CONSULTATION PAPER

P004 - 2005

February 2005

Consultation on Review of Participating Fund Business for Life Insurer

Monetary Authority of Singapore

PREFACE

The Participating (Par) Fund Review Workgroup, comprising representatives from the life insurance industry, the Singapore Actuarial Society and the Monetary Authority of Singapore, was formed to review the operations of par fund business in Singapore and to recommend measures to address any inadequacy.

2 The workgroup has now completed its review. Its findings and recommendations are detailed in this consultation paper.

3 MAS invites comments from interested parties on the recommendations to enhance governance and improve disclosure for par business. Electronic submission is encouraged. Please submit your written comments by 28 March 2005 to:

Insurance Supervision Department
Monetary Authority of Singapore
10 Shenton Way
MAS Building
Singapore 079117
Fax: (65) 6229 9694
Email: pfbrwg@mas.gov.sg

4 Please note that all submissions received may be made public unless confidentiality is specifically requested for the whole or part of the submission.

Table of Contents

EXECUTIVE SUMMARY

Participating life insurance policies (par policies) are the mainstay of the life insurance industry in Singapore and are widely used to meet the investment and life protection needs of many policyholders in Singapore.

Par policies provide both guaranteed and non-guaranteed benefits. Non-guaranteed benefits are determined based on the performance of the participating fund (par fund) managed by the insurers. Insurers are expected to exercise proper discretion when allocating bonus to policyholders, taking into account the need to ensure fairness and equity among different classes and generations of policyholders and to maintain the par fund's overall solvency.

To safeguard the par policyholders' interest, insurance regulations cap the amount distributable to shareholders from profits of the par fund at 1/9th of the value of bonuses allocated to par policyholders. This helps to align shareholders' interest closer to that of policyholders and prevent excessive distribution to shareholders. Shareholders are, however, required to bear fully any losses in the par fund resulting from meeting the guaranteed benefits due to policyholders.

Managing the par fund is intrinsically complex. Insurers have to maintain a delicate balance among several objectives, in particular, optimising returns to policyholders while not exposing the par fund to excessive risks and maintaining equity and fairness among different classes and generations of policyholders. This is further complicated by the increasingly volatile investment climate and more complex product designs.

The Par Fund Review Workgroup, comprising representatives from the life insurance industry, Singapore Actuarial Society and the Monetary Authority of Singapore, was formed to review the operations of par business in Singapore and to recommend measures to address any inadequacy.

The workgroup is of the view that the prudential rules and requirements for the management of par funds are adequate and generally in line with those in other developed insurance markets. It recognised that the asset and liability valuation bases as well as capital adequacy requirements have been strengthened with the implementation of the risk-based capital framework from 1 Jan 2005.

However, the workgroup identified several inadequacies in internal governance and disclosure practices of life insurers. In addition, financial adviser representatives and staff of life insurers handling par fund activities should be adequately trained.

Internal Governance

The workgroup noted that while most life insurers have internal practices on key aspects of par fund management, there is a need to raise overall standards of practices across the life insurance industry to better cope with the increasing complexities of par fund activities.

The workgroup proposes that every insurer should have in place a clearly defined and well-documented internal policy on par fund management. The policy should:

- set out clearly the roles of the board of directors, senior management and the appointed actuary;
- cover the principles and practices governing the key management aspects of the par fund; and
- be approved by the insurer's board of directors and reviewed regularly.

The workgroup believes that the introduction of such policies could help raise internal governance standards and ensure greater consistency in par fund management over the term of par policies and among different insurers operating in Singapore.

Disclosure Framework

The workgroup noted several inadequacies in life insurers' disclosure to par policyholders, both at the point-of-sale and on a regular basis after sales.

Point-of-sale disclosure

While current point-of-sale materials clearly highlight that non-guaranteed benefit projections are included only for illustration purposes and the actual payout may vary according to the actual performance of the par fund, the workgroup is of the view that more could be disclosed to highlight the underlying risks and the risk sharing mechanism. In particular, more information could be provided on the investment strategy, the key factors affecting future bonuses and the key principles applied in bonus allocation, including how regular bonus and terminal bonus may change in the future.

