The future of participating business in Singapore

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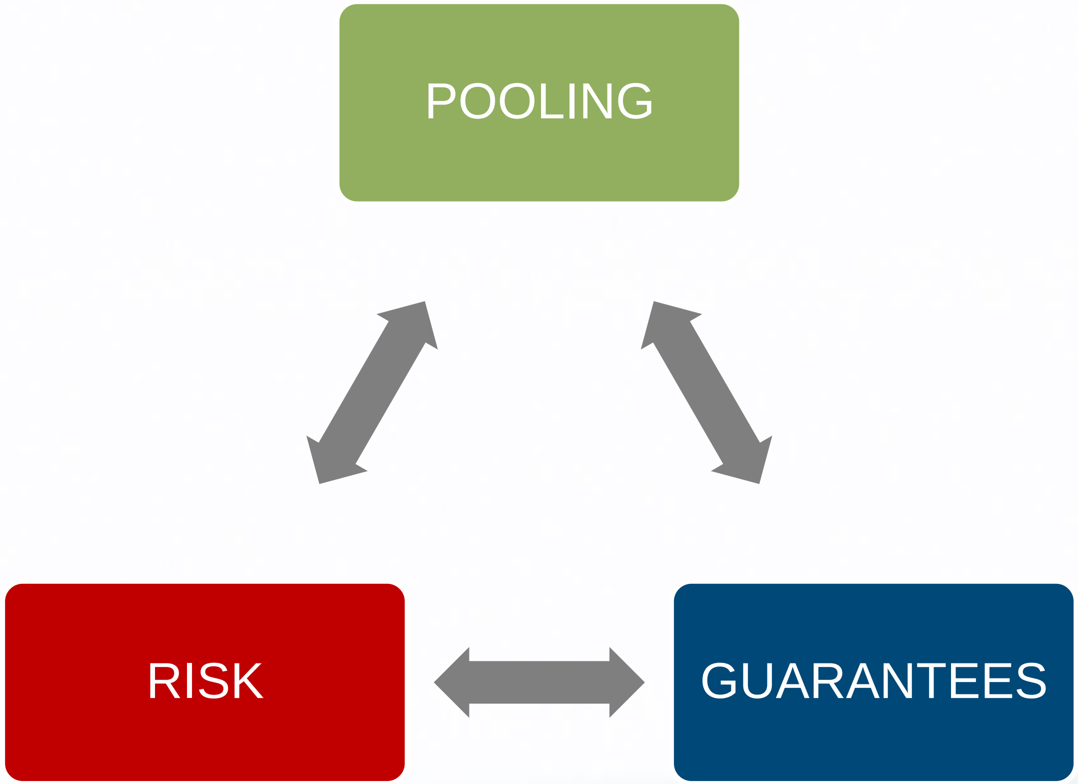
Agenda

- The market landscape in Singapore
- The regulatory regime
- Current product offerings
- Treating customers fairly and the link with risk management – a UK perspective
- The future of participating business in Singapore and the link with TCF

The links between “TCF”, risk and cost



Market landscape

Historical mix of business

by NB weighted premium

Source: Regulatory returns submitted to MAS, Weighted Premium for SP = 1/10 * SP

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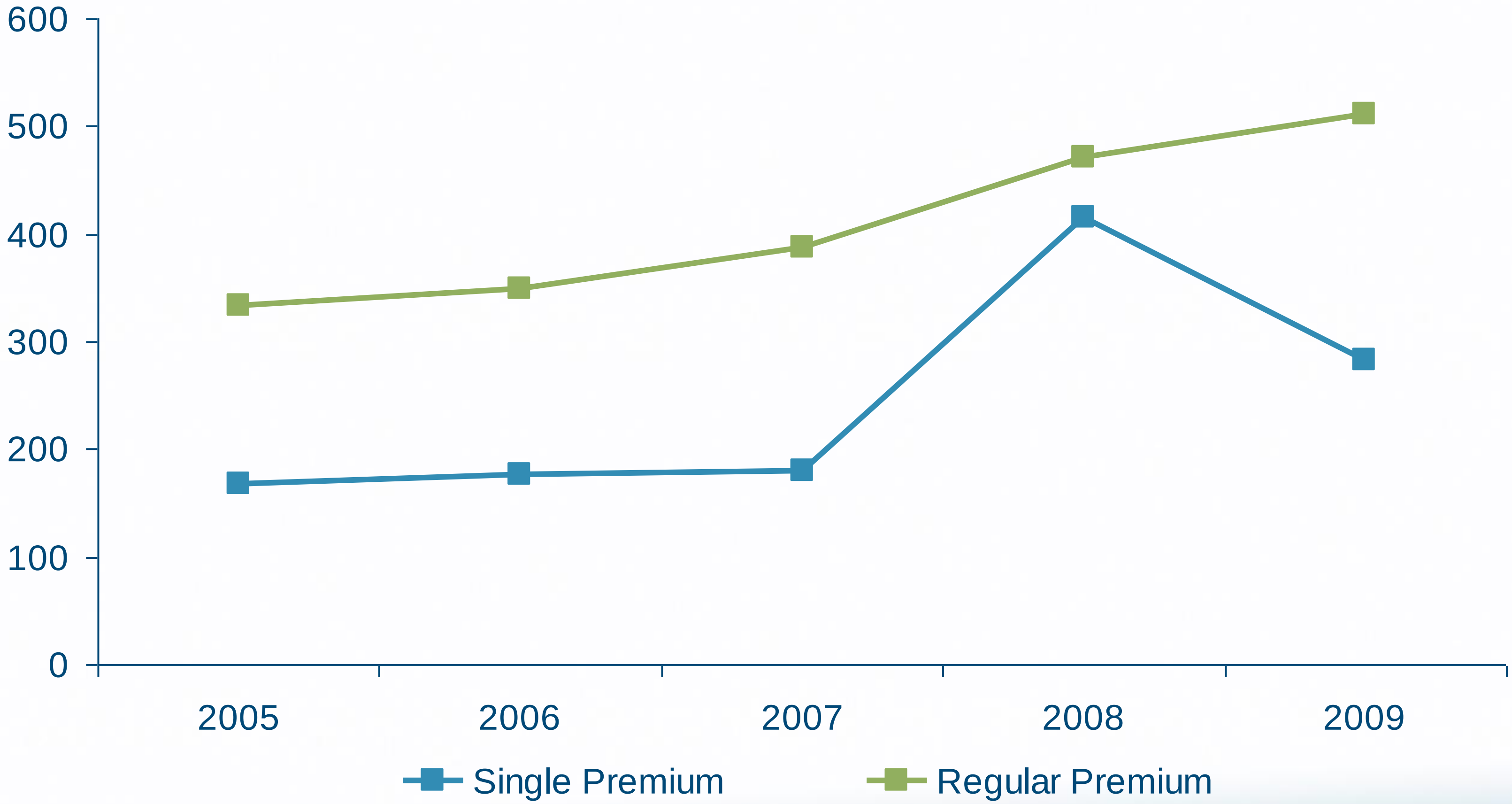
Historical weighted NB volumes by premium type for participating business (S$ million)



