Press release

Actuarial profession sets up Inquiry following Equitable Life closure to new business

21 December 2000

The Actuarial Profession today announced that it was setting up an internal Committee of Inquiry to look into the implications for the profession of events surrounding the closure of the Equitable Life Assurance Society to new business, which was announced on 8 December 2000. The Inquiry will focus in particular on the key issue of professional guidance.

The Committee of Inquiry has been asked to present their findings to Peter Clark, President of the Institute of Actuaries and David Kingston, President of the Faculty of Actuaries, by Spring 2001.

Speaking on behalf of the Profession, Peter Clark said:

"The closure of the Equitable Life Assurance Society to new business is an unprecedented development in UK life assurance which has naturally led to a grave concern felt by many thousands of policyholders.

"The profession is acting to ensure that the factors and events which led to this event are properly assessed in order to establish whether the existing professional actuarial guidance has been adequate or needs to be amended.

"The Inquiry will undertake a thorough and objective review of the events. Any recommendations they make to the Profession are likely to relate to the adequacy of relevant professional guidance and to general issues in relation to the role of the Appointed Actuary in life assurance."

Enquiries: Iain Taylor
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Notes to editors:

Members of the actuarial profession provide commercial, financial and technical advice underpinning the operation of insurance companies, pension funds and other financial institutions.

The profession is governed jointly by the Faculty of Actuaries in Edinburgh and the Institute of Actuaries in London, which lay down a stringent code of conduct for their members to ensure that the interests of the public are protected. They also set rigorous examinations which all new entrants must pass before becoming qualified members.

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Press release

Actuarial profession announces membership of Equitable Life Committee of Inquiry

19 January 2001

The Actuarial Profession today announced the makeup of the Committee of Inquiry which will look into the implications of the events surrounding the closure of Equitable Life Assurance Society to new business.

The Inquiry will focus in particular on the key issue of professional guidance. The Committee's present intention is to report its findings to the Presidents of the Faculty of Actuaries and Institute of Actuaries by Spring 2001.

The inquiry will be chaired by Roger Corley, a Past President of the Institute of Actuaries. The other actuary members of the Committee are: Malcolm Murray, a Past President of the Faculty of Actuaries and Bill Abbott, Group Actuary of Legal & General. Two non-actuaries have also agreed to serve on the Committee: Sir John Caines, retired Whitehall Permanent Secretary and currently Deputy Chairman of the Investors' Compensation Scheme and Keith Woodley, Deputy Chairman of the Abbey National and a Past President of the Institute of Chartered Accountants.

The terms of reference for the Inquiry are to:

- Review the adequacy of the professional guidance in relation to the events leading to the closure of Equitable Life to new business
- Consider whether there are any implications from those events of relevance for the roles of Appointed Actuaries and other actuaries who are directors or senior employees of long term insurance companies
- Make recommendations to the Presidents of the Faculty of Actuaries and Institute of Actuaries.

Speaking today, Roger Corley, Chairman of the Committee of Inquiry said: "The problems of the Equitable, Britain's oldest established Life Office stunned policy holders and sent shock waves throughout the life industry, the actuarial profession, the regulators and the government.

"The Actuarial Profession has set up a Committee of Inquiry including members drawn from within and without the profession. The Committee will look at the situation with the interest of the public in mind. In particular it will consider the actuaries in the regulatory process to see if the guidance provided by the Profession needs to be strengthened".

Enquiries: Iain Taylor
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Notes to editors:

Appendix 1

Roger Corley:	A Past President of the Institute of Actuaries and former Chief Executive of Clerical, Medical and General Life Assurance Society.
Bill Abbott:	Group Actuary, Legal & General Group Plc since 1986.
Malcolm Murray:	A Past President of the Faculty of Actuaries in Scotland and former Chief Executive and Director of The Scottish Life Assurance Company from 1988 until 1998.
Keith Woodley:	Deputy Chairman of Abbey National Plc and Complaints Commissioner for the Stock Exchange, PIA, SFA and IMRO and a Past President of the Institute of Chartered Accountants.
Sir John Caines:	Retired Whitehall Permanent Secretary and currently Deputy Chairman, Investors Compensation Scheme.

Actuaries provide commercial, financial and prudential advice on the management of a businesses assets and liabilities, especially where long term management and planning are critical to the success of any business venture. They also provide advice on social and public interest issues.

Members of the profession have a statutory role in the supervision of pension funds and life insurance companies. They also have a statutory role to provide actuarial opinions for managing agents at Lloyd's.

The profession is governed jointly by the Faculty of Actuaries in Edinburgh and the Institute of Actuaries in London. A rigorous examination system is supported by a programme of continuous professional development and a professional code of conduct supports high standards reflecting the significant role of the profession in society.

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Page updated: 18 January 2001

Webmaster

THE EVOLUTION OF THE GUARANTEED ANNUITY RATE (GAR)

1. This note sets out our understanding of the evolution of the guaranteed annuity rates (GARs) and options on certain products of the Equitable, set in the context of the changing legislation for insured pension business and the development of an operating philosophy for the Equitable. This understanding may be incomplete and is reliant on the memory of our contacts.

2. The following terms are used in this appendix to distinguish between different types of guarantees on annuities. The list of guarantees is not exhaustive, but all are relevant to the particular situation of the Equitable and the chain of events which resulted in the type of guarantee which was considered by the courts and the liabilities which had to be accounted for.

   (i) GAR on Premiums (‘premium based guarantees’ or GARp); a guarantee which delivers a specified amount of annuity for a given premium at an assumed retirement age (the 70th birthday). Thus for a premium of £100 paid by say a 38 year old male, a guaranteed annuity of £x per annum would be payable from age 70.
   (ii) GAR on a Fund Value (or GARf); a guarantee which converts a fund value into an annuity. Thus if the annual premiums had, with bonuses, accumulated to £1000 at age 70, there would be a guaranteed annuity of £y per annum for a fund value of £1000.
   (iii) GAR; a guarantee of either type, i.e. a GARp or a GARf.
   (iv) Guaranteed conversion rates (or GCRs); guarantees which convert a GAR into a different annuity, e.g. an annuity payable at a retirement date earlier than the 70th birthday.
   (v) Open-ended GAR guarantee; a guarantee in the original contract that allows future incremental business to be written under that contract at any time prior to retirement on terms which contain a GAR.

3. The Equitable introduced new with-profit contracts for the self-employed, following fresh pension legislation in 1956 relating to ‘Retirement Annuities’. The contracts were designed ‘to give the policyholder maximum flexibility’, with policyholders being able to pay in premiums of any amount (up to Inland Revenue limits) in any year and enter into pension at any age within a defined range. The contract thus included a GARp, GCRs and, see (viii) below, an open-ended GAR guarantee.

   The original 1957 Retirement Annuity contract provided an annuity as the primary benefit:

   (i) On death before retirement, a return of premiums was made with interest at 4% p.a..
   (ii) On retirement at age 70, the latest possible age permitted under the pensions legislation, the benefit was a guaranteed annuity amount, quoted as an amount per £100 of the (recurrent single) premium depending on age when the premium was paid – a premium based guarantee. The actuarial assumptions underlying this annuity amount were a(55) ultimate mortality and 2.5% p.a. interest (later

increased to 3% p.a., although the volume of business sold on this basis was small) in deferment and 4% p.a. in possession, i.e. premiums were rolled up at 2.5% p.a. and then converted into an annuity in payment at 4% p.a..

(iii) There were options to convert this single life annuity to a last survivor annuity or one with guaranteed periods of 5 or 10 years. These other annuities were stated to be provided as such amounts as were agreed by the insurer and policyholder, i.e. the Equitable were free to use current rates– no GCRs for this conversion facility.

(iv) There were also options for early retirement within the permitted limits. Somewhat curiously, the policies did not provide explicitly for the conversion of the contractual annuity at age 70 to an annuity at an earlier age. However the bases used in illustrations and in practice (see 4 below) had the effect of implicit guaranteed conversion rates (GCR). It is believed that the early retirement factors followed the 2.5% actuarial assumption for practical convenience, even after the main assumption was changed to 3%, thereby benefiting the early retirees with 3% contracts.

(v) The Equitable evidence to the Treasury indicated GARs going back to 1957, and this relates to these implicit GCRs which had some of the attributes of the GARfs developed later.

(vi) The contract was with profits. A reversionary bonus was added periodically: initially declarations were quinquennial, then triennial from 1965 and annual from 1986. The terms for the new contract were set so as to enable the same reversionary bonus rate to be used as for the then existing major classes of business, thereby giving a reference point as to how the new class of business was expected to perform. The move to a 3% accumulation rate (see (ii)) was to reflect, in those pre-terminal bonus days, a bonus earning power of premiums higher than had been earlier assumed.

(vii) In accordance with the legislation, there was no cash option available.

(viii) The policy was written in a form that had regard both to the minimisation of stamp duty and to client needs. This generated ‘recurrent single premiums’. A by-product was the incorporation of an open-ended option to write additional recurrent single premiums on the same terms within the contract. This option was limited to the amount permitted by legislation (then £750 per annum, but subject to subsequent uplifts).

The feature of a recurrent single premium proved to be a strong marketing feature for the Equitable because of the flexibility it gave compared with the customary regular annual premium policies, both to meet the economic circumstances of clients and the nature of the guarantees.

4. The early Equitable policies had a ‘Table of Guaranteed Rates of Annuity’. This table defined the annuity secured at age 70 by a premium paid at a certain age. At some stage before 1971 the policies included an explicit table of amounts of annuity at each age from 60 to 70 to be given up to provide a £100 cash sum. These were the annuity rates at each age on the 4% a(55) basis implicit in the policy terms. The policy itself did not provide explicitly for the conversion of the contractual annuity at age 70, although the table gave a strong indicator as to how it would be done (i.e. it would be illogical to allow commutation at an earlier age on such rates unless the annuity at 70 was also on those rates). This is equivalent to providing guaranteed annuity rates on a fund value at say age

60 which is the present value of the guaranteed annuity payments from age 70 using a fixed discount rate.[1]

5. Our understanding of the investment policy was to fund for cash at an expected average retirement date earlier than the latest date of age 70. The system gave no credit for the higher interest rates that emerged in the sixties and the higher annuities that could (if allowed) have been purchased with the notional contract value on retirement. The return on death benefit also looked meagre. As a result in the early seventies, Equitable:

   (i) added a form of terminal bonus (called a 'final bonus') to Retirement Annuities and to similar contracts (such as section 379 schemes) passing into payment to reflect the difference between GARs and current annuity rates. Policyholders were reminded that their Retirement Annuities ceased to participate in profits when they retired, as had always been the case. However, the 'final bonus' provided some non-contractual compensation for the cessation of participation rights by investing the notional policy value at the higher interest rate then prevailing, and
   (ii) did not add terminal bonuses to endowments or any other contracts that matured for a lump sum - and received no complaints from any class of policyholders.

