

simplifying with-profits reviews

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Compliantly reviewing with-profits funds – is it rocket science? With the right support there are many opportunities for quality advice to help clients find a successful outcome.

informer spoke to **Ned Cazalet**, a member of the FSA's standing panel on with-profits, to offer some practical guidance on conducting with-profits reviews regularly, thoroughly and compliantly.

i: Ned, why is there a need to review with-profits policies?

NC: If we look at the historic path of with-profits, going back to the period 1999 to 2001, with-profits experienced something of a revival. The with-profits bond was selling in huge volumes; sales that were only £2 billion a year in 1995 rocketed to £15 billion a year by 2001. Many of these life offices were very heavily exposed to equities. They believed the markets weren't going to fall – or if so by not very much. In addition, large amounts of their solvency capital was also invested in equities.

When stock markets fell in the period 2001-2003 the policyholder assets and solvency capital of these life offices were in many cases heavily impacted. The weaker the life companies became, the less able they were to hold equities, resulting in the life companies being large sellers of equities in this period and driving the markets down further. The net result for life



Cazalet Consulting's dos and don'ts for financial advisers



offices is that the £280 billion or so worth of equities they were holding in 2001 was reduced within three years to around £140 billion, the outcome being that some policyholders who thought they had bought into high equity exposure found the equity proportion had dropped dramatically.

It is the changing nature of with-profits funds which means they have to be regularly reviewed to ensure they continue to meet policyholders' expectations.

i: What is the requirement from financial advisers in terms of reviewing with-profits bonds?

NC: The FSA produced a document in 2007 entitled 'Quality of post-sale communications in the life sector and availability of ongoing advice to with-profits policyholders'. On one hand the publication targeted providers to improve the quality of information provided to advisers, but it also outlined for advisers why with-profits must be reviewed thoroughly and compliantly – and on a regular basis.

The process of this is not straightforward. For instance, a with-profits fund offering no bonuses is *not* in itself a reason for exiting. While there might be no bonuses, there might be some valuable guarantees at a specific date. Similarly, the fund being closed is *not* a reason to exit. Clearly, policyholders should exit some closed funds immediately, but again some might have valuable guarantees – and it might be that the client should eventually exit, but not immediately. It's important that regular reviews are conducted carefully – on a client-by-client and product-by-product basis.

i: What about exit penalties?

NC: Much will depend on the way the value of the with-profits contract is assessed – for instance whether there are any guarantees left. Many contracts have what they call 'spot guarantees', which offer a 'once in a lifetime' opportunity to exit without a penalty within a limited time period. So advisers need to look for any sources of value that remain and make an informed judgement.

Do...

... review your clients' with-profits holdings regularly. This means at least annually, plus as required in the case of a 'special event' such as an attribution of an inherited estate or a takeover of a life company or its book of business.

... use the Cazalet Consulting With-Profit Scores shown in the new Skandia With-Profits Analyser as a forward-looking guide to the financial health of the with-profits fund as a whole.

... keep alert for changes in the financial management practices of the with-profits fund, including asset allocation benchmarks, ability to smooth, whether and to what extent charges for guarantees and/or the cost of capital apply and (where appropriate) the outlook for the distribution of the estate. The new Skandia With-Profits Analyser captures all this information, helping advisers to make client-specific recommendations based on all relevant parameters.

... keep an eye out for upcoming spot guarantees (especially valuable in times when heavy MVRs apply) and be prepared to evaluate these carefully to ensure that your client does not miss out on any one-off opportunities – again the new Skandia With-Profits Analyser automatically takes account of these guarantees, saving time and effort for advisers.

Don't...

... use assessment of the overall strength of a with-profits fund as a whole as the main driver for individual policy review decisions. The ongoing suitability of with-profits should always be undertaken on a client-by-client basis, and the new Skandia With-Profits Analyser is designed to help you do just that, quickly, easily and compliantly.

... base the decision on whether to stay, go, top-up or reduce simply on whether a with-profits fund is open or closed. Funds close for a variety of reasons – in some cases because the guarantees contained in some of their contracts are very generous, leaving little remaining to finance the writing of new business. The Skandia With-Profits Analyser service is designed to help advisers undertake this task on a client-specific basis.

... base advice solely on whether the contract in question is paying bonuses. A contract with a zero annual bonus rate might have valuable guarantees (such as MVR-free regular withdrawals on a with-profits bond or a guaranteed annuity option on a pension) that would be impossible to replace by switching elsewhere. The new Skandia With-Profits Analyser makes it easy for the adviser to formulate value-adding strategies for their clients, take maximum advantage of any guarantees and time any switch out of with-profits to the best advantage of the client.

i: With so much to consider, how difficult a task is this for the adviser?

NC: Reviewing with-profits on a really detailed and consistent basis is extremely difficult. People often use the phrase 'it's not rocket science' – well with-profits in financial services is actually about as close as you can get to rocket science! When you combine this with the fact that recent financial turmoil means even well managed with-profits funds have been hit by extreme events, it is no surprise the financial adviser needs help and support.

The FSA wants advisers to give quality advice on with-profits, but with-profits is so complicated that, without a degree of help, advisers are always going to find this a difficult task.

i: How can with-profits review tools help?

NC: With-profits review tools, such as the one we have recently been building with Skandia, can be of enormous help to advisers in conducting compliant and thorough with-profits bond reviews. This particular tool actually does 'do the rocket science' for the adviser by providing a detailed analysis of the with-profits bond in terms of the asset mix; charges (including any levies for the cost of capital and/or guarantees) and distribution of estate; suitability for a specific individual client; value and future forecasts; benefits; spot guarantee dates; and tax considerations of cashing-in. ●

The Skandia With-Profits Analyser uses data provided by Cazalet Consulting and will be available via the Skandia Investment Solutions adviser extranet at www.skandia.co.uk/fasite before the end of the year.

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