



Institute
and Faculty
of Actuaries

THE RISK

GREAT TRANSFER

Interim campaign report



Contents

- Introduction – what is the Great Risk Transfer?1
- Our approach2
- Risk transfer - surveying the territory3
 - Pensions
 - Social care
 - Life insurance
 - General insurance and risk pooling
 - Investment - advice and consumer understanding
 - Employment
 - Disadvantaged groups
- The Great Risk Transfer – the UK experience 9
- Drivers of the Great Risk Transfer10
- Harms and benefits of risk transfer 12
 - Specific products and markets
 - Consumer factors
- Towards solutions 15
 - The role of policy
 - The role of regulation
 - Some solutions suggested by respondents
- Conclusions and next steps 18

Introduction: what is the Great Risk Transfer?

In recent decades, many risks that were previously managed by institutions such as the state, financial services providers and employers, have increasingly become the responsibility of individuals.

There has been a steadily evolving trend towards institutions giving people more choice, but this freedom comes with additional responsibility, and individuals now have to manage a range of risks that they did not need to worry about before. Evidence of this shift exists in a number of areas of public policy and amounts to a profound change in the way that individuals are required to organise their lives and finances.

Actuaries have experience and expertise in many areas where this trend has occurred, such as pensions, investment and insurance. The IFoA is looking to identify where these examples sit within a wider trend and throughout 2020 is exploring the broader social significance of risk transfer. The IFoA has developed its Great Risk Transfer campaign to look beyond specific examples of risk transfer in areas of actuarial practice and to understand the root causes and societal implications of this higher-level theme.

The implications of the Great Risk Transfer are likely to be wide-ranging and we appreciate that the trend will have both positive and negative impacts on different groups in society at different times. We have also come to understand that there are examples of risk transfers in both directions between individuals and institutions, as a result of changes in policy, public preference and the influence of other macro-trends. However, where we or others have identified negative effects from risk transfer to individuals, we are ready to speak out and to propose potential policy solutions.

Our evidence base for this report spans contributions made before and after the global outbreak of COVID-19. The pandemic has had a dramatic effect on risk transfer. Many governments reversed the prevailing direction of risk transfer to protect workers and businesses, but there is less certainty about the longer term economic and social impact of the virus.

This interim report sets out our understanding of the Great Risk Transfer, and its implications for society, informed by the insights we have gathered through our recent call for evidence.



The implications of the Great Risk Transfer are likely to be wide-ranging and we appreciate that the trend will have both positive and negative impacts on different groups in society at different times.

Our approach

It is essential that this campaign be grounded in a robust evidence base, which is why we ran a call for evidence to gather first-hand knowledge and ideas from actuaries and others working in relevant industries.

Many thanks to all those individuals and organisations who responded to the call for evidence, which ran from 31 January until 30 April 2020. We received over 50 responses. These included responses from organisations with an interest in these issues, such as National Numeracy, the Money and Pensions Service, and the Financial Inclusion Commission, as well as from individuals – both actuaries and non-actuaries.

As well as identifying examples of the Great Risk Transfer, we are also interested in the social context that underlies this phenomenon, which was described eloquently at our campaign launch event by Dr Myra Hamilton, Senior Research Fellow at the Social Policy Research Centre at the University of New South Wales, Australia. Dr Hamilton described a trend in Western nations that began around the 1980s. Until then there had been an implicit contract between citizens and governments: in return for their generalised contribution to the nation, the government would provide economic security in times of need. Over time, this approach gradually shifted, resulting in a modern social system that expects individuals to take on the responsibility for managing risks. The relationship between contributions and benefits has become much more transactional. One result of this is that there are much greater demands on individuals to devote time and effort into understanding and navigating financial markets and systems.

Expanding individual choice can be seen as positive and some parts of society stand to benefit from the enhanced freedom and flexibility this represents. But making these choices can often be extremely complex. Managing the risks involved often requires an advanced level of knowledge and understanding. This is one of the great ironies of the Great Risk Transfer: institutions that are well equipped with systems and processes to manage risk are passing risk over to individuals, who in most cases are not.

The IFoA has developed its Great Risk Transfer campaign to look beyond specific examples of risk transfer in areas of actuarial practice and to understand the root causes and societal implications of this higher-level theme.

Risk transfer – surveying the territory

“ We asked respondents **“Where and how do you see risks being transferred from institutions to individuals in the area(s) you work in, or in wider industry and society?” ”**

When we talk about the transfer of risk we are viewing this broadly. The transfer process does not have to be contractual or even formal. In fact, in many cases it can happen without either party – certainly not the individual taking on the risk – being fully aware of it.

The nature of risk transfer can also take different forms, and again we have interpreted this broadly. Sometimes there is a clear reassignment of responsibility from one party to another, such as employees’ new responsibility for investment risk that comes with a move from defined benefit to defined contribution pension arrangements. Sometimes institutions seek to reduce the likelihood of risks they are exposed to, such as insurers introducing more granular pricing to attract lower-risk consumers (with mixed results for consumers as a whole). And sometimes policy seeks to mitigate the impact of risks, for example auto enrolment, which tempers the effect of inadequate saving for retirement.

The balance of responsibility for risks is likely to reflect the extent to which a society emphasises individualistic or collective values. However, the Great Risk Transfer campaign is about transfers of risk. We accept there may be cultural differences between countries’ values about the long-term emphasis, but overall, there has been a common trend over recent decades in developed economies towards increasing the risk burden on individuals.



