



The Actuarial Profession

making financial sense of the future

Consultation response

HM Treasury

Simple financial products

March 2011

About the Actuarial Profession

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.

1 April 2011

Ms Joanna Bibby-Scullion
Savings and Investments Team
Room 3.20
HM Treasury
1 Horse Guards Parade
London SW1A 2HQ

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Dear Ms Bibby-Scullion

I am writing on behalf of the Actuarial Profession in response to HM Treasury's consultation on simple financial products.

The Actuarial Profession represents the members of the Institute and Faculty of Actuaries, the UK based chartered professional body for actuaries. Actuaries work in insurance, pensions, healthcare, investment and banking as well as in the management of risk, and so are directly involved in the provision of different sorts of financial products across a range of market segments.

Through a number of practitioner and research groups we have explored over the years many consumer and provider issues around financial products and their distribution. As Alan Botterill and Paul Atkinson discussed at their recent meeting with you and Carl Pheasey, we believe it might be valuable for HM Treasury to consider actuarial input in areas such as underwriting protection products, sustainable profitability of simple financial products and the implications of "kitemarking", in order to provide impartial, expert assessments in relevant areas.

The Actuarial Profession would be very happy to offer, or facilitate, support where appropriate and to share the thinking of some of our members in specific areas with you as HM Treasury develops its policy.

Our responses to some of the questions posed in the consultation are set out in the attached appendix A. Please note that we have not responded to questions where we believe it is appropriate for comments to come from other bodies closer to the issues raised.

We hope you find our comments helpful. We wish you success with your initiative on simplified products and we look forward to exploring with you our suggestions for support for your work going forward.

Yours sincerely



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President

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Q1: The Government would welcome general comments on the vision and objectives for a new regime of simple products

We support the vision and objectives. To initiate the changes in people's behaviour necessary for the success of simple financial products, it might be helpful to explore an approach that incorporates the following:

- A starting point with very simple products, such as savings deposit accounts and life assurance that do not require regulated financial advice;
- Product features that are very simple and capable of being kitemarked (thereby guiding the product offering, not the distribution process);
- Communications and processing that are very simple and tailored to the needs of the individual;
- Reassurance to product providers that there is no risk of the retrospective application of regulated financial advice;
- No price caps, but the encouragement of competition through transparency and comparisons.

This approach could have the advantage of establishing a basic level of products, against which other products can be compared and sold, with appropriate levels of advice and prices being determined by a competitive market.

Q2: Should this work be led by industry and consumer groups and not Government?

Due to its central role in regulation, taxation, social security and pension policy etc., we believe that at the outset the Government has to be actively involved, working with industry and consumer groups.

We understand that there might be a reasonable expectation that the development of the market for simple products should be led by the financial services industry. In this case, we suggest that the ISA model might be an appropriate way forward, with the Government setting the product and tax framework and then allowing private enterprise and competition to drive success.

In addition, however, recognising the importance of engaging people in all income sectors and the reduced levels of trust by consumers in various types of financial institutions, services or products, we suggest that a mechanism is created for the views of consumers from different sectors of society to be formally considered on an ongoing basis.

Q6: Are there any groups in particular that simple products should be targeting? If so, what implications would this have for the development and promotion of simple products?

The question of which groups, if any, to target is a policy issue that is a matter for Government. The following observations are based on the understanding that the aim is to create simple products that would have an appeal across the marketplace.

Assuming that an objective is to encourage lower income groups to start, or increase, savings from within their limited resources, it would be logical to start with very simple, easily understood products that can be implemented for this category effectively and without complication. This could help to build confidence and trust among this group of consumers. Also, reassuring providers that such products can be adequately profitable could provide a platform for the subsequent development of other products and the expansion of the market to other categories of people.

Additional detailed customer research may be required to understand fully the issues and types of consumer behaviour within different segments of society that need to be addressed in developing a framework for simple financial products. Our sense is that the recent financial crisis has impacted society's attitudes and their confidence and trust in financial institutions and Government. Also, the internet continues to grow in influence on many aspects of society - these changes to people's views and ways of interacting need to be understood and considered. There may be some valuable learning from the experience of NEST as it has developed its offering with a strong focus on the consumer.

Regardless of which target group may be involved, many consumers are put off by complexity and the need to seek advice. Security is of high importance to consumers and we therefore understand the rationale that suggests that products with the complication of investment performance might not be appropriate for initial consideration.

Similarly, assuming that Government may wish to have providers take the lead in developing simple products, it is important that they are not financially discouraged from serving the needs of all segments of society. Providers find it difficult to make an acceptable margin on low premium products where they have to provide financial advice, complex administration or extensive communication.

Question 15: What would be the benefits and disadvantages of linking simple products to CFEB's national financial advice service, including within the financial health check?

In order to achieve a sustained change in people's attitudes and behaviour in relation to savings and protection, we anticipate that simple financial products would need to fit naturally into an integrated framework of information about social security benefits (including state pensions means testing), taxation, financial advice and efficient execution. Aligning all of the different dimensions - including some new ones (such as NEST and auto-enrolment for pensions), social security and provider regulation - would have the advantage of building confidence and trust in the information, advice and products provided. The disadvantage would be the extended timeframe to align and co-ordinate multiple complex issues, many of which will change over time.

Question 19: The Government would welcome views on any other wider issues that need to be considered alongside simple products, including the impact on the wider market.

We understand that pensions are not likely to be included in the first group of simple financial products due to their complexity. However, taking a longer term view, you may wish to consider some of the key pension issues now when defining principles for simple products, in particular, the impact of the launch of auto-enrolment and NEST. This could raise questions about the future of stakeholder pensions and possibly of some occupational provision. Rationalising the pension landscape (including the changes to state pensions) and communicating this effectively could play an important part in supporting people in making informed decisions about the extent to which their savings should be directed to pensions, before any new simple pension product is introduced. The lack of a coherent, consistent framework of alternative pensions and related advice might undermine the confidence of the public and commentators in the overall initiative for simple financial products, and HM Treasury might therefore wish to consider this issue at an early stage.

Extending this point and linking back to Question 15, in order to achieve the most effective impact it might be helpful to consider how best to introduce simple financial products as a part of an integrated overall strategy for savings, social security and protection. If this is a reasonable objective, then the initiative could be linked appropriately to other relevant strategic developments such as pension policy, financial education, financial advice (CFEB), and the regulation of providers and products.

We welcome the Government's commitment to take the time to get this right. A development programme that builds steadily from a low base and provides a platform for future extensions and enhancements based on consumer feedback should provide a sustainable long term infrastructure.