In addition, the volatility of future bonuses could be better highlighted by using two different interest rates for the benefit illustrations, as opposed to the current practice of using only primarily one interest rate.

Post-sales disclosure

The workgroup considers it important for life insurers to keep policyholders informed of the par fund's performance and its impact on bonuses to policyholders. The workgroup proposes that a par fund performance report be provided with updated benefit illustrations to policyholders on a regular basis.

Training

Financial adviser representatives who sell par policies play an important role to help consumers understand the product. They should therefore be adequately trained, particularly on the new measures proposed by the workgroup.

Similar training should also be conducted for staff of life insurers who are involved in various aspects of par fund management to enhance their overall competency to carry out the relevant functions.

1 BACKGROUND

1.1 Participating life insurance policies (par policies) are the mainstay of the life insurance industry in Singapore. They are important financial products to meet the investment and life protection needs of many policyholders in Singapore.

1.2 As at 30 Sept 2004, there were 3.5 million par policies in force with aggregate participating fund (par fund) assets of S$49 billion. Common par policies include participating whole of life and endowment policies. Despite the emergence of newer products such as investment-linked policies, par policies remain very popular, contributing to 39% of total weighted new business premium over the last two years.

1.3 Par policies offer a combination of guaranteed benefits and non-guaranteed benefits, payable upon death, surrender or maturity (for endowment policies). The non-guaranteed benefits, allocated as bonuses or dividends to policyholders, are determined based on the performance of the par fund, which include the investment, mortality, morbidity, expenses and persistency experiences.

1.4 An important characteristic of a par policy is its objective of providing competitive but stable medium- to long-term returns to par policyholders. This is achieved by combining some exposure to higher risk assets like equities to generate potentially higher but more volatile returns, and adopting a bonus smoothing process to even out the volatilities over time. The bonus smoothing process, and the need to maintain solvency of par funds, require life insurers to exercise proper discretion to determine the appropriate bonuses to be allocated to each class and generation of par policies.

1.5 Because of the need to pool risks and smoothen bonus allocations over time, individual accounts, in the same fashion as investment-linked policies, are typically not maintained for each par policy. Instead all par policies are written and maintained in a par fund, which is subject to regulatory requirements to safeguard par policyholders' interest. Some of the key requirements are:

- <u>Restriction on profit transfer to shareholders</u>
  Transfer of profits to shareholders from the par fund is restricted to 1/9th of amount of bonus allocated to par policyholders. This helps to align shareholders' profit objective closer to policyholders' interest and prevents excessive distribution of profits to shareholders. Shareholders will only enjoy higher returns from the par fund when more bonuses are allocated to policyholders. Profits from the par fund cannot be allocated to shareholders via any other means.

- <u>Shareholders to absorb losses</u>
  Any shortfall to meet guaranteed benefits or solvency requirements of a par fund has to be funded by shareholders and not par policyholders.

- <u>Equity & fairness</u>
  While life insurers have the discretion to determine the allocation of non-guaranteed bonuses to par policyholders, they have to ensure fairness and equity to the policyholders. The insurer's board of directors has to approve the bonus allocation after considering the written advice of the appointed actuary. The appointed actuary

has to take into account the need to maintain equity and fairness among different classes of policies and the potential impact on the ongoing solvency of the fund.

1.6 In addition, the following regulatory requirements and industry standards safeguard policyholders' interests, though they are not specific to par policies:

- Insurance (Valuation and Capital) Regulations 2004;
- MAS Notice 312 on guidelines for dynamic solvency testing, which requires life insurers to assess the long-term solvency and sustainability of the bonus rates under different scenarios;
- MAS Notice 317 on prudent management of assets;
- Financial Advisers Act on requirements for recommendations made and information to be disclosed to clients; and
- Life Insurance Association (LIA) benefit illustration guidelines on disclosure standards

2 CHALLENGES IN MANAGING A PAR FUND

2.1 Par policies provide policyholders guaranteed benefits plus non-guaranteed bonuses based on the performance of the par fund, without being exposed to excessive volatility, via a risk pooling and bonus smoothing mechanism. Par policies appear to be well received by most consumers in Singapore judging by their sustained popularity.