COVID-19

Before discussing examples of risk transfer in financial services, we consider the potential impact of COVID-19 on risk transfer. COVID-19 has introduced new challenges and more uncertainty, rocked markets, and forced the idea of individual risk management into the consciousness of populations around the world. It has forced international comparisons of different governments’ management of the risk of a global pandemic in the past, and discussions around the potential outsourcing of these risks in future, possibly to insurers. More imminently, in the UK at least, there has also been public discussion about how the risk of further spread of the virus should be shared between authorities and individuals.

As well as these abstract discussions about the concept and ownership of risk, COVID-19 has had a clear practical impact on a number of areas of risk transfer we have previously identified. The pandemic has also served to shine a light on some issues, exacerbate others, and create new risk transfers between institutions and individuals in both directions (although many of these are expected to be temporary).

... overall, there has been a common trend over recent decades in developed economies towards increasing the risk burden on individuals.



Pensions

A recent study by Hymans Robertson,¹ for example looked at the impact of COVID-19 related market volatility on three notional DC policyholders at different stages of their careers, assuming members were fully invested in equities in the early years of their careers, and invested in a more diversified mix of assets as they approached retirement. There was wide variation in how much the market turbulence had affected expected retirement income. Defensive investment strategies meant that baby boomers approaching retirement typically experienced a fall of only 4% in the value of their fund. Equities reached their lowest levels at the start of the crisis but had recovered somewhat by the time of this study in May, meaning that millennials were already back on track to longer-term retirement goals. The hardest hit group was those in their 40s, Gen X, who had seen a fall of about 10% in their longer-term income expectations.

The COVID-19 crisis also brings further attention to questions of intergenerational fairness more generally. Governments across the world have taken extraordinary financial measures to protect jobs and businesses, with UK government borrowing reaching record levels. On one hand, not taking such action could have turned an unavoidable economic crisis into a catastrophic and more long-lasting one, and that would have harmed future generations as well as current ones. Nevertheless, it will be those future generations who have to repay the additional borrowing from 2020.

On a larger scale, it is possible that the magnitude of this crisis could change attitudes to risk in general. Some groups might focus on the need to improve protection for individuals in the face of future pandemics, while others could be more influenced by a sense of the radical uncertainty of life, and may focus less on the future (investment and insurance) and more on the present (assets which can be owned and enjoyed in the here and now).

Our analysis of the call for evidence responses suggests the following main settings in which respondents discern risk transfer from institutions to individuals. The examples described in this section reflect common views expressed by respondents. We have also quoted directly from several responses. Once again we are very grateful to everyone who took the time to complete our survey or engage with us on the campaign in less formal ways.

The IFoA, along with many respondents to our call for evidence, has identified pensions as an area of significant risk transfer in recent decades, with two important policy changes representing the predominant reason for this shift in the UK:

- **The closure of defined benefit (DB) schemes in favour of defined contribution (DC) arrangements.**

Driven primarily by longevity improvements that made companies' DB promises increasingly expensive, most private companies now offer DC workplace pensions to their employees. Although employers are still required to contribute, this has essentially left individuals with sole responsibility for saving for their retirement, with most employers now contributing a fraction of what they previously did towards someone's retirement savings. It is also one of a number of ways that the ties of responsibility between employer and employee have been severed, which we discuss later in this paper.

- **The 'freedom and choice' agenda.**

Reforms in the UK in 2015 removed the requirement for individuals to buy an annuity. Drawdown products are now very popular for those with DC pensions reaching retirement, which give people the flexibility to draw an income from their pension pot at a rate they choose. While retirees make an active choice of drawdown this is not always a well-informed choice. Individuals are responsible for making their pot last a lifetime, without the lifetime income guaranteed by an annuity. This has exposed many more retirees to investment and longevity risk. Index-linked annuity investment would mitigate investment risk, but with the consequence of a much higher savings rate being required.

In addition to recent policy changes in workplace pensions, State Pension promises are increasingly seen as unaffordable for society. Governments around the world are increasing pension ages, paring benefits, encouraging more individual saving commitments and increasing contributions. In the UK the State Pension is low relative to earnings by international standards,² although the triple lock provides some security that this position will not deteriorate further. The gradually rising pension age since 2010 can effectively be seen as a concealed cut in value. In their evidence to us, the Financial Inclusion Commission said of the UK State Pension:

There has been a gradual wind down of the potential value of state pensions. This has followed from the initial promise of a state earnings related pension of ¼ of relevant earnings being eroded and now eliminated.

1 | <https://www.hymans.co.uk/media-centre/press-releases/hymans-robertsons-new-tracker-shows-dc-pensions-hit-by-covid-19-market-turmoil-are-recovering/>

2 | <https://www.ftadviser.com/pensions/2018/02/13/uk-state-pension-worst-in-the-developed-world/>

CASE STUDY – India

Similar trends exist elsewhere but cultural and demographic factors can change their impact. For example, in India private sector employees face the risk of planning for retirement needs by themselves. Recent changes to the tax regime have removed previously offered incentives for investment in long-term assets which motivated individuals to plan for retirement care. Under a new simplified tax regime such tax benefits are withdrawn. In addition to this, there is little appetite from Indian life insurers to develop the annuity market, which would provide longevity protection, and annuity income is fully taxable which makes it less attractive for individuals.

All this is in the context of poor financial literacy, resulting in inadequate accumulated funds to maintain living standards during retirement. However many people are not too concerned as the working population constitutes a very high percentage of the total population, and there is a culture of taking care of parents in later life.³

In workplace pensions, there is a spectrum of risk responsibility from the individual (DC) to the employer (DB). Another spectrum exists in the options for drawing on pension savings, going from increased choice (the government’s freedom and choice policy) to the limited options that existed before in terms of annuities.

The long-term transition towards DC has some advantages for individuals. For example, it enables more flexible retirement. DC also offers better protection to those who move jobs than DB did, until legislation required DB schemes to preserve these benefits.

