

2020 PwC with-profits survey

Summary report
October 2020





Participants

We would like to express our thanks to the following firms who took part in our 2020 survey:

- Aegon UK
- Aviva Plc
- Chesnara Plc
- Forester Life Limited
- Legal & General Assurance Society Limited
- Liverpool Victoria Financial Services Limited
- Lloyds Banking Group Plc
- M&G Prudential Services Limited
- The National Farmers' Union Mutual Insurance Society Limited
- Phoenix Group
- Police Mutual Assurance Society Limited
- ReAssure Limited
- The Royal London Mutual Insurance Society Limited
- Scottish Friendly Assurance Society Limited
- Sun Life Assurance Company of Canada (U.K.) Limited
- Utmost Life and Pensions Limited
- Wesleyan Assurance Society
- Zurich Assurance Limited

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Introduction

Welcome to the 2020 PwC with-profits survey. This year we have covered a wide range of topics:

- **With-profits modelling and goneaways:** Stress and scenario testing, modelling of management actions; and goneaways

One of themes from the 2019 FCA thematic review of the fair treatment of with-profits customers (TR19/3) was the use of stress and scenario testing within run-off plans. Our survey shows many companies have developed the depth of their stress and scenario testing following the review, though there are still a wide range of approaches and a focus on market risk factors.

Our results show a range of approaches are taken for management actions, with the most common actions covering: changing terminal bonus rates; applying market value reductions ('MVRs'); changing regular bonus rates; and de-risking the investment strategy.

The issue of goneaways, where there is a lack of contact between policyholders and the life office continues to be significant for many with-profits funds. Our deep dive into goneaways shows common tools for tracing customers – the use of external parties and national databases, with over 50% of participants using these. The continued challenge for the industry is the cost benefit from performing these activities, where only a proportion of customers are re-engaged and ultimately reconnected with their money.

- **Information to inform the assessment of value for money in with-profits funds:** Charges, expenses, investment returns, and policy payouts

Acknowledging that there is no standard approach for assessing the value of with-profits policies, we have included a range of measures for companies to consider, including charges, expenses and investment returns.

Policy payouts used to be commonly shared in the public domain and we have been able to gather sufficient data for comparisons for endowments, whole of life, unitised pensions and bonds. This data will help companies when assessing the value of their with-profit funds.

- **Hot topics, relevant to both with-profits and the wider business:** ESG and climate change, vulnerable customers; the financial impact from COVID-19

The management of with-profits business is being increasingly impacted by wider focus areas across the business, including Environmental, Social and Governance (ESG) policies and we have explored the impact on with-profits management. This year's survey is framed by the unprecedented impacts of the ongoing COVID-19 pandemic, and the associated volatility this has generated within the financial markets. This has impacted with-profits firms, but also presents opportunities to highlight to customers that many with-profits contracts have valuable features, such as smoothing and guarantees, which protect them from this volatility. Our market observations show with-profits funds have fared well during the pandemic, with equity hedges in particular providing protection.

While the survey has been completed primarily by people responsible for day to day management of with-profits business, the output from the survey is relevant for everyone focused on the strategy and value of running with-profits business.

Our thanks go to the firms which took part for kindly sharing their time and their insights. We hope you find the report useful and look forward to engaging in discussions with you about the themes emerging.

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Use of report

Purpose and use of report

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1

Responses disclosed

In some areas, not all 18 participants responded to the questions asked. This will have been for various reasons, e.g. where data was unavailable in the format requested. In these instances, the total number of responses is less than 18; however we have ensured that results disclosed in this report are always from a sufficiently credible set of responses. Where we have received an insufficient number of responses to meet this objective, we have refrained from disclosing quantitative results.

2

Technical actuarial standards

The Financial Reporting Council ('FRC') requires actuaries to comply with Technical Actuarial Standards ('TASs') for various types of actuarial work. We also believe that it is normally appropriate to apply the requirements of the TASs to other work conducted by actuaries. Given the nature of the work, however, we have not attempted to follow the requirements of the TASs on this assignment. You will need to consider the impact of this limitation on your interpretation of our work and results.

3

The report should be read in its entirety; reading individual sections in isolation may result in misinterpretation. The report contains information obtained from survey participants. We have not sought to establish the reliability of the information or otherwise verify the information so provided. Accordingly no representation or warranty of any kind (whether express or implied) is given by PwC to any person as to the accuracy or completeness of the report.

Hot topics

ESG Considerations

While Environmental, Social, and Governance (ESG) policies are generally set at a firmwide level, there has been an increasing focus on the role of specific governance bodies. The FCA's Policy Statement 19/30¹ on the scope of Independent Governance Committees includes requirements for consideration of ESG risks and consumer concerns, and explicitly states that unit-linked and with-profits products are in scope of the guidance.

We asked participants to what extent their with-profits strategy is impacted by ESG considerations. The most common approach is an engagement strategy, making active use of proxy voting and/or interacting with company management on ESG issues. A small number of firms indicated a more nuanced approach, using either screening (selecting investments based on ESG criteria, for example within a certain sector) or an exclusionary approach, while others indicated they defer to their investment managers' approaches.

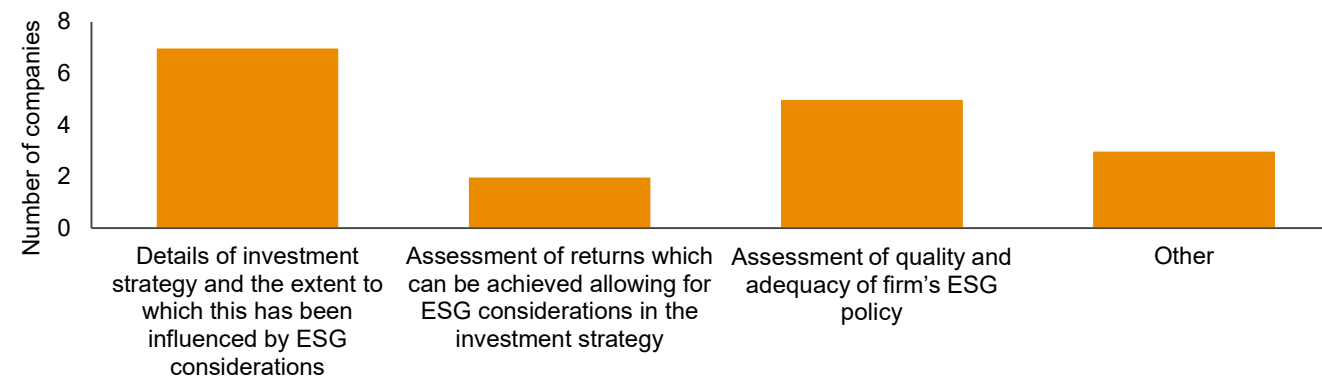
With the exception of one participant, the approach for ESG and climate change related regulation does not differ for with-profits funds compared to other investments made on behalf of policyholders. While this is not surprising, depending on the maturity of the fund and the volume of new business still being written, there is arguably an opportunity for with-profits funds to use their investment discretion to make a positive impact on ESG issues and meet the emerging regulatory guidance by 2021.

