Institute and Faculty of Actuaries

CP18/7: Improving the quality of pension transfer advice

IFoA response to the Financial Conduct Authority

25 May 2018

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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

Sandra Graham and David Berenbaum
Strategy and Competition Division
Financial Conduct Authority
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London
E14 5HS

25 May 2018

Dear Sandra and David

IFoA response to Consultation Paper CP18/7: Improving the quality of pension transfer advice

1. The IFoA welcomes the opportunity to respond to the FCA's consultation paper on improving the quality of pension transfer advice. This response, which is intentionally limited to the questions that we feel apply to our area of expertise, builds on the points made in our previous response to the FCA's CP17/16: Advising on Pension Transfers.

2. We support the FCA's goal to raise the standards of advice that firms provide in order to protect consumers transferring deferred benefits out of defined benefit (DB) schemes. Our response highlights those areas where we suggest further amendments could be made to the standards that the FCA is proposing to better protect consumers from long–term risks.

Q3 - Do you agree with the proposed changes to the appropriate exam standard ApEx 21? If not, how would you suggest we amend it?

3. We are encouraged to see that the proposed exam standards in ApEx21 include An4.5 - the ability to analyse the risk of running out of money if the customer lives beyond average life expectancy, to ensure advisors plan 'for a reasonable period beyond life expectancy'. We suggest that the exam standard explicitly requires advisers to inform clients that their safeguarded benefits will be lost upon transfer, ensuring that they clearly understand they are giving up an income for life, regardless of how long they live, for a one off payment that they will have to manage themselves. It is impossible for individuals to know how long they will live. If consumers underestimate their life expectancy and do not have safeguarded benefits through DB, or an alternative product that offers them an element of guarantee, there is a risk that they will run out of money in retirement. It is imperative that clients are made aware of this risk.

4. We recommend that the FCA's guidance clarifies what a reasonable period might be. Further, as our previous consultation response noted, we suggest estimating average life expectancy using the Continuous Mortality Investigation's annual updates for the mortality experience of DB scheme members. This set more accurately reflects future expected mortality improvements for the transferring population.[1] The ONS projections suggested by the FCA

[1] IFoA (2017) *IFoA response to FCA CP17/16: Advising on Pension Transfers*

may be too broad as they capture population mortality.

Q8 - Do you agree with our proposed guidance on assessing attitude to transfer or conversion risk?

5. We agree with the overall approach, in particular focussing on both the risks and benefits to not transferring as well as to transferring. However, it is not clear to us that the list set out adequately covers longevity risk – that is, that on transfer the risk of living longer than anticipated transfers from the scheme to the member. We would suggest that the guidance encourages those advising on transfers to explicitly highlight and asses the client's understanding of the giving up of a safeguarded benefit, as is noted in the existing regulations (COBS 19.1.6. 4b).

Q10 - Do you agree with our proposal on pension increase assumptions?

6. We appreciate that the FCA is trying to simplify pension increase assumptions. However, the proposed fixed rate increases, at the level of the collar for collars above the relevant RPI/CPI rate and at the cap for caps below the RPI/CPI rate, may underestimate the cost of providing pension increases subject to a minimum rate of increase. This could therefore significantly underestimate the true value of the safeguarded benefit. To illustrate this, if a scheme provides pension increases in line with RPI subject to minimum of 3% pa, and inflation is expected to average 3% pa, then if we understand your proposals, the assumption would be that pension increases are 3% pa. In reality, inflation will be more volatile, and even if it does average 3% pa as assumed, there will be potentially many years when it is in excess of 3%. On average therefore, pension increases are almost certain to average more than 3% pa, and the proposed approach therefore undervalues the existing benefits. (Note that it is very likely that, in calculating the transfer value in the first place, the scheme actuary has placed a value higher than 3% pa on the pension increases for this benefit). Advisors' risk analyses should cover this point.

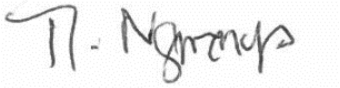
Q11 - Do you think that contingent charging increases the likelihood of unsuitable advice? If so, can you provide any evidence to support intervening in the way pension transfer advice is charged, or would another approach be more effective?

7. We strongly agree with the analysis suggesting that pension transfers are different to other forms of IFA advice and that therefore further protections are necessary to avoid inappropriate incentives for advisers to encourage members to transfer. However, as we are not directly involved in this market we cannot offer more detailed comment on the various options considered.

Should you wish to discuss any of the points raised please contact Henry Thompson (Henry.Thompson@actuaries.org.uk) in the first instance.

Yours sincerely,

Marjorie Ngwenya



President
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