Society of Actuaries in Ireland

Submission to the Financial Regulator on Consultation Paper 34, "Review of the Life Assurance (Provision of Information) Regulations 2001"

October 2008

Introduction and Executive Summary

The Society of Actuaries in Ireland welcomes the opportunity to make this submission in response to the Financial Regulator's Consultation Paper CP 34 "Review of the Life Assurance (Provision of Information) Regulations 2001". We are responding to this consultation in the context of the profession's mission to serve the public interest in areas where our input can be of benefit. The Society has worked closely with the relevant regulatory bodies in the past in relation to the disclosure regime for life assurance and has built up significant experience in this area. The Society has been proactive in adapting its Actuarial Standards of Practice in relation to disclosure to address issues arising from the evolution of the marketplace. We look forward to continued cooperation with the Financial Regulator in the further development of the disclosure regime.

We have responded to each of the individual questions in the Consultation Paper. The detail of our response is contained in the following pages. However, we would like to draw particular attention to the following points:

- **As stated in the past, we are strongly of the view that the same disclosure requirements should be imposed on all investment products, whether or not an insurance policy is involved, in the interests of consumer protection. The Consumer Protection Code has been effective in enabling comparisons across all tracker bonds, in particular. However, other investment vehicles need to be brought within this framework.**

- The Society believes that changes to the disclosure regime for life assurance should also be reflected in the Consumer Protection Code to maintain consistency between the two.

- We believe that the existing disclosure regime for life assurance provides an effective model for informing customers of projected benefits, charges and remuneration. However, there is scope to summarise some information, highlight the main features and reduce the amount of further information given to customers, while ensuring that customers are provided with the necessary information to enable them to understand the fundamental features of their policies. To that end, the Society suggests that a summary document be produced which highlights the key features, risks and benefits under the policy – see Appendix. We believe that the existing disclosure document can be appended to this in order to provide consumers with more detail, should they require it. However, we recommend that some items be removed from this disclosure document where they add little additional information or where the information is not appropriate to the product being offered (see Appendix).

- We believe that product features should be expressed in clear, jargon-free language and we propose the use of standardised definitions for commonly-applied charges. As part of this, we support the renaming of "reduction in yield" to a term such as "equivalent annual charge" or "effect of charges".

- We have reservations about proposals to provide projections on a range of growth rates. We believe that more work needs to be done to determine effective ways of explaining to consumers the different risks associated with different investments and the (relative and absolute) extent to which outcomes on different investments are likely to vary. We are willing to work with the Financial Regulator to take this forward.

- The current disclosure regulations for life assurance products exclude Occupational Pension Schemes. We understand that the Pensions Board is creating new regulations for the provision of illustrations for defined contribution pension schemes. The provision of information for Occupational Pension Schemes is a complex area and it would take more time than is available for this consultation to consider it properly. The Society is willing to work with the Financial Regulator and Pensions Board to determine whether the disclosure regime for Occupational Pension Schemes could and should be improved.

- The Society believes that, for savings and investment products, the provision of a detailed annual statement would be very useful for customers.

- Mindful that changes to the disclosure regime may be costly to implement, we recommend that the Financial Regulator carry out ‘road-testing’ of any proposals for change that it decides to take forward as a result of this consultation, to ensure that changes will genuinely add value to consumers.

Reponses to questions raised in Chapter 2, General Issues

2.1.1. How can financial advisers be encouraged to explain the disclosure material to their customers?

It may be that customers pay more attention to the personalised documentation (such as "reasons why?" letters etc.) than the disclosure material. Does the Financial Regulator's research provide evidence of this? If so, consideration should be given to the inclusion of more of the disclosure material within these letters rather than in separate stand-alone documentation.

2.1.2 The financial adviser signs a declaration stating that the particular consumer has been provided with a copy of the material required under the 2001 Regulations. How useful is this declaration?

The Society feels this declaration is useful to the extent that it underlines the importance of providing the documentation to the customer and serves as a good reminder to financial advisers to provide this. In the event of dispute, a signed statement may be very important to all parties.

2.1.3 The consumer signs a declaration stating that they have received the information specified in the Regulations. How useful is this declaration? Could a checklist of what was discussed in relation to the disclosure documentation be incorporated into this declaration?

The Society agrees that this declaration is important for the reasons given in response to Q2.1.2. A checklist would also be useful. In addition, a key issue is whether the customer has actually read any of the information provided. It may be useful to incorporate a statement to this effect in the declaration.