2.2 However, managing a par fund is intrinsically complex. Life insurers have to maintain delicate balance among several objectives. In particular, they need to optimise returns without exposing the par fund to undue solvency risks. They also need to reflect the experience of the par fund within the constraints of a policy of making stable bonus payouts in order to determine the appropriate bonuses to be allocated to each class and generation of policyholders.

2.3 This is further complicated by the increasingly volatile investment climate. The difficult investment environment over the last decade has led to most life insurers adjusting bonuses several times since the late 1990s. These bonus adjustments and the growing sophistication of policyholders have put more pressure on life insurers to disclose more on par fund management, particularly how bonuses are determined.

2.4 In addition, products written in the par fund are becoming more complex, in terms of product features and bonus structures. This results in some par funds having to cope with many bonus series, which makes maintaining equity and fairness among different classes and generations of policyholders more challenging.

2.5 For par policies to retain their relevance going forward, it will be necessary for life insurers to adopt adequate measures to meet these challenges.

3 PAR FUND REVIEW WORKGROUP FINDINGS

3.1 The workgroup was formed to review the par fund business in Singapore and to recommend measures to address any inadequacies identified. The workgroup comprises representatives from the life insurance industry in Singapore, the Singapore Actuarial Society and the Monetary Authority of Singapore.

3.2 In addition to looking at the practices in Singapore, the workgroup also referred to practices in several other countries where similar par policies are sold. These include the United Kingdom, Australia, Canada and Hong Kong.

Prudential rules on par fund

3.3 In general, the workgroup is of the view that the prudential rules on par fund controls (described in paragraph 1.5) are adequate. The prudential requirements in Singapore are generally in line with those in other countries, as shown in the table in Annex 1.

3.4 The workgroup considers the risk-based capital framework, which came into full effect on 1 Jan 2005, a major improvement, particularly in the following:

- It sets realistic asset and liability valuations and risk sensitive capital adequacy requirements that better reflect the insurers' true financial strength and encourage more active risk management;

- It requires explicit reserves to be set aside for both future guaranteed and non-guaranteed benefits of par policies using realistic assumptions;

- It requires that assets representing shareholders' interest in the par fund to be identified and kept within the surplus account of the par fund, separate from assets available to back policy and other liabilities of the par fund; and

- It imposes explicit capital requirements on asset, liability and mismatching risks as well as provides a clearer definition of recognised forms of capital.

3.5 The workgroup, however, identified several inadequacies in the internal governance of the par fund and the quality of disclosure to policyholders both at the point-of-sale as well as on an ongoing basis. In addition, the workgroup recommends that financial adviser representatives who distribute par policies be adequately trained.

Inadequacies in internal governance

3.6 The workgroup identified the following areas of par fund governance that should be strengthened:

- <u>Enhanced practices to cope with an increasingly complex environment</u>
  As highlighted in Section 2, managing a par fund is becoming increasingly complex because of the more volatile investment environment and the more sophisticated and varied par products offered.

Par fund management practices that sufficed in the past may not be adequate going forward. In particular, with a more volatile environment and the existence of many bonus series, insurers may have to put in place specific measures to track the relevant performance of each class and generation of policies. Clear rules should be established to determine the appropriate level of risk pooling and smoothing among different classes and generations of policies, taking into account the likely variability of future regular and terminal bonuses, to ensure fair and equitable bonus allocations.

As such, it is important that all life insurers review and refine their practices to better cope with these challenges.

- Well-documented internal policy on par fund management

  The workgroup recommends that insurers have in place well-documented internal policies on the principles and practices of par fund management. The policies should be reviewed regularly and updated to include any enhanced practices needed to cope with the changing risk profiles of par funds.

