1.11 #1

Peebles agenda

Service and Security is the theme of the eighth Scottish region annual conference, scheduled for Peebles in September.

The opening address comes from Michael White, Chief Operating Officer of Alexander and Alexander, and the programme includes all of the features which are now traditional at the Scottish gathering.

The debate is between motor insurers and brokers this year, on the motion 'This house believes that the lack of standardised practice within the motor insurance market creates a situation of chaos'.

On the Saturday morning, 14 September, there is a panel of Roger Taylor (Sun Alliance), Robert McCrindle (BIBA's Parliamentary Consultant), and William Morrison (Scottish Life).

The formal proceedings will close with an address by Sir Norman Macfarlane.

On the lighter side, there is a reception and cabaret, and the ubiquitous golf competition, not to mention a cocktail party and formal banquet.

The ladies title programme includes a talk by Alan Hodgkinson under the enigmatic title of 'Leave the moths in your diamonds', and a visit to Traquair House, the oldest inhabited house in Scotland. And many insurance brokers will again be day-dreaming, no doubt, that they should have signed up for the children's programme, which includes cartoon films, shows, and games.

Promises, promises

Scotland is the home of so many prominent life assurance companies that the current unease about how to illustrate the projected maturity values of with-profits policies has been particularly noticeable there. *Mike Fenwick,* PRO for BIBA's Scottish region, offers some personal opinions on the problem — and on how brokers might combine to help solve it.

THE CONTROVERSY on how to illustrate projected maturity values makes it hard to remember when bonuses were declared to be simple and actually were so.

Today, it appears that even actuaries are hard pushed to retain an agreed professional sense of proportion between what was, is, and *might* be. League tables of past and possible performance now abound in our industry, and like a politician with opinion polls, we are all able to use or abuse them. However, it is clear that the parallel with politics is becoming even more alarmingly real: as we outbid ourselves in competition, can the public any longer believe our illustrations? And indeed, do we believe them ourselves? We run a very real danger if we lose our credibility with the public.

A recent magazine article suggested that to some extent brokers were to blame for the current situation, and that this arose partly from an element of insecurity on the part of the broker, who sometimes does not feel he or she has the full trust of the client when giving advice, and so appreciates a 'bottom-line' number for support.

Personally, I cannot deny this charge as totally unfounded: but neither can I simply ignore the competitive pressures which are its underlying cause. But whether we accept a little of the blame or not — and many brokers certainly would not — can we do something positive to resolve the position and improve matters for the public?

Brokers' experience

It is interesting that we can in fact apply lessons from our own experience. Annually, we must assess and detail our assets and liabilities so that we may pass the requirements of the Insurance Brokers Registration Council.

Essentially the same is true of insurance companies — until it comes to the question of bonuses. Because the actuary needs to

continued on page 12

BIBA meets ASLO

Scottish Chairman Sandy Sinclair's intention to improve communication within BIBA in Scotland and between brokers and the companies received a boost last month when four members of the Scottish BIBA committee met ASLO chiefs at the offices of Scottish Life.

Photographed at the lunch (l to r) are: Mike Fenwick (BIBA), Alastair MacDonald (BIBA), Charles Cavaye (General Manager, Scottish Widows), Bill Morrison (General Manager, Scottish Life, and ASLO Chairman), Sandy Sinclair (BIBA), Simon Bolam (BIBA), and Joe McHarg (General Manager, Scottish Provident).

1M#2

continued from page 9

reserve only for the cash bonuses actually assessed as payable and does not offer any guarantee on, say, terminal bonuses, perhaps a third of the insurers' total assets are not matched by specific liabilities. That has allowed virtually unlimited expansion on the back of policyholders' funds. Equally, however, it has offered the temptation to indicate future projections that by definition cannot be guaranteed. These two factors are the true root cause of the present problem.

It is clearly the concern of both brokers and insurers that policyholders should not be misled. In my view, it *is* possible — and desirable — for BIBA brokers to suggest a remedy to the situation. I would like to see brokers agreeing a universal set of reasonable and realistic assumptions and criteria upon which to measure expected returns for any insurer's funds, and thus to produce a common standard by which to judge all insurers against their present estimated projections.

The only possible irony in this would be the need for brokers to employ the services of an actuary themselves!

Your view

This article is a personal opinion by a Scottish broker. We would like to know what other brokers think of this problem — or even if they think it *is* a problem. Write to *The British Insurance Broker*, 14 Bevis Marks, London EC3A 7NT.

The Scottish companies reply

By Eamonn Butler

Some insurance companies, like Clerical Medical (see box) have told the financial press quite bluntly that it is unsatisfactory to illustrate possible future benefits by projecting current bonus rates, and even more unsatisfactory to illustrate benefits which greatly exceed past performance. Others have been harder to draw on the question.

