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The UK Insurance Industry

The UK insurance industry is the third largest in the world and the largest in Europe. It is a vital part of the UK economy, managing investments amounting to 26% of the UK's total net worth and contributing £10.4 billion in taxes to the Government. Employing over 290,000 people in the UK alone, the insurance industry is also one of this country's major exporters, with 28% of its net premium income coming from overseas business.

Insurance helps individuals and businesses protect themselves against the everyday risks they face, enabling people to own homes, travel overseas, provide for a financially secure future and run businesses. Insurance underpins a healthy and prosperous society, enabling businesses and individuals to thrive, safe in the knowledge that problems can be handled and risks carefully managed. Every day, our members pay out £147 million in benefits to pensioners and long-term savers as well as £60 million in general insurance claims.

The ABI

The ABI is the voice of insurance, representing the general insurance, protection, investment and long-term savings industry. It was formed in 1985 to represent the whole of the industry and today has over 300 members, accounting for some 90% of premiums in the UK.

The ABI's role is to:

- Be the voice of the UK insurance industry, leading debate and speaking up for insurers.
- Represent the UK insurance industry to government, regulators and policy makers in the UK, EU and internationally, driving effective public policy and regulation.
- Advocate high standards of customer service within the industry and provide useful information to the public about insurance.
- Promote the benefits of insurance to the government, regulators, policy makers and the public.

The ABI welcomes the opportunity to respond to the **CP 12/10 :**

Product projections and transfer value analysis- consultation by the Financial Services Authority (Chapters 3 and 4)

Statutory Money Purchase Illustrations- consultation by the Financial Reporting Council (Chapter 5)

Chapter 3 – transfer value analysis

Question 4: Do you agree with the assumption for CPI-linked revaluation in deferment? If not, please state the level at which you believe the assumption should be set and why you believe it is more suitable.

We agree with and support the FSA's proposals.

Question 5: Do you agree with the approach and level of the assumptions for pension increases based on CPI? If not, please explain what alternative basis you think is more appropriate.

We agree with and support the FSA's proposals.

Question 6: Do you have any comments on the cost benefit analysis for our proposals in chapter 3?

We have no comments on the cost benefit analysis.

Chapter 4- Changes to COBS 13 Annex 2- investment return assumptions

General comments

The Association of British Insurers welcomes the opportunity to comment on the regulation of investment return assumptions.

We believe that the existing projections regime requires a fundamental review. As DP 04/01 acknowledged, the existing FSA requirements fail to give consumers an adequate understanding of the variability of outcomes (including the potential for downside risk) or explain the importance of term on investment return. The ABI also believes that the dual FSA objectives of projections – helping consumers to compare the effect of charges between products and giving them an indication of likely investment return – cannot both be met by the provision of the current figures so greater clarity is needed as to the purpose of providing projections.

The FSA's proposals to revise the rates downwards and strengthen rules requiring providers to use appropriate rates will not tackle these issues, and will do little to improve consumer understanding. A more fundamental review is required. The ABI is commissioning independent consumer research to test alternative approaches to presenting investment returns and we would like to work closely with the FSA on this. We recognise that it is challenging to find a replacement to the existing approach, but we are confident that there is scope to deliver better information to consumers, and believe this requires the regulator and the industry to work constructively together.

We are also mindful of the European Commission's Packaged Retail Investments Products (PRIPs) proposals, which were published recently. This initiative will have a significant impact on the form and content of pre-contractual information across Europe and includes proposals to harmonise information on risk and reward, performance scenarios and charges.

The PRIPs proposals could be agreed in 2013, giving a good indication of the impact of the initiative on existing UK disclosures. With this in mind, we query whether there is much to be gained by revising projection rates downwards in the short-term, particularly since the changes will generate few benefits in terms of increased consumer understanding and may have a limited "shelf life". In any event, we believe that the FSA should undertake a fundamental review of the projections regime, with necessary changes to be implemented alongside the PRIPs initiative.

