

## **OFFSHORE Personal Bonds.**

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**Mike Batey of Boal & Co, continues our analytical look at the offshore life assurance industry today. This time it is the turn of the industry's flagship product the Personal Bond for scrutiny.**

## Introduction

In the July issue of 'International Wealth Management' we examined single premium Investment Bonds in the offshore life assurance industry. Whilst the offshore Investment Bond product genre can place its roots firmly in the UK industry, the Personal Bond is almost unique in life assurance terms to the offshore marketplace. It has had a well-documented bumpy ride with the UK Inland Revenue and because of this we must consider today two distinct categories of Personal Bond - the Highly Personalised Bond (with few restrictions in respect of investment opportunities) and the Pooled Fund Bond (restricted, as the name suggests, to pooled investment funds e.g. unit trusts, albeit a massive universe of such funds).

## Charges

As with any other product type, cost is an important consideration with Personal Bonds. Perhaps the first thing to point out is that Personal Bonds enjoy a much more level playing field than some other unit linked products, in that by definition underlying fund charges do not differ from company to company. The sheer volume of investment opportunities makes specific external charge assumptions very difficult to come by and reliance on the UK PIA Reduction in Yield (RIY) measure to assess the effect of charges should be considered with caution. RIY measures the extent to which an illustrative investment return assumption currently set at 7% pa is reduced by product charges over an initial 10-year policy term. For example, a 1.5% RIY means that a 10-year return of 7% pa before charges would reduce to 5.5% pa after charges. Assumptions as to the extent of the underlying fund charges (initial and annual) for the vast range of available funds / investments can differ, so perhaps the most representative way to view the effect of charges, on an RIY basis, is to exclude the underlying fund charge assumption completely from the calculation. Table 1 below does so for the Pooled Fund products, using analysis from **LIFEBASE Offshore**.