A key drawback is the transfer of longevity, investment and inflation risk, as well as the risks associated with under-saving, from employers to the consumer. As one respondent to our call for evidence⁴ said: *“Ideally, one might hope that this might involve employers increasing their contributions to compensate for the transfer of risk involved but the opposite has normally been the case inflicting a double whammy on the members”*.

DC members do have a choice about whether or not to invest in risky assets, although in practice very few make this active choice, and as a result more than 90% are placed in default arrangements with significant exposure to such assets for the bulk of their working lives.

In relation to auto-enrolment contributions, the Money and Pension Service (MAPS) notes: *“current saving levels risk a significant proportion of the working-age population not meeting their retirement expectations.”* The IFoA has also highlighted pensions adequacy as a key policy concern, particularly in the long term. In our 2019 paper ‘Savings Goals for Retirement’ we expressed our concern that *“widespread under-saving will leave many unable to achieve the type of retirement they expect.”*⁵ Indeed, the UK Department for Work and Pensions predicts that two million people are still under-saving for their retirement despite the introduction of automatic enrolment⁶.

There are also concerns about the market for transfers from DB to DC schemes. When the UK Pensions Freedoms came into force in 2015, the IFoA highlighted the danger of *“unscrupulous selling or advice to the unwary”* that could mean people *“accepting more risk than they realise by giving up a lifetime income.”*⁷

Responses noted that DC members need a good understanding of how their pensions are invested. Even if the DC default is invested wisely, it may not be right for an individual. However, the introduction of charging for investment advice has priced some people out of being able to afford the expert help they might need.

... the Money and Pension Service (MAPS) notes: “current saving levels risk a significant proportion of the working-age population not meeting their retirement expectations.”

3 | Shirish Jagnani

4 | Peter Morris

5 | Institute and Faculty of Actuaries policy briefing, Savings Goals for Retirement, 2019
<https://www.actuaries.org.uk/system/files/field/document/Saving%20Goals%20for%20Retirement%20V08.pdf>

6 | DWP, Automatic Enrolment Review: Maintaining the Momentum, 2017
https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/668971/automatic-enrolment-review-2017-maintaining-the-momentum.PDF

7 | <https://www.actuaries.org.uk/news-and-insights/media-centre/media-releases-and-statements/ifo-warns-risks-new-pensions-freedoms>



Social care

In some cases, individuals' awareness of risk may be as important as the location of legal or contractual responsibilities. An example is the UK social care system: there is evidence that a large number of people are not aware of their responsibility to provide for their future care needs. A study in 2018 by the Local Government Association found that *“forty-four per cent of people think that social care is provided by the NHS and 28 per cent think that it is free at the point of access.”*⁸ This has been the case for a long time and so strictly speaking there is no risk transfer issue to debate at present. However, the risks individuals face with respect to social care are increasing, as we are living longer, but improvements in healthy life expectancy are not keeping pace. This means more people are likely to experience care needs in later life, which can come at great cost. The current social care funding system in the UK means that people are disincentivised from insuring themselves against the risk of catastrophic care costs, and in many cases must therefore shoulder this risk themselves.



Life insurance

Granular pricing of life insurance products began in the 1980s when a distinction was made in the pricing of term assurance between the rates for smokers and non-smokers. Much greater distinctions can now be applied and linked to people's health-related activities. Better underwriting can lead to improved behaviours and lower premiums for insured consumers. It can also lead to lower costs for insurers, allowing them to provide more widespread coverage and management of risk than in the past.

In the 1980s there was also a movement away from with-profits funds. Today, investment guarantees are no longer offered and life insurance products involve the transfer of most of the investment risk and, in some cases, longevity risk as well to policyholders. One respondent⁹ noted:

“People really do worry far more about losing money than they celebrate making money... In the ‘old days’, the actuarial profession had a product that addressed loss aversion: the with-profits policy. The money was invested largely in equities and real estate (plus some in bonds) but the policyholder was quoted a nice stable reversionary bonus, which smoothed out the humps and hollows of market volatility.”

8 | Local Government Association, Majority of people unprepared for adult social care costs, 2018
<https://www.local.gov.uk/about/news/majority-people-unprepared-adult-social-care-costs>

9 | Colm Fagan

10 | Institute and Faculty of Actuaries Inclusive insurance bulletin: Drivers of change, 2020
https://www.actuaries.org.uk/system/files/field/document/Inclusive%20insurance%20Issue%201%20WEB_Final%20june.pdf

Living annuities – where income is drawn down by the retiree without any longevity guarantees – are very popular, but this is attributed to the financial incentives to advisers. Most annuitants would not be able to understand the complex risks of such products.

In some markets such as Singapore, unit-linked products have higher commission rates and are pushed much harder than traditional protection products such as term assurances.



General insurance and risk pooling

In general insurance there has been a move towards increasingly accurate risk pricing, driven by advances in technology and the growing sophistication of data science techniques. Insurers are more able than ever to price their products based on a person's specific risk profile. This has led to those who are considered more 'risky', and at times those who face the highest risk (and hence the most need for insurance) being priced out of the market and without the protection that insurance provides, potentially resulting in loss of their property, good health or income.

While the intention on the part of insurers here may not have been to transfer risks back to individuals, the impact is that some people are forced to opt out of cover, or reduce cover and 'self-insure'. In their evidence to us, Fair By Design said:

“The risk transfer, to individuals from institutions, in reality means that low-income consumers’ “insurable needs” will either be limited to more expensive coverage (which may impact that consumer’s financial health and/or ability to pay) or become so unaffordable that insurance becomes a lower priority.”