  Given the long-term nature of par policies, a well-documented internal policy is critical for the consistent application of the principles and practices over the term of par policies.

- <u>Enhanced board and senior management oversight</u>
  Managing a par fund involves a wide range of functions from pricing of par polices and investing par fund assets, to allocating bonuses and managing the overall solvency of the par fund. Many of these functions need the technical expertise of the appointed actuary, as currently required in the insurance regulations.

  The workgroup is of the view that besides the roles performed by the appointed actuary, the board and senior management should exercise greater oversight to set a clear and comprehensive policy on par fund management. They should also ensure a strong compliance culture to further strengthen insurers' internal governance on par funds.

The workgroup recognised that currently there is no regulatory requirement or industry standard for insurers to adopt comprehensive and integrated internal policies on the principles and practices to manage a par fund.

The absence of such a requirement or standard has contributed to the varying practices among insurers in Singapore.

Inadequacies in disclosure framework

3.7 The workgroup identified the following inadequacies in the disclosure framework both at the point-of-sale, and on a regular basis:

(a) **Point-of-sale disclosure**

- <u>Disclosure of risk profile</u>

  Current product summary and benefit illustration provided to prospective policyholders clearly show non-guaranteed benefits and guaranteed benefits separately.

  However, these documents do not indicate the key factors that could affect future bonuses and the par fund's actual or intended exposure to each of these factors. For example, the relevant asset mix or investment strategy, which would directly determine the par fund performance, is often not disclosed.

- <u>Smoothing bonuses and exercising discretion</u>

  Most insurers intend to provide smoothed bonuses to par policyholders based on accumulated performance of the par fund over a certain time period, instead of allocating bonuses based on actual annual performance.

  However, the concept of bonus smoothing is often not clearly mentioned in the disclosure materials. The frequency of bonus allocation and the process involved are also not mentioned.

In addition, the common practice of exercising discretion to determine regular and terminal bonuses to maintain equity and fairness, as well as the par fund's overall solvency, is often not clearly highlighted.

- <u>Volatility of illustrated non-guaranteed benefits</u>
  Currently, the benefit illustration is prepared based primarily on a single interest rate scenario[1]. The focus on a single interest rate does not highlight the potential volatility of future bonuses.

(b) **Post-sales disclosure**

- <u>Ongoing reporting on actual performance</u>
  Currently, the information provided to par policyholders is largely limited to annual bonus statements that describe the amount of bonuses allocated and explanatory letters on bonus adjustments, which are often sent to policyholders when insurers cut bonuses.

  Minimal information is disclosed to par policyholders on the actual performance of the par fund. Also, explanation on how the actual past performance impacts current or future bonuses to policyholders is often not disclosed regularly.

- <u>Revised benefit illustration</u>

[1] Under current Life Insurance Association (LIA) benefit illustration guidelines, life insurers are only required to show the effect of change in projected investment rate of return for par policies at one point in time. They will need to show the projected maturity value for an endowment policy, or surrender value at year 20 or age 65 (whichever is later) for a whole life policy, at LIA's maximum interest rate assumption plus 1.5%, and minus 1.5%.

Currently, there is no consistent industry practice to provide regular updates on the benefit illustrations to policyholders. As par policies are medium- to long-term financial contracts, overtime the sustainable future bonuses may deviate substantially from the bonuses presented in the benefit illustration at the point-of-sale.

It is therefore important for insurers to update their policyholders regularly with revised benefit illustrations so that policyholders will be able to revise their expectations accordingly and will not be caught unaware when the surrender or maturity payout turns out to be different from that in the initial benefit illustration.

Knowledge of financial adviser representatives

3.8 The workgroup is also of the view that financial adviser representatives should improve their understanding of par policies, given the complexity of par policies and the inadequacies identified in paragraphs 3.5 to 3.7. It is important for every financial adviser representative to have a good understanding of par policies so that they can better highlight the risks of par policies to their clients.