ESG considerations are already being used in consumer advertising campaigns by large asset managers and are likely to become an increasing area of focus for customers.

We also asked participants what information had been provided to their With-Profits Committee (or With-Profits Advisory Arrangement) in the last 12 months in respect of ESG considerations, with the responses set out to the right.

Over half of participants indicated that they had provided details of the with-profits investment strategy and the extent to which this has been influenced by ESG considerations, and a further five indicated they had provided an assessment of the quality and adequacy of the firm's ESG policy, as required by PS 19/30. The most common 'other' information provided was an update on the Shareholder Rights Directive II initiative, which came into effect in June 2019 and focuses on improved disclosures of investments and engagement strategies, including ESG related issues.

Figure 2.1: In the last 12 months, what information has been provided to the WPC/WPAA in respect of ESG considerations?



¹ <https://www.fca.org.uk/publication/policy/ps19-30.pdf>

Hot topics

Vulnerable customers

FCA Guidance Consultation 19/03², on the fair treatment of vulnerable customers, was published in July 2019, aiming to ensure consistency of outcomes for vulnerable consumers and embedding doing the right thing for these customers in the culture of firms. Due to COVID-19 the subsequent policy statement has been deferred until later in 2020, however the pandemic has drawn a strong focus on vulnerability. Indeed, a second draft of the Guidance Consultation³ was published on 29 July 2020, remaining similar to the first in structure but setting out a more detailed description of actions firms are expected to take.

A significant majority of participants have a process in place to identify vulnerable customers in their with-profits funds, with most firms marking this on their customer records. A number of participants also noted that although not formally recorded, indicators of potential vulnerability forms part of the training provided to customer services teams.

The FCA guidance consultation 19/03 describes vulnerable and potentially vulnerable customers separately, but very few participants indicated that they identify customers separately in this way. However, in the revised July 2020 guidance consultation the FCA has moved from distinct groups and is proposing that vulnerability is considered as a 'spectrum of risk', where firms should do most for those at greatest risk of harm.

Supporting vulnerable customers

As illustrated in Figure 2.2, where a customer has been identified as vulnerable, all participants who completed this section noted that they have processes in place to provide additional support. 'Other' support mechanisms include vulnerable customer champions, signposting of additional help/support services and adapted written communications, e.g. Braille and large print options.

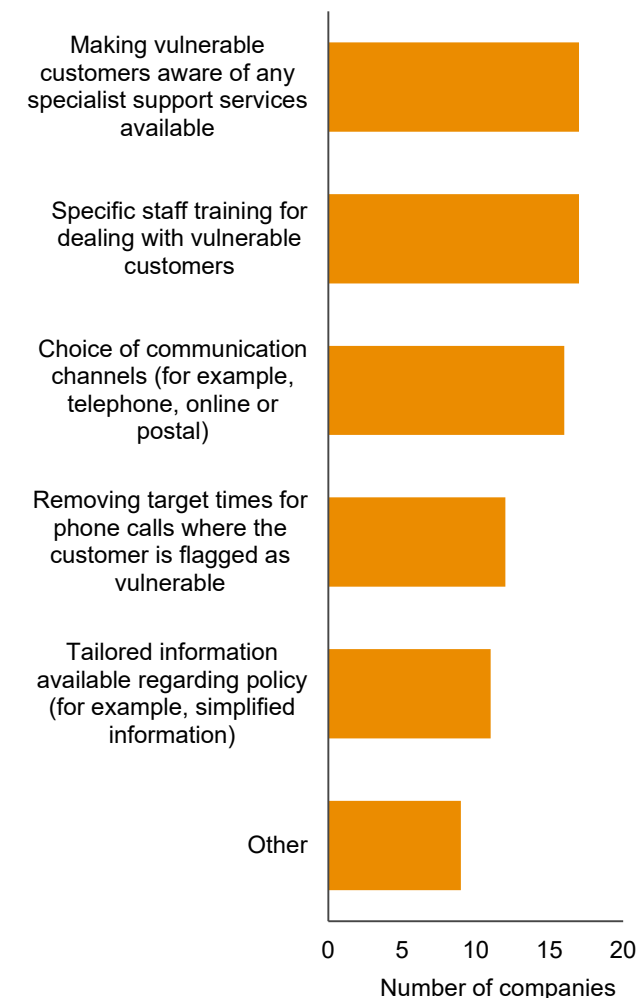
Vulnerable customers management information

Broadly, participants are equally divided as to whether they produce management information (MI) relating to outcomes for vulnerable customers. A number of firms indicated that while they don't produce MI specifically relating to outcomes for vulnerable customers, they record items such as the number of customers logged as vulnerable or the proportion of calls received from vulnerable customers. Several participants noted that outcomes for vulnerable customers are monitored on a company wide basis rather than specifically for with-profits customers.

² <https://www.fca.org.uk/publication/guidance-consultation/gc19-03.pdf>

³ <https://www.fca.org.uk/publication/guidance-consultation/gc20-03.pdf>

Figure 2.2: What processes are in place for supporting policyholders identified as vulnerable?