6. Until 1970, the Equitable had relied on the FSSU (Federated Superannuation Scheme for Universities) for much of its business. Annuities for private clients were a sideline. The disappearance of this major source of business over the period 1970-1980 gave the Equitable a major problem[2] and its resolution of that problem was to set an objective of becoming 'the market leader in the endowment and pension fields'. Consistent with that objective, and in line with the development and articulation of its strategy for the management of the company without an Estate and with the prevailing economic conditions, the Equitable:

   (i) introduced terminal bonuses in 1975 for all with-profit business and
   (ii) reclassified the final bonus described in 5(i) above as a 'final annuity adjustment factor' ('FAAF') for Retirement Annuity policyholders.

   In effect this introduced a system of differential 'terminal' bonus in favour of the policyholders who made use of the annuity rates guaranteed by reference to the premiums paid.

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[1] The upper age limit was subsequently increased to 75 in the 1971 Finance Act and the lower limit decreased to 50 in the 1988 Act. No illustrations were given for conversion into joint life annuities.

[2] The other company to feature prominently in the FSSU scheme was London Life. FSSU benefits were funded by life fund with-profit endowments through an approved panel of insurers, with no commission payable. When the FSSU was converted into a funded pension scheme, London Life paid a transfer value of its endowments to the scheme. Equitable negotiated a continuation of premiums. The policies were designed to be acceptable for contracting out of the proposed Keith Joseph State Reserve Scheme. This called for GARs to apply to the emerging cash benefits under the single premium tables. The State Reserve Scheme was dropped, but the policies continued. London Life had previous experience of a forward premium guarantee on contracts written in the nineteen twenties, with problems biting in the thirties as interest rates fell. Their policies in the seventies carried no forward guarantees.

Thus at this stage the 'terminal bonus' was intended to broadly reflect unrealised appreciation on all with-profit contracts (e.g. Retirement Annuities, endowments etc.). In addition the Retirement Annuities had the FAAF to compensate annuity contracts for the difference between GARs and current annuity rates.

7. The Finance Act 1971 introduced an option that permitted 25% of the annuity benefit to be commuted for cash.

    (i) This made it possible for experts to see the annuity which could be purchased on the open market with the cash.
    (ii) Benefit illustrations showed projections with and without the tax-free cash, but initially with no obvious link between the two forms of benefit[3].

8. With the existence of a final annuity bonus, annuity terminal bonuses in the seventies were higher than those allotted to maturing lump sums. The rate at which an annuity could be commuted into cash was the (guaranteed annuity) rate implicit in the Retirement Annuity premiums, applied to the annuity inclusive of reversionary bonus but exclusive of the terminal bonus. The commuted sum then attracted terminal bonus at the lump sum rate, whilst the remaining annuity received the higher annuity rate. In practice the calculations were done by adding the normal terminal bonus to the whole benefit, commuting for cash at the 'guaranteed option rate' with the residual annuity uplifted by the ratio of the current annuity rate to the guaranteed annuity rate.

9. The seventies were of course a decade of high inflation and interest rates. A more flexible series of contracts was introduced in 1975. The terms for accrual in deferment were increased from 3% p.a. to 3.5% p.a. for much the same reason as the increase from 2.5% p.a. several years earlier, despite the introduction of a very simple terminal bonus system. The annuity rate in possession was increased to 7% p.a., still using a(55) mortality. If a lighter mortality table had been used, to reflect increasing longevity, a rate of interest higher than 7% would have been required. As part of the package of enhancements, the death benefit was increased to a roll up of 6% p.a. on premiums.

    Policyholders were encouraged to make old series contracts paid-up and to apply future premiums to a new series contract. There was no improvement to the terms for existing pre-1975 benefits. No mechanism was introduced to reduce GARs if interest rates were to fall again.

[3] Under 'Retirement Annuity' legislation, cash commutation was limited so that cash receivable could not exceed a third of the commuted value of the remaining annuity. A larger cash amount could be generated by an insurer using artificially high annuity rates for the cash commutation calculation, with the actual annuity reflecting more normal rates. We have heard the argument that, to prevent this abuse, the Inland Revenue compelled life insurers to quote annuity rates in their contracts, using as a stick the words in the Act that required the principle benefit under an approved Retirement Annuity to be 'an annuity for the individual'. Thus companies may have been driven to including guaranteed annuity rates in post-1971, pre-1978 contracts when they would have preferred not to give any.
Under a contract where the underlying reference point for benefits is a fund value, the maximum cash is 25% of the fund, so the Inland Revenue was not concerned about artificial annuity rates under such contracts.

10. The 1978 Finance Act introduced Open Market Options (OMOs) for new Retirement Annuity contracts. An OMO endorsement was issued in 1978 and the Equitable introduced in May 1979 a new policy contract which is essentially the 'modern form'.

    (i) OMOs and Return of Fund death benefits were allowed on existing business at no charge.
    (ii) The commutation rate for OMOs was the same rate as for tax-free cash.
    (iii) Benefit illustrations now included a third option of the open market value as well as the current or guaranteed rate and the 25% commutation option.
    (iv) The new contract was written expressed as providing a fund amount at retirement to be used to buy an annuity.
    (v) A GAR option was introduced to convert the fund, using the 7% p.a. table of rates introduced in 1975.
    (vi) As a result the implied cost of the GAR options was the same as that under the old deferred annuity policies which had been given the OMO (see (i) above).
    (vii) The differential terminal bonuses (i.e. with and without the application of final annuity adjustment factors) were terminated by the abolition of the final annuity adjustment. The same practical effect of enhancing the annuity could be achieved by simply applying the open market fund (less tax-free cash) to current annuity rates.
    (viii) Interest rates were in double figures at the time. Benefit illustrations were in accordance with the voluntary agreements of the Life Offices Association and did not include the effects of very low interest rates and increased longevity.

11. In 1979, the Equitable announced that the amount payable on death would be the full fund available as if retirement had taken place at the date of death. This brought the death benefit within the scope of the 'asset share' philosophy that underlies Equitable's later actions.

12. In 1988, new legislation introduced Personal Pension Policies, as a replacement for the series of Retirement Annuities first introduced by the 1956 Act. The view of the Equitable was that the whole theme of personal pensions, as promoted by the then Government, was of an essentially cash fund contract. The Equitable took the opportunity to redesign its contracts.

    (i) The GAR was dropped from new policies. This may have been simply because the policyholder's ability to use the OMO was regarded as sufficient protection against the insurer trying to give the policyholder a poor annuity rate. We have also heard the view that the GAR was no longer a requirement of the market.
    (ii) We were told that some consideration was given to the introduction of a new (higher) bonus series for the new policies without GARs. It was not thought necessary, however, to introduce a new series because if current annuity rates fell below the GARs, a differential terminal bonus system could be operated. Such differential bonuses would be in the opposite direction from that which had effectively operated in the seventies and eighties through the final adjustment bonus, and that in a wide range of financial scenarios there would be sufficient head room in the terminal bonus system to do that without departing from the benefits of value equal to smoothed asset share. However we are not aware of the extent to which this view was communicated to directors.

(iii) In 1989, the Equitable changed their bonus system by replacing terminal bonus by a year-on-year ‘earned rate’; part of which was guaranteed like a reversionary bonus, the rest was allocated pro-tem and could be adjusted downwards. These changes permitted a more accurate tracking of asset share which was perceived by the Equitable as the yardstick for fairness and were seen by the Equitable as a simplification of the bonus system.

At this stage the choice for an existing policyholder to continue contributing to the old contracts, paying future contributions to a new contract, or splitting contributions between new and old contracts, was a matter of personal choice. This choice depended on the differences between retirement annuity and personal pension legislation (permitted retirement ages, contribution limits, maximum cash commutation etc.). In practice, all three policyholder choices were exercised.

13. In October 1993, as a result of falling interest rates, the annuity rates in the GAR policies began, for the first time, to exceed the Equitable’s current annuity rates. The Equitable considered whether it should establish an explicit additional provision for the guarantees, but no such explicit provision was made. The first explicit non-zero provision was identified in the 1998 Companies Act accounts and statutory FSA Returns.

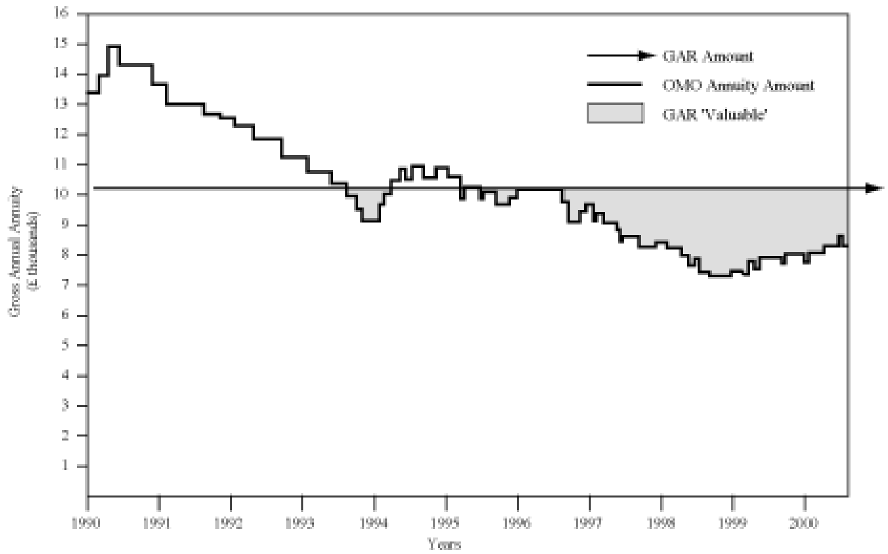
14. It was at this time that Equitable also decided to reduce the terminal bonus for policyholders with GARs who opted to take advantage of them. The reasoning reflected Equitable’s philosophy about asset shares. The Equitable thought that it was wrong for any of the policyholders to take more out of the fund than their premiums had earned, i.e. their full asset share. They therefore reduced the terminal bonus (which represented a part of the share of the profits of the company) for policyholders exercising the GAR, until the annuities which their maturity values supported were at the same level as those policies not exercising their GARs. The policies without GARs were awarded the full terminal bonus but the annuity rates applied were the lower market rates.

