Institute and Faculty of Actuaries

CP17/16: Advising on Pension Transfers

IFoA response to Financial Conduct Authority

21 September 2017

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

21 September 2017

Emily Pinkerton
Strategy and Competition Division
Financial Conduct Authority
25 The North Colonnade
Canary Wharf
London E14 5HS

Dear Emily

IFoA response to FCA Consultation Paper CP17/16: Advising on Pension Transfers

1. The Institute and Faculty of Actuaries (IFoA) welcomes the opportunity to respond to this consultation. The IFoA's Pensions Board has contributed much of the detail in this response. We have also received input from our Life Board. We have answered only the questions where we have specific comments to make.

Q1: Do you agree with our proposal to require all advice on the conversion or transfer of safeguarded benefits to be a personal recommendation? Please provide the reasons for your response.

2. The IFoA supports the proposal to include a personal recommendation on whether or not to transfer. Within a personal recommendation, there is sufficient scope for the adviser to explain the benefits and drawbacks of the transfer. As such, the balance of the argument will be clear within the recommendation. The personal recommendation also enables the adviser to set out any relevant caveats they wish to include within a recommendation to transfer.

3. A personal recommendation makes the advice specific to the individual rather than a generic exercise. The personal recommendation is more consistent with current best practice, so this approach should contribute towards a better advice framework.

Q2: Do you agree with our proposals for new guidance on assessing suitability? If not, what guidance do you think would be helpful?

4. The IFoA believes that the detail of the guidance may hide the key issues in helping an individual decide whether to transfer. Assuming there are no issues surrounding the viability of the DB scheme, and there is no desire to reshape benefits (for example dependants' benefits), the main issue for any individual looking to transfer is whether they wish to accept a transfer of longevity and investment risk from the DB scheme to their own arrangement. In simpler terms, do they want insurance or risk? Given the interim findings of the Retirement Outcomes Review, focusing on this question may lead to better outcomes.[1] The first bullet in paragraph 3.12 is crucial to achieving this.

[1] https://www.fca.org.uk/publications/market-studies/retirement-outcomes-review

London 7th Floor · Holborn Gate · 326-330 High Holborn · London · WC1V 7PP · **Tel:** +44 (0) 20 7632 2100 · **Fax:** +44 (0) 20 7632 2111
Edinburgh Level 2 · Exchange Crescent · 7 Conference Square · Edinburgh · EH3 8RA · **Tel:** +44 (0) 131 240 1300 · **Fax:** +44 (0) 131 240 1313
Oxford 1st Floor · Park Central · 40/41 Park End Street · Oxford · OX1 1JD · **Tel:** +44 (0) 1865 268 200 · **Fax:** +44 (0) 1865 268 211
Beijing 6/F · Tower 2 · Prosper Centre · 5 Guanghua Road · Chaoyang District · Beijing China 100020 · **Tel:** +86 (10) 8573 1000 · **Fax:** +86 (10) 8573 1100
Hong Kong 2202 Tower Two · Lippo Centre · 89 Queensway · Hong Kong · **Tel:** +11 (0) 852 2147 9418 · **Fax:** +11 (0) 852 2147 2497
www.actuaries.org.uk

5. The IFoA believes longevity risk is the biggest risk for individuals deciding to transfer. Even if drawdown funds perform as expected, if an individual lives longer than expected, they will exhaust their assets. As individual life expectancy cannot be derived from average life expectancy, it is important that applicants are fully aware of the consequences of transferring from the DB arrangement, where the income is guaranteed to be paid for life. A situation where half of individuals in drawdown exhaust their funds before death would not be a good outcome, in the IFoA's view.

6. It is important to consider the issue of employer covenant for the DB scheme when an individual considers a transfer. If a DB scheme member believes, with or without specific knowledge, that the employer will be unable to meet its funding commitments and that the scheme benefits might ultimately not be paid in full, the scheme member may decide to take a transfer. This knowledge may override any other information about whether a transfer would be in the member's best interests. This may not lead to an optimal outcome if the individual's knowledge is incomplete.

7. Overall, we believe that the biggest issues for members considering transferring are uncertain life expectancy, investment risk and (when relevant) the covenant of the sponsor of the transferring scheme. The existing and proposed rules governing the advice given to consumers concentrate on the slightly different outcomes emerging from slightly different investment choices. We believe that the FCA should correct this emphasis in order to satisfy its objective of creating a framework that enables advisers to give the right advice so that consumers make better-informed decisions.

