Institute and Faculty of Actuaries

CP14/11 Retirement reforms and the Guidance Guarantee

Response to the Financial Conduct Authority

24 September 2014

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

Maggie Craig
Policy, Risk and Research Division
Financial Conduct Authority
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London E14 5HS

22 September 2014

Dear Maggie

Institute and Faculty of Actuaries response to CP14/11 Retirement reforms and the Guidance Guarantee

1. The Institute and Faculty of Actuaries (IFoA) welcomes the opportunity to respond to the FCA's consultation 'Retirement reforms and the Guidance Guarantee'. This response has been led by a cross-practice group consisting of actuaries that have experience of working for life insurance companies providing contract-based pension schemes and also actuaries advising trust-based pension funds, both Defined Benefit and Defined Contribution.

2. We have focused our response on those questions where we have relevant expertise and would welcome the opportunity to discuss our response in more detail.

Summary

3. The consultation document demonstrates the broad nature of the proposed Guidance Service; in part, this is necessary to account for the freedom and choice that people over 55 will have from 2015 when they come to access their pension savings. As the document acknowledges, the introduction of greater freedom and choice into the accessibility of pension funds means that scheme members are likely to benefit most if they are able to access comprehensive information about their retirement savings that reflects their wider financial and personal circumstances. This presents a number of challenges that HM Treasury, the FCA, delivery partners and pension providers will need to overcome:

    a. The IFoA welcomes the FCA's commitment to 'set out very clearly for the consumer the scope, purpose and limitations of the guidance session'. Marketing of the guidance offer should promote realistic expectations about the nature of the available guidance, which will be tailored to individual requirements but will not extend to product or provider recommendations, or specific action to take. Managing consumer expectations will be key; not just to maximising the value of the guidance offer but also to ensuring that consumers who would benefit from more detailed advice receive appropriate signposting.

    b. The IFoA encourages the FCA to be explicit in the 'other issues' as set out in the standards [page 13] that should be covered in the guidance sessions and ensure this includes the primary risks that individuals face in retirement. We would recommend that, as a minimum requirement, this would cover life expectancy, the danger of running out of money during retirement, possible long-term care needs and investment risk.

    c. It is important that scheme members understand the significant likelihood that actual future lifetime may not be close to average life expectancy, and receive information on how they might best mitigate this uncertainty to ensure their retirement income spans their actual lifetime.

d. The proposals would require consumers to provide a significant level of detail; many individuals will be unable to access this information easily and this could act as a significant barrier to the success of these reforms. We suggest that, while the Guidance Guarantee will be universal, it would be helpful for the information requirements to be framed with regard to the needs of those consumers who would otherwise be least likely to seek guidance.

e. It will be important that the combination of requiring people to collate significant amounts of information and asking them to use it to make complex decisions involving unfamiliar concepts, does not overwhelm individuals and reduce the effectiveness of the guidance offer.

f. Whilst the Data Protection Act is referenced in section 2.13 we suggest it would be helpful if the consultation discussed the specific potential implications for data protection if delivery partners are collecting substantial amounts of personal information. Clarity on the implications for providers of disseminating sensitive information to a third party would be valuable.

Q1: Do you have any comments on the proposed standards for the delivery partners?

4. The scope of the proposed standards appears comprehensive and accounts for different stages of the guidance process; from alerting consumers of its existence, to developing a mechanism for redress. We would suggest the addition of a standard for delivery partners to provide guidance in such a way that individuals are able to meet any time constraints on their financial decisions.

5. The consultation sets delivery partners some challenging tasks in interpreting some of the requirements placed upon them:

   a. Paragraph 2.8 requires delivery partners to identify ‘relevant options for consumers and provide key facts and information on the consequences of those options’. Given the scope for significant freedom and choice, the definition of ‘relevant’ could potentially be very broad; further clarification on how the FCA might define ‘relevant’ would be useful.

   b. The need to accommodate the myriad choices that an individual could make and the requirement to present the consequences of making a particular decision necessitates the creation of a fully personalised Guidance Service. The standard requires delivery partners to request relevant information on individuals’ financial, personal and family circumstances [page 15]. The FCA should consider whether the volume of information a person will be asked to provide, along with the breadth of issues for the delivery partner to cover, could risk overwhelming the individual or diluting the value of the guidance session.

   c. Delivery partners are expected to set out ‘other issues for the consumer to consider’ and the proposed wording would seem to suggest that these are optional elements to cover in a guidance session. The phrase ‘This could’ is used, where we think it should say ‘This must’. It is very important that the ‘other issues’ are covered in the guidance sessions and include the primary risks individuals face in retirement. We would recommend that, as a minimum requirement, this would cover life expectancy and the possible variance, the danger of running out of money during retirement, possible long-term care needs and investment risk.

d. As a profession, actuaries are experts in analysing mortality experience and the consequential life expectancy. However, estimated life expectancy based on a large and relatively stable population cannot be used to determine the actual future lifetime of any individual within that population. It is therefore important for individuals to understand both the concept, and the likelihood, of their lifespan being very different from their life expectancy. In particular they should be made aware – especially if they are in better health - that they could live well beyond the expected average age, and they should be informed of how they might best prepare for this possibility by ensuring that their retirement income spans their actual lifetime.

Q2: Do you agree with the proposed use of the FCA periodic fees framework to collect the retirement guidance levy?

6. The IFoA supports the proposal that the periodic fees framework is used to collect the retirement guidance levy.

Q3: Do you agree that only firms in the proposed five retirement guidance fee-blocks (Table 3.1) should contribute to the retirement guidance levy? If no, please provide your reasons.

