

# OFFSHORE REGULAR SAVINGS PLANS

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**Mike Batey, with assistance from [LIFEBASE OFFSHORE +](#), continues Boal & Co's analytical look at the offshore life assurance industry. Under examination this month are regular savings plans.**

Last month's subject for analysis – the flexible savings plan – represents the new face of financial planning in the context of offshore life assurance savings products. The more traditional vehicle, however, is the regular savings plan designed to cater for a longer term, more stable savings need.

## Scope and Market

Flexibility in respect of premium payments and investment periods is important where, for example, remuneration packages are structured in such a way as to be heavily reliant on performance related bonuses, or there is a preference on behalf of either the employer or the employee towards short term contracts. Flexible savings is the ideal depository for those looking to “make hay while the sun shines”. The growth in such a market is not, however, to the exclusion of product solutions which suit a longer term objective – regular savings plans. Just as there is a need to cover uncertainty, there is an equally valid requirement to invest for future plans and ambitions, and that does not just mean retirement.

As we have examined earlier in this series of articles, simple bank accounts have a role to play in the savings process but for many (particularly the high net worth and high income clients) they simply do not offer the required levels of sophistication and longer term rewards. As with most other offshore savings vehicles, the regular savings plan does not really feature in the UK market. In addition to the priority placed upon pension planning, other tax incentives have made investment vehicles such as endowments (until recently) Maximum Investment Plans (MIPs), PEPs, TESSAs and now Individual Savings Accounts (ISAs) more attractive to the UK investor. Add this to the fact that, due to adverse economies of scale the inability to relieve expenses (and commissions) against tax, the offshore savings plan generally cannot compete on cost terms with a UK alternative.

The traditional *offshore* market, therefore, has been the true UK expatriate – that is an expatriate who has set his or her long-term career ambitions overseas, rather than those who are just working abroad for a while (and therefore have a greater leaning towards flexibility). The key market in this respect is the Far East and thus it is no coincidence that nearly all the major players in this product sector have authorisation in Hong Kong. Increasingly over recent years, the Far East market has ceased to be simply an expatriate market. For the key operators, local markets are just as important, in some cases more so.

With such a focus on one geographical area, how is the regular savings plan still supported? For one thing, that market and geographical area is significant enough for the handful of operators to make it a profitable line of business. Having the regular savings plan within the product suite further provides opportunities elsewhere that the newer flexible style of savings does not. Perhaps less obvious, however, is that in many cases the offshore regular savings plan and the offshore pension plan are almost identical products. Where the sale of a pension proves difficult (perhaps because provision has already been made) the appeal of a regular savings plan often still exists. The same product branded differently opens up marketing opportunities without a corresponding increase in operational overheads.

## The Providers

The choice of providers and products is undoubtedly limited, mainly due to the market restrictions that currently exist as described above. The list in Table 1 represents the key products in this area and shows only 9 companies (8 if you discount the obvious RSA group link) active in this sector. Returning to a point made earlier, 6 of the 9 are authorised in Hong Kong.

<b>Table 1 : Principal Offshore Regular Savings Products</b>	
<b><u>Company</u></b>	<b><u>Product</u></b>
CMI	Wealthmaster Classic Plan
Eagle Star International	Supra
Friends Provident International	Venturer International Investment Plan
Generali International	Vision
Hansard International	Pinnacle
Royal & SunAlliance IFS	Flexible Growth Plan
RSA Eurolife	Flexible Growth Plan
Royal Skandia	Managed Savings Account
Scottish Provident International	Quantum
	Source : <a href="http://www.lifebase.co.uk">www.lifebase.co.uk</a> <b>LIFEBASE OFFSHORE</b>

Interesting to note in the list of providers is the absence of the newer entrants. Small as the list is, there are sufficient barriers to entry for new providers to maintain the status quo. Examples of such barriers are obtaining authorisation in the markets to which the regular savings plan is most suited, and building the systems to cope with the high initial commission product designs that distributors favour. The flexible savings plan (with a recurrent single premium design) is a more natural progression for newer offices who have opted for a simple single premium product to achieve market initial market penetration.

## Product Design & Charges

Like the offshore pension plan, there is a tendency towards an initial unit design with no fewer than five of the providers incorporating this into their design. Of the others, there is a mixture of reduced allocation and establishment charge / surrender penalty in the earlier years. All but one includes a bid-offer spread as an initial charge. The designs are very much geared towards high initial (with the potential for override) and low renewal commission payments rather than a level "per premium" commission structure.

