Communication Workers Fund – Bonus Distribution

Introduction

This paper sets out the methodology used in determining bonuses in the Communication Workers Fund. It should be read in conjunction with the Principles and Practices of Financial Management (PPFM).

There are two types of bonus, regular and final. Regular bonuses are declared each year and once added to a policy cannot be removed. Final bonuses apply only to policies becoming claims during a specified period. They can be changed at any time.

Regular bonuses

Regular bonuses are calculated by projecting the fund forward, allowing for expected premiums, claims, expenses and tax. Investment income is also allowed for, although at a lower rate than that currently earned on gilts. Within claims, no allowance is made for final bonuses.

The aim is to determine a level regular bonus rate that, on the assumptions used, will exhaust the fund when the last policy goes off the books. The use of a gilt rate instead of the expected earned rate leaves a margin to provide final bonuses.

A separate rate will be determined for policies sold from August 2009 onwards, reflecting their tax-exempt nature.

The bonus rates calculated will take account of the financial strength of the fund and the current rates. They are generally expressed as a percentage of the sum assured and existing regular bonuses.

The calculations will normally take place early in each calendar year, based on the position at the end of the previous year.

Final bonuses

There are two stages in determining final bonuses. The first stage is to calculate the percentages of asset share payable on claim; the second stage is to translate those percentages into final bonus rates for death and maturity claims. These final bonus rates are expressed as a percentage of the regular bonus accrued to date.

The percentage of asset share payable on claim under the first stage is calculated by projecting forward the fund, allowing for expected premiums, investment income, claims, expenses and tax. Investment income will be that expected, based on the current asset yields and types and allowing for expected changes in the asset mix. The different asset mix for policies sold from August 2009 onwards will also be reflected in the calculation.

The aim is to determine a level percentage of asset share, payable on death and maturity, that, on the assumptions used, will exhaust the fund when the last policy goes off the books. The percentage of asset share payable on surrender will be five percentage points less than that payable on death and maturity and both percentages will be used when projecting the expected claims.

For surrender claims, the percentage of asset share so determined is fed directly into the surrender value calculation.

The second stage is accomplished by looking at policies maturing in the twelve months from the 1 May following the calculations. For each duration in force, a theoretical final bonus rate is calculated such that the total claim value equals the relevant percentage of asset share determined above. Any negative rates are set to zero.

The rates are then multiplied by an adjustment percentage and rounded to the nearer 5% to arrive at actual final bonus rates. The adjustment percentage is determined such that the total claim values, at all durations, using the actual final bonus rates is approximately equal to the sum of the corresponding claim values using the theoretical final bonus rates.

The actual final bonus rates are then subject to a further limitation, such that the claim values at each duration in force should not differ from the corresponding claim values using the current final bonus rates by more than 10%.

For durations where there are no maturities in the twelve month period, actual final bonus rates will be based on the rates for the nearest higher and nearest lower durations with maturities. These rates will be used for death claims.

Fairness of method

The method of distributing the inherited estate is fair to the policyholders because:

- It complies with the Principles and Practices of Financial Management.
- Policies that have been in the fund for a number of years and have built up a high asset share will benefit more than policies that have been in force only a short while and have a small asset share.
- Policies that remain within the fund for the long-term and build up a high asset share will benefit more than policies that exit quickly with only a small asset share.