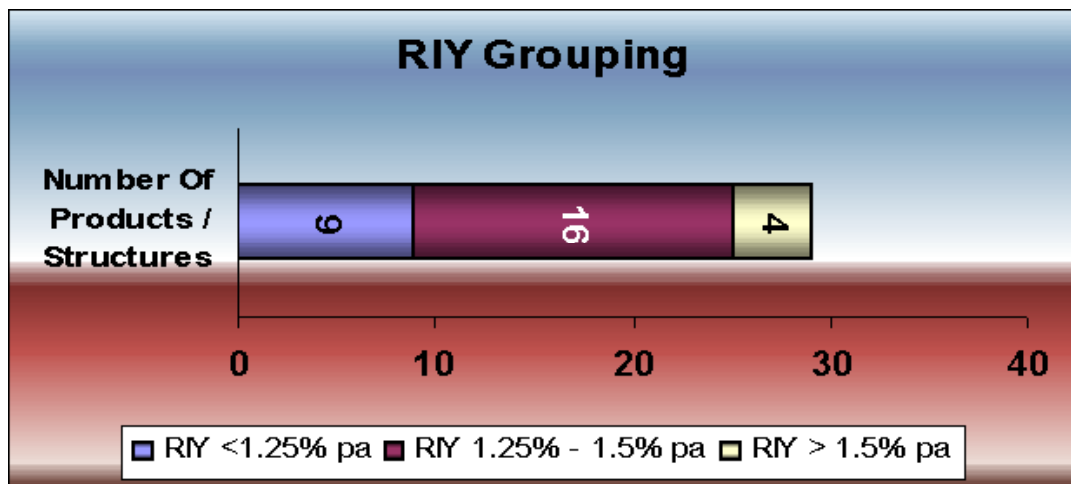
**Table 1 - Pooled Fund RIY**

<b>Company</b>	<b>Product</b>	<b>10 year RIY% - 7% growth, premium £150K, excluding underlying charges</b>
Canada Life Int'l	Premiere Account - Alpha (Structure A)	0.91
Scottish Mutual Int'l	Complete Investment Portfolio (Structure C)	0.95
CMI	CMI Portfolio Privilege Account (Structure C)	1.07
Scottish Provident Int'l	Select (Structure C)	1.08
Canada Life Int'l	Premiere Account - Alpha (Structure B)	1.09
Scottish Widows Int'l	Private Portfolio Bond	1.09
Scottish Equitable Int'l	Private Client Portfolio	1.14
Royal Skandia	Collective Investment Bond (Structure B)	1.14
Eagle Star Int'l	Elite Managed Bond (Structure B)	1.14
Irish Life Int'l	Portfolio Bond	1.16
Scottish Life Int'l	The Self Investment Portfolio	1.2
Scottish Mutual Int'l	Complete Investment Portfolio (Structure B)	1.21
Scottish Amicable European	Pooled Fund Bond	1.22
Scottish Mutual Int'l	Complete Investment Portfolio (Structure A)	1.22

<b>Company</b>	<b>Product</b>	<b>10 year RIY% - 7% growth, premium £150K, excluding underlying charges</b>
Old Mutual Int'l	International Personal Portfolio (Structure A)	1.24
Eagle Star International	Elite Managed Bond (Structure A)	1.24
Scottish Provident Int'l	Select (Structure B)	1.25
Scottish Provident Int'l	Select (Structure A)	1.25
Royal Skandia	Collective Investment Bond (Structure A)	1.26
Allied Dunbar Int'l	Managed Portfolio Bond	1.26
Old Mutual Int'l	International Personal Portfolio (Structure B)	1.27
Royal & SunAlliance IFS	Managed Portfolio Account (Structure B)	1.31
CMI	CMI Portfolio Privilege Account (Structure B)	1.35
Generali Int'l	Select Portfolio (Structure A)	1.39
CMI	CMI Portfolio Privilege Account (Structure A)	1.4
Old Mutual Int'l	International Personal Portfolio (Structure C)	1.6
Royal & SunAlliance IFS	Managed Portfolio Account (Structure A)	1.6
Generali Int'l	Select Portfolio (Structure B)	1.67
Royal Skandia	Collective Investment Bond (Structure C)	2.14

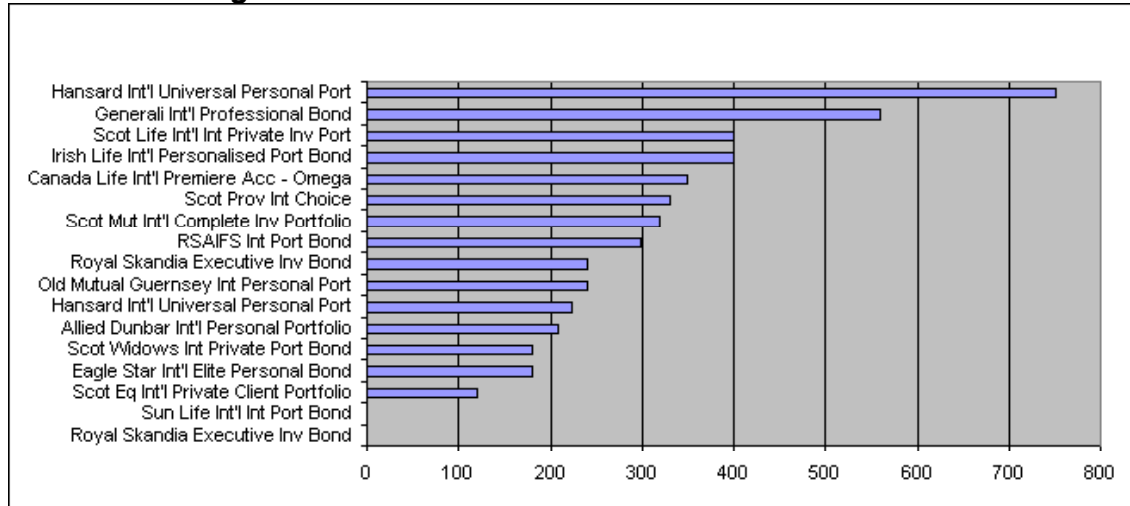
Competitive positioning is more often contested via a choice of charging structures to suit different terms (no fewer than 9 out of the 15 highly personalised bond providers covered in **LIFEBASE Offshore** offer more than one structure). That said, the most significant proportion of the industry is grouped in RIY terms (excluding underlying fund charges) within the very narrow range 1.25% pa to 1.5% pa and this includes all charging structures (see Chart 1). Further analysis **LIFEBASE Offshore** reveals that, in all but one case, there is no difference between the Pooled Fund product and the Highly Personalised versions offered by the same company. All of this, of course, appears to be good news in so much as the product cost is seemingly transparent. Not so, unfortunately.

