

The future of participating business in a low interest rate environment

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9 November 2012



Agenda

- Introduction
- ZIRP
- Managing PRE in a low interest rate environment
- Lessons from Japan
- Solutions for a low interest rate environment

Introduction

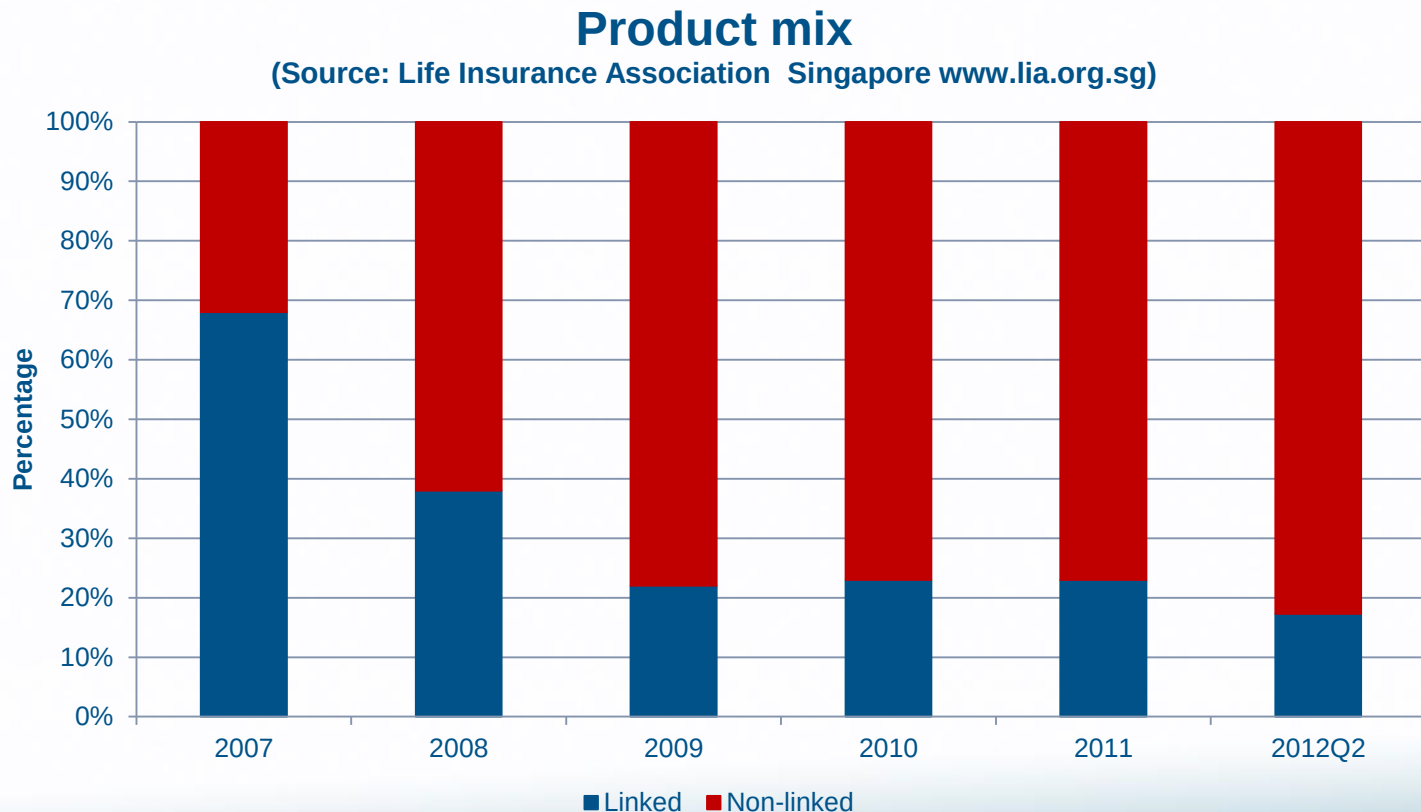


Audience question

Is there a future for participating business in Singapore?

Current market data – Singapore

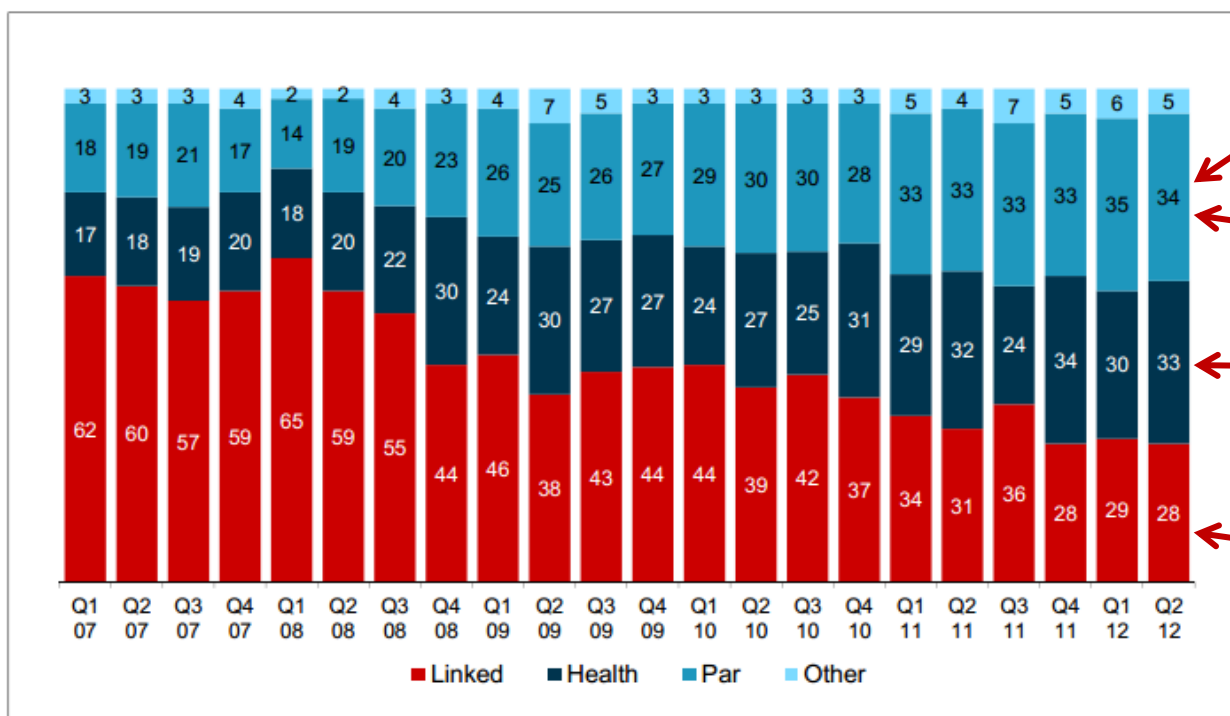
- The following graph shows the business mix of Singapore's life insurance industry, measured by new business APE:



Business mix - Prudential Asia

■ Prudential 2012 Half Year Results

Asia Life
APE sales by product - %



Hong Kong, Singapore and Malaysia only

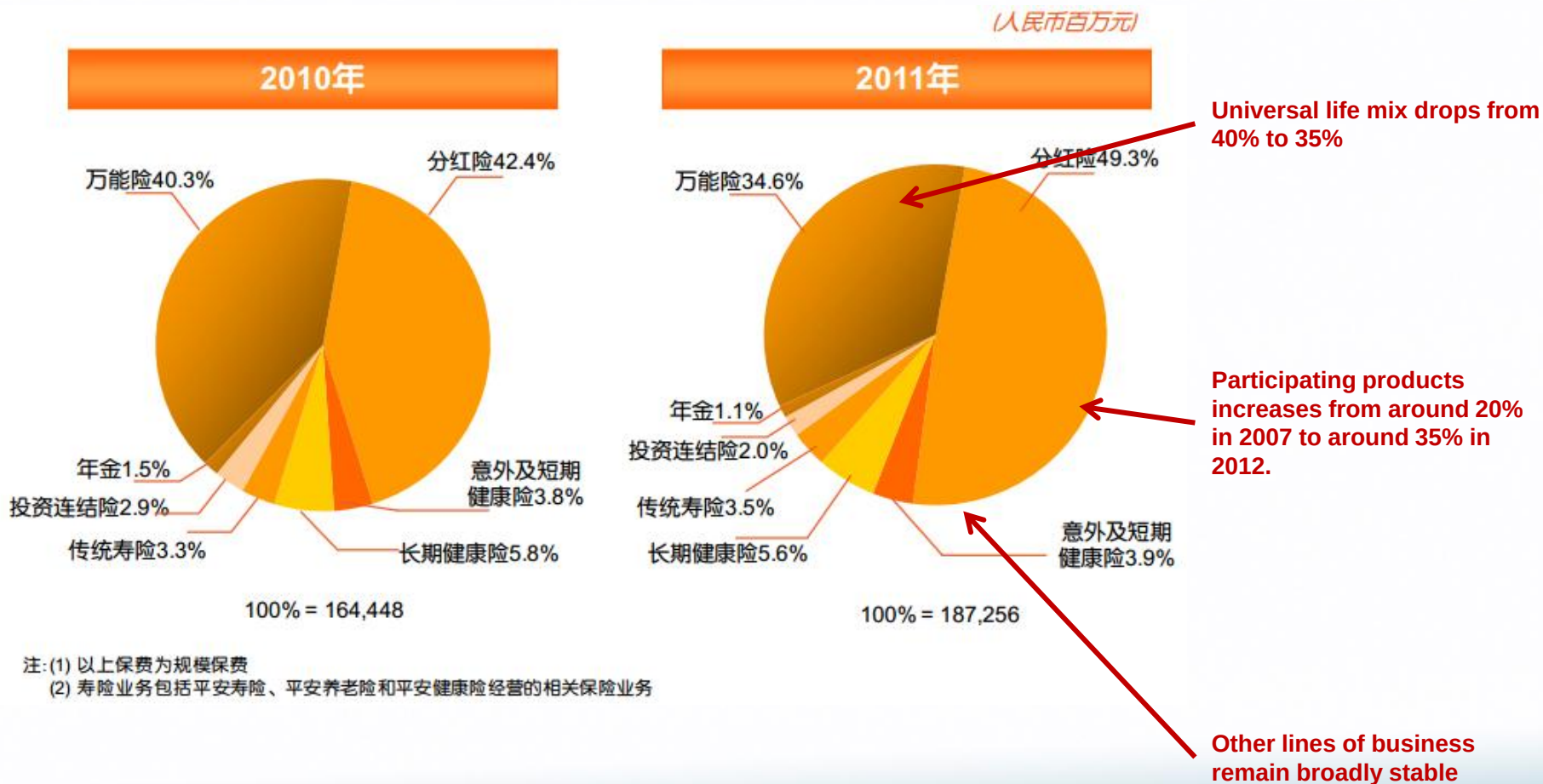
Participating products increases from around 20% in 2007 to around 35% in 2012.

