20 August 2009

The Editor, ST Forum

We refer to the letters by Mr Larry Haverkamp, 'Orphaned money: Key question MAS has not addressed', and Mr Tan Kin Lian, 'Concept of Asset Share is fairer to policyholder'. The Life Insurance Association, Singapore (LIA) and the Singapore Actuarial Society (SAS) would like to clarify some of the misleading comments:

First, "orphaned money" as what Mr Haverkamp and Mr Tan alluded to, does not exist in the participating fund ("par fund") of life insurers in Singapore. Life insurers are required under the insurance regulations in Singapore to hold all par fund policy assets to support par policies, including payment of future guaranteed and non-guaranteed benefits to par policyholders.

Hence early surrender payouts do not lead to the creation of "orphaned money" as Mr Haverkamp suggested. Instead, any gains or losses arising from early surrender will be retained in the par fund and shared by the remaining par policies.

As premature termination of par policies could incur high costs to the par fund, the surrender value of a par policy that is terminated early may be less than total premiums paid to date. This is necessary to ensure that the interests of the remaining par policyholders are not adversely affected by policyholders who choose to exit prematurely.

Second, similar to practices in other jurisdictions, the concept of "asset share" is widely used by life insurers in Singapore to determine bonuses for each cohort of par policies within the par fund. Besides "asset share", life insurers in Singapore also have to take into account other factors such as long term solvency of par fund in bonus determination.

Third, as the primary objective of par policies is to provide stable medium to long-term returns, life insurers have to smooth bonuses declared from year to year. This means the payout may be higher than its asset share in certain years and lower in other years.

All life insurers in Singapore offering par policies have in place an internal governance policy which sets out all key aspects of par fund managements including the methodology in tracking and sharing of risks and the performance of par funds between different cohorts of par policies.

The appointed actuary of each insurer is required to conduct thorough analysis of the financial conditions of its par fund and make recommendations to the board of directors on the appropriate level of bonuses to be allocated to par policyholder annually.

We are of the view that there are adequate safeguards in place to protect par policyholders' interest. We will continue to look into ways to enhance the transparency of par policies.

Darren Thomson
President, LIA

Frank McInerney
President, SAS

Aug 20, 2009

Transparency in insurance

Orphaned money: Key question MAS has not addressed

I REFER to last Thursday's reply by the Monetary Authority of Singapore (MAS), 'Interests of policyholders protected: MAS', in which MAS stated that my letter ('Transparency in insurance: Policyholders underpaid', Aug 6) suggested that insurers have built up 'orphaned money' by under-declaring bonuses to participating policyholders.

I never suggested that. In fact, I said orphaned money comes from a different source: policyholders who leave the fund early, before their policy matures.

Life insurers acknowledge that early surrenders receive less than their full asset share. The underpayments accumulate and form a slush fund commonly known as 'orphaned money'.

MAS claims I believe life insurers under-declare bonuses in order to build up orphaned money, but this would be difficult and I doubt it happens.

Bonuses are cut only in downturns, when the policyholders' fund has suffered losses. They would need to be cut in good times for the bonuses to add to orphaned money. This has probably never occurred.

Whether orphaned money exists depends on just one thing: Do life insurers pay less than the proportionate ownership - called asset share - to policyholders who leave the fund before their policy matures? To give a frame of reference, it would be like a unit trust paying less than the net asset value when investors sell.

If MAS or the life insurers say, 'We pay early surrenders their full asset share and always have', then that is the end of it. I have made an error, orphaned money does not now exist, it never has and I apologise.

The MAS reply, however, talks about the 90:10 insurance rule and the risk-based capital regime. These do not address the question of whether the full asset share is paid to policyholders when they exit the fund. That is the only way to know if orphaned money exists.

It would be easy for MAS or life insurers to disclose if they pay the full asset share. They are the only ones who can answer the question as they are the only ones with the data.

If orphaned money exists, then we can move on to the second step of determining how much it is and where it is held since - at present - no Singapore life insurer carries an account labelled, 'orphaned money'.

Larry Haverkamp

Aug 20, 2009

Concept of asset share is fairer to policyholders

IN LAST Thursday's reply, 'Interests of policyholders protected', the Monetary Authority of Singapore (MAS) stated that insurers in Singapore are required to record the total amount of assets held in the participating fund as backing liabilities to participating policyholders. It also said the issue of 'orphaned money' does not arise.

I am unable to follow its reasoning. Take, for example, a participating fund with assets of $15 billion and total individual liabilities of participating policies of $13 billion. This leaves orphaned money amounting to $2 billion.

Although this orphaned money is supposed to belong to the policyholders, it is not distributed to any individual policyholder who leaves the fund on termination of his policy.

This is not fair to policyholders who have unwittingly contributed to the orphaned money by receiving lower bonuses than they are entitled to. This has contributed to the poor return received by policyholders on the savings in their life insurance policies made over a lifetime.

The orphaned money is usually used by the insurance company to pay the high marketing expenses to acquire new policyholders and introduce new products. This benefits shareholders.

The recent practice of many insurance companies in reducing their bonus rates will aggravate this problem.

I have terminated most of my participating policies as I felt uneasy with the practice that is now adopted by the insurance company.

Several countries have addressed this problem by mandating that the 'asset share' should be computed for each individual policy. This is the amount that is attributable to each individual policy based on the premiums paid, the investment income earned on these premiums, less the charges for insurance protection and expenses.

There is also a requirement that the full asset share should be given to the policyholder on termination of the policy, after it has been in force for a certain period.

It is timely for Singapore to explore the use of this concept of asset share, to ensure that the interest of the policyholders is truly protected and that they receive a fair return for a lifetime of savings. It will also prevent the accumulation of a large orphaned fund, at the expense of the participating policyholders.

Tan Kin Lian