHOLDERS' REASONABLE EXPECTATIONS

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ABSTRACT

In the light of recent judgments by the courts, there are areas where the interpretation of Policyholders' Reasonable Expectations (PRE) by actuaries may need to be reassessed. Furthermore, the discussion paper on the exercise of discretion expected from the Financial Services Authority (FSA), as part of its review of with-profits business, is likely to raise wider issues.

The time is therefore right for actuaries to have the opportunity to debate how PRE should be interpreted in the future. This paper is presented as a catalyst to enable that debate to happen, and the authors have set out their own views on some of the key issues.

The paper discusses certain areas where the interpretation of PRE adopted by Appointed Actuaries in the past may no longer be consistent with recent court judgments. Following that discussion, the actuarial profession should attempt to establish a revised interpretation of PRE, in order to provide greater assistance to Appointed Actuaries currently advising on with-profits business.

KEYWORDS

Policyholders' Reasonable Expectations; Discretion; Smoothing; Equitable Life; AXA; Needler; Taber

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1. INTRODUCTION

1.1 Since the concept was first introduced in the Insurance Companies Amendment Act 1973, Appointed Actuaries and their colleagues within the Regulators have debated the meaning of Policyholders' Reasonable Expectations (PRE). Whilst it was clear that the definition of PRE was ultimately a matter for the Courts, the matter had never been tested. In the absence of a legal ruling, the actuarial profession and the Regulators have developed an informal framework within which Appointed Actuaries have operated.

1.2 Some guidance was provided to Appointed Actuaries through GN1.

Following this, a working party of the profession gave some further suggestions and an indication of how Appointed Actuaries were interpreting PRE in reports which were published between 1990 and 1993.

1.3 Recently the situation has changed. Two significant cases involving PRE have been tested in the courts, and in at least one of these the judgment conflicted, in some important respects, with PRE as interpreted by some actuaries at the time. More recently the Financial Services Authority (FSA) has set up a review of with-profits business, to include elements of PRE. At the time of writing this paper, the authors have not seen what the FSA paper covering PRE might contain, but a discussion document is expected to be published by the time this paper is presented.

1.4 The time is therefore right for actuaries to have the opportunity to debate how PRE should be interpreted in the future. This paper is presented as a catalyst to enable that debate to happen.

1.5 The paper is presented in the following sections:

- Section 2 provides the historical background and sets out the central position that PRE occupies in the regulation of United Kingdom life assurance business.
- Section 3 summarises the impact of the Court judgments in the Equitable Life Assurance Society case, the AXA case and the *Needler v Taber* case.
- Section 4 discusses certain areas where the interpretation of PRE adopted by Appointed Actuaries in the past may need to be reassessed.

1.6 Throughout this paper reference is to PRE, though the Financial Services and Markets Act 2000 (FSMA) has replaced this with 'treating customers fairly'. The authors believe that the latter will be interpreted as embodying the former, and that, for the purpose of this discussion, it is easier to use the terminology with which actuaries are familiar.

1.7 This paper deals primarily with PRE in relation to with-profits business, but the comments, for example in relation to the exercise of discretion, are equally applicable to unit-linked business.

2. BACKGROUND TO THE REGULATORY FRAMEWORK

2.1 *Background to U.K. Long-Term Insurance Contracts*

2.1.1 Insurance contracts provide a significant part of the long-term savings market in the U.K., as well as providing protection in the event of early death or longevity in retirement. With-profits business forms a significant proportion of in force business, and more than 50% of new business.

2.1.2 With-profits insurance contracts used for savings differ from most other U.K. savings contracts, in that the policyholder is committed for the

long term, but a significant part of the benefit provided by the contract is at the discretion of the company or society. The rationale for such discretion is to give policyholders the benefit of investment in a broad range of types of asset whilst protecting them from the full volatility of such investment. This differs from, for example, a building society deposit account, where the interest is at the discretion of the society, but the depositor has the option of withdrawing the face value of the deposit at any time.

2.1.3 In proprietary offices, with-profits contracts commonly share distributed profits with shareholders in a proportion, normally constrained by the Articles of Association to policyholders receiving at least 90%. In other cases, shareholders' profits are derived from charges less expenses, and the investment element of policyholders' funds is invested in the with-profits fund on a mutual basis. Much new business is written using this latter approach. In mutual insurance companies and friendly societies, policyholders receive 100% of distributed profits. Profits in proprietary and mutual companies and societies are allocated to policyholders at the discretion of the directors, after receiving the advice of the Appointed Actuary.

2.1.4 Directors of life insurance companies are expected to behave as if they had a fiduciary responsibility towards policyholders, because of the nature of the business, whereby premiums are received from members of the public in return for a paper promise. The ability to deliver satisfactorily on that promise, not only in contractual terms, but in accordance with PRE, possibly many years into the future, necessitates sound financial management, and is the background to the need for a significant level of regulation of the business.

2.2 *The Role of the Appointed Actuary*

2.2.1 The Insurance Companies Act 1982 has been re-enacted in the FSMA, which contains the primary legislation relating to life insurance companies. In many areas the FSMA lays down broad principles leaving detailed supervision to be covered by the FSA *Interim Prudential Sourcebook*, but the essence of the regulation is unchanged.

2.2.2 Section 340-1 enables the FSA to make rules requiring every life company to appoint an actuary, known as the Appointed Actuary, to undertake certain duties. The Appointed Actuary has wide responsibilities in relation to monitoring the adequacy of the assets to meet the liabilities on a continual basis.

2.2.3 The duties of the Appointed Actuary include making an annual investigation into the financial condition of the company and reporting the findings of the investigation to the directors of the company. An abstract of this report is included in the annual return which the company is required to submit to the Insurance Directorate of the FSA, which is responsible for the supervision of life insurance companies. The Appointed Actuary also has a

duty to advise the company with regard to the commission equivalents and appropriate charges to include in projections of future benefits.

2.2.4 The FSMA does not seek to regulate directors either in the design of contracts or in the determination of premium rates. Rather, the emphasis is on continual monitoring of the solvency of the office by the Appointed Actuary, who has a duty to report annually, and 'whistle blow' in the event that the directors act in a way that would threaten solvency. This is regarded as providing a more effective degree of monitoring than can realistically be expected of the FSA.

2.2.5 The Appointed Actuary system of regulation is generally regarded as having proved highly effective in protecting policyholders in recent years.