Increased focus on health products

Significant drop in proportion of linked business following the Global Financial Crisis

Business mix - Ping An Life

- 2011 Year-end results for Ping An Life (all channels)

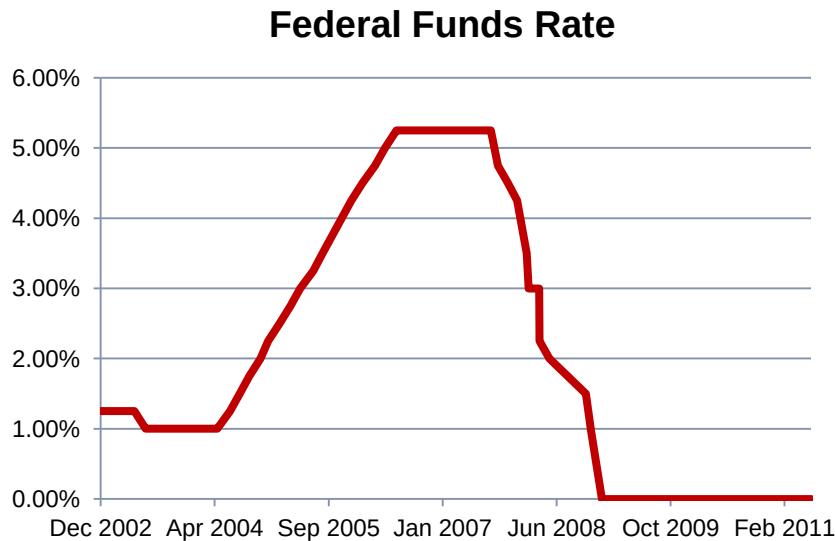


ZIRP



Zero interest rate policy (ZIRP)

- On December 16, 2008, the Federal Open Market Committee changed the rules of the game



- We're still trying to figure out what the new rules are

Press release Board of Governors of Federal Reserve System

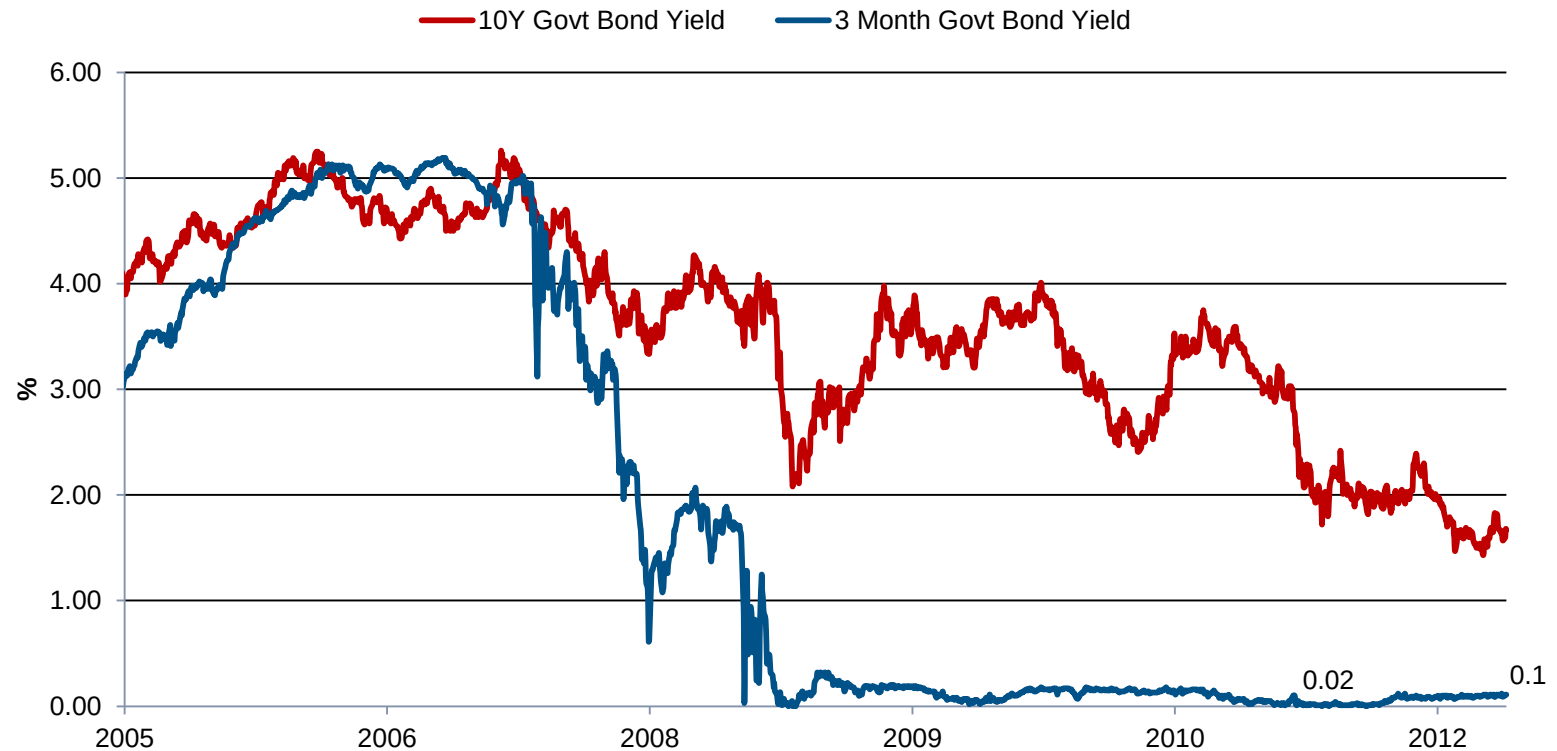
The Federal Open Market Committee decided today to establish a target range for the federal funds rate of 0 to 1/4 percent.

...labor market conditions have deteriorated, and the available data indicate that consumer spending, business investment, and industrial production have declined....Meanwhile, inflationary pressures have diminished appreciably.

*...In particular, the Committee anticipates that weak economic conditions are **likely to warrant exceptionally low levels of the federal funds rate for some time.***