As befits a product genre targeted at the longer term investor, many incorporate a loyalty bonus payment either at maturity or after specified period. Other design features, as you might expect, typically include:

- annual management charges
- policy fees
- paid up penalties (in the early years)
- switch charges

To compare the effect of charges across different products and companies, we make use here of the Reduction in Yield (RIY) measure to assess the extent to which the illustrative investment return (set at 7% pa for the following analyses) is reduced by the effect of product and fund charges. For example, a 3% RIY would reduce a gross return of 7% pa to a net return (after charges) of 4% pa. The lower the RIY, the cheaper the product is.

Because of the product shapes used by the providers, the RIY improves as the term increases (sometimes considerably as a result of loyalty bonuses), as the example in Table 2 shows:

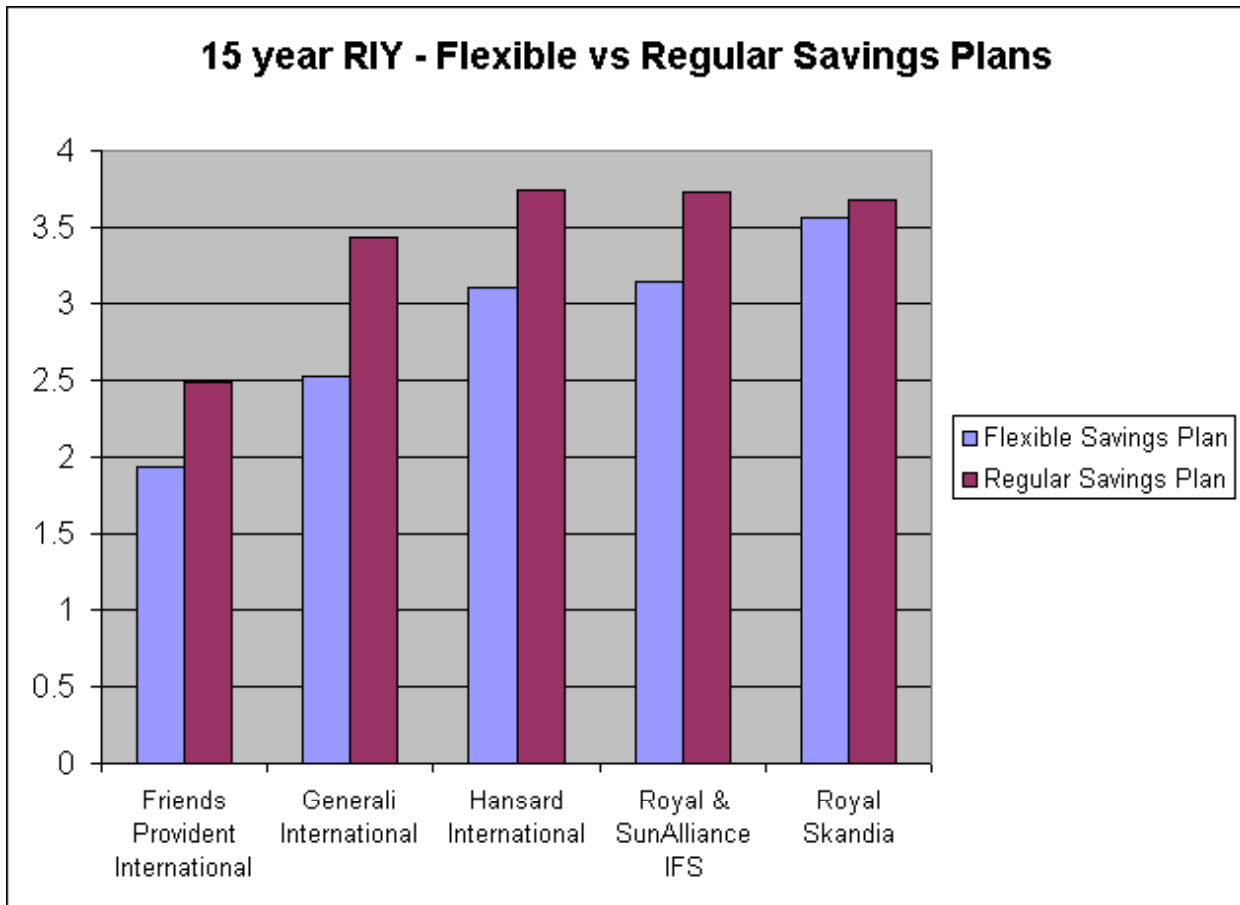
<b>Table 2 – Reduction in Yield Comparison</b>			
<b>Company</b>	<b>Product</b>	<b>RIY% pa at 10 years</b>	<b>RIY% pa at 15 years</b>
Friends Provident International	Venturer International Investment Plan	3.1%	2.4%
Eagle Star International	Supra	3.7%	3.4%
Scottish Provident International	Quantum	4.1%	3.5%
Royal Skandia	Managed Savings Account	4.1%	3.4%
Generali International	Vision	4.2%	3.6%
Royal & SunAlliance IFS	Flexible Growth Plan	4.5%	3.7%
Hansard International	Pinnacle	4.9%	3.7%
Royal & SunAlliance Eurolife	Flexible Growth Plan	5.2%	4.2%
CMI	Wealthmaster Classic Plan	6.1%	4.4%