Source: Regulatory returns submitted to MAS, weighted premium for SP = 1/10 * SP

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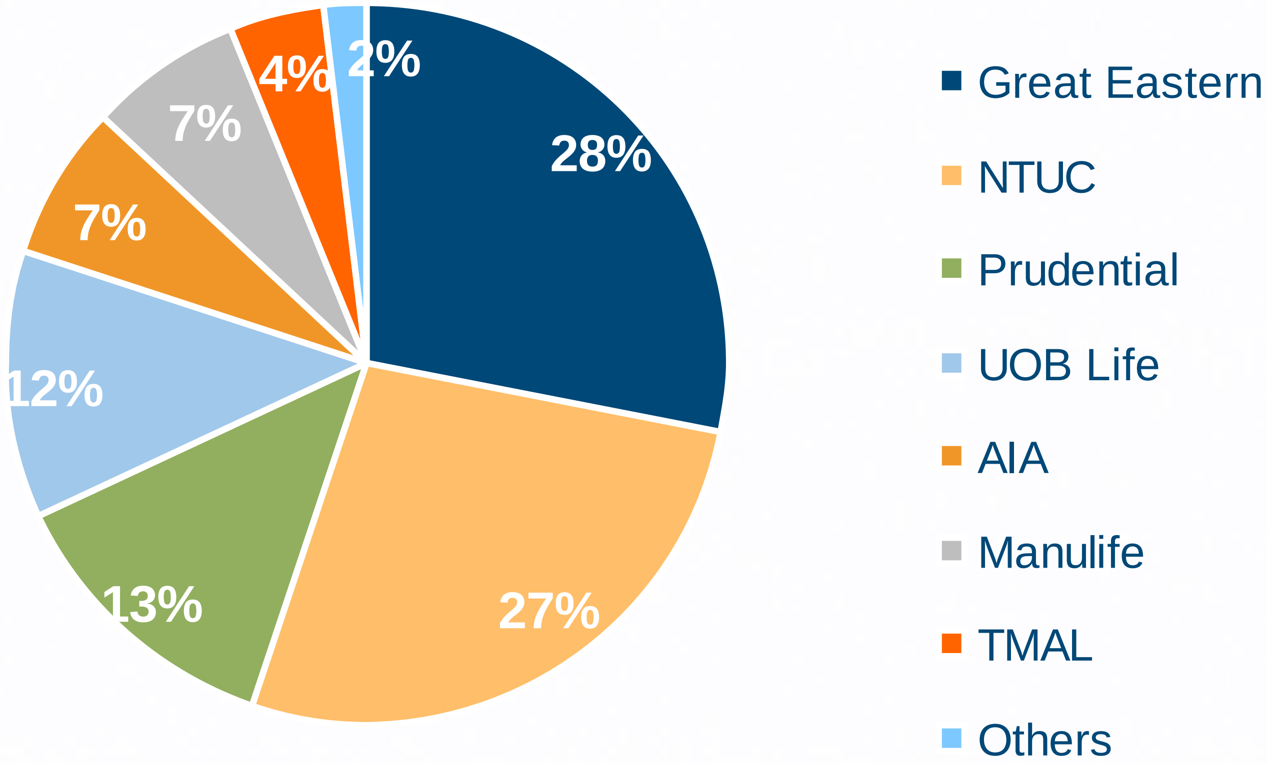
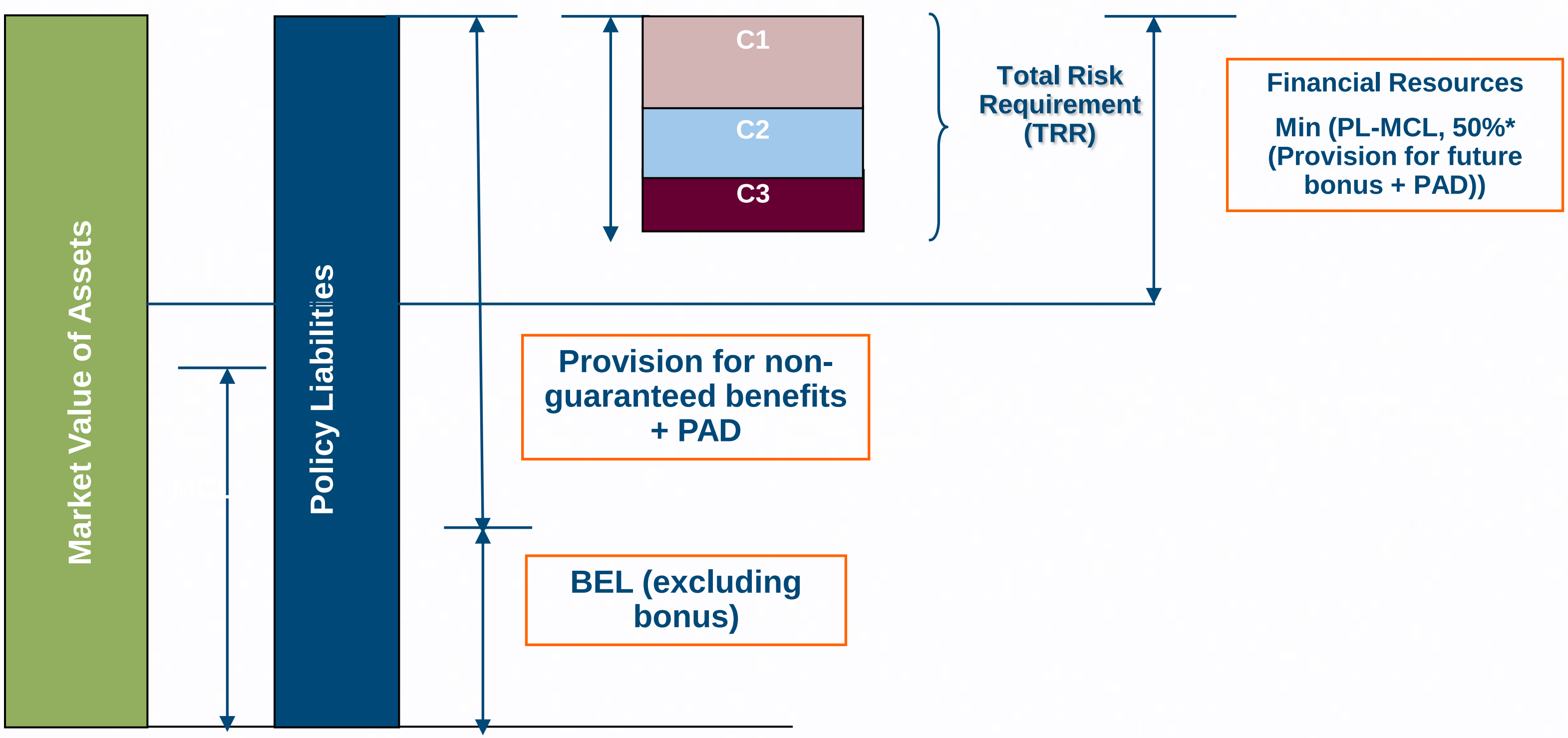
2009 NB Market share by player for participating business



Source: Regulatory returns submitted to MAS, weighted premium for SP = 1/10 * SP

The regulatory regime

The RBC Framework for Participating Fund



Capital strains on writing NB is expected to be low for strong participating funds where guarantees are far out of the money as part of the future bonus provisions can be used to meet capital requirements

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Other regulatory requirements

- Point of sale disclosure
  - Includes disclosure on investment of assets, types of risk affecting bonuses, fees and charges, approach to smoothing bonuses, impact of early surrender.
- Post sale disclosure
  - Includes annual bonus update, past performance and future outlook, bonus allocation, update on any changes to future non-guaranteed bonus.
- Internal governance policy ("IGP") around how participating fund is managed needs to be signed off annually by board of directors
  - IGP includes approach to bonus determination, investment policy, expense allocation and risk management of par business.