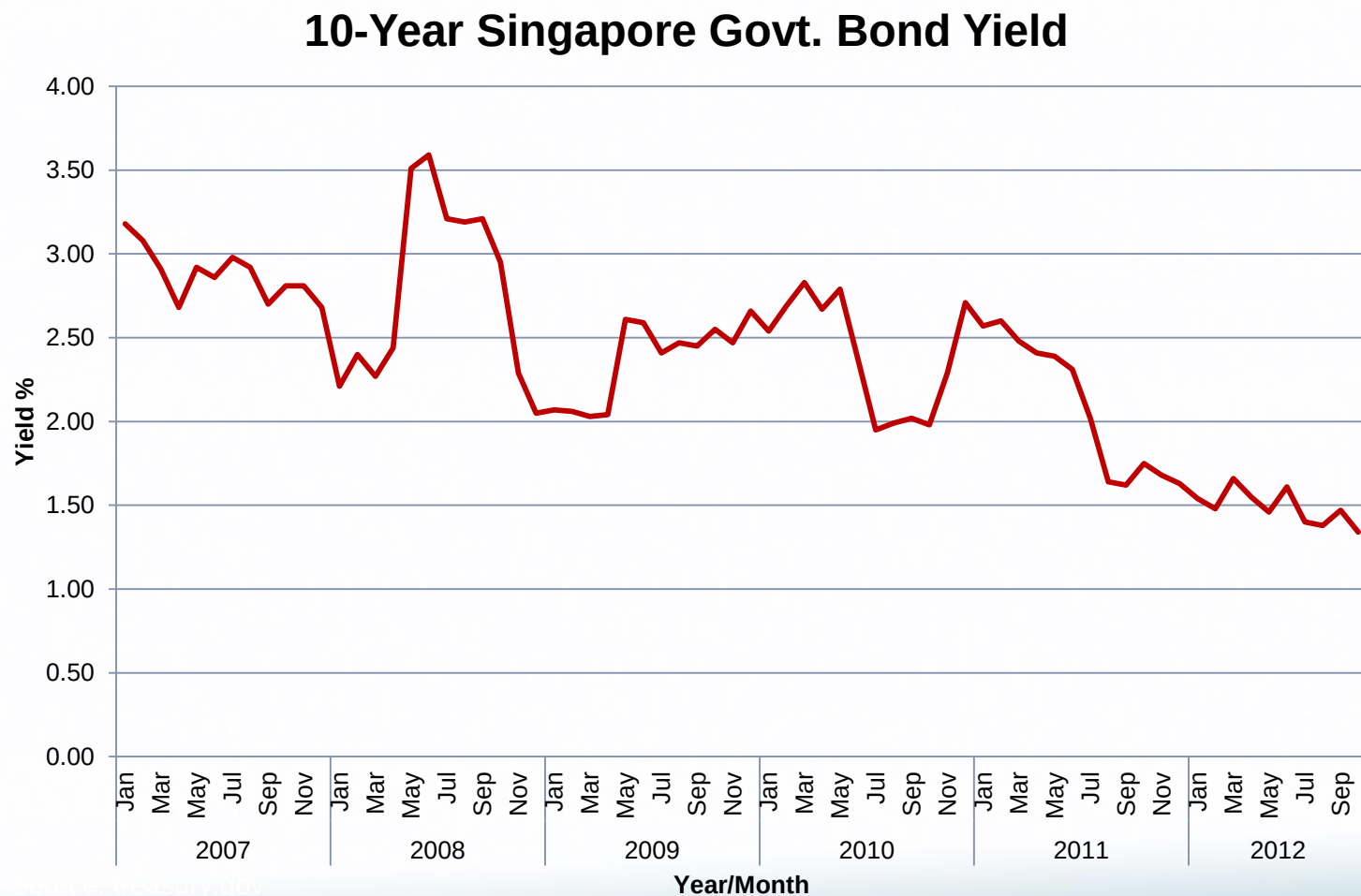
ZIRP in US

Monetary policy is producing low short-term and long-term rates



Source: treasury.gov

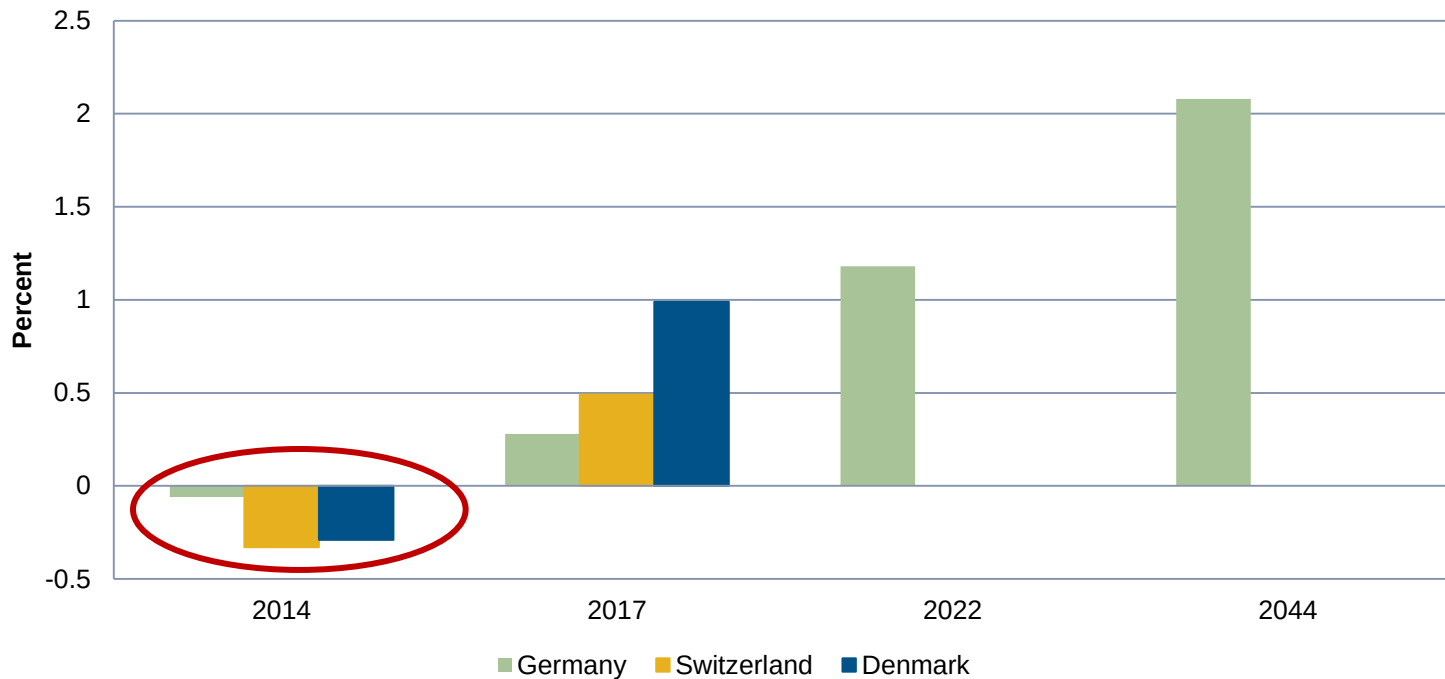
ZIRP in Singapore?



NIRP in Europe

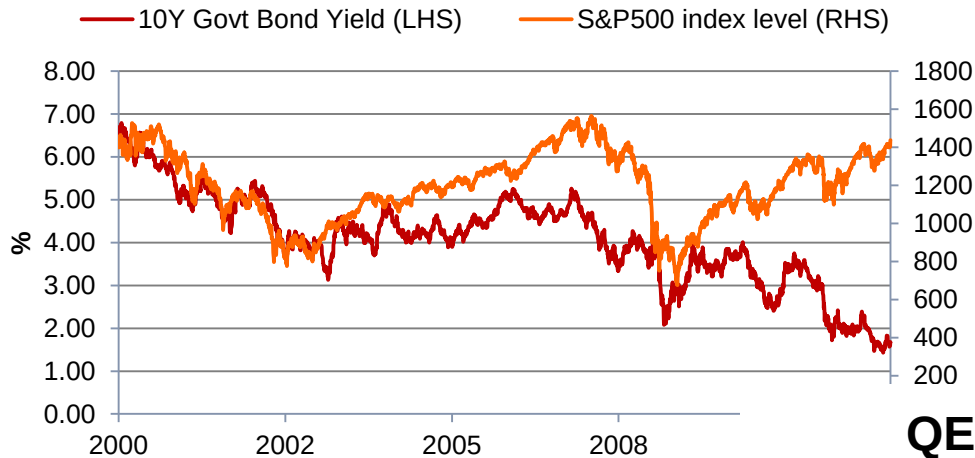
- Negative interest rates are starting to be observed in some markets

**Benchmark bond yields 23 July
(Source: Thomson Reuters)**



Current market data

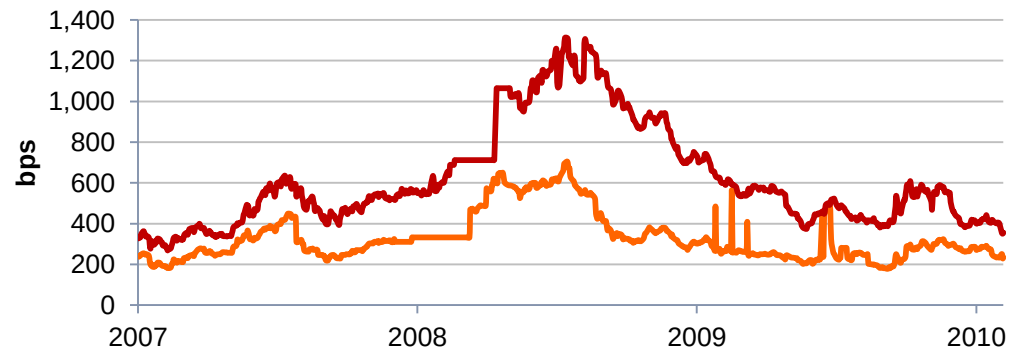
QE is boosting risky asset prices



- Equity prices have rallied as monetary policy is weakened and QE makes returns on bonds unattractive

QE is boosting risky asset prices

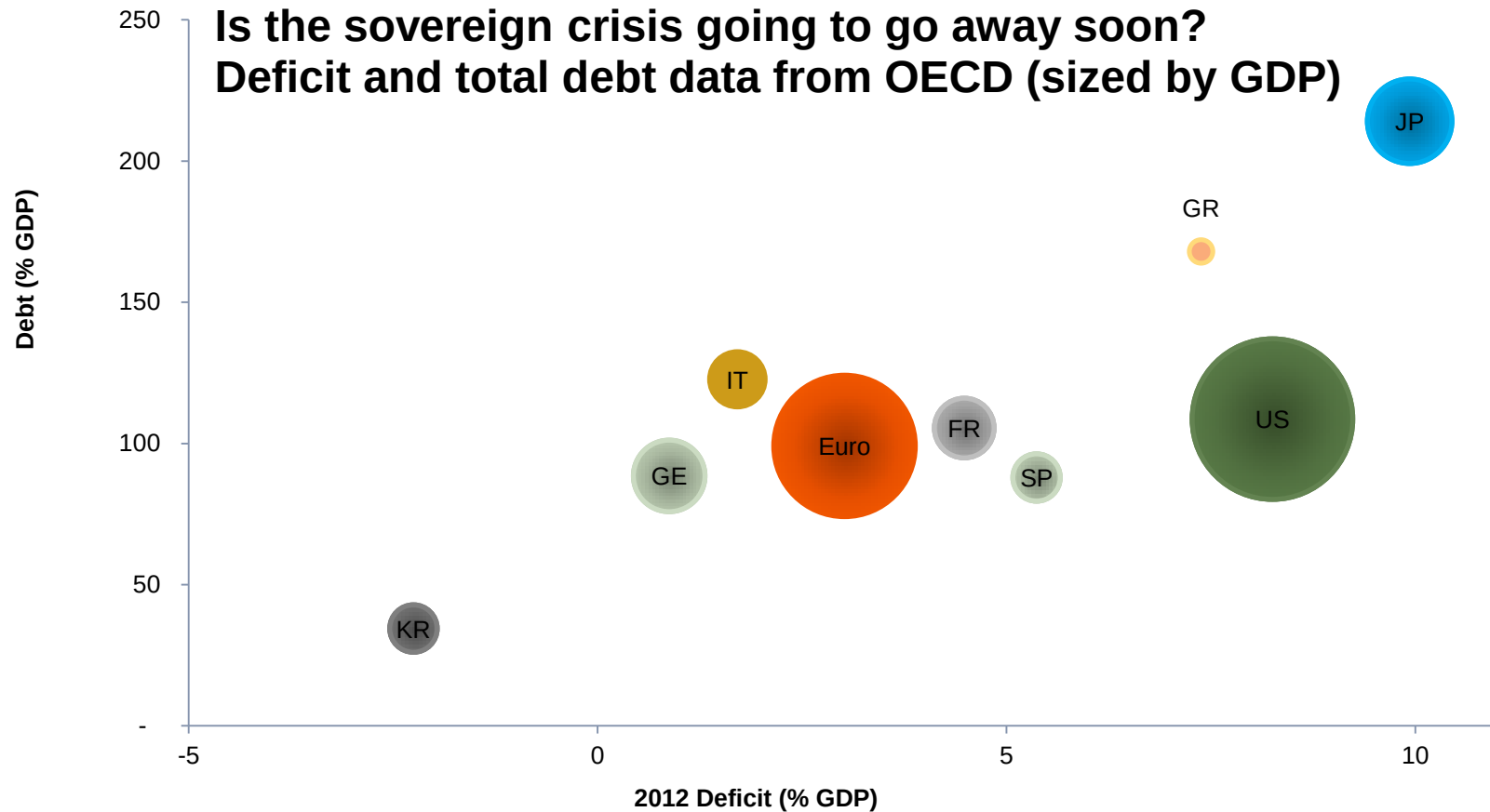
— CMA DJ CDX North_America XO SEN 5Y
— CMA ITRAXX European Union XO SEN 5Y



- High yield debt yields have shrunk as investors seek higher returns (iTraxx crossover indices illustrated on the right)