2.2.1. Does the present layout of this section (key features) adequately communicate key/relevant information on the product to consumers? Is the questions/answers format an effective way of communicating this information?

The Society believes that the questions and answers format is a useful format for communicating this information.

However, the Society feels that the disclosure documentation, while very comprehensive, suffers from the lack of a summary and anecdotal evidence is that it may not be read or understood properly by customers. The Society recommends that a summary of the main disclosure information (no longer than two pages) should be prepared (see Appendix). More detailed disclosure information can be contained in a longer document (broadly similar to the current one) but avoiding any unnecessary duplication of information contained in the Summary.

In addition, where the questions are simply not applicable, the Society believes that they should be omitted. For example, where the premiums are not reviewable, do not include a question about premium reviews.

2.2.2. Using the existing format, are additional questions and answers required? If so, please provide an outline of such questions.

We suggest that a question be included regarding the effect of inflation on the investment.

There is also a need for more information on possible risks inherent in the investment – see response to question 3.4.1.

2.2.3 Is the information about the product already adequately communicated in product brochures or does it need to be restated separately in the disclosure documentation?

Many providers have taken the initiative to incorporate the disclosure information into product brochures. This means that they can provide further detail in a user-friendly fashion and it assists the consumer in understanding the product. Where this has been carried out, the Society believes that there is no need for the information to be repeated in any formal disclosure document. However, if the Financial Regulator considers that there is merit in having all the key information in a structured format within one document (e.g. to facilitate comparisons between products), the document could nevertheless be shortened if sign-posting to other disclosures of the information (e.g. within a product brochure) was allowed.

2.3.1 Use of plain language and clear presentation

The Society believes that language should be as plain as possible. There should be little or no need for jargon and therefore a "jargon buster" should not be required. However, there will be instances when financial terms are necessary, e.g. to avoid misinterpretation, and where this is the case, they should be fully explained, perhaps in a glossary.

We suggest that consideration be given to drawing up standardised definitions of commonly-applied charges for use in disclosure documentation. In addition, we suggest that terms such as "initial allocation" and "bid-offer spread" should be condensed into a single number described as a "premium charge".

We agree that graphics could be used effectively (particularly in pre-printed documents – graphics might be impracticable in, for example, documents produced by point-of-sale systems). If the Financial Regulator believes that graphics are not appropriate, then a simple table could be used instead of graphs.

2.4.1 Proposal on layout of disclosure to reflect complexity of information

The proposal in CP34 is that predominantly textual information should be included at the start of the documentation and more complex, numerical information should be set out later in the documentation.

The Society considers that a mixture of numerical information and textual information can be useful in assisting the customer to understand the product. For instance, a description of charges followed by the effect of charges (in numerical terms) can show the customer the overall effect of the charges described. The Summary suggested in the Appendix reflects this view.

2.5.1/2 Questions regarding duplication of certain information

In CP34, the Financial Regulator notes that certain information is included in both the disclosure information and the Terms of Business document and questions whether the relevant section of the disclosure documentation should be limited to information about the insurer only.

We believe that the information on service fee should remain in the disclosure document and should be placed close to the adviser remuneration section. The information concerning the insurer, intermediary or sales employee should be grouped together and our preference is for it to be placed in the Terms of Business. This has the beneficial effect of shortening the disclosure information.

Reponses to questions raised in Chapter 3, Main Proposed Changes

3.1.1 Proposal to customise disclosure according to product type

In CP34, the Financial Regulator proposes that the Illustrative Table of Projected Benefits and Charges and information on the Reduction in Yield be shown only in respect of policies that offer the prospect of a surrender value.

The Society heartily agrees with the suggestion to remove the detailed charges and expenses table from the disclosure document in the case of contracts which do not acquire a surrender value. This would include term assurances, mortgage protection and investments which do not acquire a surrender or transfer value before maturity (e.g. some types of tracker bonds which are included under the Consumer Protection Code in any case).

We note a comment in CP34 that "The Illustrative Tables . . . outline the projected performance of the product from an investment point of view". This could be taken to mean that the Tables indicate expected performance. That is not the case. The Tables are illustrations of projected benefits (and charges) **on the basis of a particular assumed rate of investment return - and (as prescribed by regulation) a standardised rate of investment return is used, in order to facilitate comparisons of different products on a consistent basis**. Perhaps there is a need for further notes to be included with the illustration to make this clear.

3.2.1. Is there justification in showing more than one table of remuneration or is the inclusion of one table sufficient?

