Institute and Faculty of Actuaries

CP16/15 - Capping early exit pension charges

IFoA response to the Financial Conduct Authority

18 August 2016

About the Institute and Faculty of Actuaries

The Institute and Faculty of Actuaries is the chartered professional body for actuaries in the United Kingdom. A rigorous examination system is supported by a programme of continuous professional development and a professional code of conduct supports high standards, reflecting the significant role of the Profession in society.

Actuaries' training is founded on mathematical and statistical techniques used in insurance, pension fund management and investment and then builds the management skills associated with the application of these techniques. The training includes the derivation and application of 'mortality tables' used to assess probabilities of death or survival. It also includes the financial mathematics of interest and risk associated with different investment vehicles – from simple deposits through to complex stock market derivatives.

Actuaries provide commercial, financial and prudential advice on the management of a business' assets and liabilities, especially where long term management and planning are critical to the success of any business venture. A majority of actuaries work for insurance companies or pension funds – either as their direct employees or in firms which undertake work on a consultancy basis – but they also advise individuals and offer comment on social and public interest issues. Members of the profession have a statutory role in the supervision of pension funds and life insurance companies as well as a statutory role to provide actuarial opinions for managing agents at Lloyd's.

Institute and Faculty of Actuaries

Donald Cranswick
Pension & Insurance Policy Department
Strategy and Competition Division
Financial Conduct Authority
25 The North Colonnade
Canary Wharf
London
SW1H 9NA

16 August 2016

Dear Donald

IFoA response to FCA Consultation into capping early exit pension charges

1. The Institute and Faculty of Actuaries (IFoA) welcomes the opportunity to respond to the FCA's consultation into capping exit charges. Members of the IFoA's Pensions and Life Boards have written this response. We have limited our response to those questions where the IFoA is able to provide a specific response.

General Comments

2. We welcome the simultaneous consultations that the FCA and the DWP are undertaking on this matter. The IFoA believes consistency between trust and contract based schemes is important, as fairness should not depend on legal structures. Trustees, administrators and providers should all be subject to the same approach.

3. Given the request from government to the FCA for action in this area, we regard the proposals as a reasonable and balanced approach.

Q1 Do you have any comments about the impact of our proposals on equality and diversity?

5. The IFoA supports the proposed application of a cap only to those aged over 55, as this is the target age group where government wanted action in order to improve accessibility to the new pension freedoms. As an increasing number of younger people become scheme members through Automatic Enrolment (AE), they will enter new contracts and will benefit from the 0% cap in future years. Using 55 strikes a balance between individuals accessing pension freedoms and limiting losses to providers that may incur from not recouping high initial costs.

6. We would also suggest that any legislative change should cover the potential variability in the minimum age at which individuals could access pension freedoms, rather than reference a specific age.

Q2 Do you agree with our methodology?

7. Yes, we agree with the approach taken.

Q3 Do you agree that a cap of 1% on early exit charges in existing pension contracts is appropriate? If not, do you consider that a cap at a different level, or applied in a different manner, would be more appropriate (and, if so, why)?

8. We recognise the challenge in setting a cap that balances the need to protect customers' access to pension freedoms and limiting any potential loss to firms. Setting the cap at 1% ensures that a significant number of potential early retirees will benefit from the cap.

9. As we noted in our response to the HM Treasury consultation, many legacy products had a system of charges that re-couped expenses over the course of the product's term. Where such a charging structure included early exit charges, this was intended to ensure the insurer's expenses were still re-couped. Removing this charge will mean that insurers will be likely to have incurred an actual loss.

10. Applying a percentage will result in members with large pots paying more in cash terms than members with smaller policies. However, it is common to express exit charges on insurance products in percentage terms; therefore, the approach seems reasonable. An alternative approach would be to apply a maximum exit charge in cash terms, as it is unclear the work involved in processing an early exit would cost more depending on the size of the pot. However, applying a maximum monetary cap would be potentially complex and would lead to a higher impact on firms.

Q4 Do you agree that a cap of 0% on early exit charges in new pension contracts is appropriate? If not, do you consider that a cap at a different level, or applied in a different manner, would be more appropriate (and, if so, why)?

11. Changes in charging structures over the last two decades have enabled providers to offer more products that do not have exit charges. The suggestion in paragraph 3.31 that firms will not have exit charges for new products makes the 0% cap appropriate.

Q5 Would our proposals have any other implications on pension providers or on consumers that we have not considered in our analysis?

12. We are not aware of any other implications.

Q6 Do you agree that we have identified all the relevant costs and benefits?

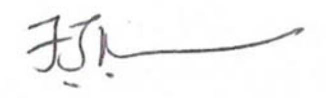
13. Yes.

Q7 Do you think the benefits to consumers, or the costs to firms, should be assessed in some other way (and, if so, how)?

14. No, but it is worth noting that the potential loss to firms would be a direct benefit to consumers.

15. Should you wish to discuss any of the points raised in further detail please contact Philip Doggart, Technical Policy Manager (Philip.doggart@actuaries.org.uk / 0131 240 1319) in the first instance.

Yours sincerely,



Fiona Morrison
Immediate Past President, Institute and Faculty of Actuaries