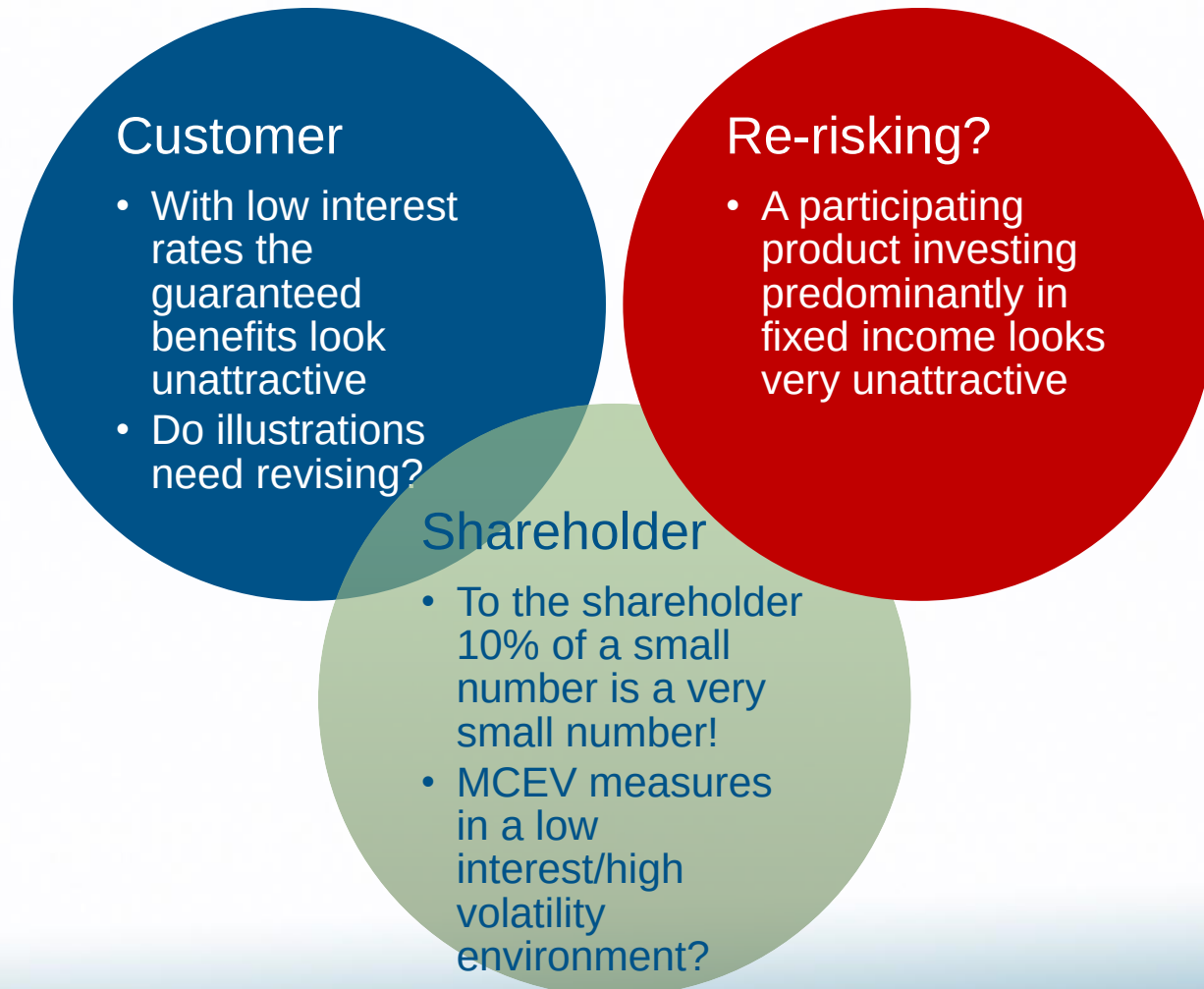
Source: Bloomberg, asianbondsonline.adb.org

Current market data



Source: Key tables from OECD - ISSN 2074-384x - © OECD 2012

Impact on participating business



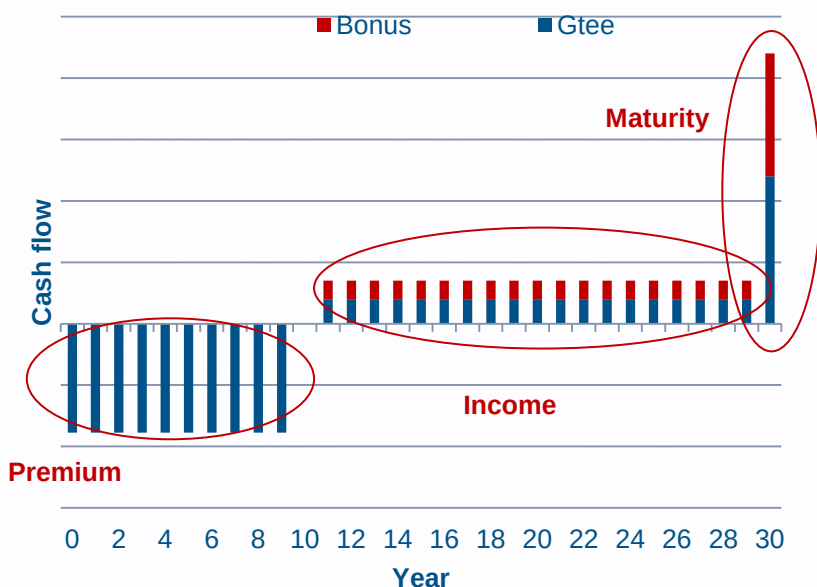
Managing PRE in a low interest rate environment



Product example – Malaysia

- The following product is a typical deferred annuity savings contract
- It is not unusual to see market participants illustrating excess returns above risk-free.
The following example is from Prudential Malaysia (Prucash premier product)

Illustrative cash flows



For illustration purpose only, cash flows not drawn to scale

Description	Amount
Premium payment term	10 years
Income benefit	20 years = 7% sum assured (4% anticipated endowment + 3% simple bonus)
Maturity benefit	Sum assured + Terminal bonus 196% + Simple bonus 85%
Illustrated return (company earns 7%)	= 4.9% each year

Product example (reversionary bonus) – Singapore

- The following is an example of typical Singapore (limited pay) endowment assurance with terminal bonuses:



SAVE

PRUDENTIAL

We understand you want the assurance that you can reach your savings goal

PRUsave privilege accelerator

Annual Premium	Payable For	Policy Term	Total Premiums Paid	Maturity Amount ⁵		
				Guaranteed	Non-Guaranteed	Total
\$50,136	3 years	10 years	\$150,409	\$136,000	\$47,754	\$183,754

$$47,754/136,000 = 35\% \text{ terminal bonus}$$



The smarter way to secure your financial future

AIA.COM.SG

AIA

Annual Premium (Payable for 12 years)	Projected Maturity Amount For AIA Smart Growth 24			Projected Return at Maturity
	Guaranteed	Non-Guaranteed	Total	
\$6,000	\$91,600	\$70,340	\$161,940	4.4%

$$70,340/91,600 = 77\% \text{ terminal bonus}$$

Product example (cash bonus) – Singapore

- The following is an example of typical Singapore (limited pay) endowment assurances with cash dividends:



Ernest receives S\$3,050 yearly when he is 40 years old until Emma reaches 20 years old.

Accumulated Annual Payout is S\$30,500

Emma receives S\$3,050 yearly from her 21st birthday until she passes on at 75 years old.

Accumulated Annual Payout is S\$167,750

Ernest's grandchild receives the death benefit of this plan when Emma passes away.

Total Death Benefit of S\$480,522

Annual cash payout:
- 2.25% guaranteed
- 0.8% non-guaranteed

Annual Premium (Payable for 10 years)	Projected Payment Amount For AIA Gen3			Projected Investment Return
	Guaranteed	Non-Guaranteed	Total	
\$79,800	\$146,250	\$52,000	\$198,250	5.25%



Single Premium	Projected Payment Amount For Great Eastern Guaranteed Rewards			Projected Investment Return
	Guaranteed	Non-Guaranteed	Total	
\$50,000	\$52,500	\$19,000	\$71,500	3.80%

Product illustrations shaping PRE

- Unlike some other territories, the participating insurance industry has some restrictions in terms of advertising of policy returns:

Pillars of policyholder protection (LIA Guidelines)

Basis of illustration

- to ensure fair and consistent illustrations of policy benefits and charges, particularly benefits and charges of nonguaranteed nature

Format of illustration

- to ensure that information provided is proper, clear and adequate so that consumers can make an informed decision

Other general requirements on benefit illustrations

- Limitations regarding wording e.g. “risk-free”
- Consequences of early termination

Compliance and annual certification

- By Principal Officer and Appointed Actuary

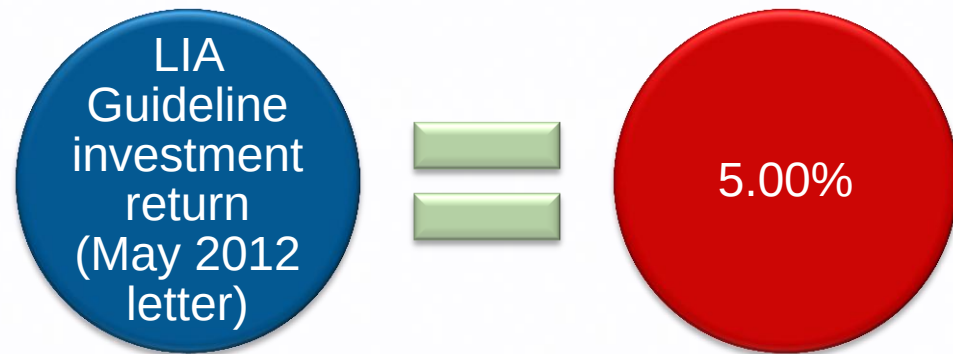
PRE and asset mixes

2011 Par Fund Asset Mix Comparison:

(in SGD millions)	Great Eastern		AIA		Prudential		Tokio Marine	
	Amount	% Mix	Amount	% Mix	Amount	% Mix	Amount	% Mix
Equities	5,128	27.9%	2,816	19.2%	2,398	21.7%	728	34.0%
Debt securities	7,418	40.3%	10,148	69.3%	7,667	69.3%	1,108	51.8%
Property	1,356	7.4%	391	2.7%	33	0.3%	85	4.0%
Loans	1,451	7.9%	365	2.5%	411	3.7%	28	1.3%
Cash and deposits	2,709	14.7%	379	2.6%	420	3.8%	187	8.7%
Fixed assets	69	0.4%	15	0.1%	12	0.1%	2	0.1%
Other assets	275	1.5%	532	3.6%	120	1.1%	3	0.1%
TOTAL	18,406	100.0%	14,645	100.0%	11,063	100%	2,142	100%

Product illustrations shaping PRE

- How achievable is 5% in the current environment of falling yields and given different asset mixes
- Alternatively, if 5% were to be too hard to achieve, how easy is it to change bonus rates in practice?



Product illustrations shaping PRE

- Revised Guidelines may help to protect policyholders, but differences with illustrations for other investments remain



- Arguably a hostile media and the difficulties faced by Equitable Life Assurance Society had a greater impact on PRE/participating business in the UK than any amount of disclosure:

“...the Financial Services Authority’s (FSA) current rules do enough to protect the interests of with-profits policyholders.(they) allow companies a significant amount of discretion to run the funds...”

www.which.co.uk

“With-profits endowments and pensions are now so widely discredited that cynics dub them ‘without-profits’ policies.”