15. Some of the policyholders who retired in the winter of 1993/94 may actually have been credited with a reduced terminal bonus, but it is unlikely that there were many, as it was later stated that the Equitable experience was that a very low proportion took a GAR pension. It is possible that these few may not have been clear that a reduction had been made, and there was little comment at that time. We believe that by frequently explaining to policyholders that the proceeds of policies would be based on asset shares, the Equitable thought that their policyholders would have understood and fully accepted the need for a differential bonus.

16. The Equitable regarded a differential bonus philosophy as having been in force from 1 Jan 1994 but as having no practical effect during the period in 1994 when the current rates were below guaranteed levels. We understand that Equitable was preparing a communication explaining the policy of differentially reducing the terminal bonus to go out with the bonus notices in the spring of 1994. The pressure was reduced to explain this detail when market annuity rates rose above the GAR again and no communication was issued.

Annex 1

Open Market Option & Guaranteed Annuity Rate History



(Source: The Annuity Bureau Ltd).

17. In May 1994 the Equitable's current annuity rates were once again higher than the annuity rates in the GAR policies. In 1995 the combination of falling interest rates and the use of a more modern mortality table in current annuity rates was sufficient to put at least some current annuity rates below the guaranteed rates. The Equitable subsequently announced that it would operate the differential terminal bonus so that any policyholder seeking to take advantage of the GAR would be awarded only a reduced terminal bonus. As noted above, the Equitable considered this to be the correct way of maintaining equity between those with-profit policyholders whose contracts provided for a GAR and those whose policies did not. Benefit was provided to those policyholders with a guarantee in the particular circumstances where:

(i) the directors decide upon a nil terminal bonus at a time of low market rates of annuity (with a nil terminal bonus, there could be no further reduction in fund value for those taking advantage of the higher GARs); and

(ii) the GAR applied to the guaranteed fund (which excludes terminal bonus) exceeds the annuity produced by applying the current rate to the OMO fund (which includes terminal bonus) because the margin between GARs and current annuity rates is sufficiently wide (a situation which existed from Autumn 1998 onwards in some cases).

The Equitable stated publicly that it expected the cost of the benefits in excess of asset share thereby produced to be of the order of £50m and in spite of its assessment of the likely liability, decided to make a provision of £200m.

Thus Equitable could maintain that the GAR provided a meaningful benefit not available to other policyholders without a guarantee.

LONG TERM BUSINESS PROVISIONS - VALUATION OBJECTIVES AND REPORTING

1. The Committee received a number of comments relating to the inclusion of an additional amount in the long term business provisions for the various options that had been written by the Equitable. These comments have to be set in a context of 'which provisions?'. The accounting distinction between reserves and provisions is not always recognised in insurance legislation (e.g. there is reference in insurance company legislation to mathematical reserves) or in the customary usage of the word 'reserve' by non-accountants. This report has adopted the accounting distinction. A provision established in UK general purpose statements would normally be less than the conservative estimate containing margins for adverse deviations from the assumptions in the general purpose statements. There is a further complication for with-profit business where, at least under current UK and EU accounting conventions, there is no recognition of policyholder bonuses not yet declared. However these bonuses have to be met out of reserves (including a 'fund for future appropriation' as specified in accounting legislation).

2. It should be recognised that accounting standards on the recognition and valuation of contingent liabilities and out of the money options have varied over time. They also vary by country. Option pricing theory itself has developed over the period covered by our investigations. The comments on whether an additional amount should have been included in the Equitable's provisions could be more rigorously converted into the following questions:

   (i) Should the long term business provisions in the prudential statutory solvency accounts have been increased for the value of the options?
   (ii) If so, should the long term business provision also have been increased in the general purpose statements?
   (iii) If the answer to the first question is no, were the reserves assessed in terms of their sufficiency to cover the payouts to policyholders if the options were triggered?

3. The various statements made by the Equitable on the cost and provisioning for certain contingencies have to be seen in the context of the disparate purposes of general purpose accounts and prudential solvency accounts. Over the last few years in particular, the communication of the quantum of the liability arising has not been as clear as it could be. Indeed, given the complexities of the reporting background, clarity is a very difficult objective to achieve. The Equitable acknowledged this in its 2000 Annual Report and Accounts and included a description of various technical terms which provides a reference framework. The definitions are reproduced below.

4. 'Best estimate commercial cost' – this is used by the Equitable to describe the impact on policyholder benefits of the future additional cost of GARs. It is calculated on the Society's best estimate of future circumstances that are likely to be experienced, including future interest rates, mortality experience, take-up rate of GARs and future contributions to GAR policies. It does not include any margins for uncertainty which would be required by a third party to take over the liability. It is sometimes called a

'best estimate liability'.

5. 'Realistically prudent technical provisions' – this is the amount shown in the general purpose (i.e. Companies Act) accounts with more prudent assumptions for the cost of GARs and incorporates a degree of prudence over and above that included in the 'best estimate commercial cost'. The 'prudence' referred to here is conceptually equivalent to the margins for uncertainty that would be demanded by a third party to take over the liability. There is currently considerable debate led by the international accounting standard setters as to how this margin for uncertainty should be established in 'general purpose financial reporting'.

6. 'Statutory reserves' – these are in fact the provisions and resilience reserves which are required to be shown in the statutory solvency returns to the Financial Services Authority (FSA). They are calculated on extremely prudent assumptions as they are designed to show that guaranteed liabilities could be paid in a range of very adverse future scenarios. The assumptions are governed by regulation and by professional guidance. In such a valuation, it is necessary to assume that almost all GAR policyholders exercise their GAR options. 'Statutory reserves' will therefore be considerably higher than the 'realistically prudent technical provisions' described above.

   'Statutory reserves' are the sum of technical provisions (which are now calculated in accordance with liability valuation regulations issued by the insurance industry regulators from 1973 onwards and augmented by professional guidance) and the resilience reserves. Resilience reserves (see10 below) were established in accordance with criteria set out in a letter dated 13 November 1985 to all Appointed Actuaries from the Government Actuary.

7. The Equitable reported to its members through its Companies Act Accounts (the 'Accounts') and also through Returns to the FSA (the 'Returns'). These FSA Returns have the specific objective of demonstrating that the excess of assets over liabilities, both conservatively assessed, exceed a minimum level of capital specified by European legislation.

8. The standard approach by most UK long term insurers is for the long term provisions in the Accounts and the equivalent provisions in the FSA Returns to be identical. However this is not prescribed, provided that the provisions are calculated in accordance with the actuarial principles set out in the EU Directive on the solvency of long term insurers.

   The assets and liabilities shown in the Accounts may differ from the equivalent item appearing in the Returns in several other ways, through the elimination of various prudential margins built into the Returns. For example, deferred acquisition costs can be established in the Accounts as an asset, whereas in the Returns there may be some allowance through an equivalent adjustment to the liabilities.

   The Equitable was exceptional, if not unique, by adopting a 'Gross Premium' valuation basis in their accounts, and this was the item rationalised in their 2000

Accounts as a 'realistically prudent technical provisions'.

9. A Gross Premium basis establishes as a long term business provision a present value for future cash flows, including an allowance for bonuses payable on with-profit policies. The Equitable's Returns indicated that they made a specific allowance for rates of future reversionary bonus additions at levels consistent with the valuation interest rates used. They indicated that the balance of total policy proceeds would be met by final bonus additions at the time of claim. Such additions were not explicitly reserved for in advance but were implicitly covered by the assets in excess of the provisions. Until 1998, no explicit provision was established for the guarantees as they were regarded as covered by terminal bonus adjustments. Paragraphs 3.11 and 3.12 of the Annuity Guarantee Working Party's Report (listed in Appendix 9) are of some relevance here. The accountability for such provisions in the Accounts is that of the directors, who would look to a 'reporting actuary' (as envisaged by Guidance Note 7) for comfort. The reporting actuary is not necessarily the Appointed Actuary.

10. The Returns require a 'Net Premium' valuation basis – the 'statutory reserve'. This generates an ultra prudent assessment of the provision to pay contractual liabilities (but not of the amount needed to satisfy policyholders' reasonable expectations). An additional margin is added through a resilience reserve to provide for the extra liability if certain prescribed adverse deviations from the basic assumptions occur. The Appointed Actuary has to certify the technical provisions and resilience reserves. Compliance with GN1 and GN8 also has to be certified. GN8 says that the actuary must be satisfied that the long term fund is able to support a proper level of future terminal bonus having regard to the bonus smoothing policy. This support may be available in any excess of the asset value of the fund over the statutory reserve and in prudential margins in the technical reserves.

11. In the pre-resilience reserve era it is conceivable that a Gross Premium basis might have looked quite strong compared to a typical Net Premium valuation with allowance for deferred acquisition costs, particularly in the financial conditions of the time.

    The existence of margins in the valuation basis, especially pre valuation regulations, enabled a company to provide in an implicit fashion for options. The fact that an explicit provision for an option was not established does not necessarily mean that a liability has not been provided for. We can merely note the existence of margins; we were not able to assess the adequacy of these to cover the additional liability related to options (on any of the three bases outlined in paragraphs 4 to 6 above).

12. Neither the accounting bases nor the solvency reporting bases described above include an explicit allowance for terminal bonus. It follows that, to the extent that GARs could be met by reductions in terminal bonus, the accounting and solvency provisions would not necessarily have to be augmented to cover the cost of the options.