Source : [www.lifebase.co.uk](http://www.lifebase.co.uk) **LIFEBASE OFFSHORE**

The examples shown in Table 2 assume a premium of £400 pm and show plan values excluding surrender penalties (but include the effect of the underlying fund manager's typical annual management charge). You can see from this that the variation in RIY is quite substantial across the providers (a difference of approximately 3% pa from best to worst for a 10-year term and 2% for a 15-year term).

A recurrent theme throughout our series of articles has been that cost is not everything. If you compare, as we do in Chart 1, the RIY of the more traditional regular savings plan against the equivalent flexible savings offering from the same office, you find that even over a term of 15 years it is still the flexible product that comes out on top in pure cost terms.

So if it cannot be argued, on a charges basis, that one type suits the shorter terms and the other designed for longer investment, where is the appeal? Well perhaps, perversely, it is the threat of charges that creates the appeal. Take, for example, an endowment policy used for the purposes of repaying a loan. You must take it to term to maximise your chances of achieving your goal. Similarly, the charges-driven lock-in of an offshore savings product creates the incentive to maintain the payments and thus achieve the original objective of taking it out, whatever that may be.



**Chart 1**

Perhaps more pertinent, however, is that in the key markets for regular savings it is often the commission incentive that drives the sale and that must be paid for one way or another. In other words, higher charges mean higher commission and higher initial charges mean higher initial commission. Recurrent single premium structures cannot really compete on this basis in markets such as the Far East, especially if the flexibility available to the policyholder means that a continued commission stream is uncertain. For these reasons there is still, for the time being at least, a significant number of advisers who can and will justify the regular savings approach.

### **Product Features**

In general terms, the product features of regular savings plans largely mirror those of pension plans, in that they may offer one or all of the following

- choice of fund sectors
- range of additional benefits
- availability of with-profits funds
- choice of plan/premium currencies etc.
- automatic premium increases (typically 5% or 10% per annum)

The second of these points, particularly, is worthy of more detailed discussion. Firstly, there is quite a diversity in the range of available additional risk benefits (e.g additional life cover, waiver of premium, total and permanent disability etc) between the main providers, as Table 3 illustrates.

<b>Table 3 : Additional Benefits Summary</b>	
<b>Product</b>	<b>Total Additional Benefits</b>
CMI, Wealthmaster Classic Plan	9
Eagle Star International, Supra	3
Friends Provident International, Venturer International Investment Plan	2
Generali International, Vision	3
Hansard International, Pinnacle	1
Royal & SunAlliance IFS, Flexible Growth Plan	2
Royal Skandia, Managed Savings Account	2
Scottish Provident International, Quantum	4

Source : [www.lifebase.co.uk](http://www.lifebase.co.uk) **LIFEBASE OFFSHORE**

Of the five providers in the list which also offer a flexible savings product (Hansard, Friends Provident, Royal & Sun Alliance, Royal Skandia and Scottish Provident), none offers anything other than basic death benefit on the flexible version. In fact, within the entire universe of flexible savings products only one company offers any additional benefits at all. After all, reduction or cessation of premiums (which is at the heart of the flexibility argument) would inevitably adversely affect the value of any additional benefits attached to a plan. Long-term savings objectives need long-term contingency and it is in this area that the regular savings plan wins hands-down.