2.3 *Practising Certificates*

The FSMA prescribes that an Appointed Actuary must be a Fellow of the Faculty of Actuaries or Institute of Actuaries. The Faculty and Institute of Actuaries permit their members to take up a position as Appointed Actuary only if they hold a current Practising Certificate from the profession. In deciding whether to grant such a certificate, the profession requires several years of relevant experience, an unblemished professional record and compliance with a scheme of continuing professional development. Evidence of a failure to comply with professional conduct standards or standards of practice set out in Guidance Notes could lead the Faculty and Institute of Actuaries to refuse to renew an actuary's certificate.

2.4 *Professional Guidance to Appointed Actuaries*

2.4.1 The Appointed Actuary to every life insurance company has to comply with professional guidance notes GN1 and GN8 issued by the Faculty and Institute of Actuaries. They are practice standard guidance notes, and are thus mandatory on the Appointed Actuary. The Appointed Actuary has to certify whether he has fully complied with practice standard guidance notes in his certificate to the FSA, as part of the annual returns which life insurance companies make to the FSA. In this way GN1 and GN8 have a place in the insurance company regulatory framework. GN1 deals with general matters and GN8 deals with the interpretation of valuation regulations.

2.4.2 GN1 makes it clear that continuously monitoring the financial condition of the company involves keeping track of everything that might impinge on its financial condition. These include:

- being consulted on the design of new products;
- the setting of premium rates and marketing plans;
- monitoring options and guarantees;
- monitoring investment policy to ensure that it is appropriate to the nature and term of the liabilities;

- current and likely future level of expenses;
- reinsurance arrangements; and
- the level of free assets.

2.4.3 GN1 requires the Appointed Actuary to supplement the annual investigation into a company's financial condition with a report to the directors on the results of a dynamic financial analysis. GN2, which is recommended practice, sets out the profession's view on how this dynamic financial analysis should test the company's ability to withstand possible future adverse conditions, making use of cash flow projections on a variety of assumptions.

2.4.4 GN1 also requires the Appointed Actuary to advise on the disclosure of charges and expenses in sales projections in line with GN22.

2.4.5 The reserving standard which was intended with the passage of the 1982 Act, and which was subsequently embodied in FSA rules and the actuarial Guidance Notes, incorporated the requirement to make proper provision for all liabilities on prudent assumptions that shall include appropriate margins for adverse deviation of the relevant factors. When assessing the liabilities, the Appointed Actuary must also have due regard to PRE. The 1982 Act was thus much more than a solvency standard for the guaranteed liabilities.

2.5 *Policyholders' Reasonable Expectations*

2.5.1 Although the FSMA uses the term 'treating customers fairly', it does not contain any definition of PRE. Because the concept of PRE is not defined in statute, any interpretation is inevitably a matter for the courts. However, until the recent Equitable Life and AXA cases, there had been no legal cases which tested the concept, so the regulators and the actuarial profession built up an informal framework over the years to determine what constitutes PRE.

2.5.2 On 24 February 1995, Mr. Jonathan Evans, Corporate Affairs Minister of the Board of Trade, stated, in response to a Parliamentary Question on 'orphan assets', that:

"The Department considers that policyholders' reasonable expectations in respect of attribution of surplus are influenced by a range of factors, notably:

- the fair treatment of policyholders vis a vis shareholders;
- any statements by the company as to its bonus philosophy and the entitlement of policyholders to a share in profit, for example, in its articles of association or in company literature;
- the history and past practice of the company;
- general practice within the life insurance industry."

2.5.3 The actuarial profession agrees that these are the relevant factors to consider in determining PRE, and, in the wider context of distribution of bonuses, would add:

- fair treatment amongst different groups and generations of policyholders.

2.6 *Actuarial Working Party on PRE*

2.6.1 Recognising the difficulty for actuaries in advising on PRE, the actuarial profession set up a working party, which reported between 1990 and 1993. No formal guidance resulted, but the working party reports are available on the profession's website. In relation to a series of interviews conducted with Appointed Actuaries, the first report of the working party stated:

"In almost every interview the point emerged as to what level of sophistication it was relevant to attribute to the policyholders in PRE. The point was repeatedly made that the policyholder himself generally had little understanding of the kinds of technical issue raised by PRE. Generally the view emerged that the expression should be interpreted in the context of professional advisers acting on behalf of policyholders, the courts, the press and similarly well informed observers of the life insurance industry."

2.6.2 In the same report, it was stated, in relation to policies which have a discretionary element:

"The holders of such contracts may reasonably expect that life offices will behave fairly and responsibly in exercising the discretion which is available to them. They may also expect a reasonable degree of continuity in an office's approach to determining variable charges or benefits."

2.6.3 The working party also concluded that:

"in the normal day-to-day actuarial management of a life office PRE is virtually synonymous with equity and the almost universal method for measuring it is asset-share calculations"

2.6.4 Asset shares are the accumulation of premiums less expenses incurred, allowing for the investment return earned for a group of similar policies. In making the calculations, the asset share would normally be charged for the cost of accruing guarantees, life cover and any capital charges.

2.6.5 The asset share is a guideline or benchmark rather than an absolute constraint. In practice, there may be good reasons why a particular group of policyholders should be entitled to more than just asset shares, or in some circumstances less, for example because of the effect of smoothing.

2.7 *PRE for Policies with Guaranteed Annuity Options*

2.7.1 GN1 gives little guidance on the specific interpretation of PRE for policies with guarantees or options. In the case of guaranteed annuity options, Appointed Actuaries were helped by the Position Statement issued by the actuarial profession and by the 18 December 1998 letter from Martin Roberts, written on behalf of HM Treasury. These are reproduced in Appendices 1 and 2 respectively.

2.7.2 These documents point to the view at that time, that reductions in bonus are appropriate for the class of policies containing guaranteed annuity rates (GARs) to meet an element of the emerging cost of GARs, but this was not necessarily the full emerging cost. However, it was by no means universally accepted that it was appropriate to declare differential terminal bonuses depending on the option selected.

3. RECENT COURT JUDGMENTS

3.1 *The Equitable Life Assurance Society*

3.1.1 The first significant test of PRE in the courts came in 1999. The dispute arose between the Equitable Life and a number of with-profits policyholders who have policies containing GARs. The latter disputed the manner in which the directors of Equitable Life exercised their discretion as to the allocation of final bonus.

3.1.2 Equitable Life brought a representative action against a policyholder, Mr Hyman, in order to obtain a declaration, in particular that its directors had exercised their discretion properly in relation to final bonus.