ISSUES RAISED AND OBSERVATIONS MADE BY RESPONDENTS

"The concealed danger of options, both in assets and liabilities, is a recurring note in this paper"

Redington:
Review of the Principles of Life Office Valuations JIA 1952

The notes below summarise the issues raised by respondents. The Committee has referred to many of these issues in the main report. Issues that are not covered in our report are mainly concerned with Regulations, which are not within the Committee's remit. These issues and a précis of the received comments on them are included below as possible contributions to a more general debate.

1. **"The heart of the problem is the insufficient charging for guarantees."**

   Respondents asked whether inadequate premiums were charged, too much bonus declared and/or inadequate provisions established or whether there was a failure in regulations or guidance.

2. **It is inappropriate for guarantees to be covered by reductions in future non-guaranteed bonuses.**

3. **The guidance issued by the profession should cover omissions in the regulations as well as supporting them.**

4. **The guidance (and/or regulations) should cover more explicitly how the appointed actuary must 'have regard to' options and guarantees both in valuation and pricing.**

   A respondent wrote **"**Pricing decisions are 'the responsibility of management having regard to the advice of the actuary'. The regulations should make this clearer and guidance should be extended to cover the production of such advice."

   A respondent wrote "References to options and guarantees should be strengthened or more particular examples given. Options would include 'embedded options' i.e. options embedded into the policy."

   A respondent wrote "It is a cardinal actuarial sin to fail to charge appropriately for the benefit of an option or guarantee otherwise than in advance of when it can be exercised".

5. **More guidance should be given to distinguish between financial and real options and the treatment of the risks arising from such options.**
   (A financial option is one that has a known financial effect for a given set of actuarial or economic assumptions. The granting of a guaranteed annuity rate would be one such financial option. For the definition of a real option see 6 below.)

Financial options will have a cost which can now be valued, whether 'in the money' or 'out of the money', using stochastic models or other models derived from modern financial economics. Some respondents suggested that the regulations should be strengthened to ensure there is a process for the receipt of actuarial advice on financial options, and the guidance in consequence could be strengthened to indicate what the actuary must do to provide such advice.

It was also suggested that such actuarial advice should address the situations where the option is covered out of existing capital within the long term fund (or, in the case of with-profit business, from reductions in future bonuses) or has been transferred to a third party (possibly through reinsurance or capital market instruments). A ‘counterparty risk’ arises from the latter situation. A respondent instanced the counterparty risk associated with an asset such as the reinsurance recovery from the Irish European Reinsurance Company Ltd and whether it was appropriate to give full value to such an asset in the Equitable’s FSA Returns. The actuary must take all reasonable steps to ascertain whether such funding arrangements are in line with the expectations of policyholders (contractual or implicit).

6. **Guidance (and/or regulations) should cover how the appointed actuary must ‘have regard to’ the granting of real options.**
   (A real option is one that does not have a known financial effect for a given set of accounting or actuarial assumptions. The granting of the right to invest a limitless or unquantifiable volume of additional business on guaranteed terms is one such real option.)

   A respondent suggested that regulations should be reviewed to consider whether they sufficiently constrain the granting of real options. In particular there may be areas for improvement in the reporting of such real options.

7. **The guidance should be expanded on cashless and other financial reinsurance following its increased usage.**

8. **Guidance (and/or regulations) should cover more adequately how the Appointed Actuary must ‘have regard to’ establishing a provision for financial options.**

   The statutory valuation by Equitable, in common with many other companies, used a deterministic approach to the valuation (including the resilience reserve) of guaranteed annuity options, which is an unsound approach in that it gives no value to options that are 'out of the money'. A more modern and rigorous approach would have many advantages, including encouraging a closer matching of the liabilities (including options).

   Some respondents say that reserving for the higher of two options is not enough; whichever option is ‘in the money’ at the time, the other might prove to be the better.

   One observation was that an appointed actuary should have sufficient training and guidance on the use of stochastic modelling, and that this requirement should be brought into the guidance notes.

9. **A net premium valuation basis may not be a suitable way of securing a management understanding of the financing of the business.**

   One respondent provided an example of where the net premium valuation may have generated an opaque view of the company’s solvency. It was said in the Ranson and Headdon paper 'With Profits, Without Mystery' that guaranteed benefits were accumulated to retirement at the guaranteed rate of 3.5% p.a. and then discounted back at the same rate. However for a period in the mid-nineties, the discount rate was increased to 4.5% p.a., and this resulted in significant new business surpluses. It was suggested that although this valuation practice is not unsound in providing for guaranteed benefits, as opposed to satisfying PRE, it may have encouraged overtrading and exacerbated the squeeze on the company’s solvency when interest rates fell.

10. **“The traditional actuarial tool of using a net premium valuation basis and deterministic methods are outdated”.**

    A respondent wrote “We need to beef up the statutory reserving for contractual benefits”.

    Another respondent suggested that the whole edifice of the current statutory solvency reporting basis for with-profit business could be criticised as being obscure and opaque. It makes it difficult for most observers, including directors, to understand the underlying financial issues. In particular accounts which demonstrate ‘solvency’ in the sense of having enough assets to meet contractual liabilities are not equally appropriate for demonstrating that the assets are sufficient to satisfy PRE.

    This respondent further argued that the regulations should be changed as soon as possible to a basis where there was a long-term business provision that could be said to represent the fair value of future policyholder benefits (including future bonuses). Such a fair value, which is basically a willing seller/willing buyer price, would have to include the value of any financial options. Prudential regulation would then relate to capital adequacy. The requirement would relate to mutuals as well as proprietary companies, with the excess capital of the company being subject to stringent risk based adequacy levels.

11. **Following on from the previous comment, truly radical reform of managing the financial soundness of insurers is required. In this context, current actuarial guidance is irrelevant.**

    This view starts from the premise that some of the controls developed in the banking arena are, with the imposition of a rigorous objective (rather than a subjective) valuation system more appropriate.

    However it was also observed that the controls of the banking system would not have addressed all the guarantees given by the Equitable, so that more research is necessary in this area.

    Respondents suggested that the risk could have been managed through using financial instruments such as swaptions or ‘quanto’ options from an investment bank, assuming that any resultant counterparty risk was acceptable.

12. **Guidance (and/or regulations) should cover <u>how</u> the appointed actuary must 'have regard to' establishing a provision for real options?**

    The treatment of providing for real options once granted should be a matter for regulation. A respondent argued that regulation 67(3) of the Insurance Companies Regulations 1994 covers the open-ended right to add additional premiums subject to the guarantee, with, in line with regulation 69(9), proper provisions allowing for no more than the future investment rate. It was thought that more specific guidance on this regulation might have made a difference to some of the management decisions.

13. **GN2 on financial condition reports should be made mandatory.**

    A number of respondents indicated that they thought GN2 should be made mandatory. A particular suggestion was that a five-year projection period referred to in the current GN is not long enough to deal with regular premium policies.

14. **A peer review of the assumptions relating to the statutory solvency valuation of the long-term business provisions may have made a difference.**

    Respondents observed that the Equitable's FSA Returns indicated, in respect of the net premium valuation basis used in the supplementary statements incorporating a resilience reserve, that a peer reviewer could have raised a number of points where the assumptions were atypical. This does not mean that the assumptions were necessarily imprudent, but the questioning would have had the result of ensuring a healthy debate on the adequacy of the assumptions and, if not mutually resolved by the two actuaries, would have ensured that the issues were brought to the attention of the board of the company.

    Examples given of questions which a peer reviewer might have raised are:

    (i) In the answer in the 1999 Returns to paragraph 7(8)(a)(ii), relating to the valuation of accumulating with-profit business, "½% p.a. of the benefit value has been deducted for each year up to the date it is assumed that benefits will be taken as a charge for expenses". Given that the only benefits valued are the fund-to-date accumulated to vesting age at the guaranteed rate of accumulation (or 0% where there is no guaranteed rate), with discounting at the maximum rate permitted by the regulations, a peer reviewer might have questioned how a deduction of ½% p.a. can be made.

    (ii) In the valuation of personal pension business in the resilience scenario, it is stated in the answer in the Returns to paragraph 6(1) that benefits have been valued "on the basis that the benefits will be taken at age 55, or, if that age has been attained, at the valuation date." A peer reviewer may have questioned the choice of the age 55 assumption, rather than age 50, the minimum age permitted by legislation, and the interaction with any right to apply a market value adjustment factor.

    (iii) The Equitable offers a very broad option for the age from which the pension can be drawn (normally 50 to 75). Has the actuary examined the 'worst case scenario' in relation to this option?

(iv) Was the investment policy (including equity backing ratios) and asset share management policy in line with bonus philosophy and management?

15. **The guidance should be strengthened to discourage combining the appointed actuary with the role of Chief Executive or other areas of significant management responsibility.**

16. **More guidance should be given on contingent liabilities and fundamental uncertainty.**

    One respondent observed “To amend GN1 so that it says something like ‘the reserves must be established to cover every contingency which might result from a legal judgement’ would be unreasonable and unworkable.” This leads into the accounting concepts of contingent liabilities and fundamental uncertainty, where one would look to the accountants to lead.

    A number of observations related to the fact that the actuaries should have been knowledgeable about the risks being run. Particular attention was drawn to the requirements for directors, who may be actuaries, to report on quantifiable contingent liabilities on Form 9 of the FSA Returns and within note 1402, which covers contingent liabilities and fundamental uncertainty.

    It was also observed that the reporting of contingent liabilities is an accounting matter as the relevant notes in the FSA Returns are subject to UK GAAP. The relevant UK standard, FRS 12, appears to exclude liabilities relating to insurance contracts.

17. **The current guidance needs pruning to focus more sharply on principles. Should the profession develop a statement of 'actuarial principles'?**

    A respondent worried that the crucial part of regulation 64(1) of the Insurance Companies Regulations 1994 “on actuarial principles” is not expanded upon in any guidance. He was aware that over the history of the profession, certain key papers have marked out ‘generally accepted actuarial principles’ but the method of their doing so was that of a learned Society and left some doubt over the borderline between true principles and issues that are properly within the judgement of the Appointed Actuary.

Specific suggestions made by respondents relating to GN1.