Daily Telegraph 25 February 2012

Appendix II: Main BI format – Participating policies

Policyholder and plan details						
Proposed insured:	Prospect (Affix signature)		Prepared by:			
Age next birthday:	35		Date:			
Sex:	M					
Smoker/Non-smoker:	NS					
Plan:	ABC Endowment Plan					
Sum insured:	\$					
Annual premium:	\$					
Term:	20					

Benefit illustration						
End of Policy Year/age	Total Premiums Paid To-date (\$)	DEATH BENEFIT				
		Guaranteed (\$)	Projected at (X-1.5%) investment return		Projected at (X%) investment return	Total (\$)
			Non-guaranteed (\$)	Total (\$)	Non-guaranteed (\$)	
1/36						
2/37						
3/38						
4/39						
5/40						
6/41						
7/42						
8/43						
9/44						
10/45						
11/46						
12/47						
13/48						
14/49						
15/50						
16/51						

SURRENDER VALUE						
End of Policy Year/age	Total Premiums Paid To-date (\$)	Guaranteed (\$)	Projected at (X-1.5%) investment return		Projected at (X%) investment return	Total (\$)
			Non-guaranteed (\$)	Total (\$)	Non-guaranteed (\$)	
1/36						
2/37						
3/38						
4/39						
5/40						
6/41						
7/42						
8/43						
9/44						
10/45						
11/46						
12/47						
13/48						
14/49						
15/50						
16/51						

MATURITY VALUE						
16/51						

What is the significance of the Projected Investment Rate of Return?

The illustrations have been prepared on two assumptions regarding the investment rate of return achieved by the investments of the fund. The two rates (X%) p.a. and (X-1.5%) p.a. are used purely for illustrative purposes and do not represent upper and lower limits on the investment performance of the Participating Fund.

The two rates shown are net of any investment expenses. Please refer to the investment expense ratio in the Product Summary, shown for up to the last 3 years, for an indication of the actual investment expenses incurred in managing the Participating Fund.

The higher rate does not exceed the maximum long-term investment rate of return (currently 4%), which has been set by the Life Insurance Association, Singapore.

[Where the bonus rates (or cash dividend scales) implied by the projected non-guaranteed values exceed the prevailing bonus rates (or cash dividend scales), state the implied bonus rates (or cash dividend scales) and provide clear explanation why higher bonus rates (or cash dividends) are used in the illustrations.]

LIA Guidelines on Benefit Illustrations (May 2012)

Key issues for PRE

How do I balance the need to protect policyholders with the need to make the product attractive?

Will I be able to make bonus cuts readily?

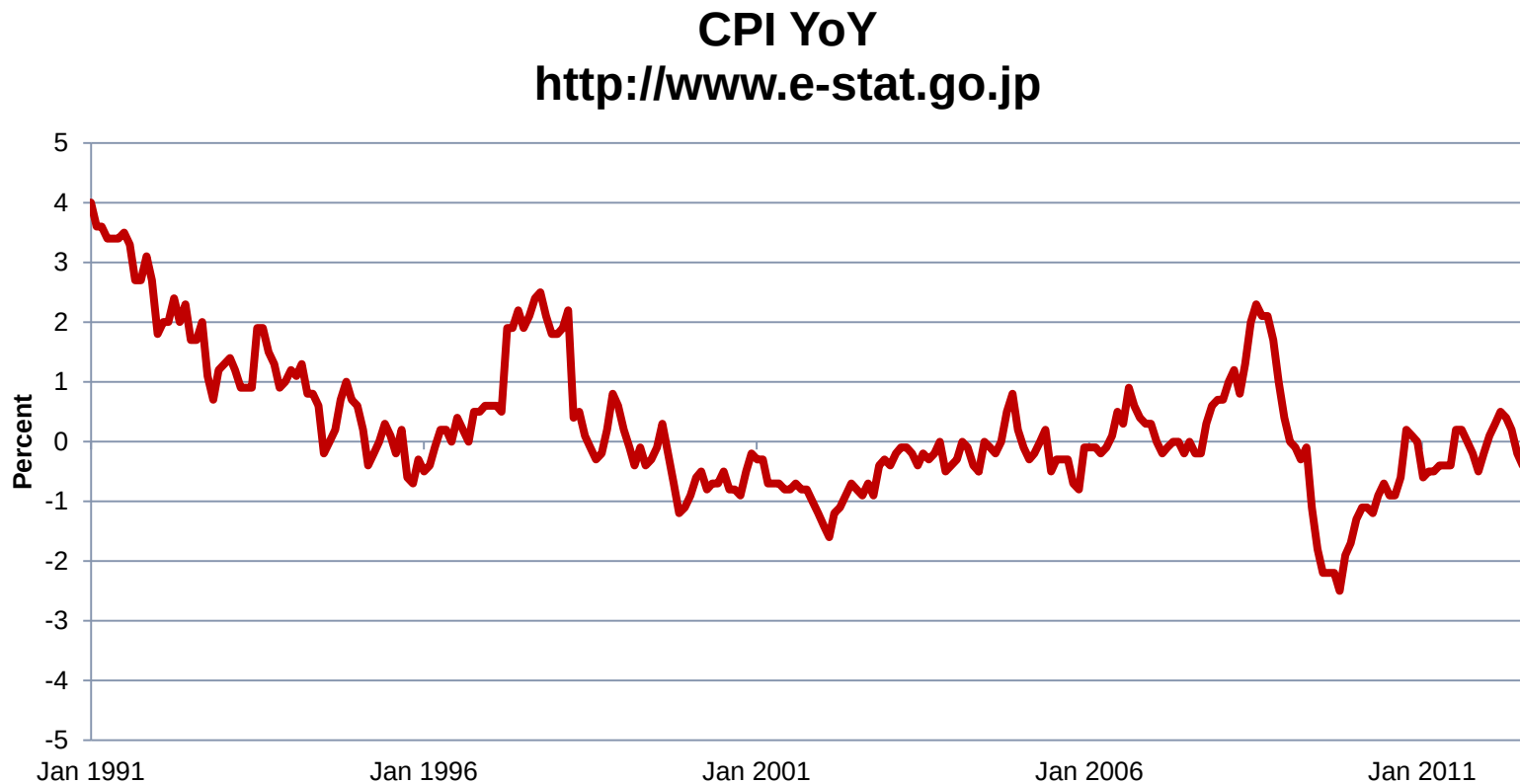
Does transparency help or hinder par business?