Hot topics

Response to COVID-19

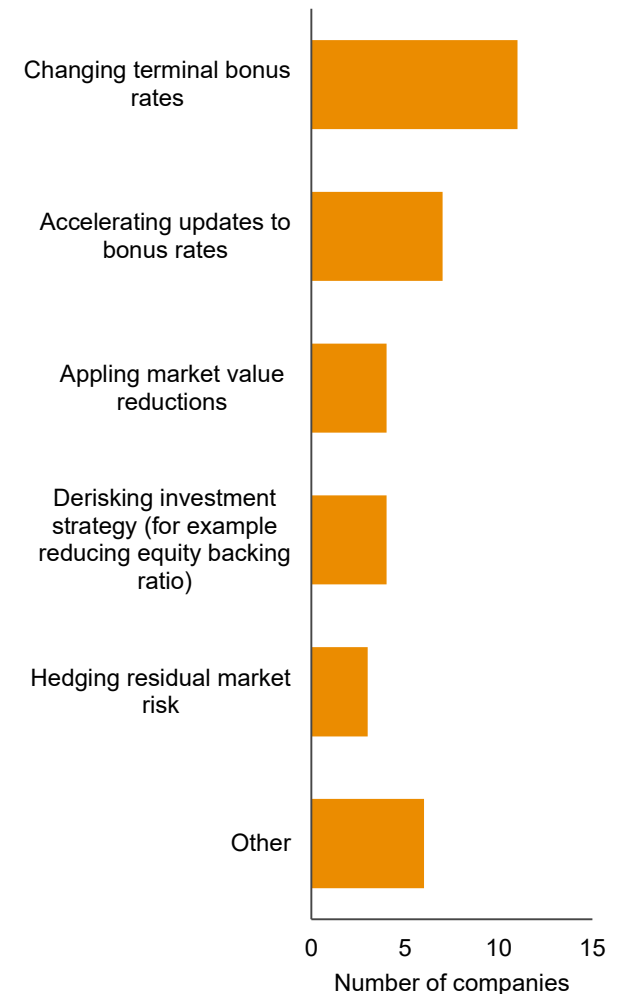
Since the beginning of 2020, significant volatility has been observed in global public equity markets – the level of volatility in equity markets around the world has surpassed levels experienced at the start of the 2008 financial crisis. Global stock markets turned ‘bearish’ over the first quarter of the year, with a decline in major equity indices between c.20%-30% from 1 January 2020 to 31 March 2020. While markets began to recover in the second quarter, the solvency position and management actions applied to with-profits funds in the first quarter were an area of focus for both management and the regulator, with the FCA writing to all With Profits Actuaries at the end of March on this topic. Overall the findings in this section support our market observation that with-profits funds have generally fared well during the pandemic, with equity hedges in particular providing protection.

We asked participants to identify any management actions applied in response to COVID-19 and the answers are summarised in Figure 2.3. Unsurprisingly, the most common actions implemented by participants were changes to terminal bonus rates and/or acceleration of updates to bonus rates.

While only four participants noted they had de-risked their investment strategy in response to market volatility, a number of others noted that their equity backing ratios had fallen over the period due to market fluctuations and had not been actively rebalanced. In some instances there was also loosening of asset allocation tolerances, to avoid excessive trading in turbulent markets. The ‘other’ management actions applied in response to COVID-19 experience related to smoothing, premium holidays and frequency of updates to hedging.

There were a number of options that were not selected by any of the participants: clawback of estate or surplus distributions; implementing reinsurance; changing fund charges; and changing guarantee deductions.

Figure 2.3: Which of the following management actions have been applied in response to recent experience caused by COVID-19?



With-profits modelling

Management actions

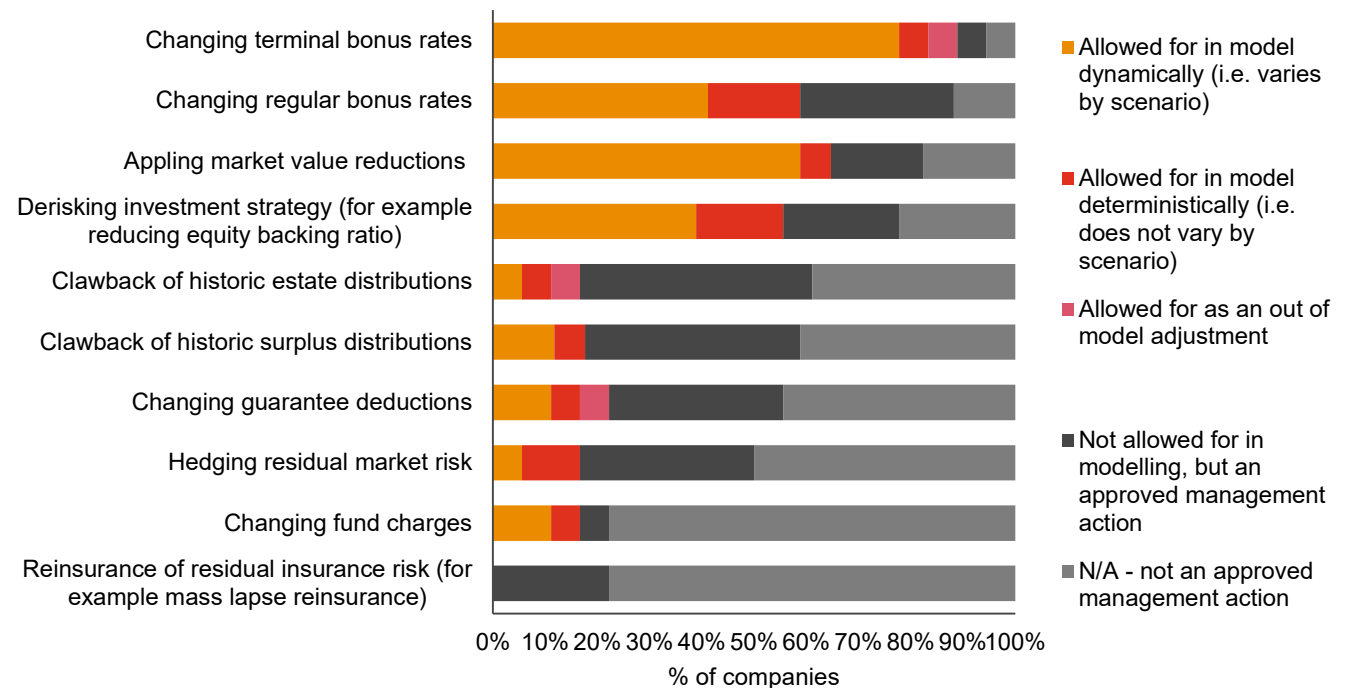
Modelling of management actions is an area where we observe differences in approach across the industry, both to the range of management actions included in the base liability model and the modelling approach, which can vary from an out of model adjustment to dynamic modelling. Where we refer to management actions that are allowed for 'dynamically' we mean management actions that are only applied at certain points in the projection and in certain scenarios, for example depending on the financial position of the fund within that scenario at that point in time.