The following comments (in an abbreviated form) were received on possible changes for GN1:

3.3 Strengthen the guidance, when referring to policyholders as a group, to cover differential relationships.

4.2 List not exhaustive. No mention of adverse experience in respect of mortality or morbidity (but discussed in GN8). Refer to ring fencing.

4.2(b) Does it include strain from future new business written on guaranteed terms (and also 5.2)?

5.3 Does this reference to probability statements, and other references to ‘reasonably foreseeable circumstances’, imply that stochastic techniques must be used (4.2.1 of GN8 also refers)?

5.4 Refer to GARs or ‘all options and guarantees described by the policy conditions including open-ended options?'

5.7 Expand references to ‘unfair contract terms’.

6.3 Refer to GARs (albeit in example in 6.7.2 – which could also be put into 6.7.1).

8.3.4(i) This should be considered to reflect more fully the House of Lords ruling.

Insert new paragraph on the extent to which an actuary can rely on a legal opinion.

Specific suggestions made by respondents relating to GN8.

2.3 Second sentence excludes a provision for terminal bonus; last sentence refers to other investigations into their proper level.

Insert new paragraph on terminal bonuses, grouping for different rates and ring fencing.

3.1.1 refer to Guaranteed Annuity Options.

3.6.2 Add “and guarantees” at end.

4.2.1 Mention of ‘extreme stochastic variations’. Include Guaranteed Annuity Options as an example.

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Retirement Annuity With Profits

The Equitable Life Assurance Society

Approved under section 226 of the Income and Corporation Taxes Act 1970

Date 18 December 1985

[redacted]

Male aged under 49 years and months (born 1936)

Pension age for illustration 65

The Premiums

An annual series of 1 premiums, each of	£	1000.00
Less income tax saved if at 30.00 % of the premium (see note 1 overleaf)	£	300.00
Net outlay per annum	£	700.00

The Benefits on survival to the illustrated pension age

		Fund (see note 2 overleaf)
Guaranteed Benefits	£	1640.00
Benefits if current bonus rates continue to the pension age (see note 8 and leaflet 'Bonuses') but excluding any terminal bonus	£	5711
Benefits if in addition terminal bonus at the current rate applies at the pension age	£	$\boxed{8453}$

The projected fund of £ 8453 if left with the Society could provide

	If annuity rates guaranteed in the policy apply	If current immediate annuity rates apply
A total annuity of (see note 4 overleaf)	£ 991	£ 1320
OR		
a tax free cash sum of	£ 2199	£ 2697
PLUS a reduced annuity of	£ 733	£ 899

PLEASE SEE NOTES OVERLEAF

QRAW/10.83 2 (18.12.85)

Registered Office: 4 Coleman Street, London EC2R 5AP
Registered in London No 37038

Notes

1. **Tax relief on premiums**
If current legislation applies and premiums paid are within the statutory limits, they will be deductible as a charge against earned income before tax. For a person paying tax at the current basic rate the income tax saved will be 30% of the premiums. For a higher rate tax payer the saving will be greater. The maximum saving possible is currently 60% of the premiums. Contributions should not usually exceed 17½% of the net relevant earnings – see leaflet for more details.

2. **Fund**
The fund is the amount of money standing to the credit of the policy which can only be used to provide retirement benefits in a form approved by the Inland Revenue. It is the full equivalent to the benefits on survival otherwise payable under the policy and is shown in the policy document as the 'Policy Annuity Value'.

3. **Open market option**
At pension age the fund may be passed to another life office for the purchase of an annuity.

4. **Payment of benefits illustrated**
The annuity is payable by quarterly instalments with the first payment at the pension age, and throughout life thereafter. The tax free cash sum is payable on attainment of the pension age.

5. **Variable premium payment**
Premiums can be varied each year to cater for fluctuating earnings. Additional amounts can be paid during the course of the year.

6. **Favourable tax treatment on receipt of retirement benefits**
If the premiums paid are within the statutory limits, then the annuity payments will be taxed as earned income. The cash sum will be tax free.

7. **Return of full fund value in event of death before retirement**
In the event of death before the pension age, the Society will pay an amount equal to the full fund accrued as at the date of death and as if that date had been the selected pension date.

8. **Bonuses**
Future bonuses depend on future profits and cannot be guaranteed.

9. **Prevailing annuity rates applied to fund at retirement**
Immediate annuity rates may fluctuate widely over the years in line with changes in interest rates and it follows that the benefits payable will be affected significantly by the financial conditions that apply when the annuity payments commence.

10. **Flexibility as to pension age**
A pension age has been selected for illustrative purposes. As will be seen from the Society's leaflet, adjusted benefits may in fact be taken at any date between age 60 and age 75 without penalty.

11. **Flexibility as to type of pension**
Only one type of pension has been illustrated. At the time the benefits are taken a pension payable for life can be chosen, or a reduced pension payable for a minimum of 5 or 10 years, or one payable until the second death of husband and wife. The alternative of an increasing pension is also available.

12. **Retirement other than on a policy anniversary**
For each complete month between the pension age shown and the previous policy anniversary, a special allowance has been included in the funds illustrated overleaf.

The guaranteed fund shown includes the allowance that is guaranteed for each month, while each projected fund includes an additional figure by way of the current allowance over and above that guaranteed in the policy.

13. **Loan facility available**
Within certain limitations and on suitable security, the Society is prepared to make a loan to the retirement annuity policyholder up to an amount equivalent to the fund in the policy (see leaflet 'Loan Facility for Retirement Annuity Policyholders').

14. **Waiver of premium facility**
If you want your retirement policy to incorporate the waiver of premium facility, the retirement benefits will be 96½% of those from a corresponding policy that does not incorporate the waiver facility. The benefits illustrated suppose that the waiver facility is <u>not</u> incorporated. Details of the waiver facility are to be found in our leaflet insert.

15. **Legislation**
This illustration is based upon the Society's understanding of current legislation.

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31.12.87

The Equitable Life Assurance Society

Walton Street
Aylesbury, Bucks HP21 7QW
Telephone: Aylesbury (0296) 393100

Our ref: BNL/2.88

Dear Policyholder,

BONUS DECLARATION AS AT 31 DECEMBER 1987

The enclosed notice gives details of the new bonus to be added to your policy in respect of the recent declaration. The purpose of this letter is to give you some background information on the considerations behind the decision taken on the level of declared bonus rates on this occasion.

We regard our with profits policyholders as participating in a special kind of 'managed fund'. The investment earnings on that fund are passed on to policyholders by means of two types of bonus : the annual reversionary bonus which steadily increases the guaranteed benefits over the life-time of the policy and a final bonus at the point at which the policy benefits become payable.

The 'managed fund' is invested in a mixed portfolio of assets (fixed interest stocks, equity shares, property etc.) with the fixed interest assets broadly matching the guaranteed liabilities under with profits contracts. We feel it appropriate to control the proportion invested in fixed interest assets, so that it is not larger than would normally be considered suitable in a balanced mixed portfolio. That means that investment strategy is then not unduly constrained by non-investment considerations.

The investment return on the portfolio in which the 'managed fund' is invested arises in the form of both income and capital appreciation. Over recent years the trend has been for interest rates, and hence the level of income, to fall whilst overall performance has been good due to capital appreciation. 1987 was rather an exception to that pattern in that only a very modest level of capital appreciation arose.

- continued -

Whilst the return arising as income is physically received as cash and can safely be distributed as declared bonuses, it is harder to decide the appropriate course of action with regard to capital appreciation. When overall returns are high it would be unreasonable not to take some account of capital appreciation when setting declared rates. However, going too far in that respect could have the undesirable effect of constraining investment strategy. We therefore need to be careful not to place too great a reliance on capital appreciation to allocate declared bonuses (which are guaranteed benefits) to our policyholders.

In the late 1970s and early 1980s high levels of income returns gave rise to increasing levels of declared bonus rates. Since then declared rates have been on a plateau. In the light of current investment conditions your board has decided that the appropriate course of action is to embark on a strategy of moving declared bonus rates down to be consistent with current levels of income returns. That action does not necessarily imply a reduction in the level of policy benefits, but rather a change in the balance between the 'declared' and 'final' elements in the overall bonus system. The final bonus rates introduced at this declaration mean that policy proceeds in 1988 will be at similar levels to last year, except at the shorter terms.

Last year we made a small reduction in the level of declared rates as the first step in that strategy. At this declaration we are continuing with the strategy by making a further reduction in the level of declared rates.

We are, of course, conscious that in some quarters maintenance of the level of declared rates is seen as an emotive subject. However, we believe that much of the comment on that subject is misguided. Our approach, as described above, is to declare bonuses which are consistent with investment experience and which will give the office the investment freedom to achieve the best possible returns without taking undue risks.

I felt it important to write at some length on this rather complex matter, because I considered it necessary to give you a clear understanding of the reasons for our decision. The main message I would like to leave you with is that the decision arises from careful and active management of the Society's affairs which is intended to produce consistently good results for all our policyholders. Our unrivalled record of consistent high performance, confirmed by our placings in tables of actual results, indicates that we have been successful in achieving this objective.

Yours sincerely,

E.B.O. Sherlock
General Manager & Actuary

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31.12.8

The Equitable Life Assurance Society

Walton Street
Aylesbury, Bucks HP21 7QW
Telephone: Aylesbury (0296) 393100

Our reference: BNL 2.89

February 1989

Dear Policyholder,

I am pleased to advise you that at the current declaration your Board has considered it appropriate to maintain declared bonus rates at the same level as last year. That action is consistent with our philosophy of ensuring that as high a proportion of the total return as is reasonable is passed on in the form of declared bonuses, the balance, of course, being passed on by way of 'final bonus'. I felt that we should take this opportunity to build on the information given last year and say a little more in general about the Society and its business.

This Society, as a mutual life office, has its own special characteristics and it may be helpful to remind members what they are. One, the absence of shareholders, is common to many well-known life offices, while the absence of payment of commission to third parties is unusual. In this Society, the members are those who effect with-profits policies: it is they who have the right to attend and vote at meetings. The Directors must themselves be members and are the representatives of the membership generally. The members, or proprietors, share in profits through bonus additions to policies and, since these additions can only be made while participating policies are in force, there is a very heavy obligation on the Directors, advised by the Actuary, to ensure that bonus additions are fair. With-profits policies, which carry a premium much higher than is needed to support guaranteed benefits, also supply the working capital needed to finance future growth. Indeed, it is a continuing process, each generation being financed by its predecessor and, in its turn, financing its successor.