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Current product offerings

Product offerings

- Single premium endowment
  - Large volumes sold historically by GE, NTUC, UOB Life and also Aviva.
  - Provides a guaranteed return plus a bonus return that is dependent on fund experience.
  - Investment can be made from CPFIS, SRS scheme
  - Product may not be as well-accepted by multi-nationals as guarantees tend to be quite high and not expected to be as profitable on a MCEV basis.
- Regular premium endowment, whole of life
  - Large volumes sold historically by GE, NTUC, Prudential and AIA.
  - Guarantees are typically quite low with bonuses accounting to quite a large proportion of payout.
  - Product can be quite profitable even on MCEV basis, particularly if packaged together with riders.

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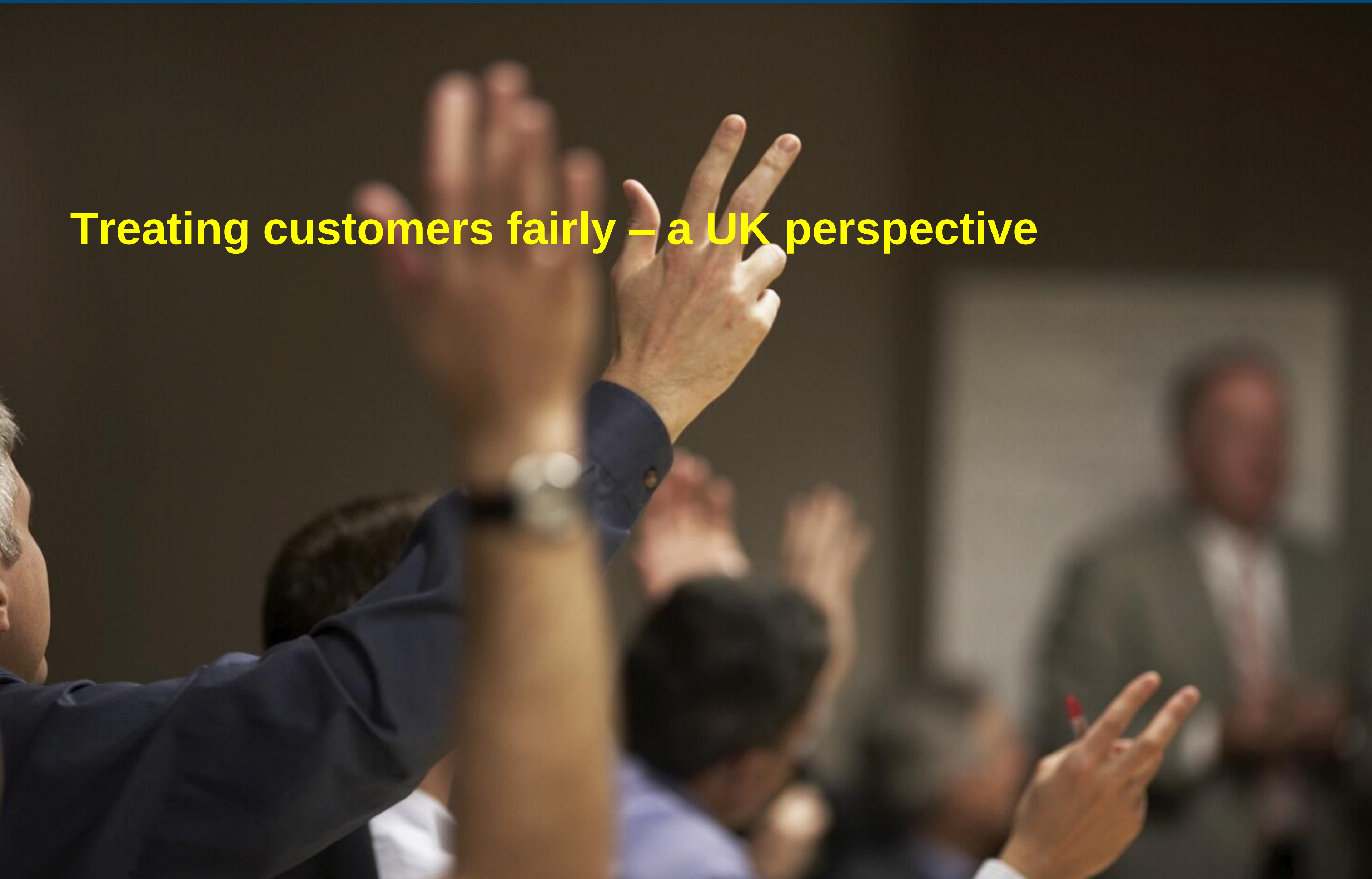
Treating customers fairly – a UK perspective