Lessons from Japan



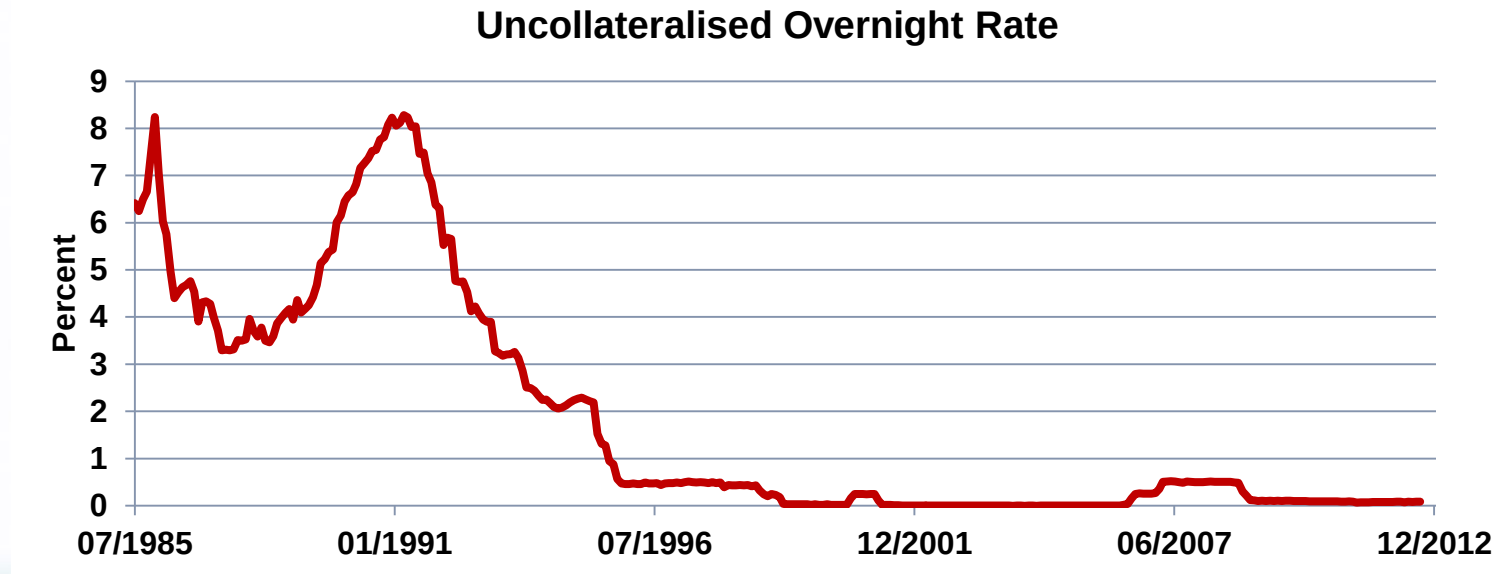
Introduction of ZIRP in Japan

- For much of the 1990s, Japan suffered from deflation



Introduction of ZIRP in Japan

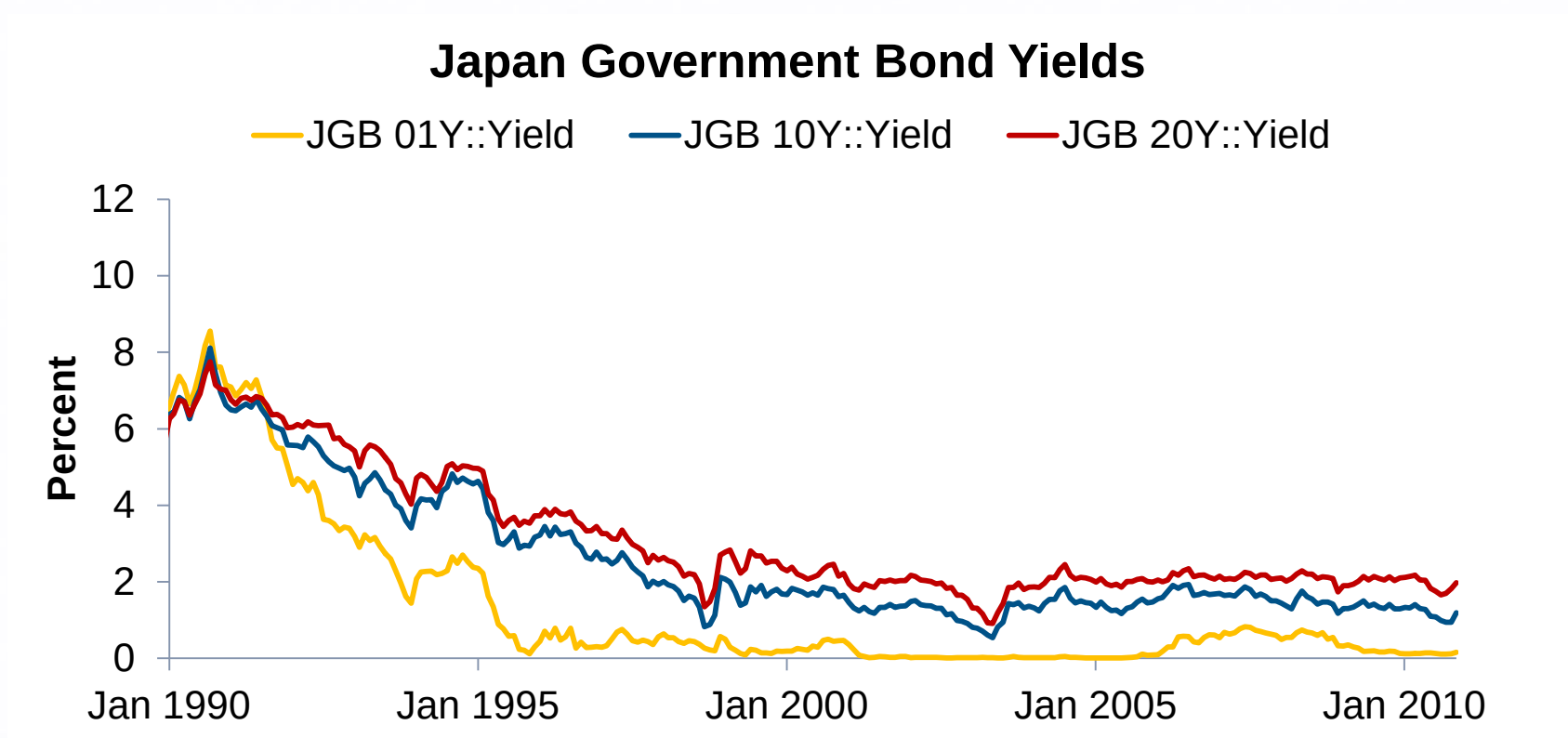
- To tackle the deflationary climate, in February 1999, the Policy Board of the BOJ embarked on ZIRP
- To manage expectations, the BOJ added that it was committed to ZIRP until deflationary concerns had alleviated



Source: boj.or.jp

Impact of ZIRP in Japan

- The impact of deflation and ZIRP on JGB yields has been pronounced



Source: wikiposit.org

Market restructuring

- Faced with persistently low investment returns, the industry found a number of solutions including a focus on product strategy, distribution, risk management and insolvency(!)

Deregulation of product and price; dramatic shift in sales mix

Improved financial reporting; solvency requirements

Gradual implementation of risk management processes

Rationalisation of sales; reduction in sales force size

Staff reductions; hiring freezes; compensation reductions

Growth of new distribution channels

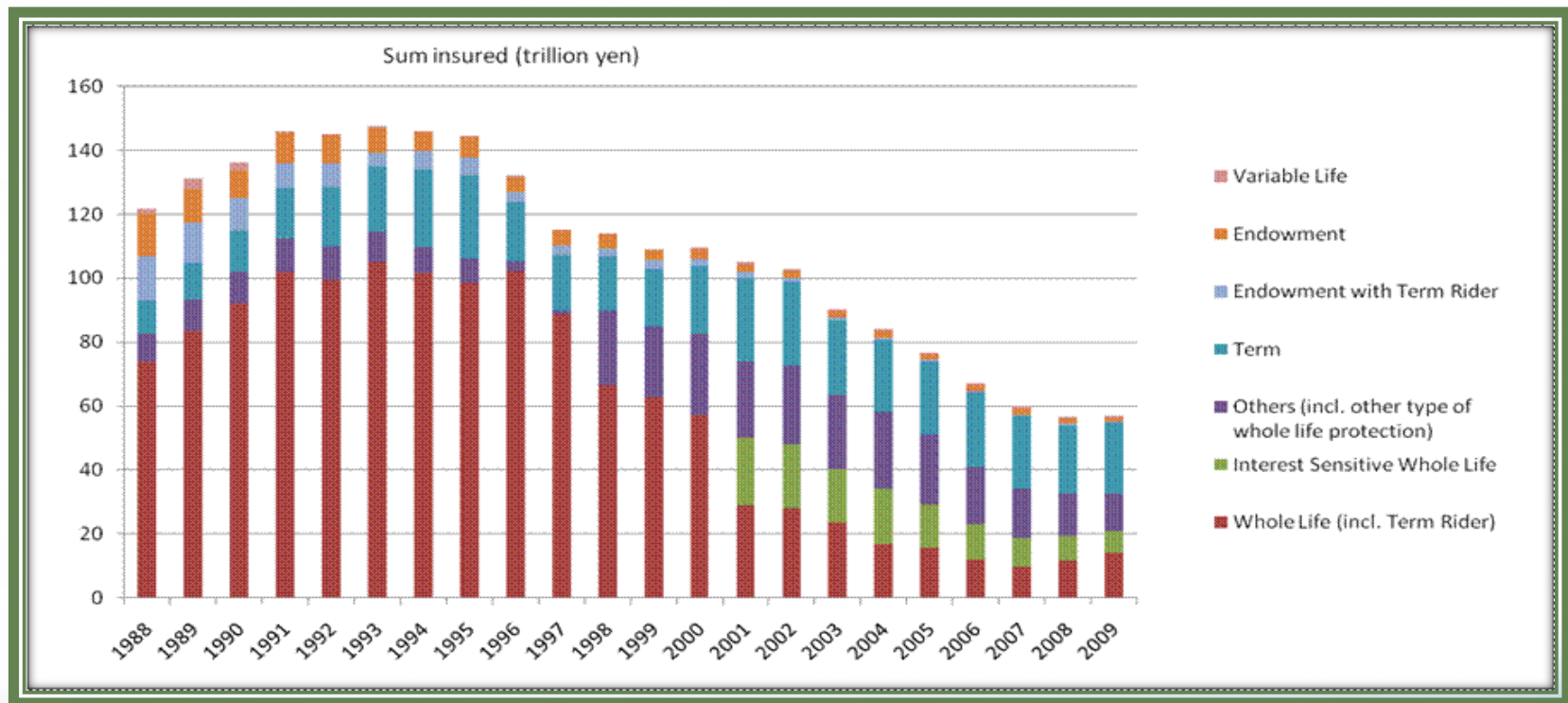
Insolvency and restructuring of weaker players

Gradual reduction in balance sheet risk

Dramatic growth of well managed new entrants

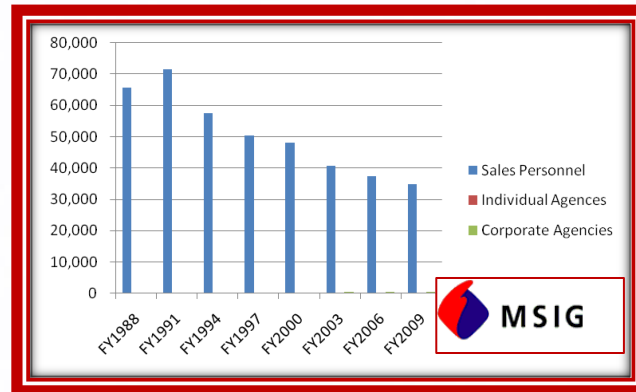
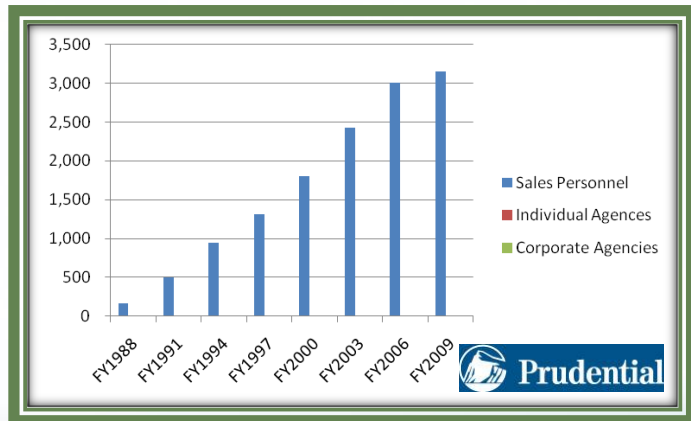
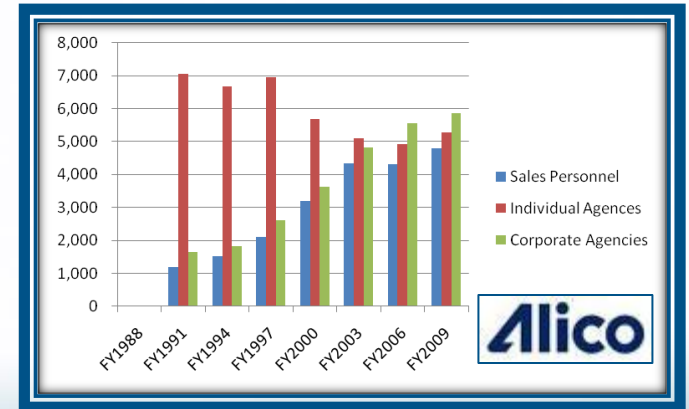
Product mix

- The major response has been a shift away from the traditional whole life product with riders to interest sensitive products and also towards protection
- Not good for par!