3.9 The next three sections set out details of the workgroup’s recommendations for each of the three areas: internal governance, the disclosure framework and training for financial adviser representatives.

4 ENHANCEMENTS TO INTERNAL GOVERNANCE

4.1 The workgroup proposes an enhanced governance framework to address the inadequacies identified in paragraph 3.6:

- Every life insurer writing par business should put in place an internal policy on par fund management, which must be approved by the Board.

  (i) The company should manage its par fund such that it complies with the rules and guiding principles set out in the policy.

  (ii) The internal policy should be reviewed regularly to ensure its relevance.

- The internal governance policy should cover the following areas:

  (i) <u>Introduction</u>
  Sets out the purpose of the internal governance policy and the roles of the Board, principal officer, senior management and appointed actuary in the par fund management.

  (ii) <u>Determining the amount payable under a par policy</u>
  Includes general items such as:
  - the key principles of par fund management (pooling of risks, smoothing of bonus payouts and exercise of discretion);

- the key factors affecting bonus payouts; and
- specific items such as how different types of bonuses are determined and how smoothing is carried out.

(iii) Investment strategy

Covers broadly:

- the investment objectives of the par fund;
- the broad asset mix;
- information on the fund managers ; and
- the life insurer's policy on using derivatives and alternative asset classes.

(iv) Risk management

Highlights the business risks that the par fund is subjected to and sets out how the life insurer manages and controls the risks. Examples of business risks include operational risk, expense risk, investment risk, reinsurance risk, new business risk and other risks.

(v) Charges and expenses

Describes the types of expenses that can be incurred by the par fund and the structure of charges for any outsourcing arrangement.

(vi) Circumstances under which to cease taking new business
States the circumstances[2] under which the par fund cannot take in new business and describes what happens under such circumstances.

(vii) Equity between par fund policyholders and shareholders
Describes the "90-10" rule to distribute par fund profit and the requirement for shareholders to meet the shortfall in the par fund.

(viii) Disclosure requirements
Sets out the disclosure requirements that the life insurer needs to comply with both at the point-of-sale and post-sales.

- Relevant information of the internal governance policy should be included in the product summary and disclosed to the policyholders in a manner that can be easily understood by a layperson.

4.2 More details on the internal governance policy can be found in **Annex 2**.

[2] Examples of these circumstances include lack of demand from consumers for the products (resulting in new business volume declining to a negligible level without any recovery prospect) and regulatory changes which significantly change the nature or profitability of the par business. Life insurer may also choose to stop writing new business for particular product groups when there is lack of demand, unacceptable terms to secure new business, or when a new product has replaced the current one.

5 ENHANCEMENTS TO DISCLOSURE FRAMEWORK

5.1 To address the inadequacies identified in paragraph 3.7, the workgroup proposes the following enhancements to the framework for information disclosure at the point-of-sale and on an ongoing basis to existing policyholders.

Point-of-sale disclosure

5.2 The workgroup proposes to retain the requirement to provide a copy of the product summary, benefit illustration and Policyholder's Guide to Life Insurance to policyholders at the point-of-sale. However, the following changes should be made to the product summary and benefit illustration to improve transparency, explain how the par fund is managed and how bonuses are determined, and highlight the volatility of non-guaranteed benefits:

(a) **Product summary for par policy**

The current scope needs to be expanded to include the following items in a manner consistent with the insurer's internal policy on par fund management set out in section 4 above:

<u>Risk profile</u>

- Briefly describe the product features of the par policy, including the split between guaranteed and non-guaranteed benefits;
- Briefly describe the key factors affecting future bonuses, such as mortality, morbidity, investment, expense, lapse and new business risks;

- Briefly describe the investment strategy including investment objective, broad investment mix and disclosure of relevant recent performance;
- Describe the charges and expenses allocated to the par policy as well as other charges incurred by the par fund;
- Briefly describe the use of market value reduction (MVR)[3] where applicable;
- State the risks of taking up a par policy under each component such as investment, mortality, morbidity, expense, lapse and new business.