3.1.3 Equitable Life's position was that the guaranteed minimum annuity amount at retirement was determined by the application of the GAR contained in the policy to the guaranteed fund. The actual annuity amount could clearly be greater than this minimum, but the minimum is as just defined. Equitable Life's practice in relation to this matter was to seek to allocate final bonus amounts which ensured that the actuarial value of the annuity taken was no greater and no less than the policyholder's asset share, subject to the guaranteed minimum annuity amount referred to above. If, and to the extent that, final bonus was added to the guaranteed fund, the GAR would also apply to such final bonus amounts.

3.1.4 The position of Mr Hyman was that the guaranteed minimum annuity amount at retirement should be determined by the application of the GAR contained in the policy, not just to the guaranteed fund, but also to any final bonus amount otherwise available. Mr Hyman thus argued that the final bonus should be the same whether the policyholder took the benefits in guaranteed annuity form or elected to take the benefit in fund form, and should not be reduced to reflect the cost of providing the guarantee.

3.1.5 It was widely accepted that Equitable Life was unusual in the way that it conducted its financial affairs. The essence of the concept was that Equitable Life regarded with-profits policyholders as participating in a 'managed fund'. The premiums they paid, after meeting expenses and the cost of life cover and other benefits and options, were invested in the managed fund. The benefits that a policyholder ultimately receives would reflect the value of the assets in the fund attributable to his policy, i.e. that policyholder's asset share.

3.1.6 Put simply, that is that the business belonged to the current generation of with-profits policyholders. These policyholders participated in a pooled fund and, when they left, should take 'full value' from the fund. In particular, Equitable Life did not believe in the concept of an 'estate', in the sense of a body of assets passed from generation to generation, and which belongs to no-one.

3.1.7 After hearing evidence that had been presented to the High Court and to the Appeal Court, the House of Lords gave judgment in favour of Mr Hyman and against Equitable Life. Their reasoning was that:

"final bonuses are not bounty. They are a significant part of the consideration for the premiums paid. The directors' discretions as to the amount and distribution of bonuses are conferred for the benefit of policyholders. In this context the self-evident commercial object of the inclusion of guaranteed rates in the policy was to protect the policyholder against a fall in market annuity rates by ensuring that if the fall occurs he will be better off than he would have been with market rates. The choice is given to the GAR policyholder and not to Equitable Life. It could not be seriously doubted that the provision for guaranteed annuity rates was a good selling point in the marketing by Equitable Life of the GAR policies. It was also obvious that it would have been a significant attraction for purchasers of GAR policies. Equitable Life had pointed out that no special charge was made for the inclusion in the policy of GAR provisions but this factor did not alter the reasonable expectations of the parties."

3.1.8 Equitable Life had thought that, if the case went against it, it could have declared a differential bonus which varied, not according to the form in which the benefits were taken, but according to whether the policy did, or did not, include GARs. If the suggestion were sound in law, the directors could, in that way, erode the substantial value of the guarantees by different means. However, the House of Lords determined that this suggested route was not open to the Society, because the object would still be to eliminate, as far as possible, any benefit attributable to the inclusion of a GAR in the policy.

3.1.9 The House of Lords' judgment took account of the particular circumstances of Equitable Life, and it clearly differed in important respects from what had become a reasonably widely held interpretation of PRE.

3.1.10 Legal opinion differs over the extent to which the House of Lords' ruling is applicable to other offices. The actuarial profession briefing statement has been replaced by a recommendation that offices should seek legal advice. The Regulator's letter of 18 December 1998 was withdrawn shortly after the announcement of the House of Lords' judgment, and has not been replaced. Rather, the FSA have asked to receive copies of legal opinions obtained by other offices, and have held individual discussions with offices that might be affected.

3.2 *AXA*

3.2.1 The AXA case refers to a 'Schedule 2C Transfer' of the long-term business of AXA Equity & Law Life Assurance Society plc to AXA Sun Life plc, that was approved by the High Court on 21 December 2000.

3.2.2 An integral part of the scheme involved an attribution of the inherited estate in AXA Equity & Law between policyholders and shareholders. On 11 January 2001 Mr Justice Evans-Lombe set out the detailed reasons for his approval of the scheme. This judgment makes several references to PRE, particularly in relation to PRE in respect of the inherited estate. The judgment states that it is accepted that the starting point for assessing the PRE of a long-term policyholder is his 'asset share'. It also states that:

"It is accepted that PRE results from a number of different sources and that it will vary in extent from company to company. It is the collective reasonable expectations of the policyholders of a company as a class. Those sources include the company's promotional material, the provision of its Articles, the past practice of the company, in particular its bonus policy, and the current practice of the insurance industry generally."

3.2.3 Specifically, in relation to the inherited estate, the judgment concludes:

"It is not an issue that an AXA policyholder would have PRE in the inherited estate to the extent it has been available to back its policy and for the uses which I have described above (supporting investment policy, smoothing etc). Such a policyholder would also have a reasonable expectation that any distribution from the long term fund would be on the basis of 90/10 in favour of policyholders. In my judgment, however, an AXA Equity & Law policyholder would not have, prior to the promulgation of the Scheme by AXA, a reasonable expectation that the whole or any part of the inherited estate would be distributed to him as a bonus or otherwise during the currency of his policy. In particular, it would not be a reasonable expectation for him to hold that the Directors of AXA would promote a scheme of reorganisation which involved the distribution of the inherited estate."

3.3 *Needler v Taber*

3.3.1 The case of *Needler v Taber* concerned the use of demutualisation windfall benefits in the calculation of compensation payments for mis-selling. The judgment handed down by the Vice Chancellor on 31 July 2001 did make reference to PRE, again with particular reference to PRE in relation to the inherited estate that was distributed at the time of the demutualisation of the company concerned.

3.3.2 In a similar ruling to that described in the AXA case above, the Vice Chancellor ruled:

"the policyholder was contractually entitled to share in the profits of the Society by way of bonus. Such bonus was likely to provide him with a reasonable return on his asset share in accordance with the PRE. But in the absence of the transfer of the long term business

under the Insurance Companies Act 1982 or the winding up or closure of the Society to new business it was most unlikely that he would ever share in a distribution of the inherited estate'

3.4 *Impact of Court Cases on the Interpretation of PRE*

3.4.1 The legal judgment in the Equitable Life case in the lower courts revolved primarily around policy wordings and the directors' responsibilities set out in the Articles. In the House of Lords' judgment, the proper exercise of discretion and the primacy of contractual entitlement were the main factors in the decision. The judgments in the AXA and Needler v Taber case focused particularly on PRE in relation to the inherited estate.