We invited a number of the Scottish offices — traditionally guarded in their press statements — to respond to Mike Fenwick's personal view of the problem. Interestingly, their replies all showed a vivid appreciation of the problem, and many said that they would endorse wholeheartedly some rationalisation, from whatever source it might originate.

The opinions we received from the general managers and actuaries of the Scottish companies on the matter of bonus projections generally accepted that there was a severe problem at present, but acknowledged that any solution was bound to cause upset. Joe Macharg, General Manager of the Scottish Provident, told us:

'The problem of how to eliminate the totally unsatisfactory illustrations of possible future benefits under with-profits policies appearing in quotations and in financial publications, has occupied and is occupying a great deal of time in life offices and in the actuarial profession. Anyone who can provide ideas that will contribution to a solution of this problem will be worthy of a hearing, but no-one should suppose that there is an easy answer that won't hurt.'

'The validity of future illustrations based on past results is universally recognised to be a problem. What is not agreed, however, is a suitable solution.'
— *W. W. Stewart, Scottish Equitable*

Bill Proudfoot, Chief General Manager of the Scottish Amicable, agreed and welcomed 'any efforts which will help to introduce sanity into the method of illustrating bonuses of new policies.' He continued: 'For several years past I have spoken out against misleading projections but more importantly I have been trying to persuade the actuarial profession and the LOA to take corrective action. I believe that there is widespread support within the industry for some kind of reform and I hope that before long that ABI will bring forward proposals which will be accepted by all life offices.'

J. L. McKenzie, Joint Actuary of FS Assurance, again pointed out the 'efforts being made by the life offices and the actuarial profession to find a solution which will be acceptable to the market as a whole. The fact that no agreed solution has as yet been produced is because there is no simple solution.' There was doubt, he said, that one illustration could satisfy the two main objectives — of conveying an indication of benefits which will emerge under a policy, and of facilitating a choice between one office and another — especially when:

'(1) the illustration should not create unreasonable expectations in the minds of potential policyholders and should be seen to be responsible at the time of making the illustration;

(2) the bonus illustration system needs to be acceptable to and easily understandable by the potential policyholders and intermediaries;

(3) the system should be based on factual information so as not to neutralise competitive differences between offices; and

(4) the system should not be so stringent as to weaken the competitive position of life offices relative to other savings media.'

What solutions?

What, then, might be the solution? Mr McKenzie suggests that brokers themselves might have more work to do:

'It is clear that a life policy is a form of investment and that the insurance broker in his role as independent adviser will need to make some judgement of the relative merits of particular offices. In this he is in the same position as a stockbroker who advises clients to buy shares on the stock market. The stockbroker must first look at the underlying performance of the particular companies in the past and their prospects for the future, and he employs analysts to carry out this task. If, in considering the merits of life offices, brokers require to employ the services of an actuary as the technical expert, then this must be applauded. It is not a simple exercise which can be determined merely by looking at past performance or current bonus projections.'

Other companies are more optimistic that common assumptions could be agreed. Assistant General Manager W. W. Stewart says that:

'We at Scottish Equitable would gladly be party to an agreement to base future illustrations on a growth rate assumption (akin to that used for unit-linked contracts). Or alternatively, to place a "bonus-type" illustration in a "required growth rate" context. Past results could then be shown for a similar contract if one exists — this, of course, is the problem when new contracts are devised and no valid past performance is available.'

Bill Proudfoot, again, notes that Scottish Amicable introduced in November 1984 a new basis for the illustration of its IPA contract:

'This adopted the "yield" approach, the accepted convention in the unit-linked market. I would hope that this could be a model for all offices to adopt, but I much regret that none of our competitors has as yet chosen to follow our lead. Surely the only sensible way to illustrate prospective benefits under a policy is on common, reasonable, and realistic sets of assumptions, such as yields? Scottish Amicable would be happy to give such an approach its full support.'

I. C. Lumsden, the General Manager (Actuarial) of Standard Life, stresses the difficulties but proposes a straightforward approach:

'We are all under pressure — brokers and

continued on page 17

IM#3

continued from page 12

companies — to show our products in the best light. When interest rates are high, for instance, it hardly helps our clients to compare us with other investment media if we ignore the possibility that policies may yield terminal bonuses as well as reversionary bonuses. Nevertheless, we should not pretend that illustrations which add together current rates of reversionary and terminal bonus are either realistic estimates for the future, or sound bases of comparison between one company and another.