Q3: Do you agree with our proposals to amend the glossary definition and to add guidance to the Handbook to clarify what a pension transfer specialist is expected to do when checking advice on transfers or conversion of safeguarded benefits?

8. In addition to our comments in response to question 1, the IFoA supports the proposed amendments. The changes permit the exercise of judgment rather than following a rules-based tick-box approach.

Q4: What are your views on how the current qualification requirements for pension transfer specialists operate in practice?

9. We do not wish to interfere in the details of the qualification requirements. However, we do believe that an understanding of life expectancy uncertainty, employer covenant and inflation risks should be seen to be as important as an understanding of tax and investment returns.

Q7: Do you agree with our proposals on the introduction of an appropriate pension transfer analysis? If not, how could we amend it?

10. There must be some objective financial analysis within the recommendation. We support the view that the customer's goals should be taken into account within that analysis. The analysis should consider the likelihood of meeting objectives, including consideration of retaining benefits within the DB scheme. This should provide a more complete understanding of what retirement can offer.

11. We do not agree with a pension transfer analysis system that uses solely average life expectancy and does not illustrate how outcomes will differ for individuals who do not die at the average age.

Q8: Do you agree with our proposals on preparing and presenting the client with a mandatory transfer value comparator within the appropriate pension analysis? If not, how could we amend it?

12. The key element within the analysis is to understand on what basis the comparison is taking place. The comparison should either be on present value, or on required yield. The graph in 4.19 suggests; however, the comparison should be on present value. This graph can form part of the analysis to the customer.

13. Paragraph 4.21 suggests a difficulty in taking commutation into account. There is no reason (other than cost) why the transferring scheme cannot provide two values – one assuming maximum cash commuted at retirement and one assuming no cash commuted at retirement.

14. It is important to emphasise that the value of the transfer to the member may not be reflected in such a comparison. There must be scope for the adviser to show additional information that reflects this value.

15. There is a risk that providing one comparator will place too much focus on that analysis. As we note in relation to longevity risk, there may be merit in suggesting advisers provide a range of scenarios, showing different outcomes.

Q9: Do you agree with the proposed changes to the assumptions for the rolling annuity interest rate, non annuity mortality, the growth rate and the inclusion of charges?

16. The CETV will be market related and any re-quotes will also reflect changes to assumptions. Consequently, if any analysis is to be comparable, assumptions should reflect current market conditions. We support the change to the interest rate assumption and would welcome the use of a yield that is no more than one month from the analysis date. Indeed, with most software packages in use, a rate at the date of comparison could be used.

17. We do not support the proposed approach to mortality assumptions. The ONS population projections do not reflect the mortality experience of DB scheme members. The Continuous Mortality Investigation produces annual updates of the mortality experience of DB scheme members. We believe this set of mortality projections would be more appropriate for the population of transferring members.

18. As the customer may decide to take a bespoke approach to retirement income, including investing outside pension funds, we would welcome a requirement to reflect the tax implications of any proposed investment decisions.

Q10: What are your views on the use of stochastic tools within appropriate pension transfer analysis? How could the outcomes be presented in a way which results in good consumer understanding, given the format and outcomes presented in other mandated documents?

19. The IFoA is concerned that many people reaching retirement (and their advisers) are oblivious to longevity risk. We would support any initiative that helped potential transferring members to recognise the risk of living for a number of years longer than expected. We strongly believe that communicating this simple idea may make the decision much easier for many customers. We would support any work the FCA undertakes in explaining longevity risk in plain English and in providing realistic scenarios.

20. Stochastic modelling is complex and understanding it will be beyond the average investor. We are sceptical that insisting on stochastic analysis would help investors make better decisions. Scenario analysis is likely to provide the explanation customers require.

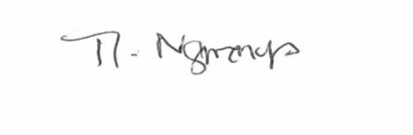
Q12: Do you have any views on the assumptions for CPI and for benefits with caps and collars?

21. We believe the 1% difference between CPI and RPI is more appropriate than the current approach.

22. We believe that having a fixed assumption about inflation is inappropriate, and is inconsistent with the use of market-based interest rates elsewhere in the calculation and advice processes. Market-based information for prospective RPI inflation is readily available.

Should you wish to discuss any of the points raised in further detail please contact Philip Doggart, Technical Policy Manager (Philip.doggart@actuaries.org.uk / 0131 240 1319) in the first instance.

Yours sincerely



Marjorie Ngwenya

President, Institute and Faculty of Actuaries