3.4.2 It does appear that the courts are likely to take a more straightforward interpretation of PRE than that to which actuaries have become accustomed; that is, an interpretation unencumbered by complications of the equity of asset shares, the financial resources of the office, and the appropriateness of distinguishing between classes and generations of policyholders as the experience of the office unfolds.

3.4.3 Since these court judgments, legal advisors have expressed a range of views on the extent to which the judgments are generally applicable to other offices. Whilst it is clear that the particular judgment in the Equitable Life case took account of the unique features of that office, there has been a distinct shift in legal opinions on the acceptability of ringfencing, particularly in relation to the cost of any guarantees. To the extent that a change in the application of ringfencing would conflict with an office's previous interpretation of PRE and its established practice, any change in this area would present further difficulties for the interpretation of PRE.

3.4.4 The judgments in the AXA case and in the Needler v Taber case are helpful in confirming that asset shares are the starting point in determining PRE.

3.4.5 The judgments have clarified that communication with policyholders, or what might be considered to have been implied by any such communication, is likely to significantly influence PRE. Such disclosure and communication is likely to be given equal weight to policy conditions. In particular, it can not easily be overridden in the desire by Appointed Actuaries to achieve a close adherence to an asset share approach.

3.4.6 In the case of new business, there will need to be greater disclosure of the way in which discretion will be exercised.

4. KEY ISSUES IN RELATION TO PRE

4.1 *Introduction*

4.1.1 PRE is only a relevant concept for contracts where the company exercises discretion which impacts the benefits received by the policyholder. The exercise of discretion can occur in different circumstances:

- those relating to the fair treatment of policyholders *vis à vis* shareholders; and
- circumstances where discretion is exercised to achieve the appropriate fair treatment between different groups of policyholders relative to each other.

Many of the issues to be considered in trying to define PRE relate to the fair treatment of one group of policyholders versus another; however, we also consider some specific issues relating to the relative treatment of policyholders versus shareholders in a proprietary office.

4.1.2 It is fundamental to with-profits contracts that there is a sharing of risks across a group of policyholders, but this raises a number of questions:

- What risks are being shared?
- How broad should the 'group' be?
- What extent of 'cross-subsidy' might be considered reasonable?
- To what extent can the approach to any of the above be varied over time?

Premium rates for traditional with-profits contracts are generally set to reflect known differences in certain rating factors or specific benefits which are expected to have a significant differential cost. Thus, for example, the sum assured for a given premium might differ between a pensions contract offering a return of fund on death, compared with one giving no return, and the bonus rates declared on both would be the same for the same term of contract and duration in-force. For unitised with-profits (UWP) contracts, it is common to deduct the cost of risk benefits from the unit fund, or, if a traditional approach is used, the asset share would be charged directly with the appropriate risk cost.

4.1.3 In some cases, benefits, such as guarantees, have been provided on certain contracts which were not expected to have a substantial cost, and no extra charge was envisaged as being necessary for this additional benefit. If, as in the case of GARs, the emerging experience differs substantially from that which was expected when the contract was written, then a key question is whether or not it is 'reasonable' to attribute the cost (i.e. the difference between actual and expected experience) to the sub-group which has this benefit. Thus, the price charged for the benefit is adjusted 'retrospectively' to reflect its actual cost. The alternative approach would be to spread the difference in cost over all with-profits policies.

4.1.4 If it is considered reasonable to charge the cost only to the sub-group of policies to which it relates, then a further question is: "Up to what level might this apply?" One approach would be to charge only a reasonable best estimate of the cost (with the benefit of hindsight); an alternative would be to apply the actual emerging experience — something which is common practice in relation to expenses, mortality and other aspects of emerging experience that impacts on the calculation of asset shares.

4.1.5 It is only by considering and defining the answers to questions like this that we can define what is acceptable practice, and hence what is meant by PRE, or treating customers fairly. In the following sections we explore these issues in more detail.

4.2 *Pooling and Ringfencing*

4.2.1 We define pooling as the sharing of risks and associated costs over the whole of the with-profits fund (or a subset of it), and we define ringfencing as the allocation of specific risks and associated costs to a separately identified group of policies within the with-profits fund (or subset of it).

4.2.2 Investment risks, guarantees and smoothing are fundamental to the nature of with-profits business, and should, perhaps, be considered together, as it is the interaction of these elements which defines the nature of the with-profits product offering.

4.2.3 Typically, the investment policy, i.e. the proportion of the fund held in different asset classes, such as equities, property and bonds, has been determined for the fund over all, and the overall yield earned on the fund would be applied to all asset shares.

4.2.4 This practice does not recognise the different characteristics of constituent parts of the with-profits liabilities, particularly in relation to the extent of any guarantees or the maturity profile of the constituent parts. Clearly, those policies that incorporate higher guarantees and policies closer to maturity, where accumulated reversionary bonuses are also guaranteed, would justify a higher proportion of backing assets in bonds than a relatively young policy with a longer outstanding duration.

4.2.5 Under traditional with-profits contracts, the sharing of risks relating to mortality, expenses and surrender profits/losses of the with-profits contracts themselves, would also be considered to be an integral part of the concept of risk sharing, whereby bonuses on participating contracts would typically reflect these elements of the emerging experience. However, there are examples of UWP contracts where these risks are borne by shareholders rather than by policyholders.

4.2.6 The treatment of non-profit surrender profits and losses, and the practice as regards other operational risks (such as mis-selling costs) is less clear, and varies from company to company. The practice of sharing profits and losses from other non-profit business or, indeed, other non-life business which may be owned by the life fund also varies considerably. Some offices will pool these items across all with-profits business, in some cases by applying profits or losses to the free assets, and other offices will ringfence these items of profit or loss so that they impact only on part of the business. For example, some offices apply surrender profits to enhance only life (not pension) profits. The rationale being that such profits arise only from life policies.

4.2.7 PRE should permit a reasonable degree of pooling of risk, both between different types of with-profits contracts and between different

generations of policyholders. Subject to policy wording and other policyholder communications, where a precedent exists based on an office's past approach, or where it is appropriate to recognise fundamental differences in the business, we believe that the various legal rulings and opinions should not limit the ability of the office to share experience across groups of policies or, if considered appropriate, to ringfence parts of the business from other parts.

