Institute and Faculty of Actuaries

CP21/14 Policyholder Protection

Consultation response to the Prudential Regulation Authority

6 January 2014

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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

Policyholder Protection responses
Orla Fitzpatrick
Prudential Regulation Authority
20 Moorgate
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EC2R 6DA

6 January 2015

Dear Ms Fitzpatrick

IFoA response to CP21/14: Policyholder protection

The Institute and Faculty of Actuaries (IFoA) welcomes the opportunity to respond the PRA's consultation 'Policyholder protection'. In producing this response, we have consulted with members of the IFoA's Life, General Insurance and Health and Care Boards.

General comments

1. The IFoA is in agreement with the general principle that policyholders should not face a penalty resulting from the failure of a firm with which the policyholder has purchased cover.

2. The IFoA welcomes the PRA's proposals for increasing the range of policyholder protection without a disproportionate increase in costs for firms remaining in business.

Proposals on compensation limits

3. It can be difficult to identify how policyholders depend on benefits from a contract; as the terms of contracts differ, so do the benefits they offer. The PRA may wish to consider how different policyholders rely on their insurance coverage in the context of the broader review of compensation limits. For example:
   i. The extent to which policyholders rely on their insurance cover does not necessarily commence from the time at which an income falls due, nor does that reliance increase at a constant rate, before or after the payment of the income.
   ii. It is not clear that the degree to which policyholders rely on the cover depends on whether the contracts provide current income.
   iii. Certain pension accumulation products could be considered as having benefits that were paid in the form of an income, such as Guaranteed Annuity Options. However, many other accumulation products are of a similar design, other than the nature of any guarantee, but they could be subject to different treatment. Consequently, a contract may not be readily distinguished as one in accumulation or decumulation. For example, a drawdown contract may have a temporary suspension of income, so it may be arguable whether it is in the accumulation, or decumulation phase. The new pension reforms are likely to make such situations more common and may result in significant product development for the decumulation market. Depending on the exact contract structures of the new products, some policyholders may have greater protection than other policyholders under the proposals in the CP.

iv. Different contract structures may also be a factor in variations in guaranteed and expected benefits. One example of this is asset share under with-profits business. Guaranteed benefits may be significantly less than asset share in both the accumulation and decumulation phases.

4. The examples above serve to highlight the differences that are inherent in policyholder protection contracts and areas where the change of limit does not appear to have sufficient clarity. We would welcome further information from the PRA on how it expects the application of the compensation limits to operate in practice across different contracts.

5. Of the two alternative approaches considered, we would support increasing the compensation limit to 100% for all classes of long-term business. The first option would remove the need for a subjective assessment of the contracts on which policyholders rely on most. It would also remove the distinction between accumulation and decumulation products, which is likely to become less clear after April 2015.

6. By contrast, the introduction of a cap on compensation may penalise a sub-set of policyholders, who fall under the terms of the cap despite having obtained cover on equivalent terms to those for whom a cap would not apply.

7. It is not clear to which benefits the 'revised guarantee' would apply. It would be helpful if all contracts that provide an income were to be treated in the same manner. Such contracts would include decumulation products.

8. The IFoA would also welcome clarity about the application of revised limits to claims arising prior to a particular date and any transition period. This would determine the extent to which policyholders would benefit from the enhanced guarantee.

Successor firms

9. The IFoA has no comments on this section.

Operational changes for the Financial Services Compensation Scheme (FSCS)

10. The IFoA would welcome any developments that would enable the FSCS to fulfil its obligations in the most efficient and cost effective manner, without resulting in any unintended consequences.

11. In addition, the IFoA supports the use of simplified terminology, providing simplicity results in greater clarity, as opposed to increasing ambiguity. We appreciate that, in communicating complex financial information, this balance can be difficult to achieve but it is critical from the policyholder's perspective that simplified language leads to greater understanding, not less..

Funding

12. It is not clear that net premium income is the most appropriate metric on which to assess the ongoing exposure to the risk of claims. However, we note giving firms a choice of metric on which to base the levy is likely to result in firms selecting the metric that would provide them with the most favourable outcome.

Should you wish to discuss any of the points raised in further detail please contact Philip Doggart, Technical Policy Manager in the first instance (philip.doggart@actuaries.org.uk / 07771813429).

Yours sincerely

David Hare
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