We asked participants to explain how various management actions are treated within their base liability modelling and the results are illustrated in Figure 3.1. The results show that management actions are more commonly reflected dynamically than deterministically; and that application in the base liability model as an out of model adjustment is relatively unusual.

The management actions most commonly reflected in the base model are: changing terminal bonus rates; applying market value reductions ('MVRs'); changing regular bonus rates; and de-risking the investment strategy.

A number of firms indicated that they have pre-approved actions which are not reflected in the base liability model, with the most common actions being: clawback of historic surplus and estate distributions; hedging residual market risk; and changing guarantee deductions. This may suggest that the actual value of management actions (in Solvency II terminology 'loss absorbing capacity of technical provisions') for these firms is higher than reflected in the model, however we note several participants indicated these management actions are reflected in the Solvency Capital Requirement calculation.

Figure 3.1: How are the following management actions treated within the base liability model?



With-profits modelling

Run-off plans

The use of run-off plans to inform management decisions was identified as a general weakness in the 2019 FCA thematic review of the fair treatment of with-profits customers (TR19/3), with an emphasis on the importance of run-off plans to ensure a fair distribution through an understanding of the associated risks. One specific weakness highlighted in the thematic review was the lack of scenario analysis within run-off plans.

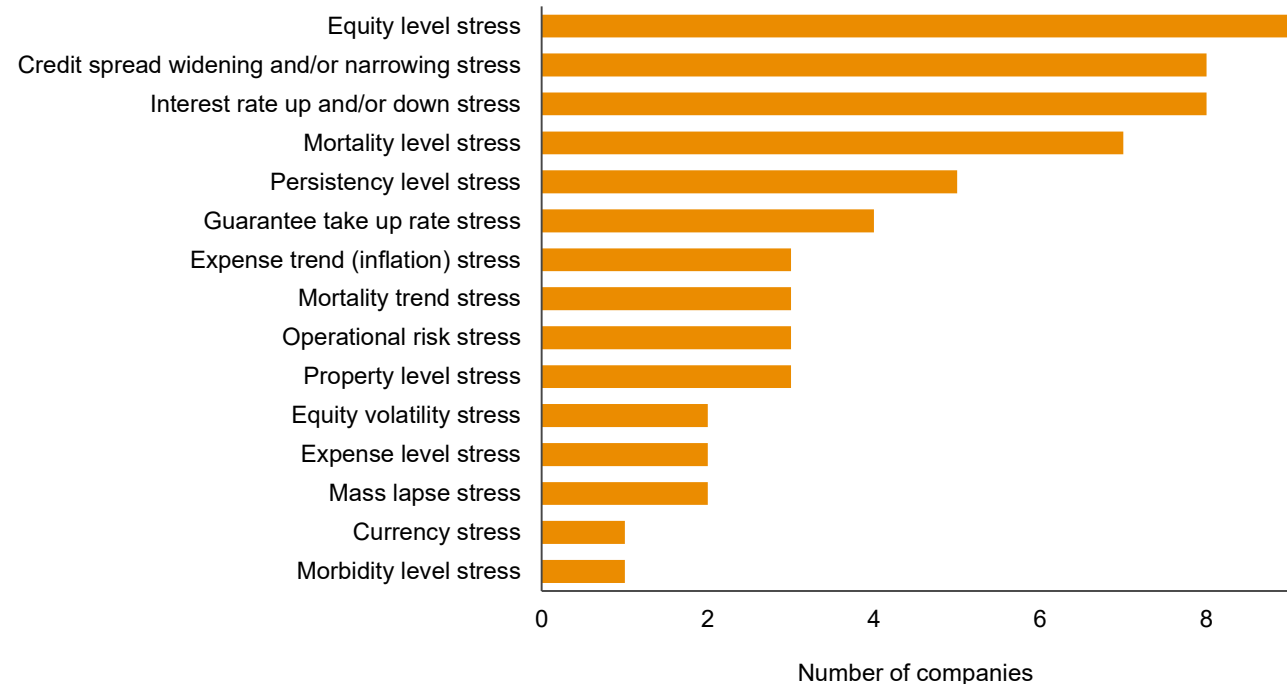
Stress testing within run-off plans

We asked participants to identify which stresses are included as part of the run-off plan and received responses from sixteen participants. The responses are illustrated in Figure 3.2. Market stresses covered the top three answers: equity level; credit spread and interest rate stresses. None of our participants indicated that they use an interest rate volatility stress in their run-off plan, perhaps as this risk is typically hedged.

Scenario testing within run-off plans

We also asked participants to indicate which (if any) scenarios are included as part of the run-off plan. For the participants who use scenario analysis, as with single stresses, market risk scenarios are the most common. Only a small number of participants indicated that they include their ORSA scenarios in the run-off plan, though we are aware that a number of firms cross reference their ORSA within the run-off plan. One participant includes a combined market and demographic scenario in their run-off plan, a scenario that has gained additional focus given the COVID-19 crisis.

Figure 3.2: Which stresses are included as part of the run-off plan?



Value for money

From discussions across the market we acknowledge that there is no standard approach for assessing the value of with-profits policies. Historically, benchmarking of annual payouts has been used to compare performance of with-profits policies, however since PRA returns were replaced by Solvency II reporting this information is no longer available in the public domain. Over time the focus of the industry and regulator has moved to looking at charges to customers, however this measure appears more appropriate for comparing similar unit linked style investments. Closely linked to the value for money discussion is the cost of administering policies; operational efficiencies and managing the risk of excess expenses are key drivers of value, especially for funds in advanced run-off. When responding to this section we asked participants to consider their most significant with-profits fund.

