# The Marketing Actuary's Response to PRS

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# Agenda

1. Background of PRS
2. Case for Deferred Annuity
3. Market Research
4. Some Product Designs
5. Other Considerations
6. Conclusions

# BACKGROUND OF PRS

# Economic Transformation Programme

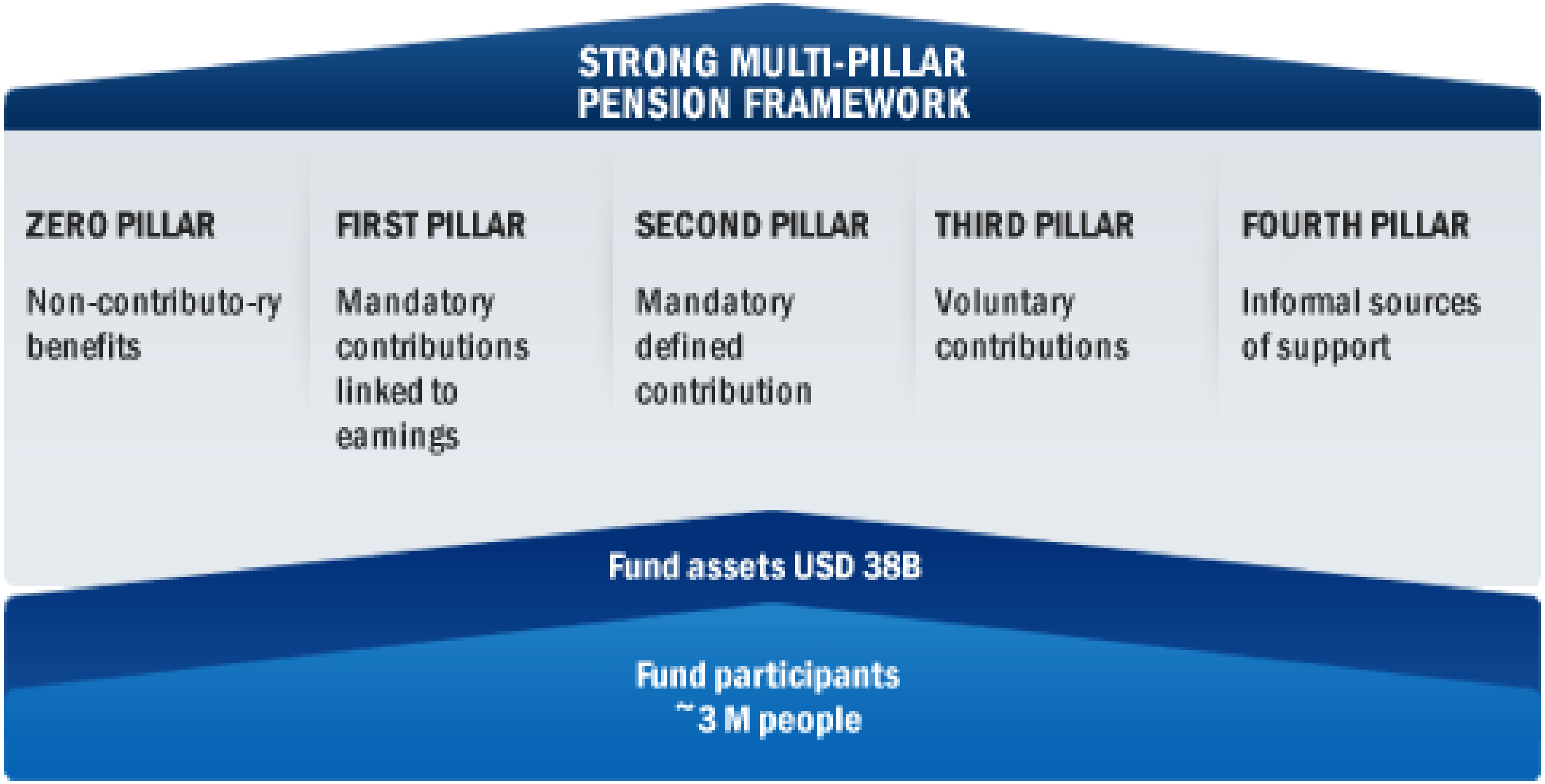
- In 2010, government set up PEMANDU to embark on ETP with the objective of transforming the country into a high-income nation by 2020
- 21 September 2010 – ETP open day
- 12 National Key Economic Areas (NKEAs) were identified
- 131 Entry Point Projects were unveiled
- Financial Services - EPP 6: Accelerating growth of the private pension industry