For contracts where the renewal commission is dependent on some factor (such as investment performance), it is important that the customer is made aware that the commission payable will depend on outcomes in relation to that factor. An example is "trail commission" which is based on fund value. Disclosure may be through the illustration of different figures for different investment returns (as is the current situation) or, if commission moves linearly with fund performance, disclosure may be through the illustration of a single set of figures (based on (say) 6% p.a. investment return) with a statement that "The renewal commission is based on the value of the fund at the end of each year. Should fund performance be better than that illustrated, your adviser will receive higher commission than that shown. Should fund performance be worse than that illustrated, your adviser will receive lower commission than that shown".

3.2.2 Should commission for protection-only products, which do not have an investment element, be disclosed differently than commission for investment products? What justification is there for a separate form of disclosure? What format should such disclosure take?

The Society believes that the current format is suitable for both protection and investment products and recommends that no changes should be made.

3.3.1 The Financial Regulator welcomes suggested formats for explaining the reduction in yield.
3.3.2 Is the actual phrase "Reduction in Yield" confusing and is there a better way to explain the concept?
3.3.3 Would it be beneficial for consumers to be provided with RIYs for each 5 year period?

The Society considers the reduction in yield figure to be essential in communicating the effect of charges to customers. It is a key number within the disclosure document which can facilitate comparison between products. We agree that the phrase "reduction in yield" may be somewhat confusing to some consumers. The phrase "equivalent annual charge" might be more appropriate, with an explanation as follows:

"The projected value of your policy is net of charges. The effect of these charges is to reduce your overall investment return. The higher the amount of charges, the greater the reduction in return to you. The "equivalent annual charge" indicates how much your annual return is reduced by charges. For instance, if the investment return was 6% p.a. and the equivalent annual charge was 1.5% p.a., the net return to you would be 4.5% p.a."

There may be a number of other, equally appropriate (or better) possibilities. The Society is willing to work with the Financial Regulator to explore options.

The Financial Regulator may wish to consider some industry standard for colour-coding the "effect of charges" figure depending on the level of this number, which could highlight high charges to the customer.

On duration-specific reduction in yield figures:

- We believe that a reduction in yield (RIY) number after various durations could be useful. RIYs could be illustrated for each 5-year period, as suggested. Alternatively, the duration-specific RIYs could be tailored to the product such that there is a total of three RIY figures produced (e.g. short-term after 3 years, medium-term 7 years, long-term 20 years), to avoid confusion. We believe that an RIY figure at maturity remains essential.
- We are conscious, however, that producing RIY figures for a range of durations is complex. It would require significant enhancement of IT systems and may impact on the operating performance of the systems due to the iterative nature of the calculations involved. The costs of the additional effort will ultimately be borne by consumers, and the benefits need to be weighed against the costs. It may be impracticable to include RIYs for a range of durations other than in generic, pre-printed disclosure documentation and subject to reasonable approximations being permitted in the calculation of the RIYs.
- We suggest that it would be worthwhile road-testing expanded RIY disclosures using, say, consumer focus groups in advance of firm decisions in this area. This research could also explore the effectiveness of other options – e.g. for savings plans, showing the breakeven point as well as the RIY might be effective. In any event, there may be a need for more consumer education on the meaning of RIY(/similar terminology) before introducing duration-specific figures.

We believe that the RIY information should be provided in the summary (see Appendix) rather than within the body of the disclosure document.

3.4.1 Proposals regarding rates of investment growth for the Illustrative Tables of Projected Benefits and Charges

In CP34, the Financial Regulator invites comments on the following proposals:

- The present option of including a second full illustrative table at a growth rate higher than the primary rate should be removed.
- Encashment values at the end of a set number of years should be shown for a wider range of possible investment outcomes than are currently shown. As well as the primary rate, encashment values after (say) 5 and 20 years, assuming growth rates 2% and 4% below the primary rate, should be shown, possibly in a separate table to the existing Table A.
- In addition, for products where the initial capital is not guaranteed throughout the term of the product, a projection at a negative rate of growth of -2% p.a. should also be shown.

The Society agrees that the second "full table" is of limited use.

Regarding the other proposals, we agree that it is important to convey to consumers that investment growth is not guaranteed, a range of outcomes is possible and (where applicable) the capital value of the investment is not guaranteed

We have concerns, however, about the proposals to show projections at a range of values. There is a risk that this will be confusing to customers and will lead to inappropriate assumptions about the likelihood of the various projections – e.g. all might be considered equally likely; it might be assumed that the most likely outcome is the average of all the outcomes shown; the "middle" value shown might be assumed to be the most likely outcome; the lowest and highest outcomes shown might be assumed to represent limits; etc.

