Institute and Faculty of Actuaries

European Commission: Consumer protection in third-pillar retirement products

Consultation Response

Institute and Faculty of Actuaries

19 July 2013

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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

Directorate General Health and Consumers
European Commission
Unit B4 – Financial Services and Redress
B-1049
Belgium

19 July 2013

Dear Sir/Madam

Consultation response: Consumer protection in third-pillar retirement products

The Institute and Faculty of Actuaries (IFoA) welcomes the opportunity to respond to this consultative document. This response has been prepared by IFoA members who have experience of working on issues related to third-pillar retirement products. Where appropriate, we have combined our answers to a number of questions to better address the issues raised.

Questions 1 and 2

The IFoA welcomes the Commission's recognition of the difficulty in accurately describing third-pillar retirement products and we believe that the proposed definition captures the essence of third-pillar retirement products. However, we would propose one refinement to the definition that would reflect the current provision of third-pillar products in the United Kingdom.

Our reason for suggesting this change is that an employer in the UK can arrange and subscribe to personal pensions for its workforce. However, the contract is between the individual employee and the product provider, with each individual choosing the desired level of contribution. This type of contract would not fall under the regulation of occupational schemes (second pillar); therefore a change of definition could incorporate this type of contract.

Our proposed definition is as follows, with our amendment in bold:

"Third-pillar retirement products are defined as any type of private retirement product **~~subscribed to by consumers on an individual basis~~ where the contract is with an individual rather than an employer**, either voluntary or mandatory".

Questions 3

There are two main risks for consumers purchasing a third-pillar retirement product – Consumer Understanding, and Product Design. These main risks can subsequently be sub-divided into specific risks.

Consumer Understanding

Consumers who do not have sufficient financial education, or who have not received suitable financial advice, may not be familiar with the detail of the issues affecting their retirement or choice of retirement products. The direct consequence of this could be inappropriate decisions or knowledge of when to review these decisions. Specific areas where consumers would be required to make decisions where they may not have sufficient understanding to do so include:

- The required level of contribution to provide for a reasonable level of benefits in retirement;
- The impact that retirement age may have on the retirement outcome;
- Informed investment decisions that reflect their capacity to accept risk and recognise the impact of investment return on retirement benefits; and
- The choice faced at retirement in respect of annuity purchase or any alternative method of converting accumulated funds into an income.

<u>Product Design</u>

Consumers may face the risk of sub-optimal or poor scheme design. The risk is potentially increased where consumers do not have the appropriate level of understanding. Particular areas of scheme design where this risk may arise include:

- Inflexible contribution structures for members;
- Insufficient/inappropriate investment options;
- Inflexible design at the point of retirement, or poor information for the required decisions at retirement;
- Inflexible/inappropriate retirement age; and
- Poor value for money.

Question 4

We believe that asymmetry of information between the consumer and the provider should be an area of concern. Consumers should receive information that reflects the benefits and risks that arise from purchasing the product. The information provided and the manner in which it is presented should be viewed as an element of the consumer's understanding of the product. Where information is not provided, or is not presented in an understandable format, the asymmetry is likely to continue, increasing the risk to the consumer of taking poor decisions leading to poor outcomes. However, there may not be a direct relationship between the provision of information by providers and an increase in consumer understanding.

Question 5

We believe the introduction of any standards should be mainly concerned with addressing the risks set out in Question 3. It is worth noting that in the UK there are detailed regulations and guidance covering product communications and design. These regulations and guidance reflect the practice and standards within the UK.

Question 6

The consultative document provides only two options. We would encourage the Commission to consider the full range of available options to ensure the best outcome for consumers. Given the level of disclosure in the UK, we do not believe a self-regulatory code would provide the best outcome. Of the options discussed in the document, IFoA believes that a self-regulatory code would be the better option to manage the risks we have listed in our response to Question 3.

Please note that our answers to questions 7-9 reflect the options in the document rather than necessarily being the best option available.

Question 7

A self-regulatory code could be the better solution of the two suggested in the following areas:

- Transparency of product benefits and risks;
- Transparency of fees;
- Increasing consumer understanding of the product;
- Showing high quality supporting information disclosures and marketing materials. (This could be equivalent to the “kitemarking” system used in the UK); and
- Ensuring the product sold meets the consumer’s needs.

Question 8

Of the options discussed in the document, IFoA believes that a self-regulatory code would be the better option to manage the risks we have listed in our response to Question 3. However, as previously stated, given the level of disclosure already in the UK, we do not believe a self-regulatory code would be of most benefit to consumers.

Question 9

A national regulator is likely to be in the best position to monitor such a code. Our experience is primarily in the UK where a majority of third-pillar retirement products are insurance contracts and are already subject to regulation by the Financial Conduct Authority (FCA) requiring transparency and consumer protection.

Consumers are likely to benefit most from transparency and protection standards when they obtain the most relevant and timely information.

Questions 10 -12

The consultative document highlighted more than once, the differences in market practice and regulation, which were also reflected in the responses to the 2012 questionnaire. While we suspect an EU certification scheme could achieve the same objectives suggested in our previous answers, the significant differences between member states would mean any re-alignment of market practice across member states could be expensive, leading to increased costs which would be detrimental to consumers.

If you have any questions regarding this response, please contact Philip Doggart, Policy Manager at the Institute and Faculty of Actuaries (Philip.Doggart@actuaries.org.uk, or +44 (0)131 240 1319)

Yours sincerely

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