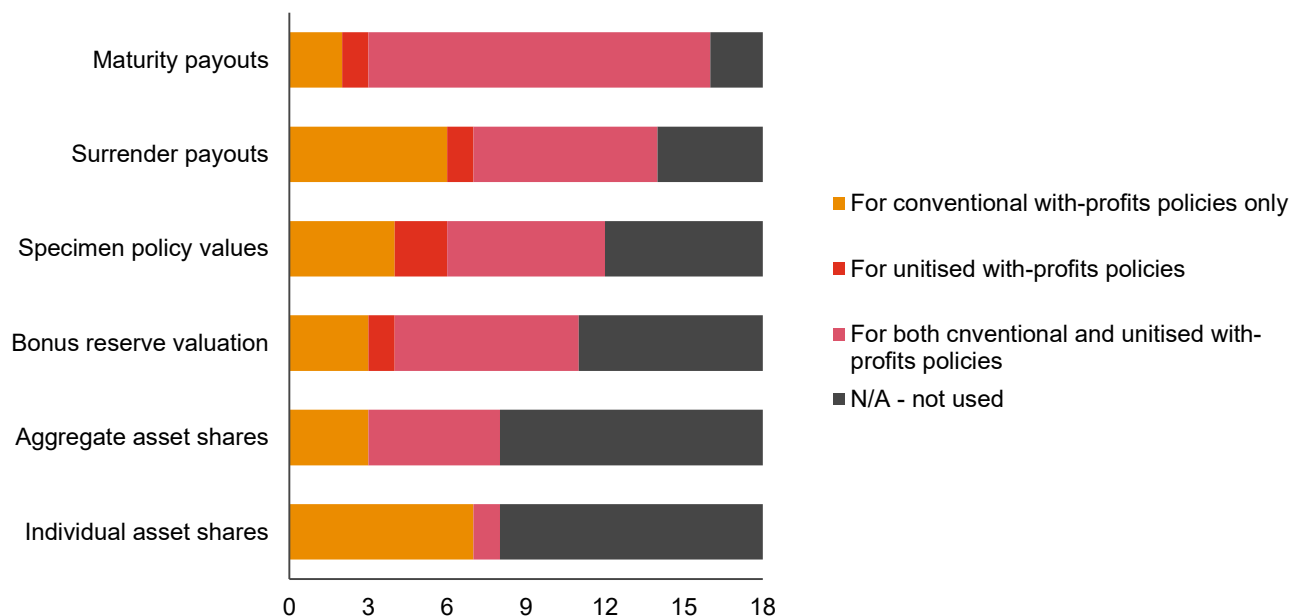
Assessing policy values

We asked participants to identify the techniques used in assessing policy values for either reserving, bonus setting or other payout purposes. As shown in Figure 4.1, individual asset shares are the most commonly used measure of with-profits policy value. Maturity and surrender payouts and specimen policy values are also commonly used, with some participants indicating these were used as part of bonus setting and monitoring target payout ranges.

In measuring with-profits BEL, participants indicated over 98% of with-profits benefit reserves (WPBR) are calculated using an asset share approach. For the majority of with-profits funds, a prospective approach (i.e. a bonus reserve valuation) is not used. Where a prospective approach is used, it is most often for small blocks of liabilities (up to 25% of the WPBR). However, three relatively small funds indicated a prospective approach was used for the entirety of the WPBR for those funds⁴.

⁴ Calculated from ratio of R0020 to R0010 in NSR.02.01.01.01

Figure 4.1: Which of the following techniques are used to assess policy values (for either reserving, bonus-setting or other payout purposes)



Value for money (cont'd)

From discussions across the market we acknowledge that there is no standard approach for assessing the value of with-profits policies. Historically, benchmarking of annual payouts has been used to compare performance of with-profits policies, however since PRA returns were replaced by Solvency II reporting this information is no longer available in the public domain. Over time the focus of the industry and regulator has moved to looking at charges to customers, however this measure appears more appropriate for comparing similar unit linked style investments. Closely linked to the value for money discussion is the cost of administering policies; operational efficiencies and managing the risk of excess expenses are key drivers of value, especially for funds in advanced run-off. When responding to this section we asked participants to consider their most significant with-profits fund.

Charges and expenses

Figure 4.2 shows expense and annual management charges have a wide spread, up to 1.5%, with one participant charging over 2%. When responding to this question, participants have used best endeavours to provide results on a consistent basis; this can be challenging, for example where expense are charged on a per policy basis.

Figure 4.2: What are the current levels of expense charge or annual management charge, expressed as an annual percentage of fund (i.e. deduction to investment return)?

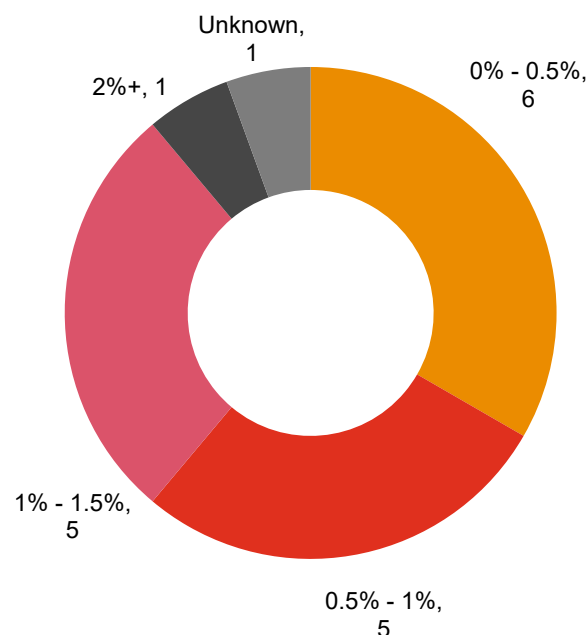
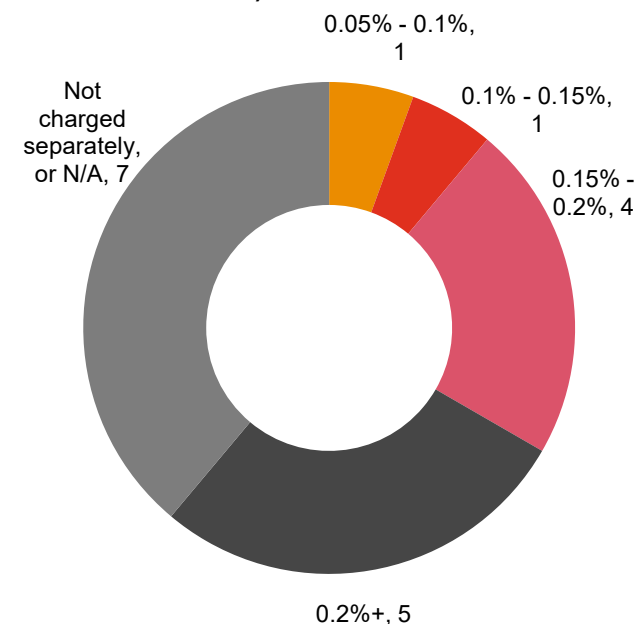


Figure 4.3 shows investment management charges for half of participants are above 0.15% and half are below this. Over a third of firms indicated that separate investment management charges are not charged. Further, one participant indicated an investment management charge covers a platform fee to access investments within its with-profits fund.