4.3 *Charging for Guarantees*

4.3.1 It is generally accepted that a charge should be made for most guarantees. The nature of the guarantee often determines the way in which the charge is made. In some instances the charge will be implicit. For example, the guarantee of basic sum assured and reversionary bonus payable on death or at maturity is met by controlling the balance of investments after taking account of the level of the free assets. The restrictions on investment freedom may reduce the earnings on the fund, which feeds through into lower bonuses. In this way, an office with relatively high free reserves may, if it chooses, make a lower implicit charge for the use of capital and underlying guarantees.

4.3.2 An appropriate charge for guaranteed interest rates incorporated in premium rates or guaranteed growth in the policyholder's fund can be similarly determined through notionally (or actually) hypothecating assets.

4.3.3 Modern stochastic modelling techniques enable offices to quantify the likely cost of quite sophisticated financial options. In other circumstances, there is sometimes a market price available for the relevant hedging. A difficulty arises where the impact of the event is large, but the probability extremely remote. In those circumstances, it is necessary to understand the shareholder's appetite for risk or the impact on members of a mutual office. It is in these circumstances, also, that the past statements made by the office in relation to such events become crucial.

4.3.4 Notwithstanding recent court judgments on ring fencing, it is normal practice to charge the cost of guarantees to policies able to benefit from the guarantee.

4.4 *Exercise of Discretion*

4.4.1 This section considers the extent to which it is appropriate to change the approach to actuarial aspects of the business in the light of changing circumstances.

4.4.2 In recent years some offices have become far more generous to payments made on early surrender. The effect of this change has undoubtedly had a downward pressure on maturity payments for some offices. Most Appointed Actuaries would regard that as a reasonable change of approach.

4.4.3 Offices are known to make changes in the approach to calculating asset shares from time to time, to take account of changes in market practice. There are a number of recent examples.

4.4.4 An office may attribute asset classes to blocks of business as part of its asset share calculations. Fixed-interest assets in the long-term fund might be attributed to non-profit business, with the balance allocated to with-profits business as a proportion of the fund. Alternatively, residual fixed-interest assets might be hypothecated to with-profits policies close to maturity, or to those with high fixed guarantees. Any changes to this approach can give rise to large changes in current asset shares if the changes are retrospective.

4.4.5 Furthermore, for some offices there are only rudimentary systems in place for calculating asset shares, and it is to be expected that these will be improved over time. In some cases this will mean retrospective changes.

4.4.6 We would regard all of these changes of approach, even where they are retrospective, as reasonable, provided that the impact on policyholders is smoothed within the office's established practice, and does not give rise to a significant discontinuity in the level of policy payouts.

4.4.7 There remains the question of how to deal with changes where a cost or profit becomes significant over the lifetime of the business.

4.4.8 There are clearly a number of alternative approaches, and each will be appropriate in certain circumstances.

4.4.9 The additional unexpected cost or profit could be spread over all with-profits business participating in the fund. For example, an annual charge could be made to asset shares in future years to reflect a cost which is expected to continue. Alternatively, a charge could be applied retrospectively, provided the change in asset shares is smoothed in determining policy payouts.

4.4.10 In the past, Appointed Actuaries have felt that there is considerable discretion in this area. For current business, PRE has been established in most offices on the basis that the office will change approach as appropriate, and we believe that meeting PRE for this business is consistent with retaining that flexibility.

4.4.11 Recent demutualisations and reconstructions have tended to be accompanied by a statement of financial principles that will be adopted in the future. These have had the effect of restricting the office from making any significant change of approach. However, in most of these there are provisions for changes to be made to the stated principles after referring the matter to the FSA, which provides some flexibility to meet unexpected events.

4.4.12 For new business, greater transparency is appropriate in making clear how such unexpected cost or profit will be dealt with, significantly reducing the discretion available.

4.5 *Smoothing*

4.5.1 The concept of smoothing lies at the heart of with-profits business, and provides the distinctive feature that differentiates with-profits business from any other form of savings or investment product.

4.5.2 Much of the marketing literature for with-profits products highlights the advantages of the smoothing of investment returns, enabling customers to enjoy the advantages of investment in volatile, though, hopefully, higher yielding investments, such as equities, without the risk of the proceeds of the with-profits policies being exposed to the extreme peaks and troughs of stock market valuations.

4.5.3 Smoothing is most often referred to in the context of the smoothing of investment returns, but can apply also to the smoothing of other experience factors that may influence the payments under with-profits contracts. For example, where miscellaneous surplus is distributed to policyholders, this is often achieved by adopting practices and formulae that smooth the distribution of emerging miscellaneous surplus, often by expressing miscellaneous surplus as an addition to the investment yield.

4.5.4 The effect of adopting a smoothing policy is often measured by reference to the difference in payouts under similar contracts from one declaration to the next; e.g. payouts on a 25-year endowment at maturity should not vary by more than $\pm 10\%$. The effects of smoothing are also influenced by the frequency of the determination of final payouts and/or terminal bonuses. Typically, more frequent assessments of terminal bonuses are associated with smaller absolute smoothing 'rules' (e.g. $\pm 5\%$) that can result in greater levels of freedom.

4.5.5 Smoothing rules are typically not disclosed in product literature nor in with-profits guides, nor, indeed, are they typically disclosed in regulatory returns. Similarly, the current state of any 'smoothing account', i.e. the accumulated difference between actual payouts and underlying asset shares, are typically not disclosed, nor are differences between asset shares and payouts on a claim. Whilst, in the general move towards greater disclosure, there may be calls for the disclosure of some of the items referred to above, there is concern that any such disclosure, particularly where it relates to the position of individual policies, could give rise to anti-selection. Policyholders may be advised to take actions with regard to payment of premiums and exercising maturity options at particularly advantageous points in the smoothing cycle.

4.5.6 Clearly, disclosure will reveal the extent to which there is cross subsidy between generations of policyholders, which may raise issues as to the extent to which such cross subsidies are 'fair'. Actuaries will need to determine limits to the reasonableness of cross subsidy.

4.5.7 If a combination of investment conditions and operation of the smoothing formulae traditionally adopted results in a smoothing account that is so large, either positive or negative, that it is outside acceptable limits, what action should be taken? Could new business be written without the adoption of a new bonus series?