'We fully support the ABI position, which is that we should distinguish between illustrations of future benefits and the competitive aspects of quotations. Where illustrations are concerned, however, we are reluctant to adopt standard assumptions entirely and ignore altogether reversionary bonuses which, whilst not guaranteed, *are* an indication of a company's intentions for the future. Nor are we keen to base competitive comparisons solely on current maturity payments, since almost any company could afford to produce good results in a single year.

'Far from being concerned about who should get the credit for a new quotation basis, Standard Life would be *delighted* if brokers could come up with a better method, generally accepted to be fair.'
— I. C. Lumsden, Standard Life

'Our view, therefore, is that illustrations should be based primarily on current reversionary bonus rates, with terminal bonuses being mentioned only in the context of historical performance comparisons. Our own opinion is very firmly that the best guide to a company's future performance is its long-term past record, since it is very difficult to predict who will improve their performance, and who will fall away. After all, companies which have done well in the past have generally continued to do well. Haven't they?'

The important distinction between illustrations and promises is made once again by J. M. Souness, Managing Director of the LAS Group:

'There is a difference between "illustrations" and "promises". No life company promises maturity values beyond the basic sum assured, but those such as LAS who operate only through brokers are obviously in the hands of the adviser as to how the sales pitch is slanted.

'These have been fat years for life offices with high interest rates, an encouraging stock market, and record sales. That well-known actuary Joseph, however, while declaring a bonus beef distribution for seven years, carefully pointed out to the retail butchers of the time that while he could confidently predict his supply of beef for the following seven years, part of the distribution was related to the conditions of the day and could vary in future. All life office illustrations now carry this caveat in varying degree, but reconsideration of practices is under way.'

Mr D. D. McKinnon, General Manager of the Scottish Mutual Assurance Society, pointed out a final aspect of the problem 'which I rarely see mentioned, namely the relationship of the assets to the liabilities and in particular the value which is placed on the latter. The two are related but not always in the way generally thought. The actual amounts paid out on claims could well arise from a relative weakening of the position of the office and so render the comparison with projected benefits less valid (if there ever were validity in such a comparison anyway!) Further, the basis on which liabilities are valued, the gearing of with- and without-profit business, the extent to which the mix of business is changing etc., are crucial in any comparison. Even if he examined an office actuarially as best one could and discovered it to be exceptionally strong how can an investor guard against a complete change in management philosophy which could result in the office being an entirely different type of undertaking.'

Are brokers to blame?

Despite the difficulties, it might be reassuring that the companies recognise things have gone wrong and are groping towards a solution. But there are some chilling complaints that brokers themselves are the chief culprits. As the Scottish Equitable's W. W. Stewart says:

'Competition is at the root of the problem and in this respect we are all culpable. "The bottom-line figure is the one people look at" has become the message, and the increasing proportion of bonus payable by means of terminal bonus as exacerbated an already dubious practice.

'A cynic would suggest that asking the broking fraternity to produce a voluntary agreement to curb illustrations is like asking Ghengis Khan to give up rape, but in all seriousness we should all work together to produce some solution which will not mislead our mutual clients.'

The point is made more bluntly by J. Gilchrist, Assistant General Manager and Agency Manager of Scottish Life:

'We are quite clear that the pressure to present illustrations in the way now commonplace stems from brokers. We have seen offices which at one time declined t include any figure relating to terminal bonu in their illustrations obliged to do so becaus of the loss of business they were suffering a result. We have seen offices which formerl included terminal bonus merely as a footnot obliged to mention it more prominently fo the same reason. Most of our field staff tell u that brokers will not put a quotation forwar unless the "bottom line", bears som comparison with others — and that mean that it must include some figure for termina bonus.'

'The answer may well be that with-profits illustrations should be standardised in the same way that unit-linked ones have been. From the projection point of view the decision is then narrowed down to present-day rates combined with a regard for past performance tables as some form of future guide.'
— Frank Attrill, Scottish Widows

Underscoring Mr Lumsden's concer about the dangers of adding high curre reversionary bonuses and terminal bonuse Mr Gilchrist says:

'The problem is of the brokers' makir and offices would like to alter the status qu However, competitive pressures affe offices as well as brokers, and so our solutic is to add clear warnings to the illustratio given which the broker and policyholder c appreciate and understand. We do not mal estimates or projections: we give illustratio based on certain assumptions which a clearly stated, and accompanied by cl caveats. Market pressures oblige us to a this way and we do not believe that o illustrations should mislead.'