Figure 4.3: What are the current levels of investment management charge, expressed as an annual percentage of fund (i.e. deduction to investment return)?



Value for money (cont'd)

Disclosure of charges and expenses

One of the outcomes from the 2016 FCA thematic review of the fair treatment of long-standing customers in the life insurance sector (TR16/2) was a recommendation about disclosing expenses to with-profits customers. The majority of participants changed their approach to disclosing expenses as a result of this.

We also asked what proportion of with-profits policyholders receive information about the cost of expenses. While 8 respondents disclose to 81-100% of their population, another 6 indicated that they disclose expenses to 40% or fewer of their population of policyholders. There will be a number of reasons why policyholders do not receive information about the cost of expenses, including:

- Policyholders do not receive statements, or statements including detailed disclosures, due to their size or legacy status e.g. industrial branch policies;
- Charges are taken to cover the cost of administering policies and therefore the cost is not relevant; and
- Expense disclosures are being developed for some types of conventional policies.

Cost of smoothing

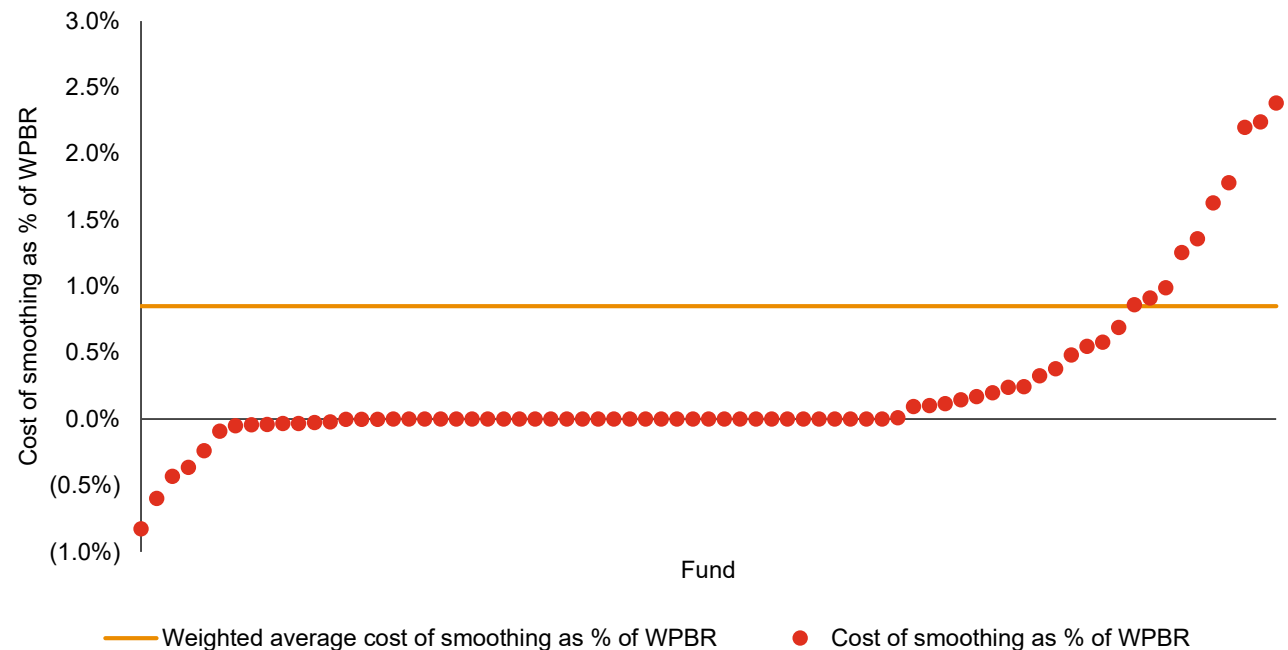
Figure 4.4 shows the cost of smoothing as a proportion of the WPBR for each fund at the 31st December 2019⁵. Whilst the median level of cost of smoothing is 0% of the WPBR, the weighted average is 0.9%. This suggests that the majority of with-profits funds expect to recycle both smoothing profits and losses directly back policyholders. Further, for funds where this proportion is higher, this suggests some of the losses will not be able to be directly passed back to policyholders.

⁵ Calculated from ratio of R0100 to R0010 in NSR.02.01.01.01

Charges for Guarantees

Two thirds of participants apply a 0% guarantee charge to the most significant with-profits funds within the organisation. However, where guarantee charges are applied, these are either 0.5% or 0.75%, and most often the same percentage charge is applied for all policies.

Figure 4.4: Cost of smoothing by fund



Projected payouts

Historically, benchmarking of annual payouts has been used to compare performance of with-profits policies, however since PRA returns were replaced by Solvency II reporting this information is no longer available in the public domain. We asked participants to provide payouts for a number of notional policies, using defined premiums and in force durations. We acknowledge that comparisons of these nature are complicated by the maturity of the fund, the size of the inherited estate and the speed at which it can and is being distributed. Nevertheless, it can provide another measure of the value different groups of policyholders will receive.

Figures 4.5(a)-(h) show comparisons of payouts for various policy types, split by conventional with profits (CWP) in figures 4.5(a)-(d) and unitised with profits (UWP) in figures 4.5(e)-(h). There are a number of factors that can drive differences in payouts, two of particular note are:

- The market falls during the first quarter of the year; and the relative timing for when companies updated their payouts; and
- The inclusion (and quantum) of estate distribution within the payout, however from observing the data the inclusion of estate distribution did not correlate with payouts being substantially different to others.

The results of this comparison show a wide spread of payouts across the industry for similar policies. Note there is an outlier on the 10 year UWP bond payouts, which is considerably higher than others.