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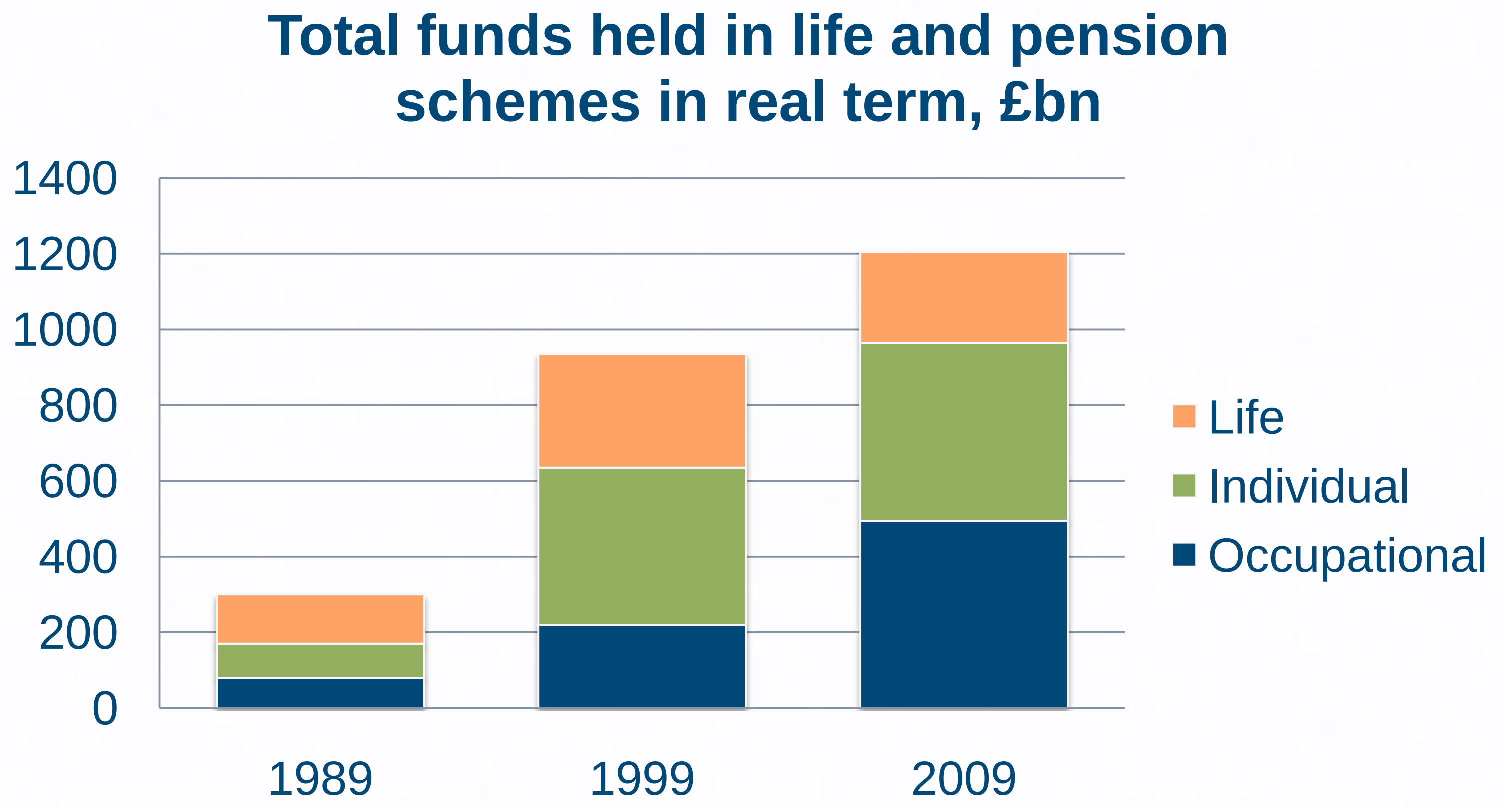
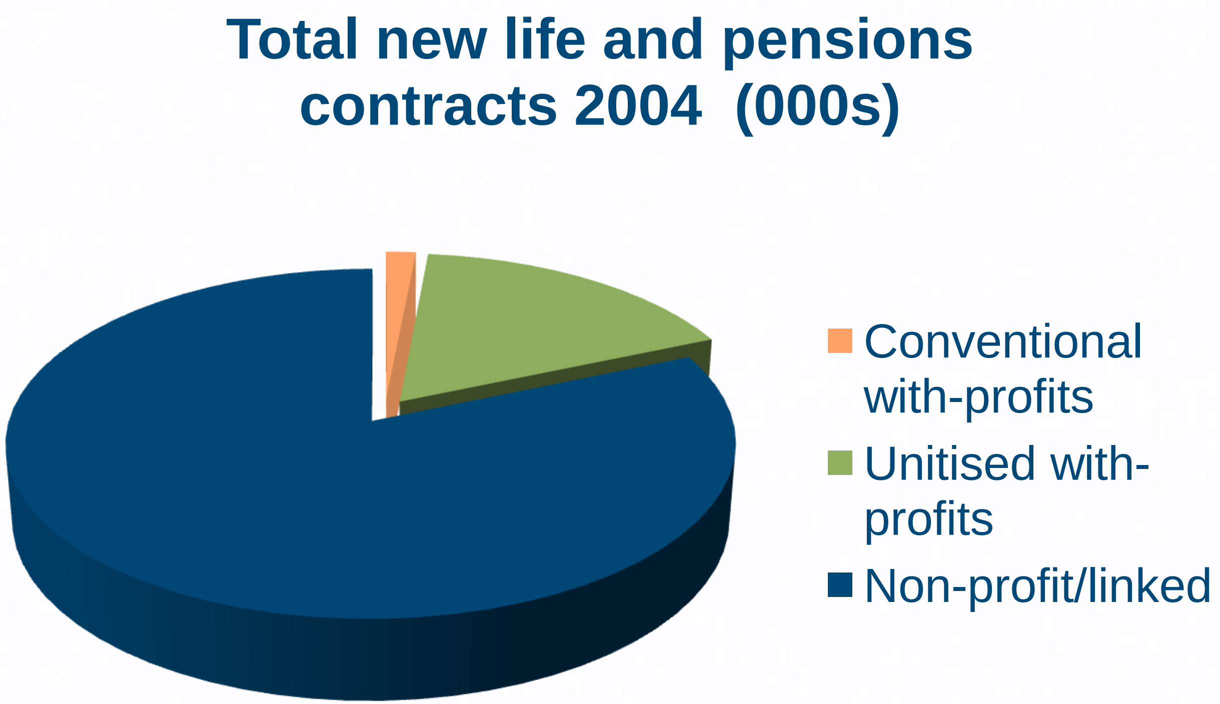
Business volumes in the UK



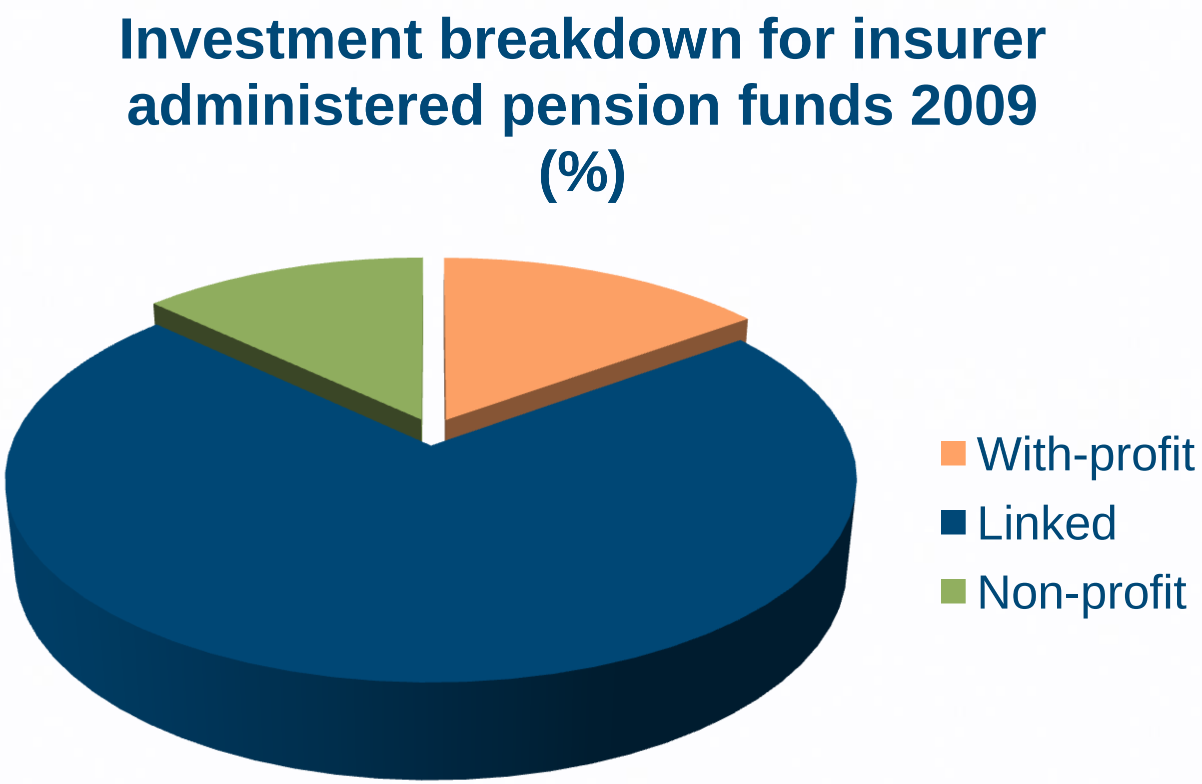
Source: ABI

Participating business volumes in the UK



Source: ABI

Participating business volumes in the UK



Source: ABI

Key Timeline

2001 2003 2004 2005 2008/09 2010

2001

FSA initiates With profits review

2003

Consulting papers on Treating Customers Fairly, CP167 and CP 207 released.

Required insurers to:

-Define and make publicly available Consumer Principles of Financial management handbook (CPPFM);

-Define explicit ranges for payout of with-profit policies;

-Sets out rules on reattribution of inherited estate

2004

Subsequent consulting paper CP04/4 released following industry feedback

2005

Policy statement PS05/1 released.