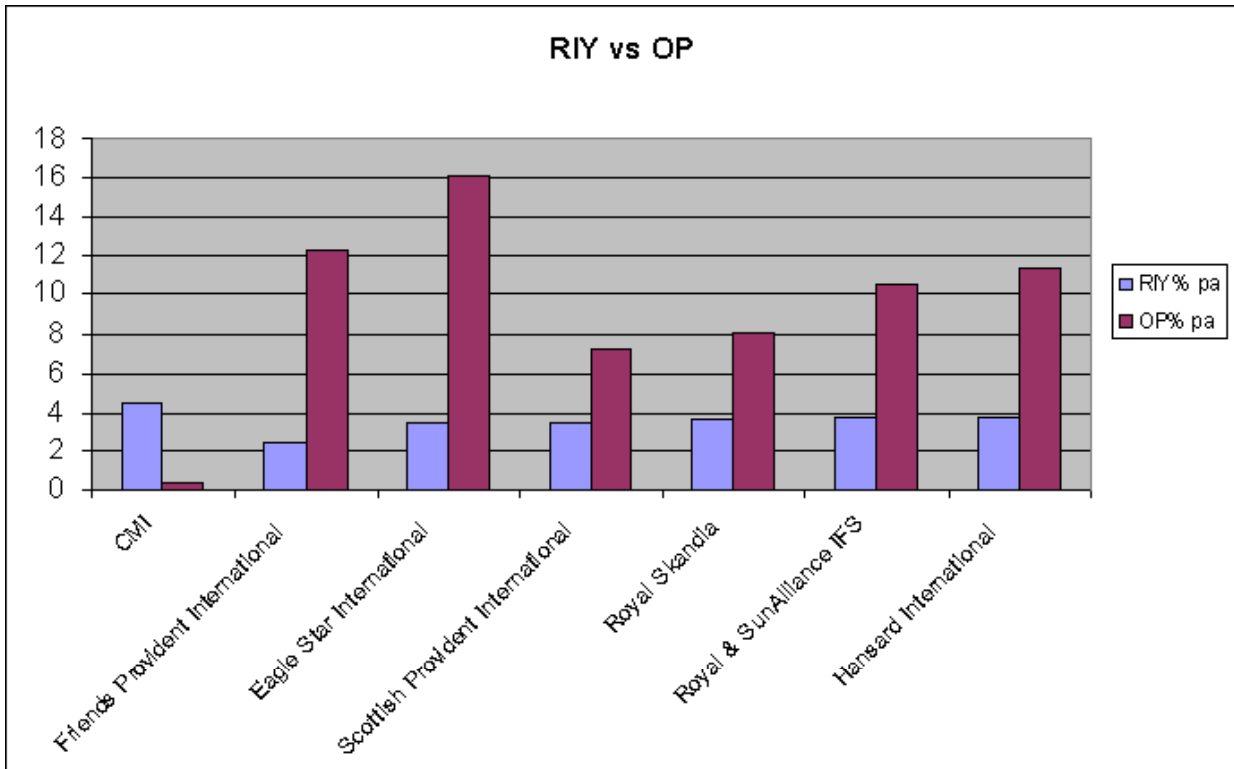
### **Overall Performance Results**

Consideration of cost and product features are of course an integral part of the financial planning process. But it is the ultimate return on investment that is the real proof of the pudding. Simple past performance measures for the underlying funds go some way forward in deciding one life office's range over another's. These do not, however, factor in the product charges and can therefore distort the picture. The Overall Performance (OP<sup>TM</sup>) measure within LifeBase Offshore + regulates this distortion by combining the effect of product charges with fund past performance. OP<sup>TM</sup> simulates the total annualised return from a product after both product charges and fund charges. Product charges allowed for include:

- bid/offer spreads
- management charges
- initial unit charges
- policy fees
- allocation rates
- loyalty bonuses etc