Figure 4.5: Specimen policy payouts

Figure 4.5(a)
25 year
CWP endowment
£50 per month regular
premium

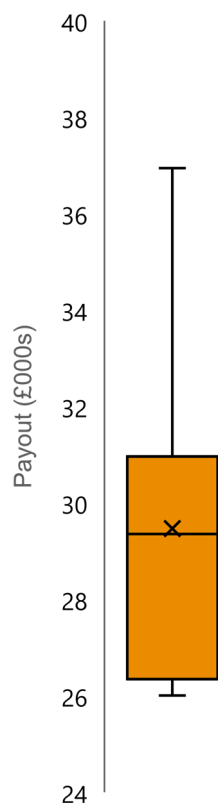


Figure 4.5(b)
25 year
CWP whole of life
£50 per month regular
premium

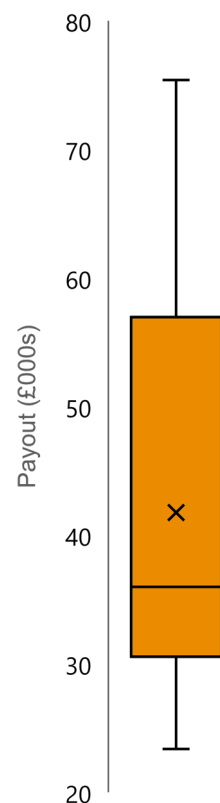


Figure 4.5(c)
30 year
CWP whole of life
£50 per month regular
premium

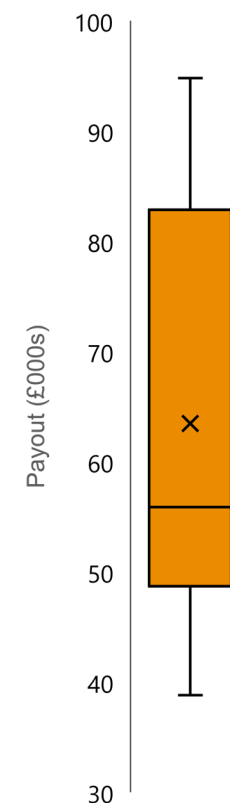
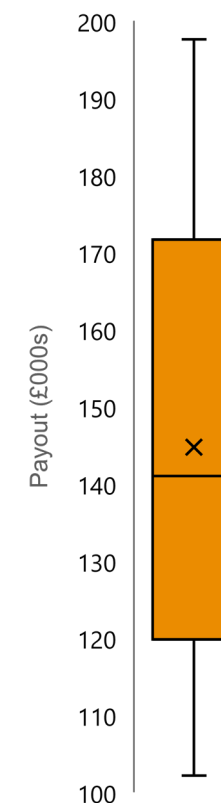


Figure 4.5(d)
40 year
CWP whole of life
£50 per month regular
premium



Projected payouts (cont'd)

Historically, benchmarking of annual payouts has been used to compare performance of with-profits policies, however since PRA returns were replaced by Solvency II reporting this information is no longer available in the public domain. We asked participants to provide payouts for a number of notional policies, using defined premiums and in force durations. We acknowledge that comparisons of these nature are complicated by the maturity of the fund, the size of the inherited estate and the speed at which it can and is being distributed. Nevertheless, it can provide another measure of the value different groups of policyholders will receive.

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Figure 4.5: Specimen policy payouts (cont'd)

Figure 4.5(e)
20 year
UWP pension
£200 per month regular
premium

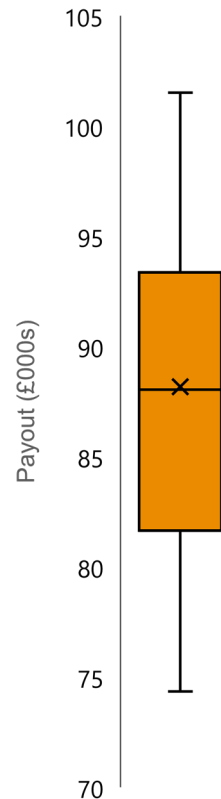


Figure 4.5(f)
25 year
UWP pension
£200 per month regular
premium

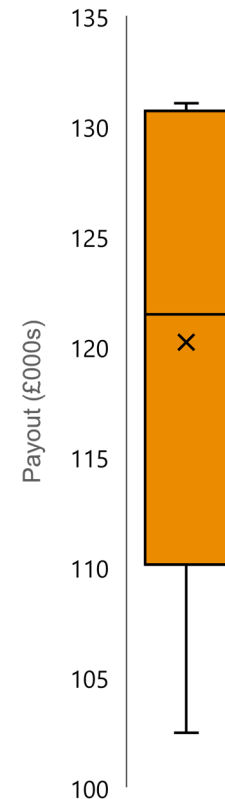
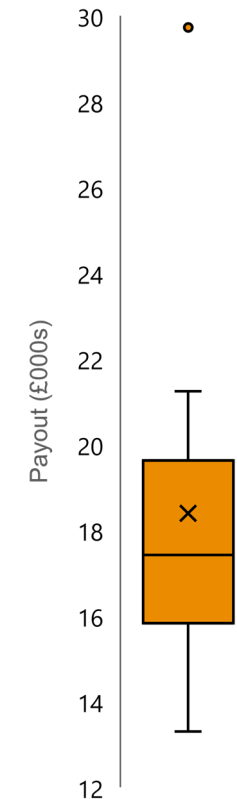


Figure 4.5(g)
5 year
UWP bond
£10,000 single premium



Figure 4.5(h)
10 year
UWP bond
£10,000 single premium



Goneaways

The issue of goneaways, where there is a lack of contact between policyholders and the life office over a period of time resulting in the policyholders either becoming uncontactable and/or heirs not realising the existence of the policy, continues to be significant for many with-profits funds, as holding reserves for policies where there are unlikely to be claims risks delaying the distribution of surplus. This is particularly true for those with significant industrial branch (IB) books, however given the maturity of many with-profits funds it is also becoming a bigger issue for ordinary branch ('OB') business.