Since the Society's costs of obtaining new business are comparatively low, the burden of financing even quite rapid expansion has not produced distortion between successive generations. The prime reasons for this are associated with non-payment of commission to third parties. We operate in the main at the top end of the market with large policies and relatively financially informed clients. Most of our sales are made directly between policyholder and our representative, for whose advice the Society is responsible. There is no dilution of the relationship between us and the policyholder and that relationship places an obligation on the Society to demonstrate that its claims are justified – a healthy pressure. One of the ways this shows itself is in the need to offer a comprehensive range of products, including, through our subsidiary, Equitable Units Administration Ltd, unit trust plans. This eliminates any risk that a policyholder might be sold an unsuitable policy because we did not offer what was needed. Another example is the choice extended to a wide range of contracts between fully guaranteed, unit-linked and with profits.

Cont'd 3195

Many of our members hold, in addition to with-profits policies, either fully guaranteed or unit-linked policies at the same or different times in their lives. We take the view that we should not set out deliberately to 'make money' out of such policies in order to enhance bonuses. But we do have to err on the side of caution in pricing such products since it is the members who bear the risks in writing such business and they should be both protected against excessive risk and rewarded for the risk they do bear. A similar philosophy underlies our approach to the discontinuance of policies. Our policyholders do not take out policies they cannot afford nor are they persuaded by our representatives to do so. Premature discontinuance occurs typically because the policyholder retires earlier than he expected. Most of our contracts guarantee to pay full benefits in such circumstances without penalty. In other circumstances our normal practice is similar but this cannot be guaranteed without imposing an improper burden on continuing members. These elements in our philosophy and practice enable our representatives to sell our policies, confident that they are competitive and flexible enough to deal with known events in the future.

It follows from the above comments that the benefits under our with-profits policies depend primarily on the successful investment of the premiums under these policies and only marginally on profit arising from other policies. Further, we aim to ensure that the total proceeds members receive reflect the investment returns on the fund during the course of the policy. However, the essential nature of with-profits business, namely the steady addition of declared and, therefore, guaranteed bonuses, means that there is no automatic link between asset values and policy benefits. In simple terms there is a smoothing of asset values over time and of the peaks and troughs through the bonus system. So the with-profits system provides a level of security between the fully guaranteed policy, which is independent of investment performance, and the unit-linked policy which is dependent on the levels of the market in the sector or sectors in which the unit is invested.

Although the with-profits system contains within it an essential element of smoothing, nevertheless the Society's practice is to limit that to evening out peaks and troughs and unduly sharp changes from year to year. Specifically, we do not set out to build up excessive 'free reserves', which some describe as 'strength'. This could only be done by deliberately, or worse still, accidentally, withholding part of the return due to members for the benefit of their successors. What is important is that there should be sufficient strength to avoid any unplanned constraints on investment freedom or growth in business, whilst still giving a 'full value' return to existing members.

Under the various requirements flowing from the Financial Services Act, life offices will find themselves increasingly under pressure to explain their business and philosophy of operation to their policyholders. That is a development which we wholeheartedly support and I hope that you will have found the above information of interest.

Your sincerely,

E.B.O. Sherlock
General Manager

Founded 1762

31.12.89

The Equitable Life Assurance Society

Walton Street
Aylesbury, Bucks HP21 7QW
Telephone: Aylesbury (0296) 393100

February 1990

Our reference: BNL 2.90

Dear Policyholder,

At recent bonus declarations we have taken the opportunity to write to policyholders giving information about our approach to with-profits business. There is currently a great deal of emphasis, which we welcome, on making with-profits policies easier to understand. The Society has been at the forefront in trying to explain with-profits business in a straightforward manner and the letters issued at recent declarations are an important element of our efforts in that direction.

This letter contains a summary of our basic approach to with-profits business and how this is translated into bonus additions, primarily for the benefit of new members, followed by a statement in a quite new form of the decisions reached by the Board.

Basic principles of with-profits business

Our starting point is that a member selects a with-profits policy because he or she wants a profitable savings or investment medium but does not want the risks, nor the trouble, involved in personal selection of the underlying investment. With-profits premiums are invested in a managed fund of assets consisting of ordinary shares, both U.K. and overseas, property and fixed interest securities, the mixture being varied from time to time to try to achieve the desired blend of profitable investment and reasonable security.

There is, however, a further and unique sense in which with-profits business spreads the investment risk. The with-profits system provides, uniquely, processes for spreading investment results over time and smoothing out short-term fluctuations in investment experience. This is important because many clients have only limited or no scope to vary the time at which the policy benefits are taken.

The major part of the returns available for with-profits policies arises from the investment of the contributions paid. However, since the Society has no shareholders, the with-profits policyholders effectively stand in the position of proprietors sharing in any profits made or losses incurred in running the business.

The earnings available, above the level needed to cover the build-up of the basic guaranteed policy benefits, are passed on by way of bonuses of various types.

An important feature of our philosophy is that we aim to pay out by way of bonuses the averaged returns actually achieved. The Board does not hold back on benefits to policyholders to achieve so-called strength beyond that which is prudent and necessary as part of the smoothing process.

Bonus additions

The Society's with-profits contracts contain a basic guaranteed level of benefits, expressed as, for example, a guaranteed amount of fund. A certain level of investment return is needed to cover the build-up of these guaranteed benefits. The return in excess of that basic level is available for distribution as bonuses.

3200

Continued

The form in which the bonuses are added to policies is consistent with the blend of security and profitable investment described above. Part of that excess is translated each year into a 'declared bonus'. Such bonuses are additional, fully guaranteed, benefits and are added to all previously guaranteed benefits. In this way, the annual addition of declared bonuses provides an increasing underlying value below which the ultimate benefits cannot fall. The accumulated amount of the basic guaranteed benefits and declared bonuses represents the consolidated value of the policy benefits.

The balance of the overall return is carried forward unconsolidated but is credited immediately as final bonus when benefits become payable under the terms of the policy. The retention of part of the accumulated total policy value in unconsolidated form is a vital ingredient in the operation of with-profits business. In that way the Society retains the flexibility to manage its investments in a way compatible with achieving the best results it can for the with-profits policyholders.

It should be emphasised that, while both consolidated and unconsolidated benefits would be paid if they became due now, only the consolidated benefits are guaranteed for the future. The amount of final bonus ultimately paid will depend on the future experience of the Society; it could be lower as well as higher than the current amount.

The 1989 bonus declaration

I am pleased to advise that the Directors have decided to announce new declared rates at the same level as those declared a year ago. The enclosed notice or statement shows how the new declared bonuses increase the guaranteed benefits under your contract.

Previously the Society has determined the 'unconsolidated', or 'final bonus', element in total policy values by the use of specific scales of rates. This year, we have simplified our approach by determining the end of year policy values by bringing forward last year's values (if any) and subsequent premiums at a rate of growth determined by the Directors. The final bonus element is now simply the difference between the total policy benefits and the consolidated element (i.e. basic guaranteed benefits and declared bonuses).

Investment in ordinary shares, both in the U.K. and elsewhere, produced very high returns for 1989 and led to a similarly high return attributable to with-profits policies. The overall rate of growth allocated for 1989 is 20% for contracts in the Society's pension fund (such as individual and personal pensions) and 16½% for life assurance contracts (such as bonds). Accordingly, total policy values at the end of the year are comprised of last year's values rolled forward at 20% (or 16½%, as appropriate) with any premiums paid during 1989 rolled forward at the same rate for the relevant proportion of the year, after deduction of the initial allowance for expenses built into the contract terms.

Conclusion

In summary, the earnings allocated to with-profits contracts can be regarded as used in three ways:

(1) The first 'slice' of earnings provides the growth in basic benefits guaranteed by the contract terms.

(2) The next 'slice' of earnings is used to increase the guaranteed benefits by the allocation of declared bonuses each year.

(3) The balance of the earnings available is granted as final bonus.

The latest development of the Society's bonus systems brings out these three uses of the allocated earnings in an explicit manner.

In the competitive world in which we live we believe it is as important to be open as it is to do well. We aim to do both. If you have any questions arising in relation to the bonus declaration please write to our Actuarial Projects Department in Aylesbury.

Yours sincerely,

E.B.O. Sherlock
General Manager

Registered in London No. 37038 Registered Office: 4 Coleman Street, London EC2R 5AP
A member of: Association of British Insurers, Insurance Ombudsman Bureau and Lautro
The Equitable group comprises: The Equitable Life Assurance Society, Equitable Units Administration Ltd, University Life Assurance Society

3201

Founded 1762

The Equitable Life Assurance Society

Walton Street
Aylesbury, Bucks. HP21 7QW
Telephone: Aylesbury (0296) 393100

Our reference: RSC BONUS 92
Date: March 1993

Dear Policyholder,

BONUSES FOR 1992

Introduction

I enclose your annual statement which provides details of the build-up of your policy benefits for the 1992 calendar year. As in previous years, I am taking the opportunity of explaining our general approach to with-profits business, and in particular our approach to the bonus declaration in respect of the year ended 31 December 1992 which takes effect from 1 April 1993.

Background

With-profits contracts provide the opportunity for investing in a managed fund of assets including equities, property and fixed-interest stock. The with-profits approach has the unique feature of smoothing out the fluctuations in the investment return which are associated with such assets.

Under that approach, the Society determines an overall rate of return for the calendar year, which is distributed in the following three ways.

1. By accumulating, at the minimum rate of interest guaranteed either explicitly or implicitly in the policy, the part of the benefits which was guaranteed at the beginning of the year, plus further contributions less a deduction towards expenses.
2. By annual declared bonus additions which, once added, increase the guaranteed benefits under the policy.
3. By passing on the balance of the overall rate of return for the year through final bonus, which does not add to the guarantees under the contract. The amount of final bonus is illustrated on the statement and, on request, from time to time but the amount is only finally determined at the time of claim.