In the meantime, we have responded to the FSA's questions below as we have reservations about the specific proposals put forward.

Question 7: Do you agree that this change of wording provides sufficient additional emphasis for providers regarding our longstanding requirement that they use appropriate projection rates?

We note that the proposed wording of COBS 13 Annex 2.3 is:

> " A standard deterministic projection must be calculated using rates that **accurately reflect the investment potential of the product** and do not exceed the following maximum rates of return…"

Firstly, we are concerned that the use of the term 'accurately' places an obligation on firms to be certain of future outcomes. Since no one can predict future outcomes with absolute certainty, we suggest that "properly" or "appropriately" would be a better alternative.

If, as the wording indicates, projections are intended to provide an accurate or appropriate illustration of potential returns, we have reservations about whether it is appropriate for them to be artificially capped. Though it is unhelpful for consumers to be overly optimistic, these proposals will prevent firms from providing realistic projections to clients invested in certain instruments, for example those invested heavily or entirely in equities. Capping projections below their expected returns means emphasising the downside of such funds without demonstrating the potential for higher returns. This might dissuade consumers from investing in certain products/funds and might create the misleading impression that they are better off investing in cash-like instruments.

Furthermore, we are concerned that the focus on "product" within the wording of the proposed rule may create confusion amongst providers regarding their obligations to project on the basis of the fund selection or investment strategy chosen by the consumer at point of sale.

Question 8: Do you agree that the proposed changes to these assumptions are appropriate? If not, what changes would you propose? Please explain why you would make other proposals.

Overall, we do not believe that the proposed changes will tackle the deficiencies in the existing projections regime. Revising the rates downwards will not give consumers a better understanding of the variability of outcomes or explain the importance of term on investment returns. Nor will it assist them in comparing the effect of charges, while there also exists an additional requirement on providers to use appropriate (and therefore different) rates.

On a specific level, we query the decision to use an intermediate rate lower than that recommended by PwC, and the lack of evidence provided to justify doing so. The PwC report recommended a maximum intermediate rate of 6 per cent. The arbitrary decision to lower the rate a full 1 per cent to 5 per cent seems to undermines the evidence based rationale for the PwC proposals. We are also sceptical about the apparent FSA justification for a downward revision of a whole 1 per cent – that using half or quarter per cent figures might imply a "spurious accuracy" to consumers. Consumers should focus on the projected

value of the return rather than the underlying projection rates and the FSA is anyway proposing a half per cent adjustment for tax disadvantaged products.

We also query whether it is appropriate to set the maximum rates on a 'typical' mix of investments, especially since the PwC report acknowledged that pension funds and insurance products have very different asset allocations. Since this methodology was developed, consumers are able to access funds/products with a wide range of asset allocations. We are concerned that setting the maximum intermediate rate at 5% understates the growth potential of investments with higher equity content, skewing their risk/return profile. Instead, the FSA should consider setting the maximum intermediate rate so that it reflects the likely returns of funds/products invested 100% in equities while making it clear that lower projection rates are required for funds/products with other asset mixes.

We also have concerns around the lack of clarity regarding the use of flanking rates of 3%, particularly for lower risk funds/products. We believe more guidance is needed regarding how companies should show the spread of investment potential for funds such as cash. For example, if the appropriate intermediate investment rate is 2%, what flanking rates should be shown?

The ABI is commissioning independent consumer research to test alternative approaches to presenting investment returns. We would like to work closely with the FSA on this and would particularly welcome consensus on the regulatory objectives/desired outcomes of providing projections, as well as debate on alternative approaches.

Question 9: Do you agree with the cost benefit analysis for our proposals in Chapter 4?