We feel uncomfortable with proposals to show illustrations at a range of values, without any indications about the relative likelihood of different scenarios.

However, this is a complex area.

In November 2007, John Caslin, FSAI, and Damian Fadden, FSAI, presented a paper to the Society of Actuaries in Ireland entitled "How risky is my investment"? The paper is available on the Society's website at:
http://www.actuaries.ie/Events%20and%20Papers/Events%202007/How%20Risky%20is%20my%20Investment%20-paper-%20.pdf.

The paper includes proposals on how risk and reward might be presented and explained to consumers. The Society believes that more work needs to be done to take these proposals forward within a solid framework, but they merit careful attention. Further work might well conclude that educating consumers on risk/uncertainty and its relationship to return is beyond the scope of a disclosure document, and that disclosure should focus only on charges / remuneration.

The Society would welcome an opportunity to discuss the proposed changes, and possible alternatives, with the Financial Regulator more fully.

3.5.1 Is there scope for reducing the numbers of years for which information is provided in Table A? If so, how many years and which particular years should be shown to provide meaningful information to the consumer?

The Society believes that having graphical information (at least in pre-printed documents – see response to qt. 2.3.1) and a summary (see Appendix) should assist many customers in understanding the product. For those who require further detail, we believe that Table A should remain largely as is within the body of the disclosure document. Consideration could be given to limiting the projection period for Table A to a number close to the target term envisaged by the product provider. For example, if the product is explicitly marketed as a medium-term product with a target term of 5 to 7 years, a limit of 10 years may be more appropriate than 20 years.

Reponses to questions raised in Chapter 4, Other Key Issues

4.1.1. Would the extension of the Life Disclosure Regulations to Occupational Pension Schemes benefit consumers or is the present disclosure regime for such pension schemes sufficient?

The current disclosure regulations for life assurance products exclude Occupational Pension Schemes. We understand that the Pensions Board is creating new regulations for the provision of projections for defined contribution pension schemes. The provision of information for Occupational Pension Schemes is a complex area and it would take more time than is available for this consultation to consider it properly. The Society is willing to work with the Financial Regulator and Pensions Board to determine whether the disclosure regime for Occupational Pension Schemes could and should be improved.

4.1.2. Many responses to CP9 indicated that commission/remuneration disclosure should be extended to occupational pension scheme policies. Should such disclosure mirror the present life disclosure requirements? If not, what changes to the existing commission/remuneration disclosure should be made for occupational pension schemes?

We believe that commission and remuneration disclosure should be consistent for all financial products (whether these are life assurance or pension policies or not) throughout the industry. The current commission disclosure structure should be adequate to deal with this. There may be complexities in disclosing remuneration for occupational pension schemes but we do not believe that these are insurmountable.

4.2.1 The Financial Regulator invites views on whether the following information should be provided to policyholders on a yearly basis on the policy anniversary:

- **Opening policy surrender value**
- **Amount paid in by policyholder in the year**
- **Details of charges related to risk benefits deducted in the year (if any)**
- **Other charges deducted in the year**
- **Investment Growth in the year**
- **Closing policy surrender value**
- **Details of risk benefits covered (if any)**

The Society believes that, in relation to policies that have a surrender or maturity value, the suggested statement would be very useful to customers. Also, for protection policies, an annual statement of current sum assured would be useful.

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Appendix

We recommend that the disclosure document should start with a Summary (1-2 pages) that sets out succinctly:

- The **Aims** of the product
- The customer's **Commitments,** including premium amount and frequency
- The **Risks** involved
- The **Charges** and the **Reduction in Yield**, with an explanation and a statement of the assumptions used in the calculation
- Any other **Key Features** of the product that the customer needs to know about in order to make an informed decision on purchase
- Details of the **Intermediary Remuneration**
- Details of **Where to go for further information or to make a complaint**.

The remainder of the disclosure information should remain in the main body of the disclosure document. We suggest that the some of the information currently required could be omitted or (as above) moved to the Summary, as follows:

- Any questions that are not relevant to the particular product (see response to question 2.2.1)
- Information that is provided elsewhere (qt. 2.2.3)
- Information about the insurer, intermediary or sales employee (qt. 2.5.1/2)
- If the product does not have a surrender value: Table A (qt. 3.1.1)
- Reduction in Yield (move to Summary – qt. 3.3.3)
- Optional year-by-year illustrations at a growth rate higher than the primary rate (qt. 3.4.1)
- Intermediary remuneration (move to Summary)