Respondents made similar points in relation to 'insurtech', where the vast expansion in the number of customer data points insurers have access to has allowed them to refine pricing considerably to match an individual's risk profile. This has the effect of breaking down the operation of risk pooling, one of the core concepts on which insurance is based. Individuals can also submit specific data to their insurer to help them price their policy, by installing a telematics device in their car to provide data on their driving competence, for example, or by wearing a health tracking device that reports on their level of physical activity. The IFoA covered this topic in detail in our Inclusive insurance bulletin 'Drivers of change':

This can undermine the principles of risk pooling and cross-subsidy, but it can also open up the market to previously excluded groups, reducing their level of risk by giving feedback and behavioural nudges.¹⁰

In Indian crop insurance, there has been a risk transfer from the government's former support through compensation and relief, to a combined private-public crop insurance programme. Premiums are actuarially determined and are divided between the farmer and the government.

The COVID-19 outbreak has caused many businesses to seek help from their business interruption insurance. Since this type of insurance cover does not necessarily include losses arising from pandemics, in April 2020 the IFoA combined with other membership organisations to call on the government to make it easier to access Coronavirus Business Interruption Loans.¹¹



Investment - advice and consumer understanding

Until 2012 an individual could access advice on investments at no explicit direct cost to themselves, as the cost of the service was covered by commission paid by product providers. The FCA was concerned that commission generated a conflict of interest that led to poor advice and bad outcomes for consumers. In 2012 the FCA Retail Distribution Review (RDR) banned commission on investment products. The RDR required an explicit charge for investment advice. Respondents pointed out that the transparency of charging has meant that many consumers can either not afford advice or are unwilling to pay for it. The cost of going to a financial adviser is usually more than £1,000 for 'vanilla' investment advice and over £2,500 for pensions. The advantages of raising the standards of independent advice may therefore have been diluted by diminishing numbers of consumers who seek it.



Employment

The trends in pension provision mentioned above reflect a shift in the relationship between employers and employees more generally.

An early example of risk transfer in the 1980s was a movement, possibly motivated by tax considerations, towards remuneration packages that included items such as company cars being replaced by car allowances (transferring risks of ownership to the employee and away from the employer).¹²

More recently, there has been a move from employment contracts to self-employment, zero-hour contracts and the 'gig economy'. Respondents noted that in many of these modern arrangements, organisations are passing on the risk of their lack of business demand to people who would traditionally be considered employees, but have been shifted to other statuses. The Trades Union Congress estimates that in the UK 3.7 million people are in 'insecure work', classified as being low-paid self-employed, agency, casual and seasonal workers, or on zero-hours contracts.¹³

For the worker, this increases uncertainty and the risk of underemployment. Gig-economy workers also don't receive many of the benefits of being employed, such as pensions and sick pay. However, the gig economy could also reduce the risk of unemployment by reducing transactional barriers between suppliers and customers. The IFoA has explored these issues in more depth in an article in our recent Inclusive insurance bulletin, 'Drivers of change':

This lack of employer provision does not mean that the benefits and protections are not needed. In some cases there may even be greater risk exposures for gig workers compared to those in traditional employment: for example, those undertaking gig work through financial necessity may be particularly exposed if they become ill and face losing their livelihood.¹⁴

The Trades Union Congress estimates that in the UK 3.7 million people are in 'insecure work', classified as being low-paid self-employed, agency, casual and seasonal workers, or on zero-hours contracts.

11 | <https://www.actuaries.org.uk/news-and-insights/news/diverse-coalition-voices-write-chancellor-calling-covid-19-support-forgotten-small-business-and-self>

12 | Richard Montgomery

13 | TUC, Insecure work: Why the new PM must put decent work at the top of his to-do list, 2019 <https://www.tuc.org.uk/research-analysis/reports/insecure-work>

14 | Institute and Faculty of Actuaries Inclusive insurance bulletin: Drivers of change, 2020

https://www.actuaries.org.uk/system/files/field/document/Inclusive%20insurance%20Issue%201%20WEB_Final%20june.pdf



Disadvantaged groups

In pensions, employment and other areas, the impact of risk transfers can be more intense for people in disadvantaged groups. For example, women's pension wealth at retirement is significantly less than men's on average, which limits their choices about how to manage their retirement income.

Social inequalities can be exacerbated at times of great risk, and the COVID-19 crisis has highlighted the precarious nature of many people's employment, and their financial resilience. Policymakers around the world have been forced to consider reversing the steady transfer of employment risk from organisations to individuals. For example, the UK government's furlough scheme is an example of the state (and by extension, society) stepping in to absorb the financial risks people have been exposed to during the pandemic and corresponding economic shutdown. Women and BAME communities are more likely to have insecure work and are therefore more likely to have been furloughed.

Although the Great Risk Transfer affects different groups in different ways, the trend has had a particularly striking impact on younger people. They are disproportionately affected by lower levels of security in employment and housing, for example, as well as being the first tranche of individuals expected to fund their retirement using DC pension provision.

Another example of risk transfer that affects younger people is the change in policy on higher education funding over recent years. Under previous regimes, the government assumed the financial risks associated with getting a degree. The financial risk now sits with students, who must take on large debts to finance their higher education, albeit with some long-term protection in the form of loan defaults. This is a significant financial decision to take at an early age.

During the COVID-19 outbreak some of the key state support has been targeted at areas that are less relevant for younger people, such as mortgage holders and those in traditional employment.

Social inequalities can be exacerbated at times of great risk, and the COVID-19 crisis has highlighted the precarious nature of many people's employment, and their financial resilience.