No, we believe the FSA are wrong to state that there will be no costs associated with making these changes. There may be systems development implications for firms, for example, where there are legacy contracts and/or where there is "hard-coding" in the systems. In addition, there could be a significant amount of testing to be undertaken to ensure that calculations are correct and the changes have not created any additional issues. Evidence from member firms who have made changes to their systems to provide realistic rates indicates that the changes would still cost a firm between £200,000 and £750,000.

We would also highlight that frequent, piecemeal changes add to costs. Firms have already made changes to their systems to allow them to provide "realistic" projections. They are also faced with a number of changes arising out of RDR, changes to mortality assumptions and changes to the SMPI. We are not persuaded that the FSA should insist on additional changes that will be of little benefit to consumers.

<u>Chapter 5 – Statutory Money Purchase Illustrations</u>

Question 1: Do you agree that the assumptions in AS TM1 should be consistent as far as possible with those specified in COBS 13 Annex 2 of the FSA Handbook?

The ABI believes that the FSA's projections regime requires a fundamental review. We are commissioning consumer research to develop an alternative. This research may recommend an approach that differs from the current deterministic regime set by the FSA. Nevertheless,

in principle, we believe there should be consistency between communications with customers from the new business quote stage throughout the term of the pension policy. This would also help providers make changes to systems more efficiently.

Question 2:

a) Should AS TM1 continue to specify a maximum accumulation rate?

Notwithstanding our comments above, we believe, at least in the short-term, that retaining a maximum helps ensure greater consistency in the calculation of SMPIs and customer communications from pension providers.

b) If AS TM1 continues to specify a maximum accumulation rate, should it be the same as the FSA's intermediate projection rate?

Notwithstanding our comments above, we believe that the maximum accumulation rate should be the same as the FSA's intermediate projection rate. This would help ensure consistency of communications for new customers and help providers make systems changes more efficiently. However, consideration needs to be given to the potential impact of any rate change on existing policyholders. A 2% change in the rates could lead to a significant lowering in projected benefits for policyholders, particularly younger ones, undermining consumer confidence in pension saving.

c) If your answer to b) is 'No', what rate should be specified in AS TM1?

N/A.

Question 3: Should the wording for the mortality assumption in AS TM1 be changed along the lines of the wording proposed in Chapter 2?

Yes. We believe it is helpful to have a clearly defined basis that is consistent with that of the FSA. The proposed wording in CP12/10 removes potential ambiguity in how mortality improvements are factored into the calculation of the gender neutral mortality tables.

Question 4: Given the proposed nature of the changes to AS TM1, do respondents envisage any difficulties with a four-week consultation period for an exposure draft of a revised version of AS TM1?

Providers do not foresee any problems with a four week period for reviewing and responding to the consultation on the exposure draft of AS TM1.

Question 5: Do you agree with our proposals for the timing of any changes?

No. We believe an implementation date of 6 April 2013 is unrealistic, especially given there is not likely to be certainty of the details of the changes until the end of 2012. Providers will need to update a significant number of systems, and ensure the appropriate building and testing is carried out.

We believe it would be preferable to follow the approach taken in implementing gender neutral mortality under AS TM1 v.2.0 where an effective date is set but firms are afforded an

additional period in which to achieve compliance. The final date for compliance could be aligned to that set by the FSA for implementing FSA projection growth rate changes.

Question 6: Do you have any comments on the impact assessment for our proposals?

It is helpful to aim for greater consistency, both of the rates to be used and timescales for implementation, between SMPIs and the point of sale illustrations required by the FSA.

In order to minimise the cost of change, it is important that consistent changes to TM1 and FSA rules must be made to the same timescales. As the FSA's proposed amendments cover a wider scope than the proposed amendments to the SMPI, we believe an implementation date of April 2013 is unrealistic.

If SMPI changes are required by a different date than FSA changes, then there will be cost implications for many firms. To develop systems to perform different calculations for different purposes, for even a short period, would entail effort and cost. It would also introduce the potential for unnecessary customer confusion or concern, and the generation of a considerable volume of enquiries.