7. In principle, the IFoA agrees that firms likely to benefit from the provision of guidance should be the firms that pay the levy. However, the principle could be taken further to ensure that the amount of the payment is in accordance with the amount of business written. This would ensure greater equity in the distribution of the levy payments. For example, a protection specialist insurer would pay the levy, but that firm would be less likely to receive benefit from the guidance than an annuity provider. There would be merit in distinguishing such firms according to the class of business written.

Q4: Do you agree that firms in the remaining fee-blocks set out in Table 3.2 should not contribute to the retirement guidance levy? If no, please provide your reasons.

8. The IFoA agrees with this approach.

Q5: Do you have any comments on the three options for allocating the overall levy across the five retirement guidance fee-blocks? If you do not agree with any of these options please advise us of your proposed alternative allocation options

9. For the first option, basing the levy on the current split of the FCA Annual Funding Requirement, so that there is no change in proportion between the blocks, will mean the allocation is determined by FCA activity, as opposed to which firms are likely to benefit from the guidance. It is likely that this option will lead to a main beneficiary of the guidance, fund managers (including life companies), paying around 6 per cent, while deposit acceptors pay around 28 per cent.

10. We would suggest that the most appropriate allocation would be in line with consumers' retirement choices. This should ensure that the costs of the service are proportionately shared based on the extent to which firms may benefit; however, we would question whether the data currently exists to support this model – if this data could start to be captured it could provide a model for future use.

Q6: Do you agree with the proposed content of the signposting information? If no, please provide alternative suggestions.

11. We agree with the general description of the signposting content. If this information is to enable consumers to make an informed decision, even without taking up the guidance offer

(4.7), then it may be helpful for the information to include a version of the high-level list of options set out at 2.25:

“ • Taking income via a formal retirement income product; for example, an annuity or drawdown product (including other income generating products that may emerge).
• Taking cash, which could be used for any purpose including providing ad hoc income or a rainy day fund.
• A combination of these options.
• Not taking any action at that time.”

Q7: Do you have any thoughts on the standardisation of this information for the future?

12. The IFoA encourages the FCA to develop a template to ensure all firms include fundamental information, such as the fund value and the specific features of products, particularly guaranteed annuities.

Q8: Do you agree with the proposal to align the timing of the signpost with the existing timing requirements for wake-up packs?

13. The IFoA agrees that an appropriate time for an individual to access the Guidance Service would be in the immediate approach to retirement.

14. However, the IFoA would suggest that signposting to the guidance could helpfully occur at various points throughout the accumulation phase to encourage individuals to plan their income in retirement at a much earlier stage.

Q9: Do you agree with the proposal to introduce a transitional provision to ensure that those receiving wake-up packs before April 2015 do not miss out on being signposted to the guidance?

15. The IFoA agrees with the introduction of a transitional provision.

Q10: Do you agree with the proposal to add this guidance?

16. The IFoA agrees with the proposals outlined in section 4.15.

Q11: Do you agree with the proposal that firms should refer to the availability of the guidance whenever they are communicating with a customer about retirement options?

17. In line with our comment in paragraph 14, the IFoA agrees with the proposal that firms should refer to the availability of the guidance when communicating with a customer about retirement options.

Q12: Do you agree with our proposal to clarify the information provision requirement and add guidance on information that should be included?

18. The IFoA agrees with the FCA’s proposal to clarify the information provision requirements as outlined in section 4.24.

Q14: Do you agree with the proposal to remove the reference to maximum withdrawals and require a general statement about sustainability of income?

19. The IFoA agrees with the proposal to remove the reference to maximum withdrawals and require a general statement about sustainability of income as outlined in sections 4.30 to 4.32 of the Guidance Consultation.

Q15: Do you agree with our proposal to remove the reference to maximum withdrawals in COBS 13 Annex 2 2.9R?

20. We agree with the proposed changes to the COBS given that maximum withdrawals will no longer apply.

Q16: Do you agree that there do not need to be any changes to the key features contents rules? If no, please explain why.

21. The IFoA is not aware of any required changes.

Q17: Do you agree that the projection of an annual income in retirement and a projection of the total fund is still useful and therefore this rule should not be amended?

22. The purpose of the projection of an annual income in retirement and a projection of the total fund is to help an individual to understand the range and uncertainty of potential outcomes from their investment; to help them plan for the future and demonstrate the relationship between the amount of money a person draws down and the risk of running out of money over the course of their retirement. We would welcome a review of this rule to assess the extent to which it will continue to fulfil this purpose given that a wider range of products is likely to be developed in future.

23. The IFoA would encourage the FCA to consider the risks that could be considered within projections (e.g. longevity, investment).

24. The IFoA suggests that these projections could have greater importance following the freedom and choice agenda; as individuals will have greater flexibility over their retirement income, it is vital that they understand the potential implications of choices around drawing down a lump sum on their income over the course of their retirement.

Q18: Do you agree with the proposal to add a requirement for providers to provide their customers with a description of the possible tax implications when they are applying to access some or all of their pension fund using any of the options available?

25. One of the major challenges within the new regime will be ensuring retiring scheme members are fully aware of the tax consequences of decision making. Part of that awareness should also involve the use of any previous information obtained.

Should you want to discuss any of the points raised please contact Policy Manager, Philip Doggart (philip.doggart:actuaries.org.uk or +44 (0) 777 181 3429), in the first instance.

Yours sincerely,

Nick Salter
President, Institute and Faculty of Actuaries