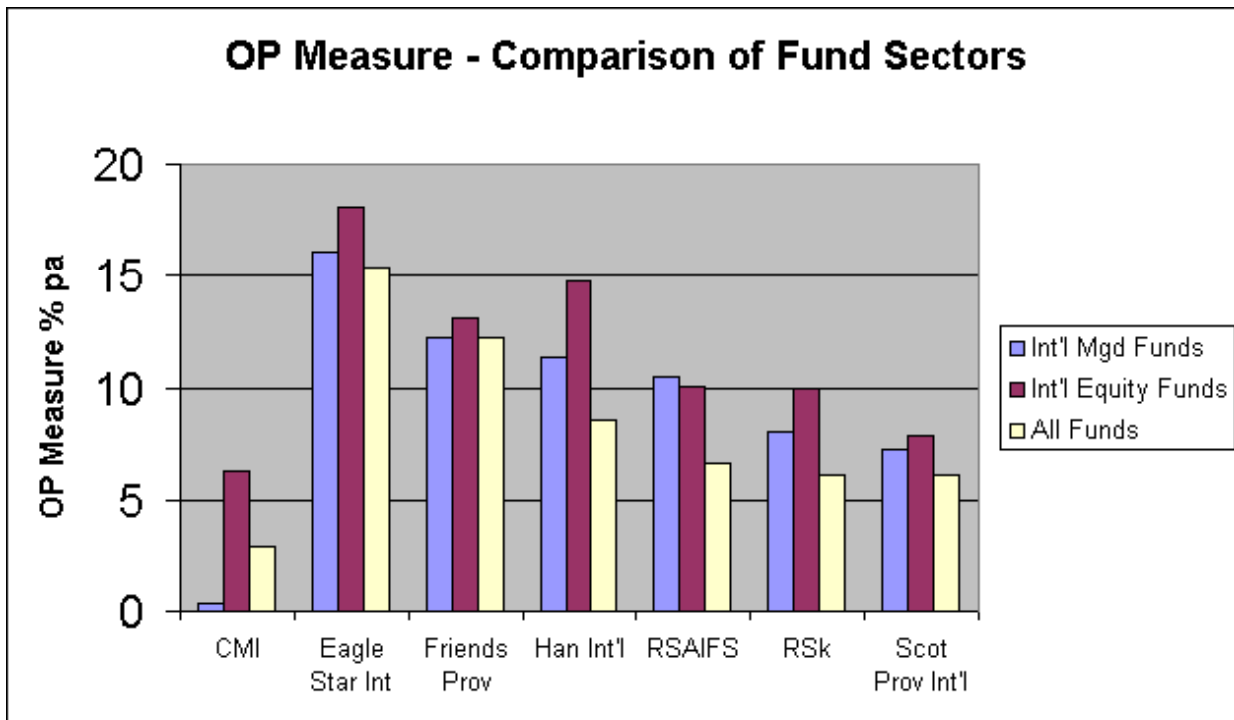
throughout the policy term.

Chart 2 shows a comparison between the RIY and OP<sup>TM</sup> measure of each company's regular savings product (£400 per month, 5-year International Managed funds performance for a £ investor to September 2000) and illustrates fully the danger of assessing products on cost alone. Five out of the seven products shown operate within a very narrow cost range of one another, but this does not carry through to a corresponding range between the OP<sup>TM</sup> measures for the same companies.



**Chart 2**

For regular savings products, as we have discussed, the objective is longer term savings. Attitudes to risk can, and do, change over time and so it is useful to assess the life office's investment record (or that of its chosen fund managers) not just for a single fund sector but across a range of sectors. In Chart 3 we have picked out 2 popular fund sectors accessible through the key regular savings products, as well as an analysis of all funds, and compared them on an OPTM basis for each company.



**Chart 3**

The landscape makes interesting reading in so much as the product performance record of each company is consistent across all three measurement bases. In other words, regardless of whether you are comparing the companies' merits in respect of International Managed Funds, International Equity Funds or All Funds (in all cases 5-year performance to Sept 2000 for a £ investor), you are likely to draw very similar conclusions as to which is (or has been) the best.

## **In Conclusion**

In many respects the regular savings plan is a specialist product servicing a specialist need. It only features in the international financial planning process for those who can view long term savings with a degree of certainty. Nevertheless, for the limited number of providers it is an important part of the product range. To sum up:

- the product type is very definitely not flexible, but that is not to its detriment because locked-in commitment to long term savings is incentive in itself
- it would appear that competition for business does not come down to charges, otherwise you would expect the range in Reduction in Yield figures to be much tighter
- instead the focus should be, and probably is, on investment returns. Our Overall Performance measure shows that across different investment sectors some providers have been consistently better than others in this regard

*Mike Batey is director of Boal & Co and can be contacted by e-mail [mail@boal.co.uk](mailto:mail@boal.co.uk) or by telephone on +44 1624 824181.*