Adapting UK actuarial skills to the Polish market

For actuaries and product directors at UK life insurers taking savings products abroad: what UK actuarial practice brings to a new market, what has to change, and how a money-back guarantee reshaped a with-profits product for Poland.

IN BRIEF

The problem

A savings product designed around UK customers can miss what customers in another market most want protected, and how the people selling it expect to be paid.

Why it happens

UK actuarial methods travel well, which makes it easy to assume that the product design and its assumptions will travel with them.

What to do

Find out early what customers fear, price the guarantee that answers it before fixing the investment options, and design remuneration and surrender values together.

01

What travels, and what doesn't

A UK insurer taking a savings product into a new market brings its actuarial methods with it, and most of them work as well in Warsaw as in London. Profit testing, asset shares, bonus-setting and smoothing, surrender values and the market-consistent valuation of guarantees all carry over.

What doesn't travel is the set of assumptions built into a UK product: what customers most want protected, what they compare a savings policy with and how the people who sell it are paid. In Poland the first and the last were different, and the first shaped most of the rest. Briefing 1005 covers the launch itself; this one is about the product.

02

Fear of loss and the money-back guarantee

In my experience, customers in Poland, and the agents who sold to them, cared much more about getting back what they had paid in than about how much the policy might grow. Household savings point the same way: in the National Bank of Poland's 2016 household wealth survey, more than four in five households held bank deposits and about one in 25 held investment funds. A savings policy was competing with a deposit whose value doesn't fall.

The product was a conventional with-profits endowment: regular premiums, a guaranteed sum assured payable on death or at maturity, annual bonuses that are

guaranteed once added, and a final bonus at maturity. For Poland it had to be priced with a built-in money-back guarantee: at maturity the policy would pay at least the premiums paid.

A guarantee like that is a put option the insurer writes on the policy's share of the fund. Its cost depends on four things: the equity backing ratio (the proportion of the fund held in shares), the level of interest rates, the charges taken from the fund and the term. The table shows the effect of the first.

ILLUSTRATIVE EXAMPLE

What a money-back guarantee costs, by equity backing ratio

Equity backing ratio	Cost, % of premiums	Extra charge a year
25% (low)	1.0%	0.2%
50% (medium)	2.9%	0.7%
75% (high)	5.6%	1.5%

Illustrative assumptions: equal premiums at the start of each year for 10 years; at maturity the policy pays at least the total premiums; no deaths, lapses, expenses or commission; the fund stands for the policy's asset share, with no separate sum assured, bonuses or smoothing; shares and bonds rebalanced yearly; charges of 1.5% of the fund a year; market-consistent simulation with a constant 4% interest rate, share volatility 20%, bond volatility 5% and correlation 0.2. Cost: the guarantee's value as a share of the premiums' value. Extra charge: the annual charge whose value equals the guarantee's, allowing for its own effect on the fund. Not the basis of any real product.

At interest rates of 4%, the guarantee on the low option costs about 0.2% of the fund a year. On the high option it costs about 1.5% a year, enough to double the example's 1.5% charge. The cost also rises as rates fall: at 2%, the low option's guarantee would cost about 1.4% a year and the high option's about 4.2%.

UK with-profits practice already has the method: the realistic basis, which the Financial Services Authority (FSA) required of larger with-profits funds from 2004 until Solvency II replaced it in 2016, valued guarantees like this one as options on the fund's assets.

Bonus-setting needs the same care. Annual bonuses are guaranteed once added, so they become part of what the insurer has promised, whatever happens to the fund afterwards. With a money-back guarantee also in place, cautious annual bonuses and a larger final bonus keep the promises from running ahead of the fund.

03 Fewer options, each able to carry the guarantee

The original design offered three investment options, with low, medium and high equity backing ratios. The higher the ratio, the more the policy can grow, and the more the guarantee costs.

The cost of the money-back guarantee meant the high option went before launch. The product launched with two options: the low one, and the medium one relabelled as high. More than a decade on, the with-profits savings policies Prudential sells in

Poland still offer two investment profiles, and a guarantee that the premiums paid will be returned at maturity, now as an option.

The order of decisions is the lesson. The guarantee customers want sets how much of the fund can sit in shares at a charge they will accept, so price the guarantee before fixing the investment options. An option that can't carry the guarantee is easier to remove before launch than after, and fewer options are easier for an agent to explain well. Labels are relative to the range on offer, so when the range changes, check that the documents still say what each option holds.

04

Paying agents without undermining the guarantee

Remuneration worked differently in the two markets. In the UK, the Retail Distribution Review ended commission on advised investment sales from 31 December 2012, and at Prudential UK I updated the quote systems for it. In Poland, agents sold the product and its price had to fund their pay, which made remuneration part of the actuarial design. Three choices matter most:

- **How much.** The total the price can bear after the cost of the guarantee, within charges customers will accept.
- **When.** Paying most of it at the sale rewards the sale; spreading it over the premium-paying years, or paying more for policies still in force, rewards policies that stay.
- **What happens if a policy lapses early.** Commission clawed back from the agent, a lower surrender value for the customer, or a cost the insurer absorbs.

The last choice links back to fear of loss. Remuneration paid up front has to be recovered somewhere, often from early surrender values. A customer who bought the policy for its money-back promise and surrenders in the second year for much less than they paid has had the outcome they most feared. Design remuneration, surrender values and the illustration together, and if the guarantee applies only at maturity, say so plainly.

> FROM EXPERIENCE
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> As the actuarial product development lead at Prudential Polska, a start-up subsidiary in Warsaw, I designed the investment proposition, policy illustrations and bonus-setting methodology, and recommended the local pricing assumptions and agent remuneration. Fear of loss shaped the product, from the built-in money-back guarantee to the two investment options it launched with.
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> I came to it from Prudential UK, where I set bonuses, surrender and transfer values on conventional with-profits products and reported on the realistic basis, among others. Those methods worked as well in Warsaw as in London. What I had to learn locally was what customers wanted protected, and how the people selling to them expected to be paid.

Questions for the board

01 What do customers in this market most want protected, and how do we know?

02 What does each guarantee cost at today's interest rates, and at rates two points lower?

03 Which investment options can carry the guarantee at a charge customers will accept?

04 How are the people selling the product paid, and what does a customer get back if they surrender in the first two years?

05 Would a customer reading the illustration know when the guarantee applies and when it doesn't?

06 How much annual bonus can we add each year without the guaranteed benefits running ahead of the fund?

In Poland one cultural difference, fear of loss, decided the guarantee, and the guarantee then decided the investment options. A firm entering a new market can find its equivalent early, by asking local agents and a few customers what they most want protected, and pricing the answer before the rest of the design is fixed.

If this is on your table, a 30-minute conversation is usually enough to tell whether I can help.

Talk to Mark mark@markwoodruff.co.uk · 07391 820971 · markwoodruff.co.uk

ABOUT THE AUTHOR

Mark Woodruff is a Chartered Actuary (FIA) and Chartered Financial Planner (FPFS). He spent 15 years pricing and building products at Aviva, Prudential, Partnership and St. James's Place, then more than seven years founding and running advice firms through to a substantial sale. Through Mark Woodruff Consultancy he works with financial services firms on product, pricing, distribution and governance.

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