JFAR risk perspective | additional risks | Debbie Harrison

April 2015 'freedom + choice' DC decumulation regime

1. **Pre-2001 policies**

   - From April policyholders with contracts written to age 65, for example, have the freedom to cash out/transfer. Most of these policies with have either a guaranteed annuity rate (GAR) or exit penalties.
   - Actuaries will be involved in assessing the impact on the policy value of early termination. It is inevitable that some policyholders will make poor decisions. Although actuaries cannot be held responsible for 'freedom + choice', their reputation is at risk where a large swathe of policyholders loses out significantly.
   - It is not clear how actuaries can help in this situation, but they must be alert to reputational risk and it might be wise to be proactive, e.g. in conversations for the firms for which they work (what support will the firm/scheme give policyholders?); and also as a profession, e.g. by issuing a press release and possibly a short paper on the perceived risks.
   - This is about ethics as much as technical issues

2. **DB to DC**

   - Similar issues arise as with the above. Estimates vary but it is likely that a significant number of DB members will transfer to DC to take advantage of freedom and choice. This might be a sensible move – e.g. an AVC fund transfer where the core DB benefit remains intact; a core DB transfer where the member has a life-shortening medical condition/has no dependents etc (i.e. the DC route is likely to confer better value/flexibility for the circumstances.
   - It is already possible to do a DB-DC transfer. What has changed is that employers and their advisers view this mechanism as government-condoned/lauded and therefore as the green light to use this as a more significant de-risking mechanism.
   - Actuaries will be involved in calculating transfer values. They need to consider all stakeholders: the member (fair TV relative to the funding level), the employer/scheme (impact on funding level). In the past DB-DC transfers have been insignificant relative to the scheme as a whole. The position changes where a large number of members transfer out – or where, in a smaller scheme, a few high-liability members (directors etc) transfer out. The impact on PPF-level funding could be detrimental, leaving the remaining members at risk.

Suggested additions to the document

Page 7: in the box

Second point ('characteristics') add high level risk 'evaluation of older policies in the light of April 2015 tax regime for DC decumulation; focus on DB-to-DC transfer value calculations

Third point ('environmental'), add high level risk 'unpredictability of government policy change'

Page 12: in the box

Under second bullet point add details from my note (1) above. If too much text, could put some in a footnote

Page 13: in the box

First point: suggest you add at end, 'These products also need to demonstrate value for money. This extends beyond design to distribution costs, e.g. in the retail market. A well designed product where the total charges are excessive will reflect poorly on the actuaries involved.

Page 20: 3.6.5: opening statement in box

Suggest add: 'Widespread mis-selling and mis-buying will lead to consumer detriment and undermine confidence and trust in the market'

Page 27: Annex 3

Add my points (1) and (2). They could come under several headings, e.g. 'understanding of risk + return', 'product design and distribution', among others. However, I suggest this should be a priority risk heading in its own right.

So, I suggest a separate heading at the top of 'April 2015 DC decumulation tax regime' – then under description 'actuarial treatment of older policyholders' and 'DB-to-DC transfers'