# Case for Change - PEMANDU

- 2 million self-employed not covered by EPF
- Most EPF members exhaust their lump sums within 3 to 5 years
- Aging population increases strain on the system

# Aspiration - PEMANDU

- Model pension system with vibrant private pension industry



# Recommendations - PEMANDU

1. Develop private pension funds to supplement existing public pensions
2. Provide incentives to rapidly build up critical mass in PPF industry
   - Employers' contributions >12% into PPFs with tax parity
   - Withdrawal from a/c I & II, tiered return >RM1 mil
   - EPF relief for self-employed
   - Tax exemption for PPF pension income
   - Additional RM6,000 tax relief for PPF
3. Improve education on importance of financial and retirement planning

# PRS Progress

- 18 July 2012 – PRS was launched by PM
- 31 October 2012 – Hwang Investment Management rolled out first PRS
- 10 November 2012 – CIMB Principal received approval to launch PRS
- 22 November 2012 – Manulife NESTEGG series
- 26 November 2012 – Public Mutual launched 6 PRS funds.

Source: actuaries.com.my/insurance-news

# CASE FOR DEFERRED ANNUITY

# Factors to Consider

- Market potential
- What consumers want
- What are the constraints
- What others are doing
- What are our choices
- Other considerations:
  - How to reach customers
  - Internal operations – underwriting, claims, finance, actuarial
  - Customer service
  - IT

# Market Potential

- 1.7 million tax payers in Malaysia
- Highest tax rate = 26%
- RM3,000 * 26% = RM780
- 1.7 million * 3,000 = RM5.1 billion per year?
- Areca Capital: RM600 mil
- CIMB Principal's target: RM2 bil in 5 years
- Hwang's target: RM100 mil in 3 years
- Manulife: RM18 bil, 1st yr: RM90 mil, 2nd & 3rd: RM200 mil
- Steve Ong: RM39 bil per year!

# What Consumers Want?

- Guaranteed income
- Lifetime income
- Indexed to inflation
- Lump sum on death
- Drawdown flexibility
- Portability

# What Concerns Insurers

- Investment
  - Duration mismatch
  - Guarantees are costly
  - No suitable assets – e.g. indexed bonds
- Mortality
  - Longevity risk
  - Anti-selection
- Anti-selection with too many options

# Market Research

- Unit Trust – “H” PRS
- Unit Trust – “C” PRS
- Insurer – “P” – SP & RP
- Insurer – “G” – Deferred Annuity

# “H” PRS

| Category | Features |
|---|---|
| Funds | Growth, Moderate, Conservative, Shariah Growth |
| Commission | Nil |
| Fund Management Charge | 1.8%, 1.5%, 1.3%, 1.8% |
| Trustee Fee | 0.04% p.a. |
| Switching | Free |
| PPA Admin Fee | 0.04% p.a. |
| PPA Account Opening Fee | RM10 (one-off) |
| PPA Annual Fee | RM8 p.a. |
| PPA Withdrawal Fee | RM25 per withdrawal |
| Transfer Fee | RM50 per transfer (PPA: RM25, Fund: RM25) |

# “H” PRS – Asset Allocation

| Fund | Equities | Fixed Income |
|---|---|---|
| Growth | 0 – 70% | 30 – 100% |
| Moderate | 0 – 60% | 40 – 100% |
| Conservative | 0 – 20% | 80 – 100% |
| Shariah Growth | 95 – 100% (feeder fund) | 0 – 5% |

# “C” PRS

| Category | Features |
|---|---|
| Funds | Growth, Moderate, Conservative, Equity, Asia Pac ex-Japan Equity. Both conventional and Islamic. |
| Commission | Class A – 3%, Class C – 0.5%, Class X – 0% |
| Fund Management Charge | Class A – 1.4%, Class C – 1.5%, Class X – 1.4% |
| Trustee Fee | 0.04% p.a. |
| Switching | Free, once per month. No switching between classes. |
| PPA Admin Fee | 0.04% p.a. |
| PPA Account Opening Fee | Classes A & C: RM10 (one-off), Class X: Waived |
| PPA Annual Fee | RM8 p.a. |
| PPA Withdrawal Fee | RM25 per withdrawal |
| Transfer Fee | Max RM100 per transfer (PPA: RM25, Fund: RM75) |