Distribution

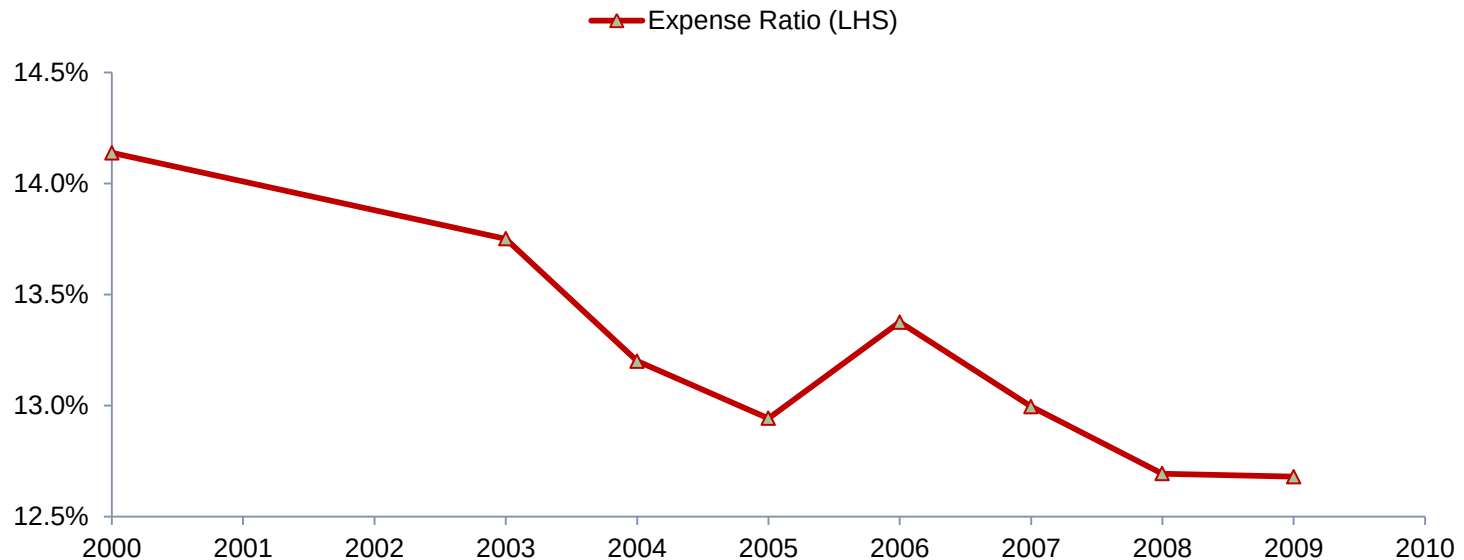
- Inefficient sales forces have been restructured while professional sales advisor channels have flourished
- Is the trouble with par really a trouble with distribution costs?



Cost control

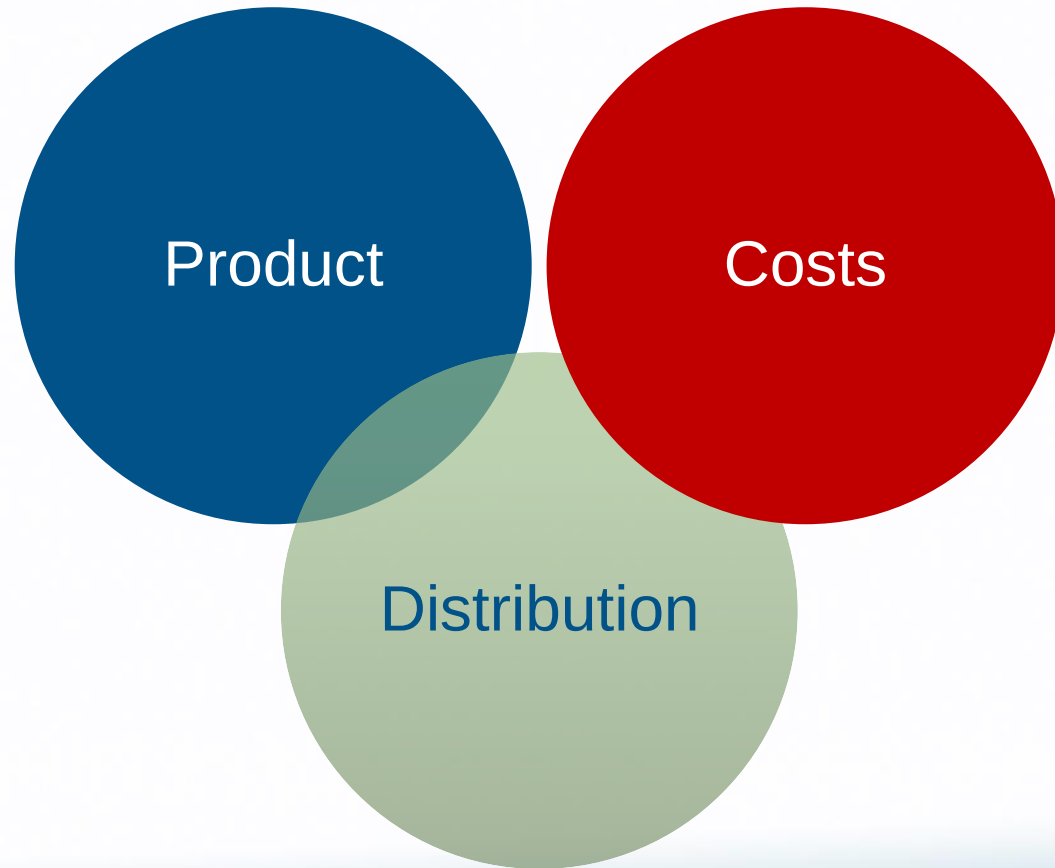
- Successful companies have managed costs aggressively
- Mortality profits against the reserving bases have made helpful contributions to the bottom line

Japan Life Insurance Overview



Source: Life Insurance Association of Japan

Lessons from Japan



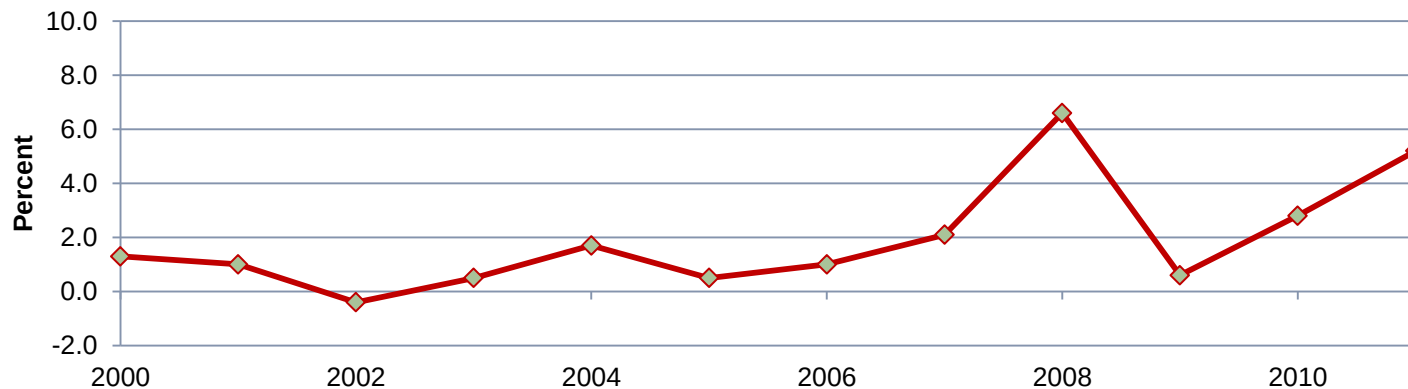
Solutions



Cost or distribution management: too demanding?

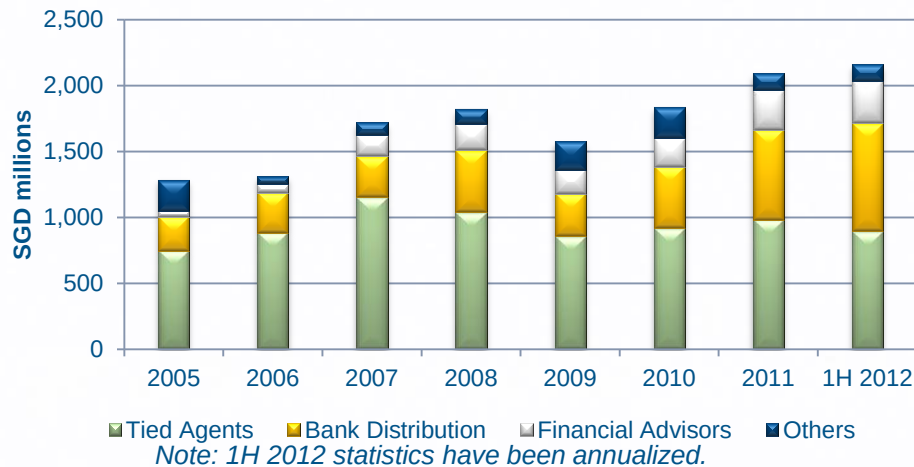
- Low interest rates are helping to drive the US\$ downwards
- Inflation is picking up in many countries which are finding it difficult to conduct “normal” domestic monetary policy given the stimulus efforts in the United States and Europe
- At the same time agency costs are surprisingly “stubborn” to reduce, but agency remains an important component of insurance distribution

Singapore annual Inflation rate (CPI)

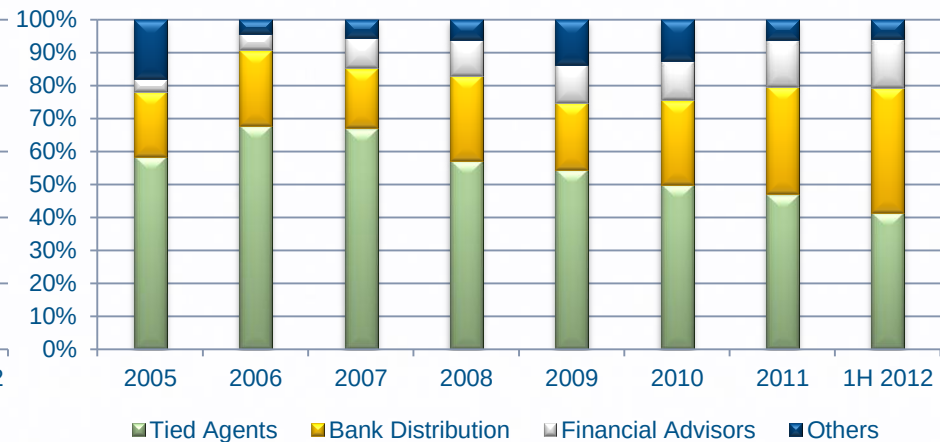


Cost or distribution management: too demanding?