The Great Risk Transfer – the UK experience

😊 1990s

Pensions

- I have a guaranteed income for life provided by employer
- I'm entitled to State Pension, but its value has been eroded over time

Work

- I am employed in long-term, contract-based employment
- I have access to benefits and protections provided by my employer
- I have immediate access to unemployment benefits if I lose my job

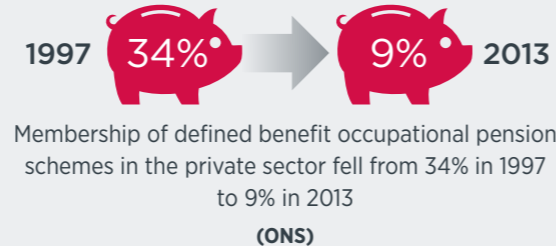
Health

- The NHS is free at the point of use
- I am unlikely to need social care

Insurance and other finances

- Risks to my property are pooled with others through insurance products
- I may be unable to obtain some kinds of insurance because of judgements made about my risk profile
- I have a with-profits life insurance product, which smooths returns and protects me against market shocks

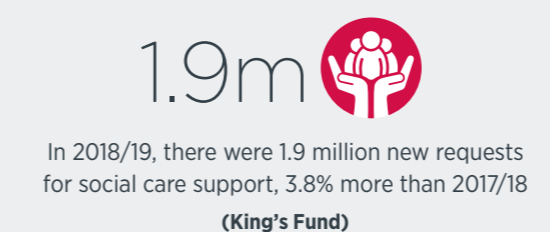
Employers close DB schemes to new members. Government introduces Freedom and Choice



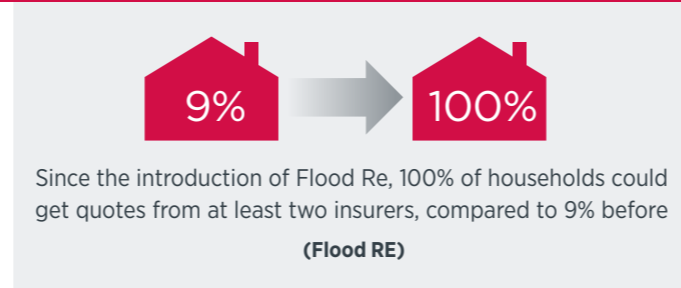
Growth of service industries, skilled roles and less secure patterns of employment



Longevity improvements increase demand for adult social care



Improvements in data science



2020 😞

Pensions

- I'm auto-enrolled into a DC scheme, responsible for saving enough for retirement
- My retirement savings are exposed to investment risk through saving and retirement phase of my life
- I'm responsible for making my retirement income last a lifetime
- The value of my State Pension value is maintained by Triple Lock

Work

- I am more likely to be in insecure work, possibly on a zero-hours contract
- I may also lack access to benefits and protections provided to workers in long-term, contract-based employment
- I must wait for a period of time to access State benefits if I lose my job

Health

- The NHS is free at the point of use
- I am more likely to need social care, but I do not have a good understanding of how the system works
- Paying for social care may add significantly to my expenditure in later life

Insurance and other finances

- My insurance premiums are directly linked to how risky I am. If I can reduce my risk, I can reduce my premium. If I can't, I pay more.
- I can now access some kinds of insurance I couldn't previously, by changing some of my behaviours
- I have a unit-linked life insurance product. My returns rise and fall with the stock market

ONS Pension Trends - Chapter 7: Pension scheme membership, 2014 edition <https://www.ons.gov.uk/economy/investmentpensionsandtrusts/compendium/pensiontrends/2014-11-28/chapter7pensionschememembership2014edition>

DWP Automatic Enrolment Review: Maintaining the Momentum 2017 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/668971/automatic-enrolment-review-2017-maintaining-the-momentum.pdf TUC Insecure work, Why the new PM must put decent work at the top of his to-do list <https://www.tuc.org.uk/research-analysis/reports/insecure-work>

TUC, Insecure work: Why the new PM must put decent work at the top of his to-do list, 2019 <https://www.tuc.org.uk/research-analysis/reports/insecure-work>

Good work: the Taylor review of modern working practices https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/627671/good-work-taylor-review-modern-working-practices-rg.pdf

The changing role of care homes by Nat Lievesley and Gillian Crosby CPA and Clive Bowman Bupa <http://www.cpa.org.uk/information/reviews/changingroleofcarehomes.pdf>

The King's Fund Social care 360: access <https://www.kingsfund.org.uk/publications/social-care-360/access>

Flood Re Our Vision: Securing a future of affordable flood insurance https://www.floodre.co.uk/wp-content/uploads/2018/07/Flood_Transition2018_AW.pdf

Drivers of the Great Risk Transfer

“ In order to understand the Great Risk Transfer better, it is useful to think about what is driving the trend. We asked respondents **“What do you think are the main drivers of this phenomenon?”** ”

We can categorise the responses as a mixture of ‘push’ and ‘pull’ factors that have led to the transfer of risks from institutions to individuals. These can be summarised as follows:



Legislative and regulatory frameworks and institutional behaviour

These are the supply-side factors that cause institutions to ‘push’ for a greater transfer of risks to individuals. A good example cited in the evidence we received was how stricter solvency requirements have made guarantees prohibitively expensive in some industries. Here well-intentioned regulatory policy has reduced the appetite for firms to provide customers with certain guarantees because of the cost implications of meeting solvency requirements.