4.5.8 The answer depends on many factors, not least what a company has told its policyholders. Factors likely to effect such decisions will include:

- past practice;
- asset mix;
- communications with policyholders;
- level of maturities/deaths (and hence cost of under/overpaying);
- extent of realistic estate;
- statutory financial strength; and
- competitive position.

4.5.9 There is a clear trade-off between keeping payouts close to asset shares and avoiding large changes in payouts. We would expect PRE to give more weight to change in payouts from year to year rather than to the relationship with assets shares, as the former is what the policyholder 'sees'. Nevertheless, companies with limited financial resources facing large levels of maturities will not be able to afford to maintain large differentials between payouts and asset shares for very long, so this will constrain a heavily smoothed approach.

4.5.10 It may also be more 'acceptable' (subject to the financial position of the office) to maintain payouts at, say, 120% of asset shares, compared with a situation where payouts are only 90% of asset shares.

4.5.11 Clearly, the existence of an estate facilitates the operation of a smoothing formula. Companies with an estate have often utilised the estate to absorb the 'costs' of smoothing that cannot be met within the normal smoothing formula. This has been particularly the case where miscellaneous surplus is included, and unexpected 'miscellaneous' costs have arisen. Similarly, the significant costs arising from a sudden move in investment conditions, e.g. from high yield to low yield, may be met from the estate.

4.5.12 For offices with little or no estate, an important question is whether the office should continue to accept new business at times where the available assets are less than a realistic measure of its PRE liability to with-profits policyholders. (The latter might be expressed as the aggregate asset shares plus the expected cost of smoothing payouts down to asset shares; alternatively, it could be assessed as the 'fair value' of the liabilities to existing policyholders, which could be considerably higher if the business has substantial guarantees).

4.5.13 If a deficit exists, then should this be disclosed to new policyholders? Should companies either cease writing new business or start a new bonus series if a deficit exists, or if it exceeds a certain limit — say 2.5%? The latter would represent a negative smoothing reserve. If smoothing is an accepted part of the with-profits deal, then at what point does a negative smoothing reserve become unacceptable?

4.6 *Surrender Values*

4.6.1 The determination of surrender values for with-profits business

is typically one of the areas where some discretion lies with the management and/or board of the company, although such discretion is restricted by recent practice, communications with policyholders and market practice.

4.6.2 Typically, the exercise of discretion is applied in one of two ways:

- in setting the value paid on early termination (conventional with-profits); or
- in setting a deduction from a previously notified value (setting the MVA or equivalent for UWP business).

4.6.3 Many of the issues around the exercise of discretion in setting bonus rates apply also to the exercise of discretion in setting surrender values. In addition, many offices have adopted the practice of imposing a 'penalty' charge on surrenders, possibly in recognition of a loss of future profits, but also in recognition of the early termination of a long-term contract. In the absence of specific disclosure, there must be some question as to whether PRE could currently be construed to support a continuation of such practices.

4.6.4 It would seem that the moves toward greater disclosure for the operation of with-profits funds will lead to greater disclosure of individual policyholders' interests in the with-profits fund, if not actual levels of asset share at an individual policy level. In these circumstances, and particularly for new business, the justification for any deductions from asset share on surrender would seem to be a necessary feature of disclosure at surrender.

4.7 *Interest in the Estate*

The judgments relating to the inherited estate largely confirmed the views expressed by actuaries, and set out in the profession's position statement. In particular, it was confirmed that, prior to the promulgation of the scheme, a policyholder would not have a reasonable expectation that the whole, or any part, of the inherited estate would be distributed to him as a bonus or otherwise during the currency of his policy. In particular, it would not be a reasonable expectation for him to hold that the directors would promote a scheme of reorganisation which involved the distribution of the inherited estate.

4.8 *Summary*

4.8.1 Recent judgments by the courts have identified areas where the interpretation of PRE by Appointed Actuaries in the past may no longer be acceptable. Furthermore, the discussion paper on the exercise of discretion expected from the FSA, as part of their review of with-profits business, is likely to raise wider issues. In this paper we have set out our own views on some of the key issues.

4.8.2 For these reasons, we believe that the time is right for actuaries to have the opportunity to discuss how PRE should be interpreted in the future. Following that discussion, the actuarial profession should attempt to define more clearly how PRE should be interpreted in order to assist Appointed Actuaries currently advising on with-profits business.

APPENDIX 1

ANNUITY GUARANTEES — ACTUARIAL PROFESSION POSITION STATEMENT

[This position statement is no longer in force]

Ownership: Life Board

The Public Relations Committee, in association with the profession's Practice Boards, produces from time to time various position statements to enable its officers, members of its Council and senior members of staff to respond to questions from the profession, the public and the media about important topical issues and developments.

These statements may be used as background for public pronouncements. They are not formal guidance, neither are they a definitive expression of the views of the profession as a whole on the subject.

There is a contact name for enquiries at the end of each statement. Please feel free to speak to this person if you would like more information.

In recent months there has been a good deal of comment in the press about "annuity guarantees". The actuarial profession is concerned to enable policyholders and others to gain a better understanding of the issues involved, and the Life Board of the Faculty and Institute of Actuaries has therefore prepared this position statement.

This statement is for use within the Faculty and Institute of Actuaries in order to enable Officers, Council members and senior members of staff to respond to questions from members of the actuarial profession, members of the public and the press. It is not formal guidance, nor should it necessarily be taken as a full expression of the profession's views on the subject.

Introduction

1. The expression "annuity guarantees" covers the practice, which used to be widespread in pension policies during the 1970s and 1980s, of guaranteeing the conversion rate between cash and pensions at retirement.
2. This guarantee took many forms. Some contracts have a pension as the policy benefit and give a cash option. Some have a cash benefit and give an annuity option. Current concerns are about the latter form.
3. Even with a contract giving a cash benefit the regulations insist that most of the money is used to buy an annuity. There is usually an "open market option" allowing the policyholder to purchase the annuity from any life assurance company.
4. There appears to be some confusion in recent reports published in the press concerning annuity guarantees. Four key questions have been raised:
 - i. Should these guarantees have been provided in the first place and, if so, how should they have been priced?
 - ii. Have companies reserved adequately for their own guarantees and are they appropriately managing the likely cost through their investment strategy or through investment hedges?
 - iii. Who should bear the cost of guarantees?
 - iv. What is the likely impact of these guarantees on the industry?
5. Policyholders may not be aware of the options available to them or may misunderstand their rights under their contracts. Press comments may also have led to them having doubts about whether or not they are being dealt with fairly by their insurer.
6. The actuarial profession is concerned to improve the understanding of policyholders so that they have a clearer idea of how the existence of these guarantees may affect them and the companies whose policies they hold.

