



The Actuarial Profession

making financial sense of the future

consultation response

personal accounts delivery authority

**Building personal accounts:
choosing a charging structure**

April 2008

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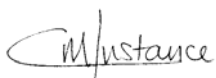
Dear Sirs,

Building Personal Accounts – choosing a charging structure

Thank you for providing The Actuarial Profession with the opportunity to comment on this consultation. Our substantive comments are attached to this letter.

If you have any questions or would like to discuss any of these matters further, please do not hesitate to contact us.

Yours faithfully



Caroline Instance
Chief Executive

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Introduction to The Actuarial Profession

Actuaries provide commercial, financial and prudential advice on the management of a business's assets and liabilities, especially where long term management and planning are critical to the success of any business venture. They also advise individuals, and advise on social and public interest issues.

Members of the Profession have a statutory role in the supervision of pension funds and life insurance companies. They also have a statutory role to provide actuarial opinions for managing agents at Lloyd's.

The Profession is governed jointly by the Faculty of Actuaries in Edinburgh and the Institute of Actuaries in London. A rigorous examination system is supported by a programme of continuing professional development and a professional code of conduct supports high standards reflecting the significant role of the Profession in society.

Introduction

The Actuarial Profession welcomes PADA's consultation on charging structures.

We agree there is no charging structure that meets all of the desired assessment criteria. The consultation paper demonstrates that decisions around charging structures are far from straightforward. This is hardly surprising since the life insurance industry has been grappling with similar issues in trying to price stakeholder pensions and personal pensions over a number of years.

In attempting to determine an optimum charging structure, we believe it is critical to undertake sensitivity analysis to assess the impact of differing assumptions applied to different possible charging structures. We would urge PADA, therefore, to apply the same type of financial management techniques that are currently being widely used in the life industry.

Responses to your questions

We have responded only to those questions where it is relevant for us to do so.

How should the principles of the personal accounts delivery authority relate to the charging structure recommendation, and in what way should the principles best be applied in this context?

The principles that relate to the charging structure appear to be:

- Encourage and facilitate participation in qualifying schemes

The charging structure should not discourage members from joining, although we know that charges are not a particularly significant factor in a prospective member's decision.

- minimising adverse impacts on qualifying schemes and their current and prospective members

There should not be an unfair advantage for personal accounts relative to other forms of qualifying pension scheme other than to the extent that personal account charges do not include any profit margin. It would be unfair if charges were at an unsustainably low level or inappropriate cross subsidies existed, particularly if this discouraged membership of other forms of qualifying pension scheme.

- minimising the cost of membership
- taking into account investment preferences

The greater the investment choice, the greater are the costs. Specialist funds only appeal to a small minority of investors but it is reasonable to pass any extra costs to those members that choose such funds. These extra costs can be recouped by way of a slightly higher annual management charge.

In relation to the charging structure options:

Single charge products are inherently risky for the product provider so we agree that combination charges are by far the best way to manage business risks and create equity between members.

Should additional charges be made for particular scheme activities?

It is appropriate for extra charges to be levied for non-standard activities (e.g. specialist fund choices). Two important points should be borne in mind

- a) Any extra charge should equate as closely as possible to the additional costs that are likely to be incurred.
- b) The number of non-standard activities should be kept to an absolute minimum. Any non standard activity (whether it is paid for or not) adds to the overall administration burden and inevitably leads to increasing costs.

What evidence is there about how consumers' perceptions affect participation in pension schemes or other financial products?

Charges are unlikely to be a significant barrier to consumer participation. The key factor is affordability. Other factors of importance relate to trust and security. Individuals want to know their money is safe. For this reason, we place considerable importance on those criteria relating to sustainability, and believe they have a strong link to member perception.

What evidence is there about the way in which administrative complexity or member behaviour have affected costs in existing financial products?

A modern policy administration system would easily cope with any of the charging structure proposals that are under discussion with no noticeable difference in the charges which would have to be levied.