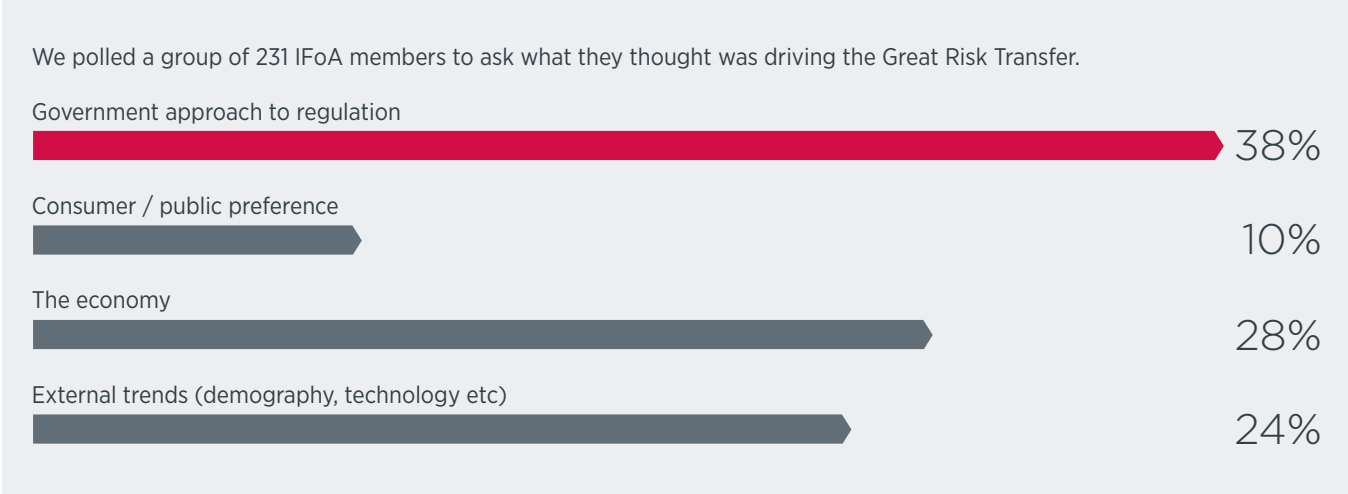
On a more conceptual level, these ‘push’ factors can be linked to a government’s approach to social security, underscored by the beliefs and philosophy of those in positions of power (and, arguably, reflecting public opinion on that approach).



Changes in consumer / public preference

These are the demand-side factors where consumer appetite may lead to them assuming responsibility for more risks. This could include people’s preference for flexibility, for example to manage their finances online, or their own views on individualism vs. collectivism. It can also be linked to public trust (or lack thereof) in institutions, which may lead them to prefer not to have a close relationship with those institutions.

There is a strong argument, for example, that the ‘freedom and choice’ agenda was a reaction to a public desire for more flexibility and choice because of the perceived poor value of annuities in the lead up to the reforms. Indeed, the reforms remain popular among the current cohort of retirees.





Overarching

There are a range of other overarching factors that are driving the Great Risk Transfer:

Megatrends such as changing demographics and rapid advancements in technology. These are largely external factors that have led to changes in institutional behaviour and public preference.

Economic factors for example impact of monetary policy on the attractiveness of different types of financial products. Some are external market forces and some deliberate policy choices. The low interest rate environment, for example, has also pushed up the actual cost of the guarantees, making them less affordable and therefore less attractive to providers or customers.

“Because no one knows how long they will live, or when they will retire... providing a secure income in later life is about collective risk management which has been gradually replaced by individual saving. This is partly public policy - the erosion of the UK state pension to the lowest among OECD countries, and partly the change in the employment relationship from one of mutual support and loyalty to short term performance and contract which is the main explanation for the demise of defined benefit pensions in the private sector.”¹⁵

“The financialisation of the economy.”¹⁶

“Risk transfer has primarily been driven by the financial interests of either employers or government.”¹⁷

15 | Ken MacIntyre

16 | Anonymous respondent

17 | Financial Inclusion Commission

Harms and benefits of risk transfer

“ Our survey asked **“Are these transfers working in or against consumers’ best interests, and why? / Which consumer groups are benefitting and which are being negatively affected by this risk transfer? / How are these groups being affected?”** ”

As discussed earlier, there are several forms of risk transfer, from actually changing responsibility from one party to another, to financial institutions reducing their risk exposures, or policies focused on mitigating the impact of risks.

Sometimes the impacts of risk transfer on individuals are mostly a reflection of how particular financial products and markets are designed and regulated. However, two individuals could be exposed to similar financial products and services and yet be affected in very different ways by risk transfer, so there are aspects of these individuals that need to be studied, not just the products.

Several respondents said that only a tiny minority of consumers had the combination of wealth and market awareness to benefit from certain decisions, while the vast majority did not. If this is a fair reflection of the environment consumers face at present, it means that most are losing out. This is an important narrative and constitutes a strong case for policy reform.

The IFoA’s Working Party on Communicating Investment Returns in the Retail Customer Journey has completed analysis of consumers’ understanding of investment risks. *“The experienced [customers] will be the least affected [by the Great Risk Transfer] but they only make up 9% of the total market.”*¹⁸

In this section we bring out some of the key harms and benefits of risk transfer that respondents to the call for evidence highlighted, dividing these into impacts that can be traced to financial products and those that depend on consumer characteristics.

Specific products and markets

Pensions

Many DB schemes have failed, and members have been left out of pocket, or the PPF has had to make up (not necessarily all of) the shortfall. Some members may face regulatory barriers if they wish to transfer out to reduce risks and improve flexibility.

Meanwhile, members of DC schemes lack a safety net to withstand reductions in pension capital and drawdowns. This is seen as important as many pensioners rely on their corporate pension as their only source of income. DC pensions often provide very low incomes relative to previous earnings.

Many members, especially if they are younger, mistakenly think the minimum auto enrolment contributions are enough for a comfortable lifestyle in retirement, and face the risk of only realising at retirement that they have not saved enough.