Background

7. The precise position of insurers in relation to their annuity guarantees varies substantially. It depends amongst other things on
 - the exact wording of policy terms and conditions;
 - references made in marketing literature; and
 - other representations made by the insurer on this subject.

8. As a result of these guarantees some policyholders may be entitled to receive more than the normal investment proceeds from their premiums.
9. These contracts were generally with-profits and some companies intended that the accumulated fund would pay the greater of the cash option or the value of the annuity at retirement date. In such cases the asset distribution of the fund would usually be matched towards providing either the cash or the pension payment, depending on which had the greater value from time to time. A modest charge might have been included in the premium rates at issue to allow for this potential need to move the asset distribution. The expectation would be that bonus rates were calculated allowing for the more expensive of the two options.
10. Where non-profit contracts were issued with annuity guarantees there is clearly a significant potential mismatch between the values of the alternative benefits. At issue this would have represented a very small risk, but the cost of the option will have risen rapidly over the last two years leading to a need for a significant increase in reserves.
11. Suitable hedging instruments were not available at the time that these contracts were introduced. Recent market prices for these instruments suggest that there is a significant demand. Companies may choose to hedge or may choose to run the option risk within their own funds.
12. Companies need to consider their individual position, and also to consider the reserves required in order to meet their policyholders' reasonable expectations. The letter from Martin Roberts (Director, Insurance, HM Treasury) of 18 December 1998 demonstrated that there is considerable variation in how policyholders' reasonable expectations may be interpreted but, as mentioned above, individual offices may be constrained in different ways. The profession fully supports the regulator's position as set out in that letter.
13. A subsequent letter from the Government Actuary to all Appointed Actuaries dated 13 January 1999 seeks to clarify guidance on reserving for annuity guarantees. The profession supports this clarification of guidance. Professional differences of opinion which were not breaches of the previous guidance would not be regarded as disciplinary issues by the profession. However the profession expects returns for 31 December 1998 and subsequent periods to conform with this clarification of the guidance.
14. It has been suggested in the press that a number of companies have not reserved fully for these annuity guarantees. The profession is unaware of any specific examples of this but would clearly be concerned to ensure that such cases were as a result of reasonable professional differences of opinion. If not, they would be subject to the profession's disciplinary procedures. The profession will continue to pursue this question until these doubts have been resolved.
15. The additional reserves set up to meet the guarantees are not a measure of the cost. Unless interest rates fall significantly from current levels, these additional reserves may be released in future (particularly over the next 10 to 15 years).
16. Until recently, the option to take cash and apply it on the best available annuity rates has been more valuable than the guaranteed pension option under most pension contracts. It has become established market practice (for contracts with a specific pension option) to pay the cash option, in one of two ways. Either it was paid as a transfer value to another insurer which provided an annuity based on it, or else the existing insurer would use the "cash" option and provide a pension using its current annuity rates, rather than the lower level of pension which the guaranteed annuity option would have paid. The former ("open market option") case was frequently an extra-contractual concession for the benefit of the policyholder.
17. Now that fixed interest yields have reduced to a lower level, the position is reversed and the pension option is usually worth more than the cash option. Improvements in mortality since these options were granted have also made them more valuable to the policyholder.

Alternative ways of dealing with Guaranteed Annuity Options

18. For an insurer with no constraints caused by the policy conditions, marketing literature or other representations, it would be reasonable to reverse the practice described in paragraph 16. What they will do is to ensure that the value of the cash benefits and the value of the pension benefits remain the same, by working out the amount of the guaranteed annuity but then re-expressing the cash option on the basis of current annuity rates.

In this case the policyholder is likely to receive full value for the funds built up to support the policy, regardless of whether they take a cash option or pension option under their policy. The terminal bonus rates for individual policies will be set so that the accumulated fund equals the cost of the annuity provided. The "guarantee" may seem to be lost, but the position is no different from the position of the past under older policies with a guaranteed conversion the other way - from pension into cash. The guarantee will still bite if terminal bonus rates fall to zero.

With this approach the cost to the insurer from this class of business including its guaranteed conversion terms is largely met by the choice of terminal bonus for this class. There will be an additional cost to the office only after terminal bonus rates have fallen to zero.

19. Other insurers will allow the two values (the true value of the guaranteed annuity as opposed to the cash value) to move apart to reflect the difference made by the guaranteed conversion rate. What they will do is to apply the guaranteed annuity option rate to the full accumulated fund. The policyholder then receives full value for the guarantee and a significant cost to the office arises.

This loss will need to be funded from some other source, e.g. out of other policyholders' bonus, out of the shareholders' fund (if any) or from the estate (if there is one). Part of the cost might be met by reducing bonus rates for this class of business.

20. Insurers may take an intermediate position between these two extremes, e.g. by applying the guaranteed annuity rate to the sum assured plus reversionary bonus but not to the terminal bonuses, or by applying the guarantee to the whole amount but only when the policyholder chooses the option specified in the policy.
21. With the exception of insurers following the method of paragraph 18 there will usually be a financial advantage to policyholders in taking the pension amount rather than the cash amount. Policyholders need to be clear as to their options in this situation. Taking some cash may result in a "loss" to the policyholder (by giving up pension for the value at the guaranteed rate rather than the value at the current rate). Since the additional benefit may be tied to a specific date and a specific form of annuity, policyholders will need clear information from the insurer.

Research

22. A working party of the profession reported in 1997, identifying annuity guarantees as an important issue due to the substantial variation between insurers in the way that these options were being dealt with. The large reduction in long-term interest rates during 1998 moved this issue from one of future concern to one of current concern.

Conclusions

23. *Should these guarantees have been provided in the first place?* These guarantees were a reasonable feature of with-profits pensions contracts. Policyholders were protected from the possibility that they might be unable to exchange cash for pension (or vice-versa) except at disadvantageous terms.

The profession notes that these options have provided benefits to many policyholders by establishing a guaranteed minimum level of annuity under policies which would otherwise have been fully exposed to movements in annuity prices.