Mr McKenzie of FS Assurance is al concerned:

'It must be accepted that competiti between offices is healthy — as also mu competition between brokers and oth intermediaries. It is clear, however, that t dangers inherent in the present system bonus illustrations have arisen large because of this competition. Each office (a each broker) wishes to ensure that products are presented in as favourable light as possible when facing competitio This freedom must somehow be retain while removing the "telephone numbe syndrome, which is clearly the unacceptal face of illustrations.'

Frank Attrill, the Assistant Gene Manager at Scottish Widows, thinks th

continued on page

continued from page 17
insurance brokers must do a great deal more:

'I have always considered that the broker buys the right assurance or pension for his clients. Yes, he has to *sell* the need and convert that "need" into a "want", but given the correct professional broker/client relationship, it is his duty to buy the best. Having decided on the best office for the particular circumstances he may well, briefly, show his client other figures — even ones that look better — to pre-empt his shopping around. The best that is being bought is then explained in terms of the many other factors that *must* be considered when potentially paying out a considerable amount of money over the term — for example, surrender values, paid-up values and conditions, conversion options, renewable options, etc.

> 'The problem is a problem for the industry as a whole and must be solved by the industry as a whole. If we as an industry do not solve this problem, then it is clear that the new Marketing of Investments Board will produce solutions which we may not find palatable.'
>
> *—J. L. McKenzie, FS Assurance*

'This may sound like throwing the ball back into your court, but the life offices have tended to quote "telephone numbers" because brokers have claimed that they are necessary in order to sell against some of the opposition. I submit that the type of business that your colleagues really want is not a lapse-prone, figure-chasing, fickle bank of clients, but the sensible, satisfied ones who will provide up to two-thirds of future, *non-opposed* business; clients who are satisfied with the facts of their contracts. It wouldn't take life offices long to realise that you wanted to buy the best for your clients and not potentially broken promises, promises.'

Your view

The above comments represent insurers' views of the causes and the cures of the problem of bonus projections. We would like to hear the views of more brokers on this question. Should BIBA get together and draw up a standard system itself? Write us a letter about it: Our address is *The British Insurance Broker,* 14 Bevis Marks, London EC3A 7NT.

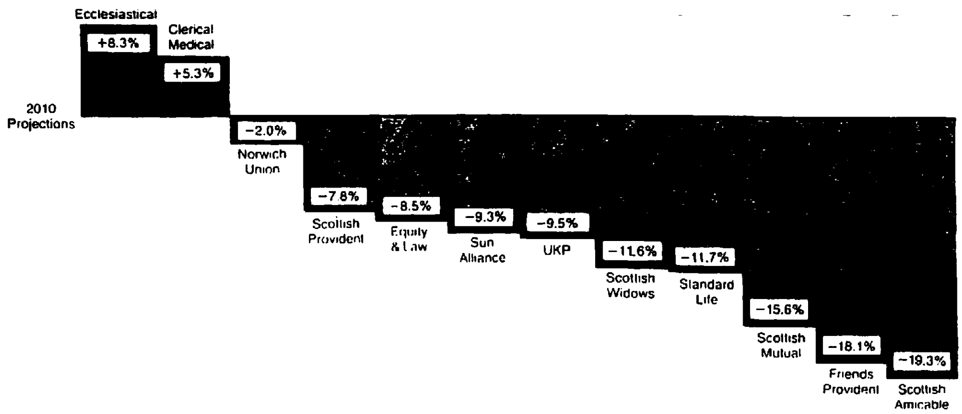
Performance and projections

According to the past performance survey published by *Money Management* in May, actual results for a 25-year endowment policy varied very widely — from 24.1% better than projected to 35.3% worse.

Clerical Medical wasted little time in pointing out that of the top twelve life offices, only it and Ecclesiastical achieved a performance better than they project, but other companies complain that the comparisons are not comparable and ignore changes and differences in conditions.

PERFORMANCE v PROJECTIONS

PERCENTAGE BY WHICH ACTUAL RESULTS VARY FROM FUTURE PROJECTIONS FOR A 25 YEAR ENDOWMENT ASSURANCE.



Information is based on the top 12 offices in the past performance survey published in MONEY MANAGEMENT, May 1985.

St. Giles's, Edinburgh

BIBA outreach

The Scottish region of BIBA is in the midst of an important campaign to make companies better informed about insurance brokers' views.

Company offices in Scotland have been offered subscriptions not only to *The British Insurance Broker,* but to the region's own broker newsletter — so that they can get a first-hand understanding of what is going on in BIBA and how members are thinking.

So far some forty company offices in Scotland have taken up subscriptions, and more are in the pipeline.

The Scottish conference in Peebles this month will provide another important opportunity for broker-company communication at every level.

On page 23, Stuart Blythe looks at the distinctive features of the Scottish broker market