The UK government’s freedom and choice policy means that individuals have to self-insure their longevity risk. It is inefficient to self-insure in retirement since they need a higher fund at retirement than if they bought an annuity. That means they need a larger pension pot at retirement, which means that larger contributions are needed to achieve this. This in turn raises the question of how much people need to contribute under auto enrolment. The IFoA has completed analysis to determine a set of ‘Savings Goals’ to help people understand how much they need to save for retirement, depending on their likely needs.¹⁹

According to the FCA²⁰ just 15% of savers use the free, impartial Pension Wise guidance service when accessing their benefits. 62% of those who withdrew the full value of their pensions did so without advice or guidance, leaving them more exposed to

18 | Gary Smith

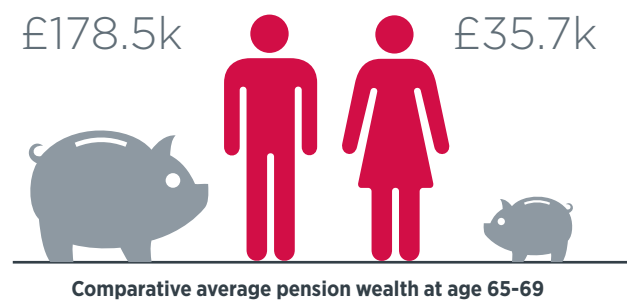
19 | <https://www.actuaries.org.uk/system/files/field/document/Saving%20Goals%20for%20Retirement%20FINAL.pdf>

20 | <https://www.fca.org.uk/data/retirement-income-market-data>

Risk transfer helps insurance companies with their planning, but this is arguably at the detriment of the societal needs they are meant to meet.

risks such as pension scams, avoidable tax charges, reduced income as a result of investment losses or exhaustion of pension savings, lost or reduced benefits, and the purchase of poor value or inappropriate retirement products.

There are significant gender differences: a study in 2018 by the Chartered Institute of Insurance (CII) notes that by the time a woman is aged 65 to 69, her average pension wealth is £35,700, roughly a fifth of that of a man her age.²¹ This is not simply about unequal wealth – it also means that on average women have more limited choices than men about how they manage their retirement income.



Insurance

Risk transfer helps insurance companies with their planning, but this is arguably at the detriment of the societal needs they are meant to meet. One respondent notes: *“Without regulated rates, insurers are free to compete for the least risky clients by offering low-cost contracts. But this diminishes the solidarity aspect of insurance, whereby the better risks subsidise the worse. The consequence may well be that those who most need cover have trouble affording it, and are therefore underinsured and at greater risk.”*²²

In life insurance there has been a long-term trend from with-profits to unit-linked products, meaning that consumers have lost the guarantees they enjoyed in the past. However, with-profits policies also had drawbacks: respondents noted they were not very transparent, with much discretion left with the insurers, while policyholders struggled to understand the reasons for the level of their bonuses.

Unit-linked products are seen as more transparent and offering higher expected investment returns. However, the majority of

policyholders may be unaware of how much investment risk they are taking on via the unit-linked products, until an adverse investment event takes place. Only a small well-informed group may benefit, in that they have a wider product range to choose from for their own risk appetite.

In general insurance, more granular pricing can lead to lower premiums for some, for example younger and/or healthier drivers. Motor insurance using telematics can also have a social benefit, improving the driving habits of policyholders, particularly the young. Conversely, older and/or less healthy policyholders will get less benefit from risk pooling with lower-risk policyholders, making premiums less affordable. More people may become uninsurable even if data advances now allow more prices to be quoted. Some less affluent policyholders will be unable to afford cover which means they will be unprotected when an event occurs. For those who can still afford cover, they will still have significant loss variance and will benefit from having this smoothed through the insurance process.

Employment

The growing number of low-paid ‘gig economy’ workers have limited ability and knowledge to enforce their rights or choose secure employment. Such work arrangements can effectively prevent people from finding other clients. A small number of more highly skilled workers may be able to ensure that they can benefit from their contractual arrangements.

Consumer factors

The evidence received on these questions suggests that there are some factors that affect the impact of risk transfer on consumers across pensions, insurance and employment.

Wealth

Many of the respondents contrasted the impact of the risk transfers between wealthier and less affluent consumers:

- Wealthy consumers can afford to take risks as they have safety margins and are therefore less impacted by downside outcomes. Their net investment returns are probably higher – they get investment services at lower cost because providers are all focusing on their needs. They can also afford advice and private insurance.

21 | https://www.insuringwomensfutures.co.uk/wp-content/uploads/2017/03/COH_J012646-IWF-Pension-Life-Journey-Report-Update-P2.pdf

22 | Angus Sibley

- By contrast, less affluent consumers cannot afford to take risks, but may be forced to accept risks if the cost of mitigating them is uneconomic. They are likely to see lower returns and higher taxes. Basic financial planning advice is often not available, while more complex advice is expensive.

As well as consumers' wealth, there were other qualities that led to very different outcomes of risk transfer for consumers. These qualities are probably quite highly correlated with wealth but each raises slightly different issues.

Being financially 'savvy'

These consumers are very well informed about financial markets and products and can manage their own risks. They can avoid the costs of guarantees as they have little need for them. However, this group is seen as being very small.

The vast majority of consumers are exposed to risks that they do not understand and cannot quantify or mitigate. They are likely to experience low investment returns with poor matching to their needs, such as inflation protection.