# "C" PRS – Asset Allocation

| Fund | Equities | Fixed Income |
|---|---|---|
| Growth | 0 – 70% | 30 – 100% |
| Moderate | 0 – 60% | 40 – 100% |
| Conservative | 0 – 20% | 80 – 100% |
| Equity | 70 – 99.8% | 0 – 0.2% |
| Asia Pac ex-Japan Equity | 95 – 100% (feeder fund) | 0 – 5% |

# “H” & “C” PRS - Summary

- No insurance cover
- No protection against longevity risk
- Upside potential
- No downside protection
- Choice of funds, with default selections
- Portable

# “P” Annuity

| Category | Single Premium | Regular Premium |
|---|---|---|
| Guarantee charge | 0.1% of unit value p.a. | 1% of premium (savings) |
| Fund Management Charge | Equity: 1.5%<br>Bond: 1.0%<br>Managed: 1.1% | Equity: 1.5%<br>Bond: 1.0%<br>Managed: 1.1% |
| Service charge | RM100 one-off | RM5-6 per month |
| Administration charge during payout | RM2 per month | RM2 per month |
| Processing Charge | RM25 per transaction | RM25 per transaction |
| Insurance Cover | 125% SP - annuity | Max (o/s annuity, value of units) |

# “P” Annuity – Asset Allocation

| Years before Payout | Equities | Fixed Income |
|---|---|---|
| <= 0 | 20% | 80% |
| 1 - 5 | 25% | 75% |
| 6 - 10 | 30% | 70% |
| 11 - 15 | 35% | 65% |
| 16 - 20 | 40% | 60% |
| 21 – 25 | 45% | 55% |
| 26 – 30 | 50% | 50% |
| 31 – 35 | 55% | 45% |
| 36 – 40 | 60% | 40% |
| 41 – 45 | 65% | 35% |
| > 45 | 70% | 30% |

# “P” Annuity – Guaranteed Income (RP)

| Payout Period | 10 | 15 | 20 | 25 | 30 | 35 |
|---|---|---|---|---|---|---|
| Guaranteed Income | 10.80% | 7.45% | 5.80% | 4.80% | 4.15% | 3.65% |

# “P” Annuity – Guaranteed Income (SP)

| | Payout Period | | | |
|---|---|---|---|---|
| Accumulation Period | 15 | 20 | 25 | 30 |
| 5 | 7.00% | 5.65% | 4.70% | 4.10% |
| 10 | 8.00% | 6.25% | 5.20% | 4.50% |
| 15 | 9.00% | 7.00% | 5.80% | 5.00% |
| 20 | 10.00% | 7.75% | 6.40% | 5.50% |
| 25 | 10.70% | 8.25% | 6.80% | 5.85% |
| 30 | 11.35% | 8.75% | 7.20% | 6.20% |
| 35 | 12.35% | 9.50% | 7.80% | |
| 40 | 13.35% | 10.25% | | |

# "P" Annuity – Guaranteed Yield

| | Payout Period | | | |
|---|---|---|---|---|
| Accumulation Period | 15 | 20 | 25 | 30 |
| 5 | 0.40% | 0.83% | 0.95% | 1.07% |
| 10 | 1.06% | 1.14% | 1.20% | 1.24% |
| 15 | 1.36% | 1.37% | 1.38% | 1.39% |
| 20 | 1.50% | 1.49% | 1.48% | 1.47% |
| 25 | 1.48% | 1.46% | 1.44% | 1.44% |
| 30 | 1.44% | 1.42% | 1.41% | 1.41% |
| 35 | 1.47% | 1.45% | 1.43% | |
| 40 | 1.48% | 1.46% | | |

# “P” Annuity - Summary

- No protection on longevity risk
- Small investment guarantee (<1.5%)
- Potential upside gain
- Not losing out if dying too early
- Small insurance cover throughout the life of the policy
- Pre-determined choice of funds
- Not portable

# “G” Deferred Annuity

- Non-par
- Retirement age: 55 or 60
- Premium payment term: 10 years
- Annuity payment period: 15 or 10 years
- Death, TPD, CI – cash value
- No medical underwriting

# “G” Deferred Annuity - Yield

- Age 35, pays RM3,000 for 10 years
- Receives RM65,475 in 15 equal instalments from age 55

$$3000\ddot{a}_{\overline{10|}} = \frac{65{,}475}{15} v^{20} \ddot{a}_{\overline{15|}}$$

- Guaranteed yield: 3.56%
- At highest marginal tax rate of 26%, yield: 4.98%
- EPF: 2.5% minimum guarantee, 4.25% - 6% in last 10 years
- Maybank: 3.8%, 60-month FD