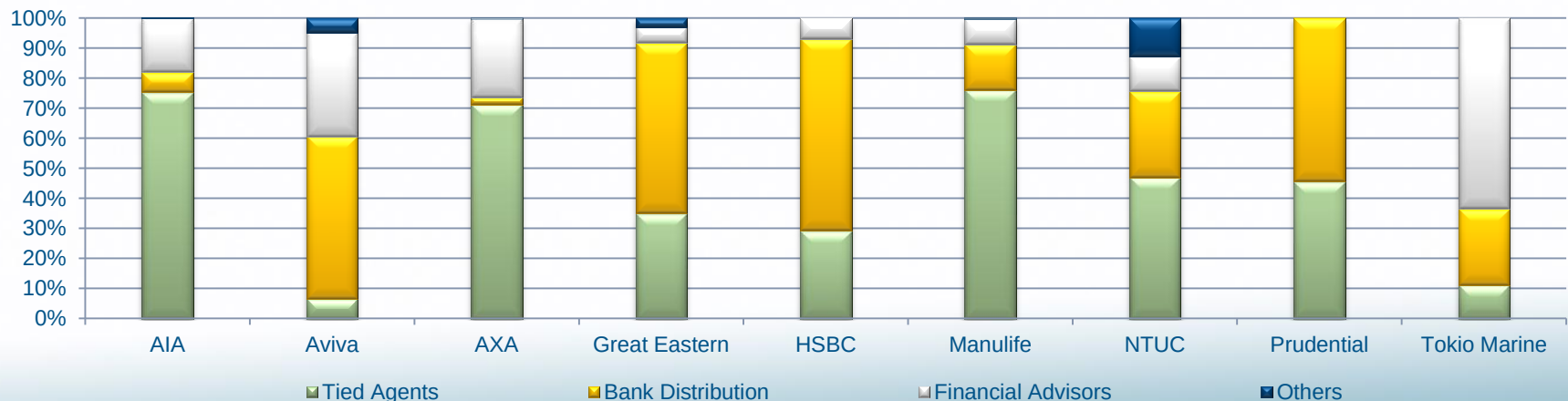
New business APE by distribution channel



New business APE by distribution channel

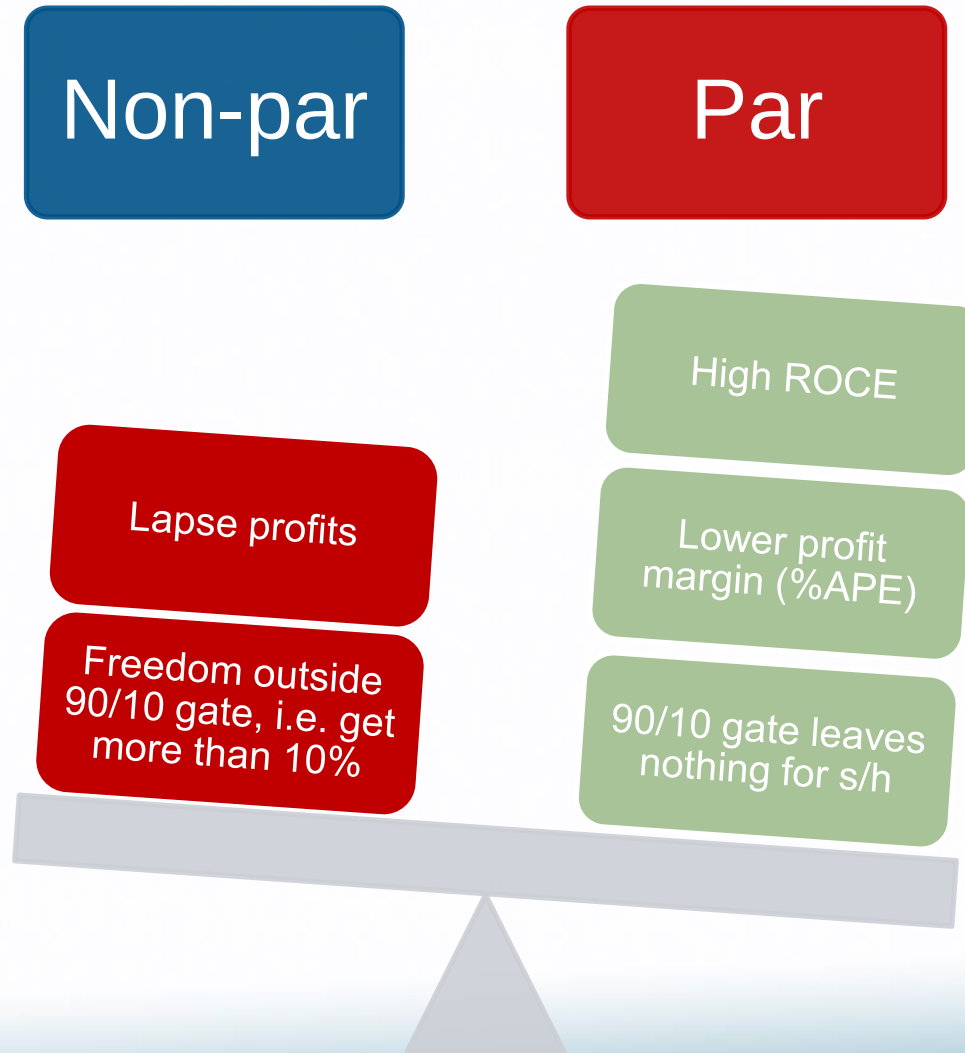


New business APE by distribution channel based on 1H 2012



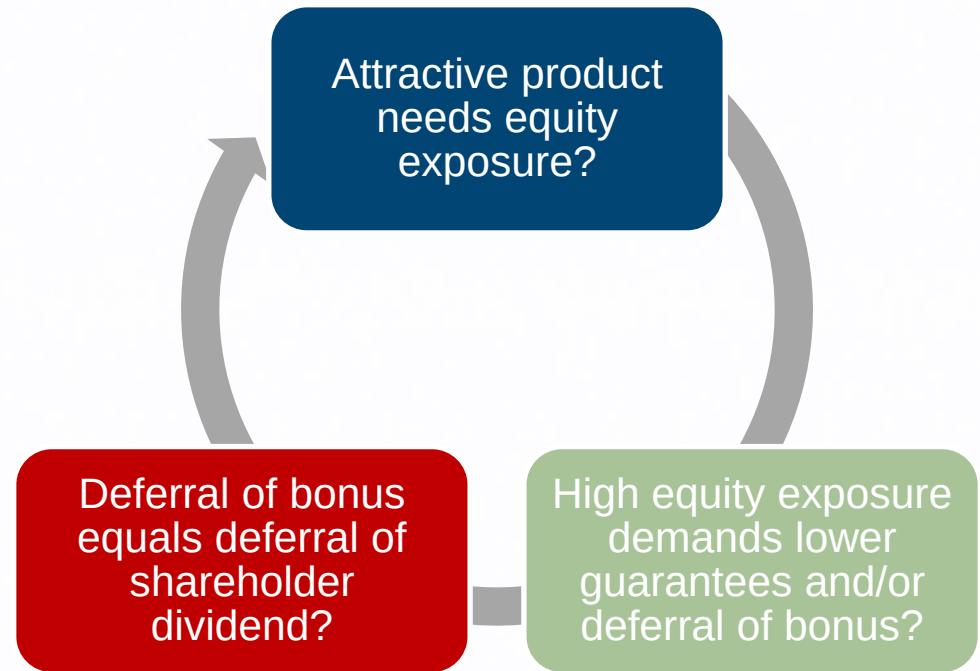
Source: Life Insurance Association of Singapore

Product: try something else?



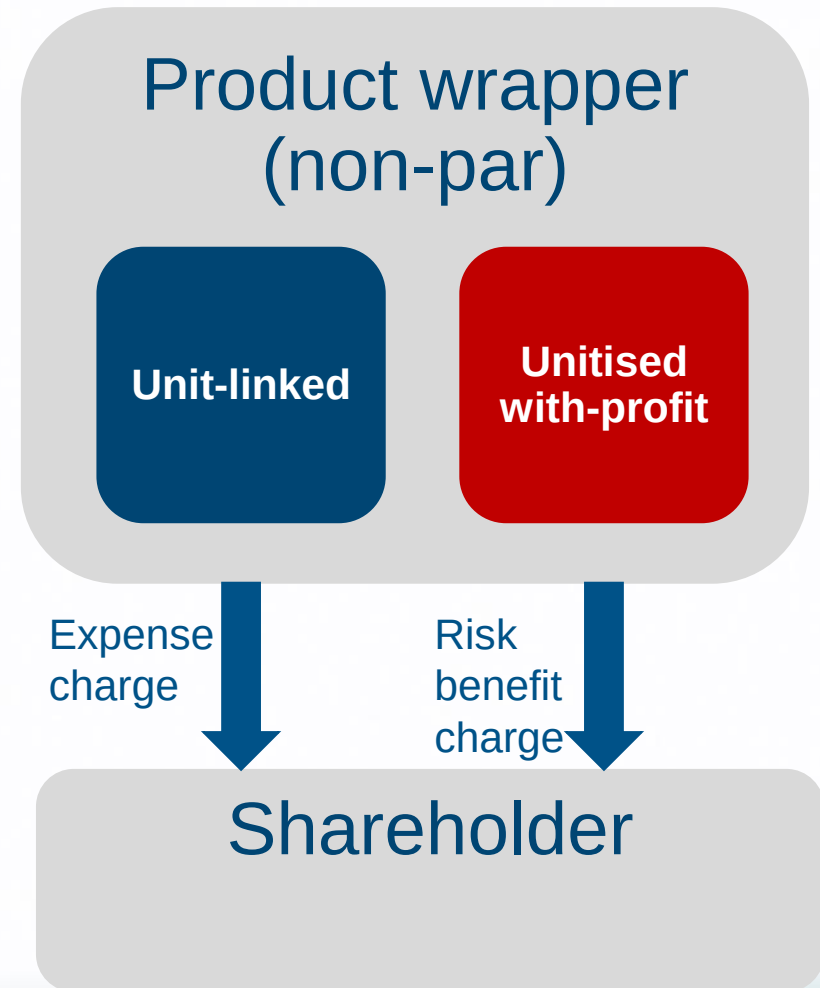
Customer: Is high equity exposure the answer?

- How do we earn 5% (or should we be aiming higher?)
- The impact of higher equity exposure on risk management (capital requirements) and on risk adjusted profitability measures (MCEV) may be unattractive?
- High equity exposure dictates low guarantees and ideally a greater weighting towards terminal bonus. Does this work from a customer perspective?
- High terminal bonus weighting delays the emergence of shareholder profits



Product: unitised with-profits?

- Many unitised savings contracts in the United Kingdom are written as unitised with-profits
- This is effectively a “fund option” inside a linked master wrapper
- The policyholder
 - enjoys a 100/0 investment return subject to smoothing
 - enjoys pooling of asset risk with other participating policies and the existing inherited estate
 - benefits from guaranteed claim values at maturity/death
 - and pays for explicit protection and expense charges just like a normal linked product
- The shareholder
 - enjoys a transparent charging structure, which may be profitable under market consistent measures
 - gets paid for providing risk capital to support insurance risk not paid for “borrowing” existing par fund capital



Product: unitised with-profits?

- Participating funds work well for the exercise of discretion and in particular the pooling of risk between generations
- Alternatives like variable annuity products might work to provide some of the benefits of UWP in a cost effective manner (but not pooling)
- The Insurance Act (revised 2002) in Singapore requires separate funds to be established for separate policies defined to be “investment-linked”, “participating” or “non-participating”
- In the United Kingdom, many of these hybrid policies are written as linked policies with a reinsurance into the participating fund

Variable
annuity/CPPI

Par

S/h provides
capital instead of
estate

No “arbitrary
exercise of
discretion”

Uses existing
estate capital

Benefits less
“formulaic” at the
expense of less
transparency?

Allows pooling
between
generations more
easily

Audience question

Is there a future for participating business in Singapore?

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