-Implementation of rules by 30 June 2005

-CPPFM available by 31 Dec 2005

2008/09

Consulting papers relating to With Profits fund compensation and redress CP08_11 and CP 09_09 released.

New proposed rules would require shareholders to bear the full cost of any compensation and redress paid to policyholders as a result of any errors or negligence from management.

Current rules allow the use of the inherited estate for such payment.

2010

FSA releases paper setting out findings on With Profits Review.

Findings revealed that majority of firms reviewed did not satisfactorily demonstrate that their practices were consistent with 2005 rules. Strong intervention expected from FSA to ensure compliance against rules.

Contents of PPFM

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With profits policy payouts (TCF)

PPFM Disclosure

Needs to include:

- Approach used to determine policyholder payout;
- Firm's approach to setting annual and final bonus;
- Approach to smoothing

Maturity payments

General rules are:

- Maturity payments for each policy must fall within target range expressed as a % of unsmoothed asset share, with target defined in PPFM;
- Firm may make deduction for cost of guarantees;
- If firm proposes making maturity payment that falls outside target range, it should be satisfied that treatment has been fair from the perspective of particular policyholder and also firm's other with-profits policyholder

Surrender payments

General rules are:

- Similar calculation as maturity payment although target top-end range for surrenders may be lower than target top-end range for maturity payment
- In calculating Surrender Value, firm must not make a deduction from unsmoothed asset share unless it is necessary to protect interest of remaining with-profits policyholder

Investment strategy (TCF)

In determining investment strategy, firms must take into account:

- The extent of the guarantees;
- Representations made to policyholders;
- Firm's established practice;
- Amount of capital available
- Changes in investment strategy only necessary to take into account material changes in economic conditions, changes in policyholder utilisation of policy options or changes in level of capital available to support business.

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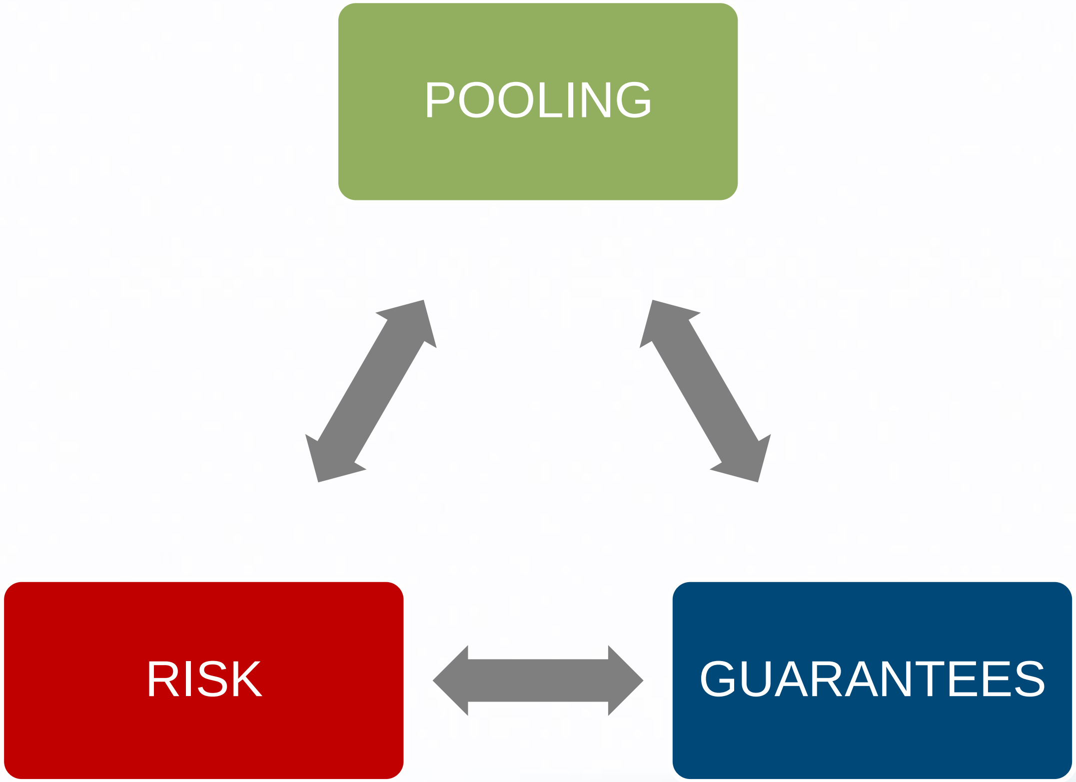
The links between “TCF”, risk and cost



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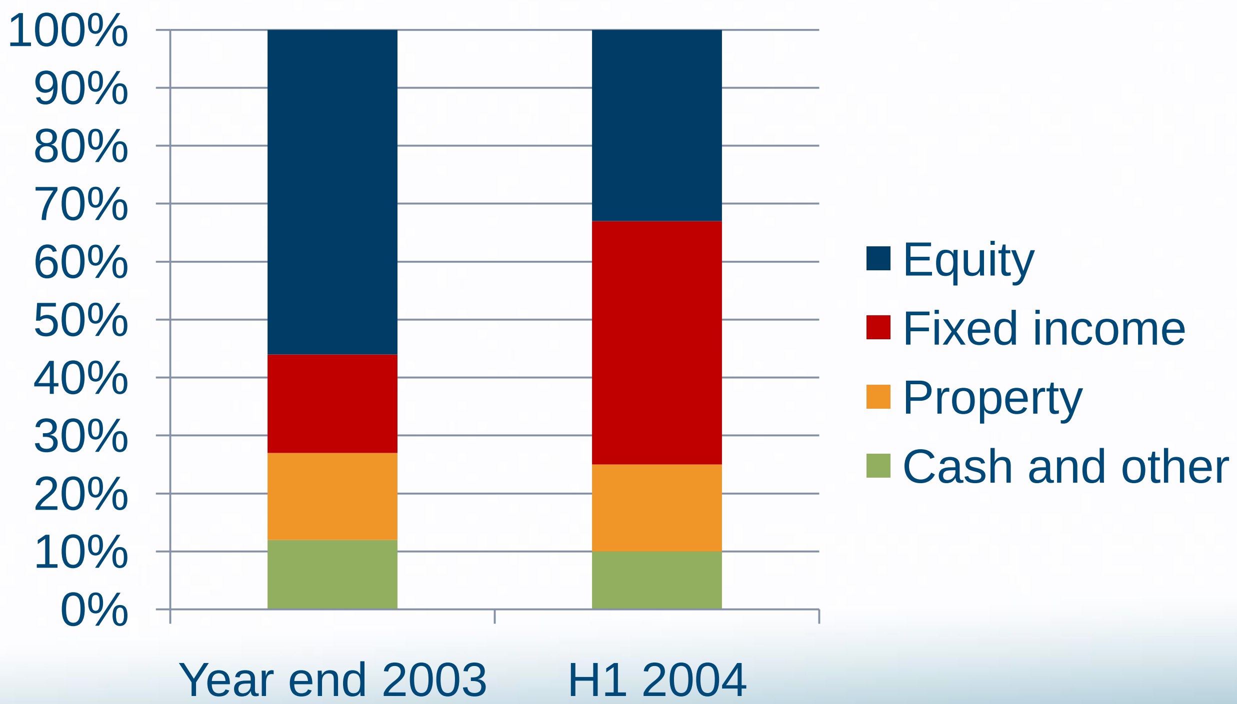
Investment strategy under market consistent measures – example 1