# "G" Deferred Annuity - Summary

- No protection on longevity risk
- Moderate investment guarantee (3.56% - 4.98%)
- No potential upside gain
- Not losing out if dying too early
- No insurance cover throughout the life of the policy
- No choice of funds
- Not portable

# Requirements under Deferred Annuity Guidelines

- Annuity (yearly or more frequent) from age 55 or retirement age
- Paid until age 70 or at least for 10 years, whichever is later
- Definition of Insurance under FRS 4
- AP/SP, traditional/ILP, basic/rider, immediate/deferred
- Annuity (>=50%) and Non-Annuity Premiums
- Commission: 3%, ARE: 0.5%
- Minimum Retention Amount (MRA = AAP x MRF)
- Full surrender at any time subject to tax clawback

# PRS vs Deferred Annuity

| | PRS | Deferred Annuity |
|---|---|---|
| Early Withdrawal | Only sub-account B (30%) | Partial and full withdrawal |
| Tax Penalty | 8% on withdrawal amount | 8% of accumulated tax reliefs |
| Retirement Age | Prevailing retirement age | Locked in at inception |
| Withdrawal Frequency | Once a year | Unlimited |
| Portability | Portable | Not portable |
| Costs | Other ancillary charges (e.g. PPA) | No such charges |

# SOME PRODUCT DESIGNS

# dAnnuity 1

- A product to mimic PRS – if you can't beat them, join them!
- Recurring single premium ILP:
  - Maturity age at 55 (2012) or 60 (2013 and beyond)
  - At maturity age, equal drawdown of units over 15 or 10 years
  - On death, cash out units plus x% (e.g. 10%) of total premiums paid
  - Monthly mortality charge based on attained age and sum at risk
- Advantages:
  - No investment risk
  - Manageable mortality risk
  - No longevity risk
  - Easy to implement / fast to launch

# dAnnuity 1

- Why would consumers buy?
  - Tax relief
  - Some death benefit (with no underwriting?)
  - Provide some sort of discipline in drawing down retirement fund
  - Smooth out investment volatility over longer term
  - Some sort of hedge against inflation risk
- Needs not met:
  - Longevity protection
  - Investment guarantee
  - Not much of inflation hedge
  - Can't take lump sum

# dAnnuity 2

- Reward those survive by enhancing the retirement income
- “Penalise” those who die too early
- Example:
  - Retirement age: 60
  - Annuity payable until age 70
  - Units accumulated at age 60 is 1,000
  - Receive 1,050 units each year if survive, forfeit all units if die
- Advantages:
  - Enhanced annuity payment
  - Compensate for no lump sum at retirement

# dAnnuity 2

- Disadvantages:
  - Painful for those who die too early
  - Company takes on some longevity risk
  - Only slight improvement in annuity amount

# dAnnuity 2L & 2LS

- Extend annuity payment period to age 100
- Advantage:
  - Fairly good longevity protection
  - Longevity risk manageable
  - Even longer investment horizon
- Disadvantage: too painful to die early
- dAnnuity 2LS
- On death before age 100, forfeit x% of future units

# dAnnuity 2LS

- Needs not met:
  - No lifetime guarantee
  - Not inflation hedged
  - Not portable

# dAnnuity 3G & 3GS

- Provides investment guarantee as well!
- Method 1:
  - Use some sort of structured note to lock in investment guarantee
  - May need to roll over the structured note periodically
- Disadvantages:
  - Lower upside gain
  - Guarantee may be only for a short period, new lock-in guarantee depends on prevailing rate
- Method 2:
  - Variable annuity – GMIB, GMAB

# dAnnuity 3G & 3GS

- Disadvantages
  - Complex
  - Lack of matching assets
  - Some got burned
- Method 3
  - Dynamic hedging using ALM
- Advantage:
  - Wider choice of assets
- Disadvantages:
  - Complex
  - Company takes on more investment risk

# Other Considerations

- Distribution channel:
  - Low commissions: 3% +0.5% ARE
  - Bancassurance
  - Agency
  - Seminar selling
  - Worksite marketing
  - Internet
- Traditional annuity?

# Conclusion

- PRS is practically just another type of unit trust.
- Does not address longevity risk.
- Not likely to have investment guarantee.
- Can tap into the additional 7% employer contributions.

- Many ways to structure annuity product.
- Advantage of longer investment horizon.
- Investment guarantee may not be that costly.
- Longevity risk can be manageable, good hedge to mortality risk.
- Preference for lump sum may disadvantage insurer.
- Portability

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