24. *How should these guaranteed annuity options have been priced?* Most of these contracts were with-profits and the assumption by the insurer may well have been that the accumulated fund would pay the greater of the two values, the cash amount or the value of the pension. In this case the liability for the total reserve needs to be adequately matched. This requires the asset distribution to move longer if interest rates are low and shorter if interest rates are high. Bonus rates would be calculated allowing for the greater of the two values.

An alternative approach was that the cash value would be paid and an additional benefit added if the annuity value was greater. This is the only approach in the case of non-profit contracts with an annuity option. In this approach there is an underlying mismatching risk which would have justified an option premium in the price.

25. *Have companies reserved adequately for these guarantees?* The Appointed Actuary of each insurer has a duty to ensure that sufficient reserves are held to meet that insurer's obligations under its own approach. In so doing, the Appointed Actuary should have regard to the comments made in the Government Actuary's letter of 13 January 1999 as well as the requirements of the Regulations, and the profession's guidance in GN1 and GN8.
26. *Are companies appropriately managing the likely cost?* Companies may choose to hedge or may choose to run the option risk within their own funds.

The profession is concerned to play its part in ensuring that companies have reserved adequately for annuity guarantees and all other liabilities. It is up to individual companies to decide whether this should be achieved through asset management or whether hedging strategies are appropriate.

27. *Who should bear the cost of guarantees?* For individual policyholders different outcomes are very likely from different insurers. The approaches described above show that the cost may be being met by the specific class of policy itself in whole or in part or may be met by other policyholders' bonus, out of the shareholders' fund or from the estate. Each of these methods may be appropriate and all are capable of meeting the requirements of the regulator in appropriate circumstances.

28. *What is the likely impact of these guarantees on the industry?* There has been widespread misunderstanding of the effect of these guarantees on the insurance industry. The financial effect is likely to be comparatively modest for some companies but will be significant for others. Some policyholders may gain substantially from the presence of these guarantees. In aggregate, billions of pounds will be paid out to policyholders with policies of this type but this is, of course, why the industry exists and why insurers offered the benefit of the guarantee in the first place.

Recommendation

29. The profession urges insurers to explain their position so that each policyholder (particularly those close to retirement) may have a clear idea of how the existence of these guarantees may affect them. Policyholders need confidence that their insurer has dealt fairly with customers who have (and those who do not have) these policy options.
30. Advice from a qualified and registered financial adviser is highly recommended to any prospective pensioner approaching retirement.

Contact for enquiries: Paul Bristow, Secretary to the Life Board

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For additional information see *Guaranteed annuities - the fact and the fiction*. Article by C G Thomson, Chairman of the Life Board, published in *Money Marketing* (29 October 1998)

Site redesigned 31st August 1999

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APPENDIX 2

LETTER FROM INSURANCE DIRECTORATE, H.M. TREASURY

[This letter has been withdrawn and is therefore no longer in force]

HM Treasury
Insurance Directorate



1 Victoria Street
London SW1H 0ET

Enquiries: 0171 215 0128
Fax: 0171 215 0244

Our ref: DD1998/5

The Managing Director
All companies authorised by the Treasury
to carry on long-term business

18 December 1998

Dear Managing Director

**GUARANTEED ANNUITY OPTION COSTS AND POLICYHOLDERS'
REASONABLE EXPECTATIONS**

As you will know the Government Actuary's Department undertook a survey of life offices' exposure to guaranteed annuity options (GAOs) earlier this year. The results of that survey indicated that the exposure to GAOs was relatively widespread within the industry and had the potential to have a significant financial impact on a number of companies. The nature of the guarantees offered by companies varied widely, but one issue that needed to be addressed by all companies was how the concept of policyholders' reasonable expectations (PRE) should be interpreted in the context of GAOs. The purpose of this letter is to provide some guidance to companies on the Treasury's interpretation of PRE in these circumstances.

As a starting point, we take the view that policyholders entitled to some form of annuity guarantee or option on guaranteed annuity terms could reasonably be expected to pay some premium, or charge, towards the cost of their option or guarantee.

Charging for the cost of providing a guarantee or annuity option

For linked contracts, any charge would have to be included within the normal explicit charges levied under the terms of the contract, and these charges could clearly only be raised to cover the costs of guarantees to the extent that this was permitted under the contract. Any cost arising to the office in respect of meeting the guarantees over and above the accumulated charges, would therefore have to be covered by the insurer from other available resources.

In the case of participating policies, any charge could be deemed to be met out of each premium received (or the investment return to be credited by way of bonus), and hence would impact on the assessment of bonuses, including in particular any terminal bonus that would normally be payable to the policyholders. Generally we consider that it would be appropriate for the level of the charge deemed to be payable by participating policyholders for their guarantee (or annuity option) to reflect the perceived value of that guarantee (or option) over the duration of the contract. This could be achieved in some cases through some reduction in the terminal bonus that would be payable if there were no such guarantee (or option) attached to the policy. However the selected treatment by each office would need to depend on the wording of the contract involved and how it had been presented to policyholders.

HM Treasury
Insurance Directorate



Under the majority of participating policies which have been written it appears that any guarantee or annuity option is applicable to at least the guaranteed initial benefit under the policy and any attaching declared bonuses. As a consequence of this, we would expect that for most companies the present guaranteed cash benefits (including declared bonuses) would be converted, as a contractual minimum, to the annuity on the guaranteed terms. However as indicated above, it would appear possible, depending on the particular circumstances relating to the contract, that any terminal bonus added at maturity may be somewhat lower than for contracts without such options or guarantees, and that this terminal bonus could in some cases be applied at current annuity rates.

Apportionment of costs of GAOs not recovered under the relevant contract

In the case of both participating and non-participating contracts any residual cost for the insurer in respect of annuity options and guarantees will need to be recovered from available resources within the long term fund or from shareholder funds.

Where the long-term fund is to be used, we would in the first instance expect to see the cost met out of any 'estate' held by the company. However, where the cost is significant relative to the estate available, then an insurer may wish to consider adjusting the future bonus allocations for some or all of its participating policyholders, or making a transfer to the long term fund from the shareholders' fund.

The appropriateness of any such adjustments to bonus allocations for participating policyholders would need to be assessed by each office in the context of the reasonable expectations of all their policyholders. This assessment will be influenced by their policy documents and any representation made through marketing literature, bonus statements or elsewhere.

The above is the Treasury's considered view, and is without prejudice to any decision of the courts which may affect it.

Please supply a copy of this letter to your Appointed Actuary.

Yours sincerely

Martin Roberts
Director, Insurance

XAB 1906 Part 1