

**SUMMARY OF MY UNDERSTANDING OF THE WITH-PROFITS  
INDUSTRY WHEN I STARTED AS PA**

1. I of course accept that the existence of guarantees, which are a fundamental feature of with-profits insurance products, requires the fund to hold sufficient capital reserves (or to make suitable other arrangements) over and above the expected cost of guarantees to cover unexpectedly bad times. But I had assumed that such reserves needed to be at the level required for a fund's *existing* guarantees taking into account the level of risk in the assets backing those guarantees and the level of risk in the assets in the reserve itself; I had not expected that substantial amounts would be retained to provide a security buffer for possible future new business.
2. Of course, if the assets backing the guarantees were perfectly matched to the guarantee liabilities, there would be no need for additional reserves to cover bad times. It is clear that there is a decision to be made about the level of risk in the assets backing the expected cost of guarantees, and that the riskier these assets are, the greater the level of additional capital reserves required.
3. The cost of holding capital to cover the expected cost of guarantees, and the additional reserve to cover bad times at the level of risk chosen would be an integral part of the calculation undertaken in deciding if investments should be made in new business, and the assessment of whether new business was the best available investment for the capital in the fund.
4. Although an inherited estate has traditionally been used to mean all the surplus of assets over liabilities in a with-profits fund, I expected that the essential purpose of such an estate was to provide such a capital reserve on an ongoing basis to in-force business. I also presumed that the level of risk in the assets backing guarantees and in the estate would be set at a level which optimised the risk-adjusted reward for the fund with the purpose of maximising expected returns to current policyholders and shareholders.
5. As is clear, the reality of the operation and regulation of with-profits funds is quite different from my initial expectations.