- De-risk?
- Standard Life Assurance Company With Profit Fund asset mixes circa 2003



Source: Company website

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Investment strategy example 2 – Phoenix With Profits Fund

General Rule

- 70% growth investment;
- 30% fixed interest

Unless

Outstanding term remaining < 9 years

- Change mix proportionally such that following mix achieved with 1 year term or less:
  - 29.2% growth investment;
  - 70.8% fixed interest

Unless

Required rate of return on asset share to meet guarantees > 5%

- 5 to 7.5% required return: Reduce growth investment by 33%;
- 7 to 10% required return: Reduce growth investment by 67%;
- 10%and above: Reduce growth investment by 100%

Phoenix

Source: Company website

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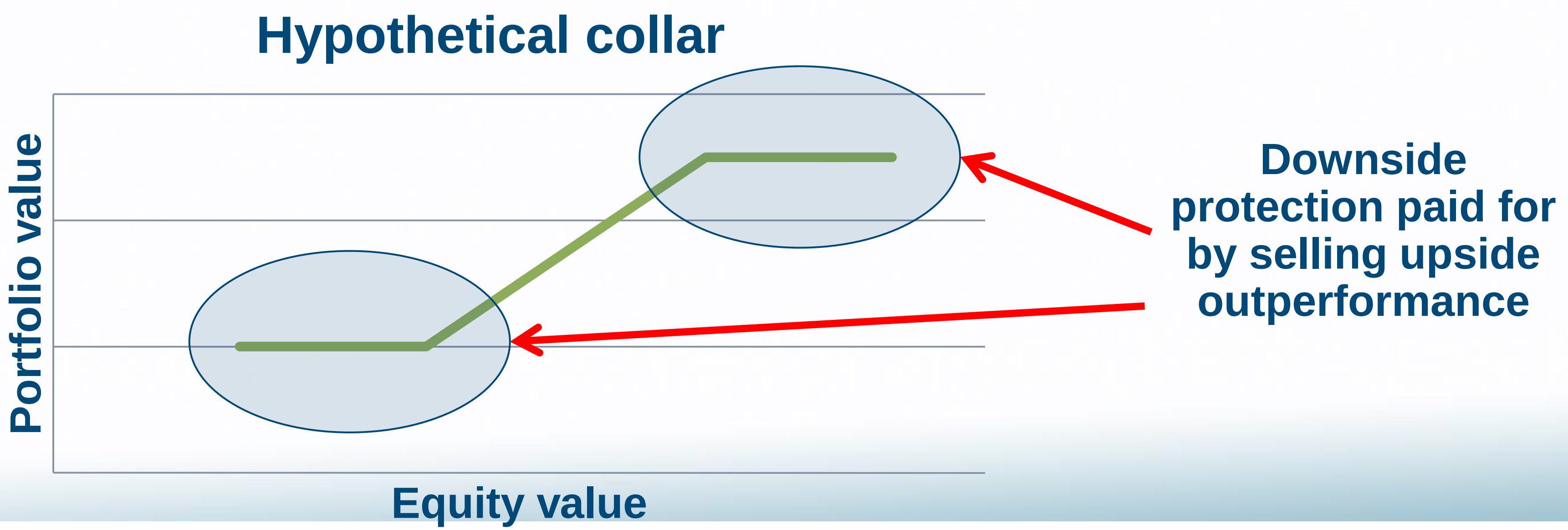
Investment strategy example 3 – Zurich Assurance 90:10 fund

- Equity collars
  - Who pays for the downside protection?
- Example Zurich Assurance 90:10 fund
  - 25% equity backing ratio for life and unitised pension business
  - “Cost of protection” (returns foregone) was 2.4% in 2009



Source: Company website

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Investment strategy example 4 – notional hedge replication

- Long-short positions
  - Approximate put replication “Asset share shorting”
  - “assets held in respect of the expected cost of basic benefit guarantees comprise fixed interest investments and derivative contracts whose value is linked to changes in equity markets” (excerpt Friends Provident Life and Pension Ltd PPFM)

Source: Company website

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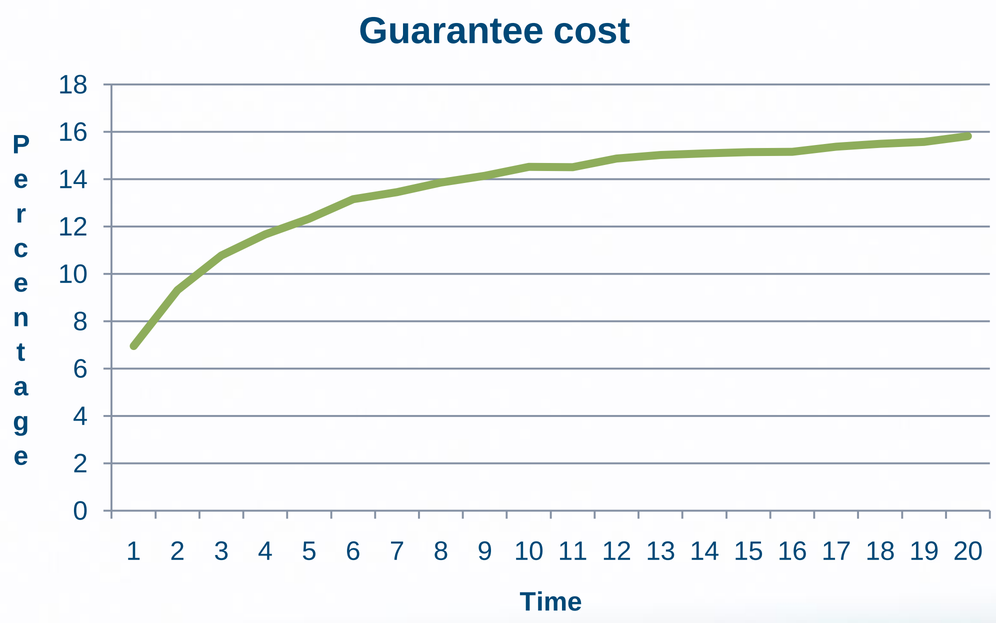
Guarantee costs

- Guarantee costs can be onerous under market consistent measures
  – 50:50 fixed income:equity, rebalanced annually, no smoothing
  – Claim is individual asset share with money-back guarantee
  – Cost expressed as percentage of asset share

Source: Milliman calculations

Guarantee costs

- Higher equity content gives rise to higher investment risk (and larger guarantee costs)
  - Graph illustrates 100% equity investment.
  - Recall the EBR in early 2000 was up to 70% for some offices