The return passed on to date through guaranteed interest and declared bonuses can be regarded as consolidated for the purpose of determining payouts on the happening of certain events as described in the policy. The return passed on through final bonus can be regarded as unconsolidated as its amount is not guaranteed and could fluctuate in the future.

The 1992 declaration

The smoothing of troughs in investment returns described above was a particularly significant feature of with-profits business in 1990 when, despite negative investment returns, we were able to announce a rate of return which reflected the intrinsic earning power of the assets and represented an attractive build up of policy values over the year.

During 1991, more normal investment returns were earned overall, and we felt it appropriate to maintain the same rates of return as for 1990.

Over reasonable periods of time, however, returns passed on must reflect actual trends in investment conditions and, in the same way that the with-profits system smooths out troughs in investment performance, so too will it smooth out peaks.

continued.....

For 1992, investment performance was considerably better than in the previous two years. That has, therefore, given us the opportunity to allow for the smoothing of the trough in 1990 by some smoothing of the 1992 return. With that in mind, the Directors have decided to grant an overall rate of return for recurrent single contribution pension contracts for 1992 of 10% in respect of benefits purchased up to 31 December 1991. They have also decided, however, to recognise the more favourable investment conditions in 1992 by granting an overall rate of return for such pension contracts for benefits purchased in 1992 of 12%. A similar approach has been adopted for recurrent single contribution life contracts, but recognising the different tax position of such contracts.

For many years, the Directors have taken into consideration the redemption yields from time to time on gilt-edged stocks when determining the rate of build up of the guaranteed benefits under policies. Given the recent well publicised reduction in rates of interest available on such stocks, the Directors have decided, in common with many other leading life offices, that it is appropriate to make a reduction in the level of declared bonus rates. That approach will help to minimise the investment constraints on the Society, leaving greater freedom to invest for better overall benefits.

Main details of the declaration, which apply from 1 April 1993, are as follows:

	Recurrent single contribution pension contracts	Recurrent single contribution life contracts
Overall rate of return for 1992 applied to total benefits:		
for benefits purchased up to 31 December 1991	10.0%	8.0%
for benefits purchased in 1992	12.0%	9.5%
This is credited by way of:		
basic guaranteed rate of interest	3.5%	0.0%
declared bonus rate for 1992	5.0%	6.0%
final bonus	which tops up the growth arising from the guarantees and declared bonus rate for the year to the overall rate of return	
Interim overall rate of return for 1993, until changed, for bringing forward policy values from 31 December 1992	10.0%	8.0%

Conclusion

The results which a life office can pass on to its with-profits policyholders are largely determined by the underlying investment conditions during the lifetime of each policy. The important point is that, whatever investment conditions do, in fact, emerge, the Society will continue to strive to produce consistently fair and attractive results for with-profits policyholders. That philosophy has served us well for many years past and we are convinced it will continue to do so in the future.

Should you have any queries in respect of the 1992 bonus announcement, please contact our Customer Information Desk here at Aylesbury. If you would like further information on the range of products offered by The Equitable, please complete and return the reply-paid card enclosed with this letter.

Yours sincerely

R H Ranson
Managing Director and Actuary

Founded 1762

The Equitable Life Assurance Society

Walton Street
Aylesbury, Bucks. HP21 7QW

Our reference: RSP/G
Date: February 1994

Dear Policyholder,

BONUSES FOR 1993

Introduction

I am pleased to enclose your annual statement which illustrates the build up of your policy benefits for the 1993 calendar year. As in previous years, I am also taking the opportunity of reminding you of our general approach to with-profits business and to explain the particular approach for 1993.

Background

With-profits contracts provide the opportunity for investing in a managed fund of assets including equities, property and fixed-interest stock. The with-profits approach has the unique feature of smoothing out the fluctuations in the investment return which are associated with such assets.

Under that approach, the Society determines an overall rate of return for the calendar year, which is distributed in the following three ways.

1. By accumulating, at the minimum rate of interest guaranteed either explicitly or implicitly in the policy, the part of the benefits which was guaranteed at the beginning of the year, plus further contributions less a deduction towards expenses.
2. By annual declared bonus additions which, once added, increase the guaranteed benefits under the policy.
3. By passing on the balance of the overall rate of return for the year through final bonus, which does not add to the guarantees under the contract. The amount of final bonus is illustrated on the statement and, on request, from time to time but the amount is only finally determined at the time of claim.

The 1993 declaration

(i) Overall rate of return

In 1993 the Society earned about 28% overall on its assets at market value over the year. Equities, both U.K. and overseas, performed particularly well and property contributed in a significant way for the first time for many years. Fixed-interest securities also appeared to provide a high yield, but it has to be remembered that most of the return was generated by a rise in market value as interest rates fell significantly, from under 9% at the beginning of the year to close to 6% at the end. Such a change in market values for redeemable fixed-interest securities is transitory because future interest payments and redemption proceeds are unaffected by that change – it is only the interest payments actually being received that should be taken into account. Using that argument, the board identified the total 'attributable' earnings for the year as about 17% before bringing smoothing considerations into account.

As we have said on previous occasions, with-profits business must take a reasonably long-term view of the intrinsic value of assets and smooth short-term peaks and troughs of performance, particularly where a peak or trough is caused by an abrupt shift in investor sentiment which could be reversed just as quickly.

continued.....

On the other hand, we do not think we should ignore the current buoyancy in capital values. Having balanced these two considerations, and taking into account allocations over the past five years, the Directors have decided to allocate an overall rate of return for recurrent single contribution pension contracts in respect of 1993 of 13%, the highest since 1989. The interim rate for 1994 will be at 10% p.a. That rate is, of course, subject to change in the light of investment conditions throughout the year.

(ii) Declared bonus rate

We have previously described how we make a broad link between the level of declared bonus rates and redemption yields on fixed-interest stock. In the light of the sharp reduction in yields described above, that approach indicates that declared rates should be reduced.

There is widespread agreement in the industry that declared rates need to be reduced to reflect the current levels of yields. We are aware that some offices have used the high nominal returns experienced in 1993 to defer making such reductions. We prefer to adhere consistently to our established strategy because that will ensure that we retain a high level of investment freedom. Accordingly, we have reduced declared rates so that the level of earnings passed on by this means is 1% p.a. lower than was the case in 1992.

(iii) Details of rates

Main details of the declaration, for recurrent single contribution pension contracts, which apply from 1 April 1994, are as follows:

Overall rate of return for 1993 applied to total benefits:	13.0%

This is credited by way of:

basic guaranteed rate of interest	3.5%
declared bonus rate for 1993	4.0%

final bonus which tops up the growth arising from the guarantees and declared bonus rate for the year to the overall rate of return

Interim overall rate of return for 1994, until changed, for bringing forward policy values from 31 December 1993	10.0% p.a.

These returns are added into the existing benefits for policies which were in force on 31 December 1993 and are still in force at 1 April 1994. Policies leaving the fund between these dates are given equivalent treatment.

In summary, therefore, we have substantially increased total policy values, but with a smaller increase in the guaranteed element than in recent years. We feel this is the proper response to events in 1993.

Conclusion

The results which a life office can pass on to its with-profits policyholders are largely determined by the underlying investment conditions during the lifetime of each policy. The important point is that, whatever investment conditions do in fact emerge, the Society will continue to strive to produce consistently fair and attractive results for with-profits policyholders. That philosophy has served us well for many years past and we are convinced it will continue to do so in the future.

Should you have any queries in respect of the 1993 bonus announcement, please contact our Client Servicing Centre (statement queries) either in writing or by telephoning 0296 386688. If you would like further information on the range of products offered by The Equitable, please complete and return the reply-paid card enclosed with this letter.

Yours sincerely

R H Ranson
Managing Director and Actuary

BONUS NOTICE NOTES FOR BONUS YEARS 1994 TO 1997

1994 NOTES

1 The total value as at 31 December 1994 has been calculated by rolling up the total value as at 31 December 1993 at the overall rate of return actually allotted for 1994 and accommodating any benefits secured by premiums paid during 1994 at the rate for the appropriate periods up to 31 December 1994. The overall growth for 1994 is made up of "guaranteed interest and bonus declared in 1994" and "increase in final bonus".

The bonus declared for the year ending 31 December 1994 is formally added to policies on 1 April 1995.

If benefits become contractually payable at any date on or after 1 April 1995 but before 1 April 1996, they will be calculated by rolling up the value as at 31 December 1994 plus any benefits secured by further premiums at the interim overall rate of return in force at the time of the claim.

2 The total fund values include amounts of final bonus which are not guaranteed and may vary up or down. The fund available at retirement may therefore be less than the total value shown, but would not be less than the guaranteed value.

3 In circumstances other than those covered by the policy conditions, for example transfer to another pension provider, the Society reserves the right to calculate the fund in a different way.

4 The times at which and the form in which retirement benefits may be taken are subject to the rules of the scheme and Inland Revenue rules where appropriate.

1995 NOTES

1 The overall rate of return for the year 1995 is as announced in the enclosed letter, with proportionate amounts applying for part years.

The overall rate of return is credited by the rate guaranteed in the policy, the announced declared bonus rate and the balance representing non-guaranteed final bonus. Each rate is proportionately applied for part years.

The total fund value at 31 December 1995 is the result of accumulating the fund value on 31 December 1994 at the overall rate for the year, and adding in new purchases in the year accumulated at the appropriate proportionate rate.

The guaranteed fund value at 31 December 1995 is the result of accumulating the guaranteed fund value at 31 December 1994 at the rate guaranteed in the policy, together with the announced declared bonus rate, and adding in new purchases in the year accumulated at the appropriate proportionate rate.

The non-guaranteed final bonus addition is the difference between the total fund value and the total guaranteed fund value.

The bonus declared for the year ending 31 December 1995 is formally added to policies on 1 April 1996.

If benefits become contractually payable at any date on or after 1 April 1996 but before 1 April 1997, they will be calculated by accumulating the value as at 31 December 1995 plus any benefits secured by further premiums at the interim overall rate of return in force at the time of the claim.

2 The total fund values include amounts of final bonus which are not guaranteed and may vary. In addition, where the policy provides a guarantee of terms on which annuity benefits can be secured, the final bonus then payable will take account of the cost of providing that guarantee. The fund available at retirement may therefore be less than the total shown, but would not be less than the guaranteed value.