Bonus policy

- Briefly describe the bonus policy, the different types of bonuses that may be paid, and the key principles in determining bonuses, for example, ensuring fairness, pooling of risks, smoothing of bonus payouts and exercise of discretion (corresponds to items 2.4 to 2.8 and 2.12 of the internal governance policy in Annex 2);
- Briefly describe how bonuses are determined, including the frequency and timing of bonus determination;

[3] Where specified in the life insurance contract, there may be a provision which allows a life insurer to apply a market value reduction (MVR) under certain conditions to reduce the surrender value of the policy. The intention is to ensure that the surrender value is not unfairly higher than the market value of the policy's assets, and a fair share is left for remaining policyholders.

Disclosure documents

- Briefly describe the documents that the life insurer needs to provide policyholders at both point-of-sale and after sales;

Other relevant information

- Outline the responsibilities with respect to the management of the par fund (including delegation of responsibilities) of the Board, Principal Officer, Senior Management and Appointed Actuary;
- State that valuation of par fund assets and liabilities are performed in accordance with the Insurance (Valuation and Capital) Regulations 2004;
- Describe any conflict of interest which may exist or may arise for the par fund and its management, and how these conflicts of interest will be resolved or mitigated;
- Describe any soft dollar commission or arrangements present in the par fund; and
- Disclose the names and addresses of the insurer and fund managers.

(b) **Point-of-sale benefit illustration**

The workgroup is of the view that the following changes to the basis and format of the benefit illustration could help improve overall clarity and better highlight the volatility of illustrated benefits:

Volatility of non-guaranteed benefits

- The benefit illustration should be prepared based on two different interest rate scenarios instead of primarily one scenario to better highlight potential volatility of the performance of the par fund;

- The higher gross interest rate used must not exceed the industry's best estimate rate and the lower gross interest rate should be set at 150 basis point below the higher rate;

- The two interest rates used must be highlighted clearly;

- Other assumptions used in the benefit illustration should not be more aggressive than the life insurers' best estimate assumptions. Where applicable, the best estimate assumptions should be consistent with those used in the latest audited year-end valuation.

Format and layout

- Illustrations of benefits should be shown for the first five years of the policy and for every five years thereafter, but in any event, should not exceed the later of 40 years of the term of the policy or age 65 of the policyholder;

- Total charges and distribution costs should also be shown. The "Effect of Deductions" column will be replaced by “Total Charges”, which includes the distribution costs.

5.3 A sample new format for point-of-sale benefit illustration is in **Annex 3**.

Post-sales disclosure

5.4 The workgroup is of the view that the current practice of only updating policyholders via an annual statement on bonus or dividend declared may not be adequate to manage policyholders’ expectations in the long term. The workgroup proposes that the following additional documents be given to existing policyholders annually:

(a) **<u>Report on the performance of par fund for previous year</u>**

Every life insurer writing par business should provide their par policyholders on an annual basis a summary report on the par fund’s performance in the preceding year.

The report should cover:

- the actual experience for key factors such as mortality, morbidity, investment, expense and lapse; and
- comments on the future outlook and its potential impact on future bonuses.

The report should be prepared with reference to information available in the annual audited returns for the par fund.

(b) **<u>Post-sales benefit illustration</u>**

Life insurers should also provide updated benefit illustrations to the existing policyholders annually to inform them of the latest illustrations based on the actual performance and revised future outlook. This will enable life insurers to better manage the policyholders' expectations over the term of their policies.

The post-sales benefit illustration should be prepared using a basis that is consistent with the one adopted for the annual audited returns.

6 TRAINING FOR FINANCIAL ADVISER REPRESENTATIVES

6.1 For most prospective buyers of par policies, exempt or licensed financial adviser (FA) representatives are usually their first point of contact instead of life insurers. As such, it is important that FA representatives selling par policies are adequately trained on the proposed enhancements so that they are able to provide well considered advice to their clients.