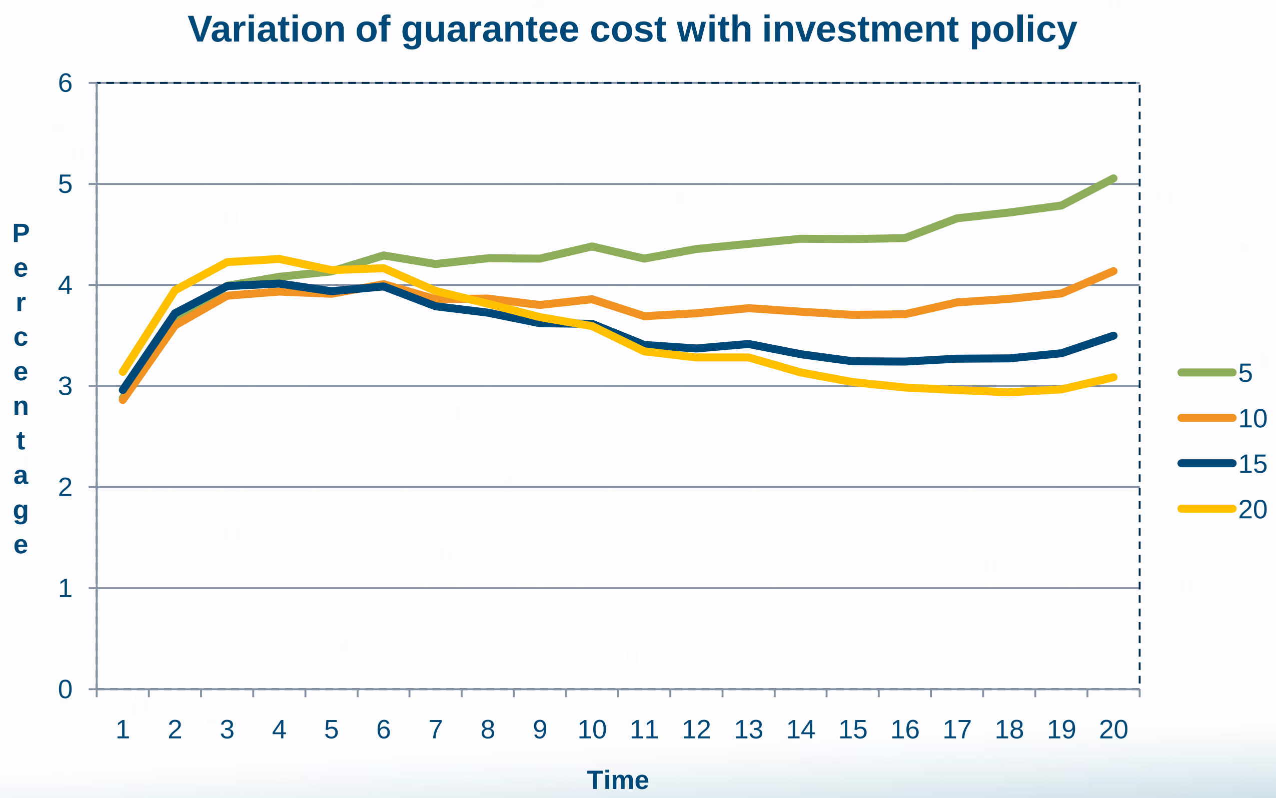


Source: Milliman calculations

Guarantee costs

Graph to show guarantee costs by duration for SP PE

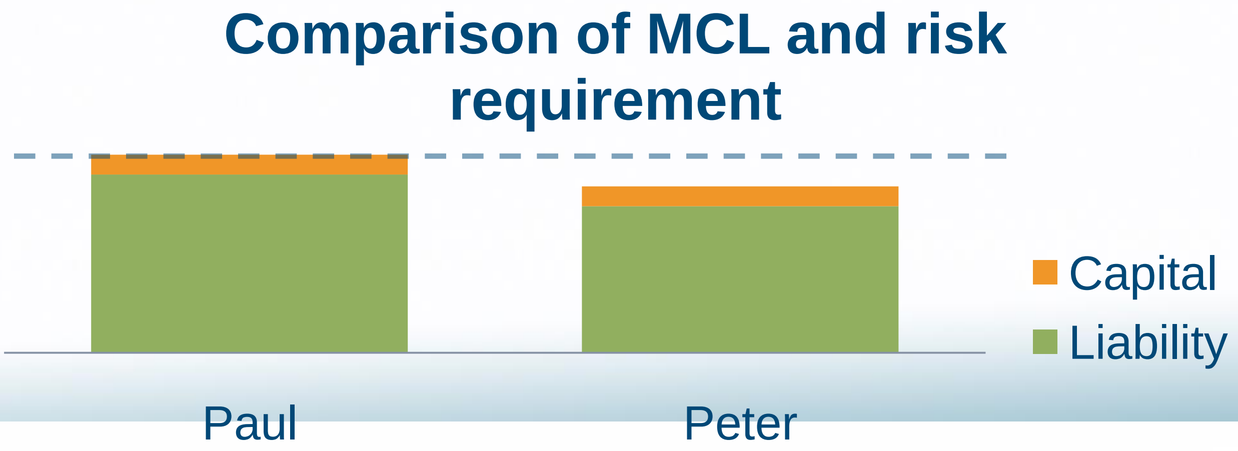
- What happens if you bucket match



Source: Milliman calculations

Hypothetical example

- Paul has a single premium pure endowment due to mature in December 2015. There is a return of premium guarantee.
- Peter has a similar contract maturing in December 2025.
- Assume we invest in some risky assets as well as government bonds
- Paul's contract can be more onerous than Peter's under the MCL+ C2 lens



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Guarantee costs

Graph to show guarantee costs by duration for SP PE

- What happens if you pool risk between Peter and Paul.

Source: Milliman calculations

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Future of with-profits business in the UK

Significant decline in with-profits business in UK in last decade due to a number of factors:

- Consumer preference
  - Adverse publicity for industry in general and bull market performance of linked business
- Capital
  - With-Profits without discretion is capital intensive under market consistent measures
  - Weakening of with-profits fund as a result of the decline in interest rates and fall in equity markets;
- Profitability?
  - MCEV places nil value on future investment returns above risk free

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The future of participating business in Singapore

Estate as at 31 December 2009 for some of the bigger participating players in Singapore

Prudential
S$1.5 Billion

NTUC Income
S$1.5 Billion

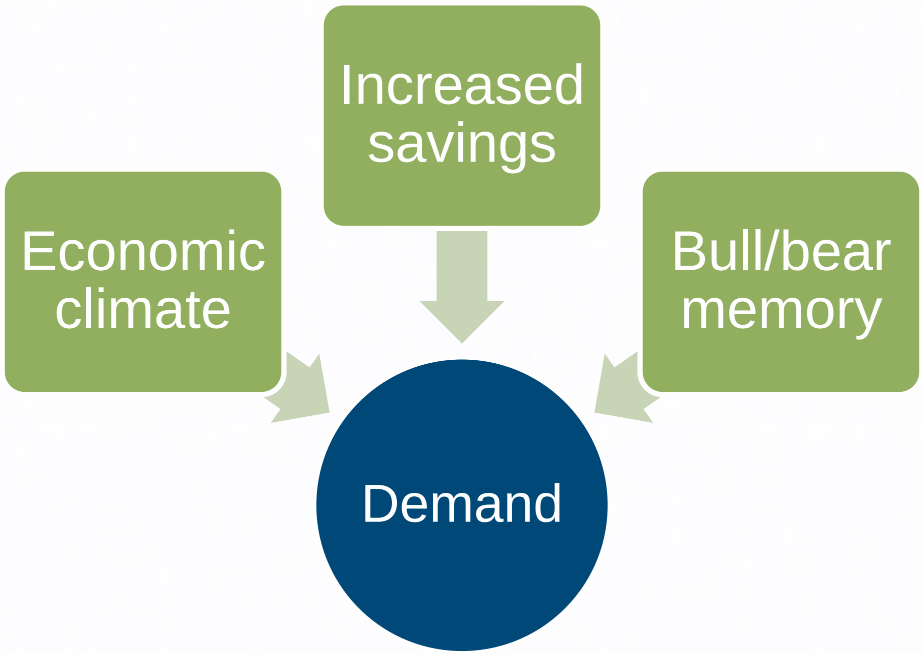
Great Eastern
S$0.5 Billion

TM Asia Life
S$0.5 Billion

For these funds, capital requirement for writing participating new business can be met by the large historical estate accumulated.