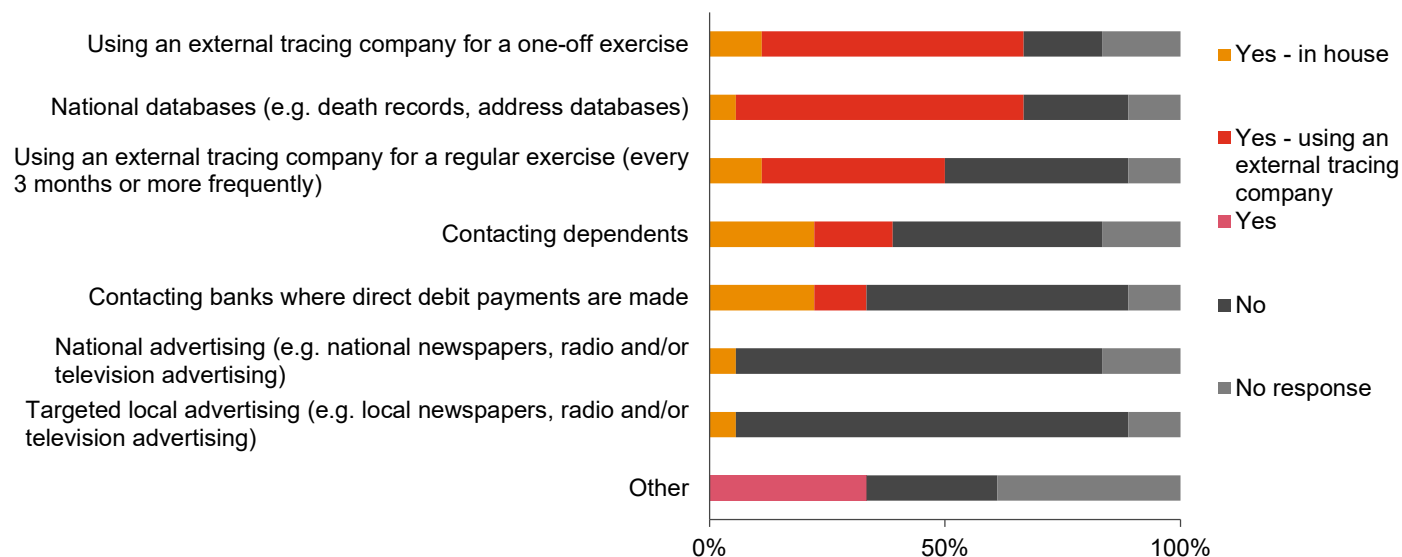
Tracing activity on goneaway policies

The 2016 FCA guidance on the fair treatment of long-standing customers in the life insurance sector (FG 16/8⁶) sets out the FCA's expectations around tracing 'gone-away' customers, with outcome 2.4 noting the expectation that firms 'consider and use appropriate activities to contact closed-book customers' and 'attempt to re-establish contact with customers who have 'gone-away''. However, the low values often associated with these policies can mean the cost of action could outweigh the payment to the policyholder, there are questions over the fairness of using the estate to fund the cost of tracing and success rates observed are typically low.

We asked participants which tracing activities had been carried out in the past 24 months, with 16 companies responding to this question, as summarised in Figure 5.1. Tracing using an external party or using national databases are the most commonly used tools, with a significant number of companies employing both of these tools. Over half of respondents perform regular (quarterly) tracing exercises, with an additional two companies highlighting in the 'other' category that they perform regular exercises, but less frequently than quarterly.

⁶ <https://www.fca.org.uk/publication/finalised-guidance/fg16-8.pdf>

Figure 5.1: For funds most impacted by goneaways, which tracing activities have been carried out in the past 24 months?



Goneaways (cont'd)

The issue of goneaways, where there is a lack of contact between policyholders and the life office over a period of time resulting in the policyholders either becoming uncontactable and/or heirs not realising the existence of the policy, continues to be significant for many with-profits funds, as holding reserves for policies where there are unlikely to be claims risks delaying the distribution of surplus. This is particularly true for those with significant industrial branch (IB) books, however given the maturity of many with-profits funds it is also becoming a bigger issue for ordinary branch ('OB') business.

Allowance for goneaways on the Solvency II balance sheet

Historically, reserving for goneaway policies has been relatively simplistic, often on the basis that the policyholder is alive and will claim until a specified age where the policy is written off, e.g. at age 100. While this approach has the advantage of being straightforward to communicate and model, it results in significant deferral of the emergence of surplus. Following the move to Solvency II in 2016, we now see the majority of insurers adopting a more 'best estimate' approach. The most common practice is to compare claim rates for non-premium paying policies with those for premium paying policies, with some overlay of expert judgement e.g. in respect of reserves for fixed expenses.

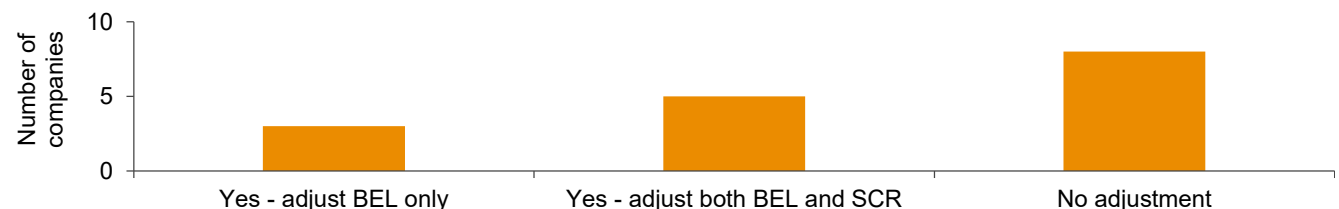
We asked participants whether any adjustment is made to the BEL and/or solvency capital requirement (SCR) in respect of goneaway policies. The results of this are set out in Figure 5.2. This shows that not applying an adjustment is the most common approach, suggesting that it is considered the BEL is appropriate, possibly because goneaway policies are not sufficiently material to alter the results. We considered the approach taken for firms with significant IB goneaways, and this showed, consistent with our expectation, most firms with a significant IB goneaway book adjust both BEL and SCR to reflect the reduced probability of these policies ever claiming.

Distribution of surplus emerging from unclaimed assets

We asked participants at what point reserves held in respect of goneaway policies are fully released as unclaimed assets, and therefore the full profits emerging from these policies become available for distribution. From the 15 responses, more than 10 years after the claim date was the most popular response. We also considered whether there was a correlation between firms where goneaways are a large proportion of their funds and the practice of releasing funds at the expected claim date – this indicates a preference to wait longer (i.e. either 5-10 or 10 years +) before releasing the funds. A number of participants also commented that they release whole of life proceeds when policyholders reach a certain age and some funds stage the release of the unclaimed assets over a period of time.

The majority of participants indicated that surplus generated by releasing reserves for goneaway policies is distributed in the same manner as the inherited estate. A small number of participants indicated that this surplus is not currently being distributed. This might suggest a potential to build up a backlog of assets for distribution in the future; however the further information provided suggests this relates to a combination of the approach for wider estate distribution in the fund and the small value (including zero) of any unclaimed assets.

Figure 5.2: For the fund which is most impacted by goneaways, is an adjustment made to best-estimate liabilities (BEL) or the solvency capital requirement (SCR) for goneaway policies?



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