6.2 The training for the FA representatives should meet the following objectives:

- Appreciate the rationale behind the proposed changes to the governance and disclosure framework;
- Be aware of the introduction of a board-approved internal governance policy and the relevant information disclosed in the product summary for policyholders' benefits;
- Fully understand the new disclosure requirements at point-of-sale and post-sales under the proposed framework;
- Understand the new format of benefit illustration at point-of-sale and be able to highlight volatility to prospective policyholders;
- Understand the post-sales benefit illustration format and be able to explain to existing policyholders any departures from previous illustrations;
- Highlight the key concepts of a par policy (such as pooling of risks, smoothing of returns, and exercise of discretion) and the factors affecting the performance of the par fund; and

- Able to highlight the bonus determination process to a layperson.

6.3 Similar training should also be conducted for staff of life insurers involved in various aspects of par fund management to raise their overall competency to carry out the various functions.

7 NEXT PHASE

7.1 The workgroup proposes to implement the recommendations via a combination of MAS regulations and industry guidelines.

7.2 After the close of the consultation period for this paper, the workgroup will continue to work on the following:

- Review feedback from the public consultation and finalise the details for each recommendation; and
- Work with the Life Insurance Association to make necessary changes to the current industry guidelines.

7.3 MAS will issue a new notice on par fund management to set out the mandatory requirements.

Annex 1

Comparison of Regulations on Par Fund Controls

	Singapore	**UK**	**Australia**	**Canada**	**Hong Kong**
• Need to establish a par fund to maintain par policies separately from other insurance policies and shareholders' fund	Yes	Yes	Yes	No, but need to maintain a separate account for par policies	No
• Regulatory restriction on maximum transfer to shareholders from par business	Yes, 90-10 split of cost of bonus allocations between par policyholders and shareholders	None in the past; but currently under review	Yes, 80-20 split of cost of bonus allocations between par policyholders and shareholders	Varying percentages of profits distributed but not more than 10%	No restriction
• Explicit reserving for both guaranteed and non-guaranteed benefits	Yes	Yes, under the new rules	Yes	Yes	No
• Capital adequacy framework imposing explicit capital charges on asset, liability and mismatching risks	Yes	Yes	Yes	Yes	No

Annex 2

Layout and Content of the Policy on Management of Par Fund Business

The workgroup proposes that all life insurers writing par business have in place a board-approved policy on management of par fund business. The Board of Directors will be responsible to ensure that the par fund is managed according to the rules and guiding principles set out in the governance policy, which will be reviewed annually. The document should comprise of the following:

Section 1 – Introduction

1.1 State the purpose of the governance policy.
1.2 Briefly describe the par fund and types of business that can be written in it.
1.3 State the responsibilities (including delegations of responsibilities) of the Board, Principal Officer, Senior Management and Appointed Actuary.

Section 2 – Determining the Amount Payable under a Par Policy

2.1 Describe the guaranteed benefits payable.
2.2 Describe the non-guaranteed benefits payable and the types of bonuses (regular and terminal).
2.3 State the main objectives of bonus distribution principle.
2.4 Include a statement on fairness in treatment.
2.5 Explain the concept of pooling of risks.
2.6 Explain briefly what is smoothing and how it is done.
2.7 Describe the amount of discretion that management can exercise in declaring bonuses.
2.8 Describe the factors affecting bonus payouts (e.g. mortality, morbidity, investment, expense and lapse).
2.9 State the frequency and timing of bonus determination.
2.10 Explain how regular bonuses are determined.
2.11 Explain how terminal bonus rates are determined.
2.12 State the amount of discretion that can be exercised by the Board.
2.13 Explain the use of Market Value Reduction (MVR), if applicable.

2.14 State that bonus distribution is based on audited year-end valuation of par fund policy liabilities.

2.15 State that future bonuses are required to be explicitly reserved for in the valuation basis.

2.16 Set out broadly how reversionary bonuses and terminal bonuses are apportioned in the final payout.

2.17 Set the limits on the extent to which products of different classes and duration can be pooled together in bonus determination.