Chart 1 - RIY Grouping



Traditional projections do not necessarily take into account all product charges, and furthermore what they omit can be significant. Let us take, as our first example, dealing charges. As a rule, dealing charges are not assumed when projecting returns (and this is not just an offshore scenario, it happens with switch charges in the UK also). Firstly, dealing charges are more usually expressed on a 'per transaction' basis so the figures quoted are generally for either a purchase or a sale, rather than the 'switch' approach (i.e. purchase and sale) more commonly found with other product types. The picture can be further clouded by differing approaches to dealing in life office internal funds some offices will waive or reduce the charge for internal deals where others apply the same charge regardless. For Chart 2, we have taken data from **LIFEBASE Offshore**, this time for the highly personalised version, and assumed 6 external deals and 2 internal deals per annum. The chart shows a quite significant diversification in the associated costs across all providers. There are one or two companies which apply different dealing charges to different charging structures and are therefore shown more than once on the chart. Only 2, however, offer completely free dealing.

**Chart 2 - Dealing Costs**



There are other hidden charges that can be associated with Personal Bonds. For example, custodian fees incurred by the life office (which may vary by custodian, type of asset, or both) may or may not be passed on to the client in full or in part. Also, there is a mixed approach to the treatment of both currency exchange, and deposit interest / bank charges. The former is not necessarily confined to personal bonds (but is more acutely felt given the almost unlimited geographical diversification of investment opportunities), but the latter certainly is, due to the widespread availability of general transaction and deposit cash accounts. Advisers should be alert to the approach of each life office in passing on to policyholders the benefits of 'bulk buying' in respect of exchange and deposit interest rates. Similarly, the emergence of preferred provider lists has seen, at least in marketing terms, a push towards refining the hitherto massive list of fund managers and funds down to a manageable number, the restricted choice in theory being balanced by preferential charging terms negotiated with the preferred fund provider.

## Service

Of course, cost competitiveness and the facilities available through a personal bond are heavily undermined if there is not an acceptable standard of service to back them up. As the saying goes, past performance is not necessarily a guide to the future, and this can extend to service levels with providers becoming well-used to the cyclical process of being in and out of favour with intermediaries as far as service levels are concerned. Companies with large numbers of in-force policies receive more dealing instructions which need placing and settling, more capital events (e.g. mergers, acquisitions, rights issues) that require processing, more dividend payments that must be applied. Increased volumes of business result in more strain on providing valuations and applying (accurate) charges. The dichotomy has been that an increased reputation for personal bond service levels invariably results in a corresponding increase in pressure on resources which can detrimentally effect the standards.

There are variety of methods being employed for addressing these problems. For example, the preferred provider approach mentioned earlier helps to concentrate dealings with fewer external managers. Some life offices have chosen to outsource some or all of the investment administration to a third party (e.g. investment banks or stockbrokers) more geared up for this type of business. The internet, too, can play its part with some offices already making valuations available on-line and dealing instructions over the internet are becoming a reality. Time will tell how effective these are.

