Institute and Faculty of Actuaries

Discussion Paper DP13/1 : Transparency

Financial Conduct Authority

30 April 2013

About the Institute and Faculty of Actuaries

The Institute and Faculty of Actuaries (IFoA) 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 actuarial society 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 actuarial 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

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30 April 2013

Dear Carol Anne

Discussion Paper DP13/1 Transparency

The Institute and Faculty of Actuaries (IFoA) welcomes the opportunity to respond to this discussion paper. This response has been prepared by some of our members who practice in both General Insurance and Life Assurance.

The IFoA believes that transparency is a valuable element for consumers to understand financial products. We agree with the discussion document that a benefit of transparency is to help consumers make more informed choices. However, the limitations on that benefit depend on the disclosure of relevant information that can be clearly understood. To that end, we wish to comment on two specific issues arising out of section 5 of the document.

Improved transparency in the annuity market (Paragraphs 5.6 to 5.10)

The problems that consumers can experience when engaging with the annuity market are well articulated in the text. However, we would question whether the additional disclosures envisaged in these sections would improve the practical operation of the market.

One concern we have identified is how significantly the design of an annuity will affect the amount in payment. It is difficult for consumers to value the inclusion of escalation rates, guarantee periods, returns of capital and differing survivors' annuities. These factors also have material impacts on the expected term of the annuity. Providers will use differing mortality and investment assumptions that may mean it would be unreasonable to extrapolate the relative pricing from a benchmark annuity to the specific circumstances of the individual.

The value for money argument is also dependent on the design of annuity where terms are enhanced due to medical or lifestyle conditions, or even due to postcode. Guarantees are relatively more expensive for those eligible for enhanced annuities, or who live in high mortality areas, than for the healthy. The opposite is true for escalation. Thus, it is important that like-for-like comparisons are made and that these represent the annuity the consumer actually wants/needs.

We believe that to improve the effectiveness of annuity market operations it is key to improve the access to relevant comparison quotes and advice, while applying the lessons of the FCA's work on behavioural economics.

Publication of claims data on insurance products (Paragraphs 5.11 to 5.17)

The aim of the FCA's proposals on product disclosure is to improve consumers' decisions in the market of the value of products (5.4). We agree with the view expressed that if consumers better understood the value of products this could improve consumers' decisions in the market.

However we do not consider that the publication of claims data is necessarily the best way to help consumers understand the value of products. Our main concern is that, in the FCA's own words, unless presentation of any data is "sufficiently rigorous and where it would not cause unreasonable conclusions to be drawn", it might serve to confuse rather than to enlighten.

Likely products for which additional disclosure has been suggested by the FCA as working well are add-on or non-core products such as warranty, home emergency, identity theft, and mobile phone insurance (5.14). Ratios have been suggested in paragraph 5.15 such as claims per customer; successful claims percentage following initial contact; premium vs. payout ratios; reducing/refusing claims due to non-disclosure.

By way of example of the challenges and costs to producing rigorous and meaningful claims data, consider the measure of successful claims percentage following initial contact for the home emergency product. Whether at a market level or a firm level, for this statistic to reliably inform the consumer the measure needs to be consistent across firms. A firm which encourages the consumer to contact it on a help line either by phone or app may record "first contact" quite differently from one that doesn't offer such a facility and have a low ratio, which may be misleading. To compound this, first contact may be with an intermediary firm rather than an insurance firm - i.e. the denominator and numerator reside in different firms.

Similar challenges exist in the above example in the measure of claims per customer, in terms of the definition of a claim. Even in measures of reduction or refusal of claims due to non-disclosure, it is not clear whether the statistic may show prevalence of customer fraud as much as any indication of product performance.

Of the measures cited in the paper, we feel that the most useful would be the premiums versus payout ratios. This is typically measured as loss ratios measuring the claims amounts incurred across the product over a year divided by the corresponding premiums. If used for products which are not expected to be volatile (such as products exposed to weather or others exposed to infrequency large claims), this measure could give an indication of value for money. The definition of this loss ratio would however need to be very clear: measures of claims amounts based on claims paid for example could be inappropriate where claims may be reported late. Here the least inappropriate measure may be the claims incurred booked in a period divided by the premiums "earned", albeit that this measure could understate or overstate the value of a product where a company is growing or reducing its sales of a product. It should be borne in mind, however, that there may be "peace of mind" value in insurance products over and above any such quantified financial value.

The FCA may wish to consider the extent to which focussing efforts on costly data collection with potentially limited benefits should be limited. We consider that there could be as much, if not more benefit in focussing on appropriate educational material for the consumer and clear English explanations for product features and benefits presented in a way that the consumer gains a better understanding of the value of products.

If you require any further information from the IFoA about this response, you should contact Philip Doggart (Philip.Doggart@actuaries.org.uk or +44 131 2401319) in the first instance.

Yours faithfully

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