2.18 Define a bonus series – what constitutes a new bonus series.

Section 3 – Investment Strategy

3.1 State objectives of strategy.

3.2 State the broad asset mix.

3.3 State the fund managers.

3.4 State the roles of the Board and the Investment Committee.

3.5 State how frequently is the strategy reviewed.

3.6 State the method of deciding asset allocation and choice of duration (e.g. Asset Liability Modelling).

3.7 Describe the company's policy on using derivatives.

3.8 Describe the company's policy on making a loan to, or investment in any other Group Companies.

3.9 Describe the company's policy on new investments.

Section 4 – Risk Management

4.1 State the business risks that the Par Fund is subjected to.

4.2 Briefly describe how the life insurer manages and controls such risks.

4.3 State how regularly the risks are reviewed.

Section 5 – Charges and Expenses

5.1 Describe the expenses that can be allocated to and taken out from the Par Fund.

5.2 Describe the method used for expense allocation.

5.3 State how regularly a review of the fairness of expense allocation is done.

5.4 Mention any outsourcing arrangements and the structure of charges for such arrangements.

Section 6 – Circumstances under which to Cease Taking New Business

6.1 State the circumstances under which the fund will be closed to new business. Examples include lack of demand from consumers for the products (resulting in new business volume declining to a negligible level without any recovery prospect) and regulatory changes which significantly change the nature or profitability of the par business.

Life insurer may also choose to stop writing new business for particular product groups when there is lack of demand, unacceptable terms to secure new business, or when a new product has replaced the current products.

6.2 Describe what will happen upon the closure of the fund to new business.

Section 7 – Equity between Par Fund Policyholders and Shareholders

7.1 State the “90-10” rule of profit distribution.
7.2 Explain meaning/implication of “90-10” rule.
7.3 State that the shareholders are responsible for meeting any *shortfall* in the Par Fund.
7.4 Define what this shortfall is (i.e. meeting guaranteed benefits).

Section 8 – Disclosure Requirements

8.1 Highlight that the company needs to comply fully with the disclosure requirements to policyholders as set out in the regulations and industry guidelines (when these are made available).
8.2 State the mandatory items that need to be disclosed.

Annex 3

New Proposed Format for the Benefit Illustration at Point-of-Sale

XYZ Life Insurance Company

Proposed Insured:	Prospect
Age nb:	35
Sex:	M
Smoker/Non-smoker:	NS
Plan:	Regular Premium Endowment Plan
Sum Assured:	
Annual/Monthly Premium:	
Term:	20

Benefit Illustration

End of Policy Year/Age	Basic Premiums Paid (S$)	DEATH BENEFIT				
		Guaranteed (S$)	Non-guaranteed (S$)		Total (S$)	
			x%	y%	x%	y%
1/36						
2/37						
3/38						
4/39						
5/40						
10/45						
15/50						
20/55						

Page 1

End of Policy Year/Age	Basic Premiums Paid (S$)	SURRENDER VALUE				
		Guaranteed (S$)	Non-guaranteed (S$)		Total (S$)	
			x%	y%	x%	y%
1/36						
2/37						
3/38						
4/39						
5/40						
10/45						
15/50						
20/55						

		x%	y%
Maturity Benefit:	Guaranteed ($):		
	Non-guaranteed ($):		
	Total ($):		

Page 2

Note: The above benefit illustrations are based on projected investment returns of x% and y%. The two rates of return are used purely for illustrative purposes – the actual rate may be higher or lower, and are not guaranteed.

End of Policy Year/Age	Basic Premiums Paid (S$)	Total Distribution Cost (S$)	Total Charges (S$)
1/36			
2/37			
3/38			
4/39			
5/40			
10/45			
15/50			
20/55			

Page 3

<u>Other changes to the layout</u>

1. The “Effect of Deductions” column will be removed. This will be replaced by “Total Charges”, which includes the distribution costs, expenses, mortality and morbidity costs, surrender penalty, expected transfers to shareholders and expected tax payments.
2. The “Total Distribution Cost” will be shown alongside with “Total Charges”.