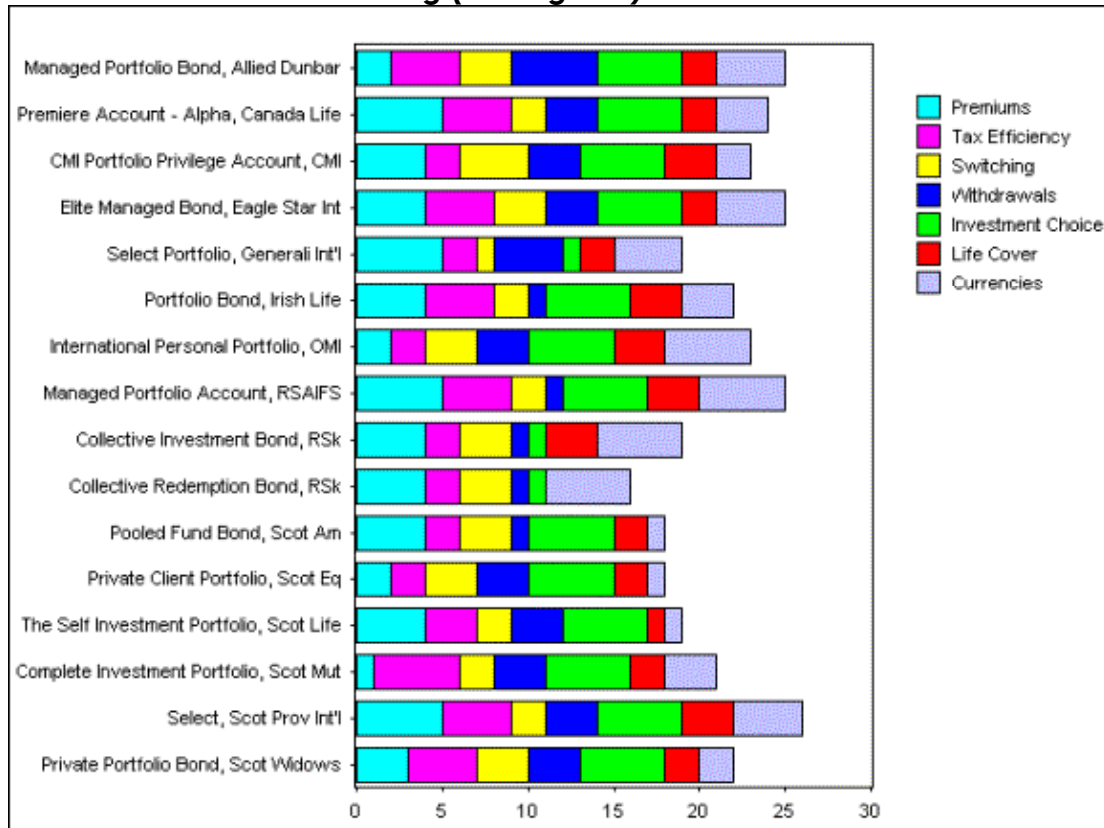
## Product Features

With charges being so tightly grouped, service levels so important and investment performance more a matter for the client / adviser than the life office, distinguishing between a shortlist of personal bond providers is as much about the features and benefits that are available as anything else.

Expectation is high amongst the more sophisticated investors, and in many respects personal bond providers rise or fall by their ability to meet that expectation. Of course, once the policy is up and running, the issue of service standards plays its part, as we have seen. At outset, however, it is the flexibility of fundamental product rules (around which administration systems are built) that figure strongly in assessing the suitability of the product.