3 The full fund value is only guaranteed to be payable in the circumstances detailed in the policy and is based on the assumption that the fund is used at pension date to purchase a pension at rates current at the time. If amounts become payable in other circumstances, for example as a transfer to another pension provider or a switch to unit-linked investment, then the amount available is not guaranteed, and may be lower than the amount shown.

4 The times at which and the form in which retirement benefits may be taken are subject to the rules of the scheme and Inland Revenue rules where appropriate.

1996 NOTES

1 The overall rate of return for the year 1996 is 10.00%.

The overall rate of return comprises the rate guaranteed in the policy, the declared bonus rate and the balance representing final bonus. Rates are used to accumulate values for the relevant whole or part years.

The total value as at 31 December 1996 is calculated by applying the overall rate of return for the year to the fund value as at 31 December 1995, and then adding in the benefits purchased by contributions paid during the year accumulated at the equivalent rate for the periods of investment.

The guaranteed value as at 31 December 1996 is calculated by applying the rate guaranteed in the policy and the declared bonus rate to the guaranteed fund value as at 31 December 1995, and then adding in the benefits purchased by contributions paid during the year accumulated at the equivalent rates for the periods of investment.

The non-guaranteed final bonus addition is the difference between the total value and the guaranteed value. The total values include amounts of final bonus which are not guaranteed and may vary. In addition, where the policy provides a guarantee of terms on which annuity benefits can be secured, the final bonus then payable will take account of the cost of providing that guarantee.

The bonus declared for the year ending 31 December 1996 is formally added to policies on 1 April 1997.

2 On retirement on or after 1 April 1997 but before 1 April 1998, the benefits will be calculated by accumulating the value as at 31 December 1996 and the benefits purchased by any further contributions at the interim overall rate of return in force at the time.

3 On retirement the amount payable is the guaranteed value plus the non-guaranteed final bonus addition, if any, available at the time. The total value represents an illustration of the amount payable on the dates shown. The amount payable in other circumstances (for example, as a transfer to another pension arrangement or a switch to unit-linked investment) is not guaranteed and may be less than the guaranteed value.

4 The times at which and the form in which benefits may be taken are subject to Inland Revenue rules.

1997 NOTES

1 The guaranteed value as at 31 December 1997 is calculated by applying the rate guaranteed in the policy and the declared bonus rate to the guaranteed fund value as at 31 December 1996, and then adding in the benefits purchased by contributions paid during the year accumulated at the equivalent rates for the periods of investment. The guaranteed value is also adjusted to allow for any payments/switches out as they occur during the year.

2 The non-guaranteed final bonus addition is the difference between the total value and the guaranteed value. The amount of final bonus payable is not guaranteed and may vary. The actual amount payable will be determined when benefits are taken.

3 The total value as at 31 December 1997 is calculated by applying the overall rate of return for the year to the fund value as at 31 December 1996, and then adding in the benefits purchased by contributions paid during the year accumulated at the equivalent rate for the periods of investment. The total value is also adjusted to allow for any payments/switches out as they occur during the year.

4 On retirement on or after 1 April 1998 but before 1 April 1999, the benefits will be calculated by accumulating the value as at 31 December 1997 and the benefits purchased by any further contributions at the interim overall rate of return in force at the time. The value is also adjusted to allow for any payments/switches out as they occur.

5 On retirement the amount payable is the guaranteed value plus the non-guaranteed final bonus addition, if any, available at the time. The total value represents an illustration of the amount payable on the dates shown. The amount payable in other circumstances (for example, as a transfer to another pension arrangement or a switch to unit-linked investment) is not guaranteed and may be less than the guaranteed value.

MATCHING RECOMMENDATIONS WITH EXISTING GUIDANCE NOTES

In the report we have stated that most of the recommendations that we have made amount to making guidance more explicit. The nearest match between current guidance and our recommendations is shown below. It is not part of our remit to re-write any of the guidance, and we willingly leave consideration of any necessary re-wording to the Life Board of the Faculty and Institute.

A. the Faculty and Institute, in their current investigation into ways of monitoring compliance with professional standards, make an external peer review of the work of the Appointed Actuary a requirement. (paragraph 34)

This is not a requirement at present.

B. the provision of an annual Financial Condition Report be made mandatory. (paragraph 35)

GN1 6.1 The Appointed Actuary must …… be satisfied as to the resilience of the financial position of the company in all reasonably foreseeable circumstances which might affect that position. [Effective from July 1992]
GN2 1.1 …... it is advisable for Appointed Actuaries to provide their Board …… with a more extensive written report into the current solvency position …… and its possible future development - a Financial Condition Report. [Effective from March 1996]

The recommendation is that the Financial Condition Report should be made mandatory through GN1, whilst its form remains 'Recommended Practice' as set out in GN2.

C. the Guidance Notes refer specifically to open-ended guarantees and their potential impact on the financial condition of the life insurance company. (paragraph 39)

GN1 4.2 The appointed Actuary must have regard to all aspects likely to affect the financial position of the company …… including the effect of any contingent liabilities should they crystallise. …… the financial position is particularly affected by: …… (b) the nature of the contracts in force and currently being sold, with particular reference to all options and guarantees; [Equivalent wording effective from May 1975]

D. the Guidance Notes make plain that the Appointed Actuary should require that there is a process for reviewing communications to policyholders and potential policyholders. The process should embrace:

- **(i) stated principles that the illustrations and other literature must reflect, and**
- **(ii) a consideration of how the policyholder who is not familiar with the constraints on a life office might read them.** (paragraph 51)

GN 1 3.3 It is part of the Appointed Actuary's continuing responsibility to advise the company of the Appointed Actuary's interpretation of its policyholders' reasonable expectations. …… When a significant change is likely to take place, the Appointed Actuary should take all reasonable steps to ensure that the company appreciates the implications for the reasonable expectations of its policyholders. It is also incumbent on the Appointed Actuary to take all reasonable steps to ensure that the company's incoming policyholders should not be misled as to their expectations. [Effective from July 1992; the Appointed Actuary's responsibility for interpreting PRE was introduced in December 1988 by GN1 8.3.4 (d)]

E. **the Guidance Notes have more explicit references to the formulation of bonus recommendations to directors, maybe through a separate section. This section should include some wording that when a new with-profit product is introduced, the Appointed Actuary should consider whether it should join an existing common bonus pool.** (paragraph 54)

GN1 8.3.4 (d) (i) …… that in the recognition and allocation of profits ……groups of participating policyholders are appropriately and equitably distinguished having regard …… to the terms of the policies …… [Effective from December 1988]

F. **the Guidance Notes require that, when advising the Board on policyholders' reasonable expectations or any successor concept under insurance regulations, the Appointed Actuary should ensure that other relevant strategies for meeting them are presented to the Board for discussion.** (paragraph 60)

Not explicit in current guidance.

G. **the Guidance Notes should require that an actuary resists holding the dual role of Chief Executive and Appointed Actuary or any role which compromises his or her ability to fulfil the duties of the Appointed Actuary.** (paragraph 68)

Not covered by existing guidance

H. **the Guidance Notes require that, in the fields where the Appointed Actuary is responsible for making recommendations to the Board, the reasonable alternative courses of action with their advantages and disadvantages should also be set out.** (paragraph 75)

Implicit, not spelt out

I. **the wording of GN1 and GN8 be reviewed to ensure that they are expressed in a clearer and more user-friendly manner.** (paragraph 81)

As shown above, the Guidance Notes are based on broad principles and many practical considerations or aides memoire. It may be more helpful if they are set out with first the principles and then the reminders of how these apply to the Appointed Actuary's responsibilities.

At the end of July 2001, the Faculty and Institute of Actuaries published on the website an exposure draft (EXD44) of a proposed new version of GN1 to take account of the Financial Services and Markets Act 2000, which will become effective from 30 November 2001.

A comparison of the proposed new version with the existing guidance shows that whilst improvements have been made in the clarity of the wording, few of the recommendations arising from this report have been covered more specifically than they were in the previous version.

The FSA have published Consultative Paper 97 which includes some new proposed rules on valuation intended to be introduced in 2004 or 2005. This may well cause GN1 to be revised again. The Committee believes that it would be in the interests of the profession to make any changes to GN1 arising from this report as soon as possible, rather than awaiting the indeterminate outcome of these further issues.

OTHER MATERIAL REVIEWED

The following written material has also been considered by the Committee (with details, where appropriate, of how to locate the material):

Faculty and Institute of Actuaries Guidance Notes	*http://www.actuaries.org.uk/map/GN01V5-1.pdf* *http://www.actuaries.org.uk/map/GN02V1-0.pdf* *http://www.actuaries.org.uk/map/GN08V6-0.pdf*
Memorandum by the Financial Services Authority to the House of Commons Treasury Select Committee	*http://www.publications.parliament.uk/pa/cm200001/cmselect/cmtreasy/272/01021513.htm*
Memorandum by the Faculty and Institute of Actuaries to the House of Commons Treasury Select Committee	*http://www.actuaries.org.uk/life_insurance/equit_life_memo.pdf*
Memorandum from the Equitable Life Assurance Society to the House of Commons Treasury Select Committee	*http://www.publications.parliament.uk/pa/cm200001/cmselect/cmtreasy/272/01021502.htm*
'With Profits, Without Mystery'	RANSON, ROY H & HEADDON, CHRISTOPHER P. (1989). With profits without mystery. *Journal of the Institute of Actuaries* **116**, 301-345. *http://www.actuaries.org.uk/library/ranson_jia116.pdf*
Report of the Annuity Guarantees Working Party	BOLTON, MICHAEL J. *et al.* (1997). *Reserving for annuity guarantees: the report of the Annuity Guarantees Working Party*. Faculty of Actuaries and Institute of Actuaries, 1997. *http://www.actuaries.org.uk/library/annuit_report.pdf*
Briefing Statement on Guaranteed Annuity Rates	*http://www.actuaries.org.uk/news/annuit-guarantees.html*
Letter from the Government Actuary's Department to Appointed Actuaries dated 13 January 1999 & Letter HM Treasury dated 18 December 1998 from Martin Roberts	

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