Source: Regulatory returns submitted to MAS

The future of participating business in Singapore



- Demand likely to remain strong
  - During economic downturns where investors move away from investment linked products.
  - Schemes like CPFIS, SRS is expected to continue stimulating the growth of Single Premium Participating Endowment business.

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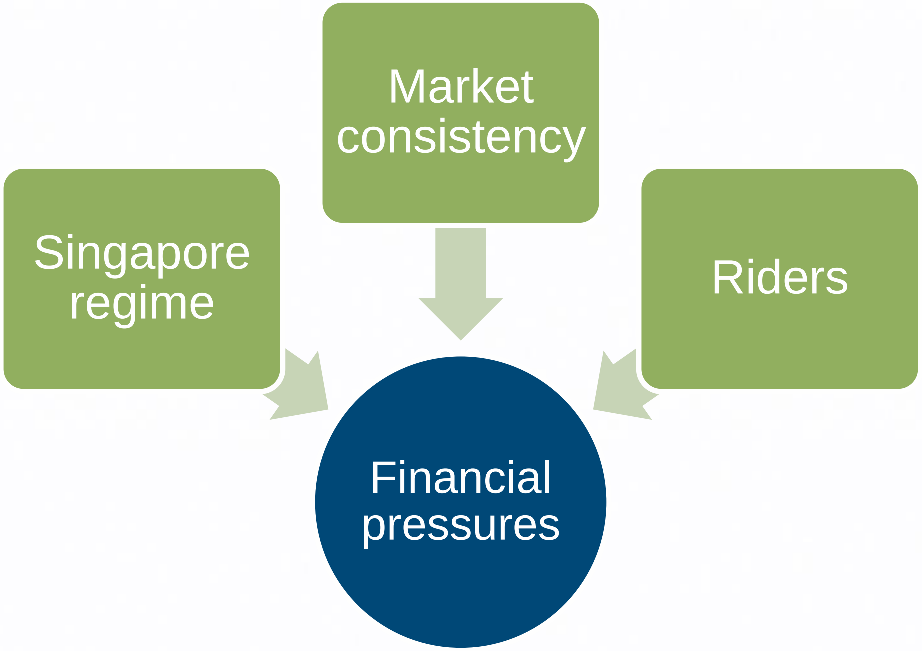
The future of participating business in Singapore



- Participating business less attractive under market consistency
  - Guarantees may be onerous
  - Volatility introduced into the balance sheet

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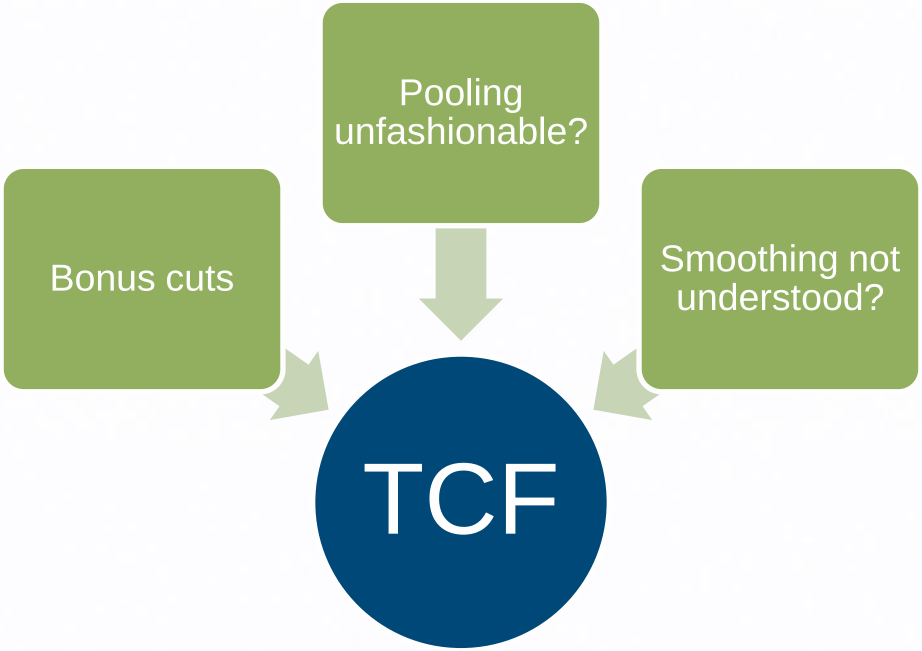
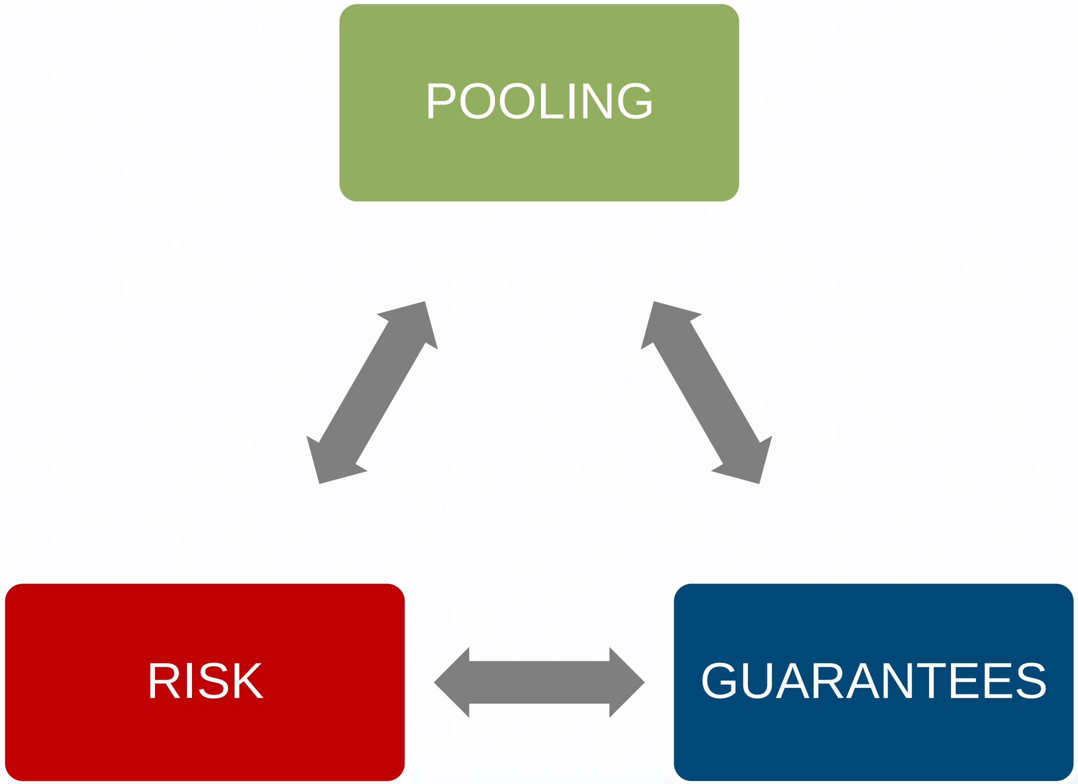


- Heightened awareness of what participating business doesn't do
  - Customers want high guarantees
  - Participating business cannot defy gravity
  - Smoothing can be good as well as bad
  - Increased disclosure since 2007, but still more work to do

The links between "TCF", risk and cost



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The future of participating business in Singapore

- Participating business can work even under market consistency, but matching what the company can afford to offer with the policyholders' aspirations will be challenging!