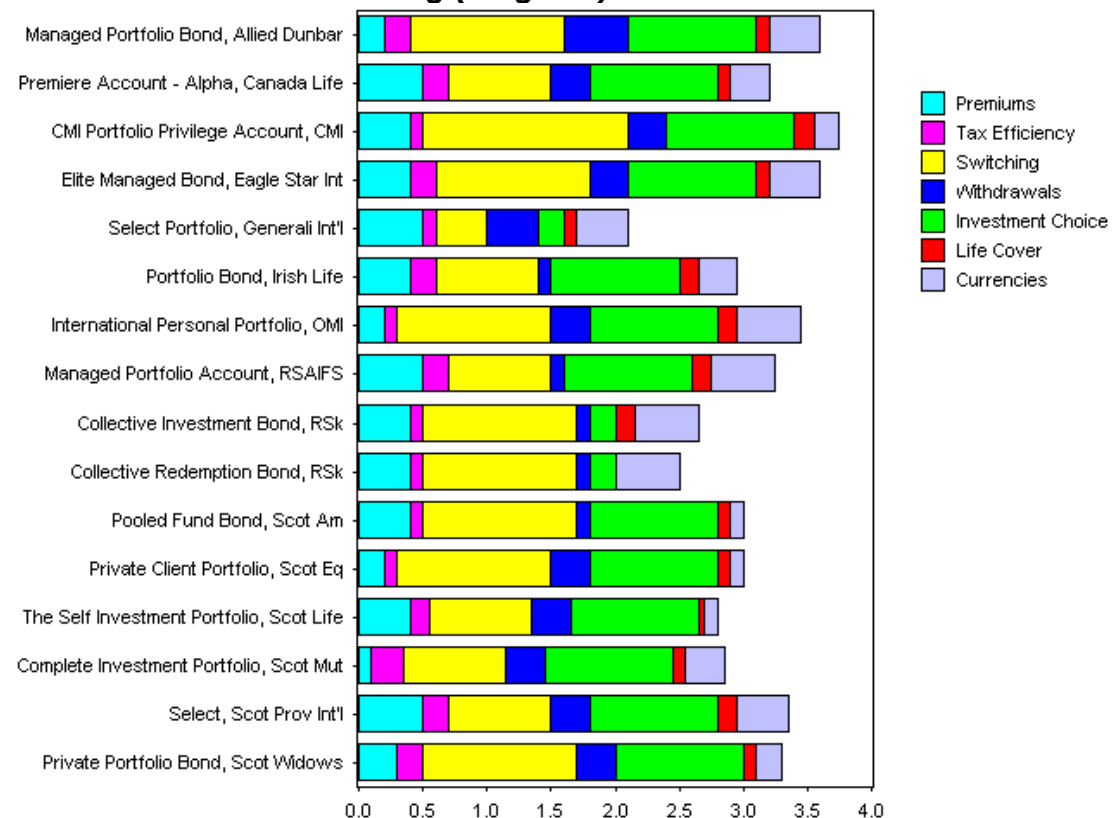
The primary task in such qualitative analysis is the extent to which facilities such as withdrawals, investment switching, top ups, currencies, life cover etc are available. Differentiating between the products and the providers, however, comes down to the quality of these facilities. The **LIFEBASE Offshore** qualitative analysis (the Investment Flexibility & Access (IFA) Rating), having identified the important features that relate to Personal Bonds goes on to make an assessment of each feature for each product, using a 1 (bad) to 5 (good) scoring system. The results of this on a pure score-per-feature basis for the Pooled Fund variety are shown in Chart 3.

