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15. Glossary

AMC or Annual Management Charge
A charge that is levied by the provider as a proportion of funds under management. A 1% AMC means that the consumer is charged 1% of the value of his contract each year. This is usually taken monthly, with the result that the reduction in yield is not always equal to the AMC even if it is the only charge on a financial services product.

Annual Premium Equivalent
A method of expressing the amount of business sold by a provider encompassing both regular and single contribution business. Regular contribution business is given a weight equal to the expected annual contributions. Single contribution business is given a value of 1/10th of this single contribution.

Anti-selection
A consumer may know more about his personal circumstances than the provider offering the contract and enough about the contract to know that he or she can gain an advantage. The provider offers contracts and contribution rates priced according to the average consumer they believe will take out each type of contract. Anti-selection refers to the case where the consumer believes that his personal circumstances differ from the average and are therefore not reflected in the terms offered so he is able to make use of this to his advantage. The result can be detrimental to the performance of the provider.

CP166
A consultation paper issued by the Financial Services Authority on reforming polarisation (see also depolarisation). The outcome is expected to lead to distributors adopting one of three main business models:

- Tied advice (acting as an appointed representative of just one provider). These advisors will remain restricted to selling the products of the provider or group to whom they have tied, albeit that the provider can ‘adopt’ the products of other organisations if not available from themselves;
- Directly authorised distributors who restrict their advice and marketing to either a limited range of products and/or a limited number of providers (often referred to in the market as ‘multi-ties’);
- Independent financial advisors able to advise on products across the whole market.

Depolarisation
See CP166 above.

Discount rate
Money received today is worth more than the same amount of money received in one year’s time because of the interest that could be earned on the capital in the interim. When putting a present value on future cashflows, these therefore need to be reduced in value to take account of this. The discount rate is the percentage of the cashflow that is taken off its value for each year that it is delayed.

DP19
A discussion Paper issued by the Financial Services Authority in order to consider the options for regulating the sale of "simplified savings products". Various options are being considered. This report has assumed that the second option, that of guided self-help, will be adopted which will include the requirement for the use of filter questions to identify the suitability of the customer to the product being offered.

FPC
The Financial Planning Certificate (FPC) is the minimum qualification required to practice as a financial advisor.

IRR
The Internal Rate of Return is the discount rate that, when applied to future cashflows, gives a total present value of zero for the all cashflows. In effect, the IRR shown for any investment represents the return earned on the investment.

Lapse
When consumers withdraw their funds and close their contract, they are said to lapse. Lapse rates refer to the percentage of consumers who do this each year.

Menu
A document provided to consumers in the early stages of the sales process. It would set out an outline of the services the adviser is offering and their fees. Commission rates would also be compared to the average rates available in the market. As yet, the precise nature of the 'menu' has yet to bet set down by the FSA.

MVA
Market Value adjusters (MVAs) are discretionary adjustments made by the company to the value of the contract when a payment is made at death, surrender or maturity. In theory these can be positive or negative but in practice the term is usually used to refer to a negative adjustment.

Open-ended
The total value of contracts that can be sold at any time is not restricted. New contracts can be taken out without existing contracts being surrendered.

Overheads
Expenses that are incurred irrespective of whether any contracts are sold or not. Examples include senior management and channel management and the cost of corporate infrastructure. These are normally fixed in nature.

Paid up
Contracts that still have a value but to which the customer is no longer contributing. Paid up rates refer to the percentage customers that become paid up in each year.

Payback period
If a provider sells a large number of contracts at a given point in time, this is the subsequent period it takes for the provider to recoup his initial investment. Before the payback period is reached, the total expenses of the provider outweigh all the charges received to date.

Persistency
A generic term referring to the rate at which contracts remain on the books, and hence do not become paid up, transfer or surrender.

Profit signature
The pattern of the profit earned in each year following sale of the contract. Typically this may be a large negative in year one due to the large initial expenses followed by a gradual improvement in profitability as the charges grow.

PUP
Paid Up Policies (PUP) refer to those contracts to which the customer is no longer contributing (but which still have a positive value).

PVFP
The Present Value of Future Profits (PVFP) is the value a provider places on a future stream of profits (or losses). Profits expected to be earned in future years are discounted before being summed.

Regular contribution
Contracts that receive contributions at regular intervals. This is typically monthly but may also be quarterly, annual, or at other regular intervals.

Required rate of return
The rate of return that is required by a provider before he will enter the market. If the internal rate of return is greater than the required rate of return then the provider will be encouraged to participate. If it is less then he will not.

Reserves
The funds that the provider has to hold in order to be able to meet his future liabilities.

RU64
Regulatory Update 64 was issued by the Financial Services Authority in advance of the release of Stakeholder Pensions to require advisors offering alternative pensions to also make their customers aware of these lower priced alternatives.

Solvency margin
The amount of capital that a provider holds in excess of its liabilities.

Surrender
When a customer opts to terminate his contract and withdraw his funds, albeit that these may subsequently be transferred to another provider.

T&C requirements
The level of training and competence that is required of sales staff before they can be allowed to sell financial products.

Termination
This is the process of winding up a contract.

Tied
Tied distributors are permitted only to sell the products of the manufacturer/provider/marketing group to whom they are tied, although under the new rules envisaged by CP166, companies or groups to whom such distributors are tied will be able to 'adopt' products from other companies or marketing groups .

Up front (or initial) charge
A charge that is applied to contributions and is analogous to the bid-offer spread on unit trusts (or a lower than 100% allocation to the investment fund). Unless specifically stated to apply for a designated term (e.g the first five years of contributions), it will apply to every contribution made during the lifetime of the contract. It will also normally be applied in the event of a transfer of funds from one provider to another, thereby 'doubling' the contribution percentage deducted from any individual's investment.

With Profits
A type of policy that aims to smooth the returns to policyholders. Payouts are designed to be less than the actual returns achieved in times when these are high and more than actual returns when these are low. The guaranteed payout is typically a fairly low proportion of the total payout, with the remainder being made up of discretionary bonuses (although with traditional contracts these bonuses act to increase the level of guarantee on the contract).