**Chart 3 - Combined IFA Rating (Unweighted)**



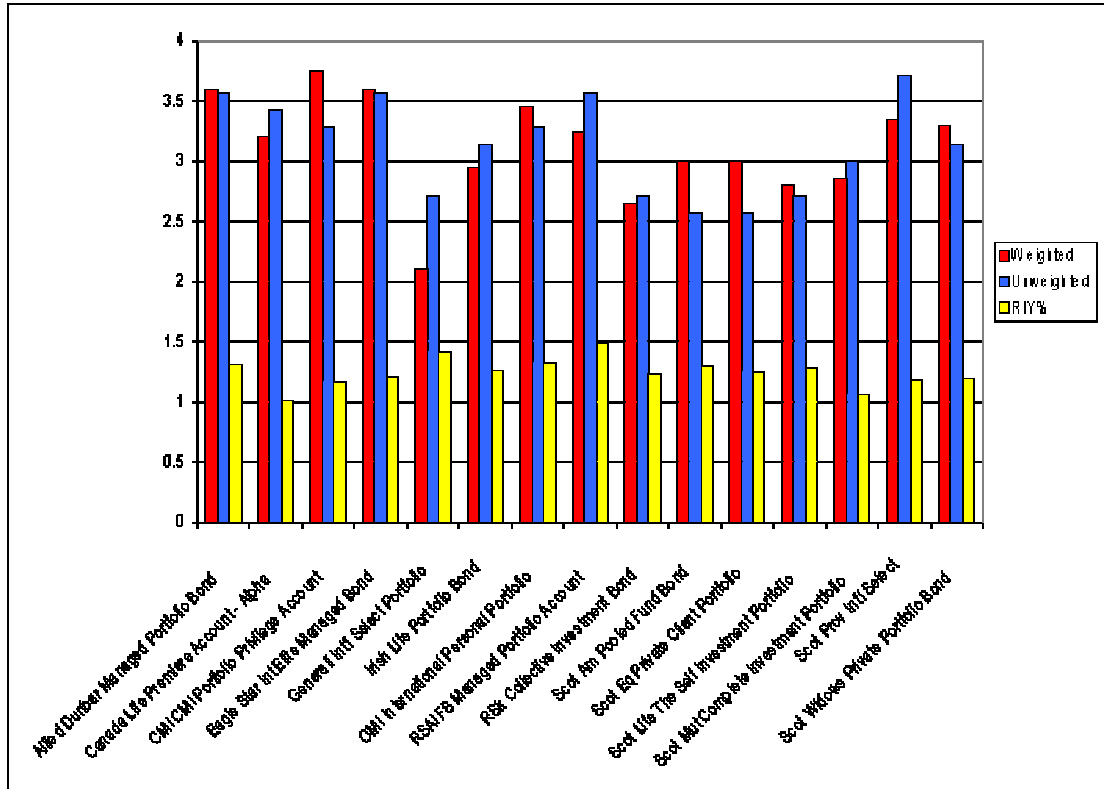
This analysis, whilst valuable in its own right, may to some observers tell only half the tale. It is a valid comment to suggest, for example, that where Personal Bonds are concerned, a good score in respect of life cover does not necessarily improve the merits of a product that has a lesser score in respect of, say, investment dealing facilities. In short, to simply aggregate the scores could perhaps distort a product's worth against others. For this reason, **LIFEBASE Offshore** includes a weighting facility to promote the more important features. The results in Chart 4 show how this changes the results from those of Chart 3 (unweighted results) for the same study group. Assessing value in a Personal Bond, therefore should take due consideration of quality as well as quantity.

**Chart 4 - Combined IFA Rating (weighted)**



So, if we return for a moment to the subject of product cost, we can legitimately ask the question: 'Does the policyholder pay for quality or quantity?' Chart 5 shows an analysis of RIY (excluding underlying fund charges) against weighted (qualitative and quantitative) and unweighted (qualitative only) IFA Ratings. This indicates that there is no specific correlation between product cost and either of the qualitative or quantitative features ratings. Perhaps there should be one way or another?

Chart 5 – Cost vs Features



## Conclusions

Personal Bonds are very much a breed of their own. Measures which are usually secondary in choosing a provider for other product types, can often come to the fore as regards Personal Bonds, and the reverse is also true. In this regard, we can summarise by suggesting:

- Headline cost issues are closely contested for Personal Bonds, but they only reveal part of the truth. It is hidden (and uncertain) future costs that deliver the reality of a product's worth in cost terms.
- Service is the holy grail of personal bond provision. It would be unfair to suggest, however, that providers are blissfully unaware of this. They are taking steps to make things more efficient.
- Product features take on greater significance but should be carefully considered in terms of their individual worth to the policyholder. Simply piling on the features does not necessarily result in an increase in appeal.

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