Being numerate and financially literate

This could be seen as a necessary condition for being savvy, though not sufficient. National Numeracy commented *"More numerate people who engage with their finances are benefitting. This group encompasses more men than it does women. Conversely, less numerate people (encompassing by definition more women) will be adversely affected. This is because simplification of products and services may not be helping these individuals to make better, more informed choices."*

Being financially naïve

These consumers are at greater risk of scams and fraud. They may suffer serious financial losses and mental health issues. There is a sense that the distinction between unregulated and regulated financial services is not understood or appreciated, which adds to these risks.

The following table summarises some of the key harms and benefits of risk transfer:

Positives	Concerns
Consumers have greater choice	Only consumers with sufficient wealth, financial literacy and confidence can make informed decisions
The price of protection more closely represents the consumer's risk profile	This approach reduces the benefits of risk pooling and can price those with the highest need out of the market
This approach can have societal benefits eg the black box leading to safer roads and wearables leading to healthier behaviours	The use of granular pricing factors can lead to questions around when a factor becomes unfairly discriminatory

"Without regulated rates, insurers are free to compete for the least risky clients by offering low-cost contracts. But this diminishes the solidarity aspect of insurance, whereby the better risks subsidise the worse. The consequence may well be that those who most need cover have trouble affording it, and are therefore underinsured and at greater risk."

Towards solutions

“ We asked respondents **“Are there any examples of regulatory or policy interventions which are either supporting consumers to maximise the opportunities afforded by choice, or helping to tackle the potential adverse impacts? / What are the current barriers to interventions in this area and how might they be overcome?”** ”

Solutions to the Great Risk Transfer are interventions that either help remedy some of the harms noted above, or possibly help people maximise the opportunities they are afforded by increased freedom, flexibility and choice. These solutions fall into two broad categories:

- Interventions aimed at reversing the trend. These could be policy or product innovations that (re)introduce an element of risk sharing, or ask institutions to take back some of the risk that has been transferred, where it is deemed to have occurred to the detriment of consumers or citizens.
- Interventions aimed at better equipping people to deal with the risks they now face. This could include improving financial education, innovation in product development, or the role of defaults, which kick in when individuals are unwilling or unable to make active decisions.

Before embarking on this campaign, we identified three broad policy recommendations, informed by our previous work in the specific areas of risk transfer outlined above. These were:

1. Consumers need a minimum level of knowledge to make informed decisions that are in their best interests. Institutions should retain the responsibility for providing consumers with communications that empower them to make informed decisions.
2. Consumers' freedom to choose must be coupled with access to products and services that meet their needs.
3. There must be mechanisms in place that enable individuals to hold institutions to account, such as sanctions and redress, as well as a need for oversight bodies that have the expertise to act as guardians and create societal accountability, eg Ombudsmen.

The role of policy

Where there is evidence of risk transfer harming individuals or groups of consumers, policy options tend to focus either on reversing the direction of risk transfer or on risk mitigation strategies to help the most vulnerable groups cope with the fallout. The ideas proposed in our call for evidence responses reflect both of these approaches.

Is responsibility with the right parties?

Policymakers should remember that there is a differential impact of risk transfer on different groups, and it may do most harm to those who are already disadvantaged.

Is risk sharing preferable to risk transfer?

Policy interventions could potentially alter market structures to rebalance knowledge and power between individuals and corporates. This might increase opportunities for risk pooling, for example.

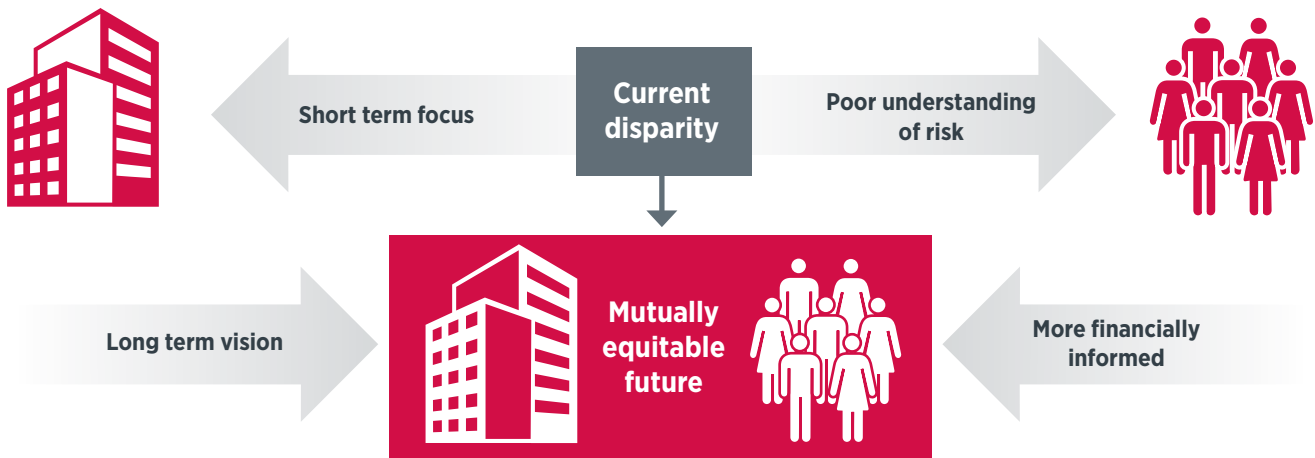
What should the State's role be?

Corporates and insurance companies need to manage their short term risks to protect their balance sheets, but the needs of individuals are long term. This lack of alignment suggests there may be a need for greater State involvement in developing and driving solutions.

How can we incentivise institutions to innovate?

There is a lack of risk appetite among institutions, despite the significant business opportunities. Succeeding with an idea for a progressive product is an uphill task: you have to convince business leaders with a focus on short-term profits/bonuses;

... policy options tend to focus either on reversing the direction of risk transfer or on risk mitigation strategies ...



you also need skilled communication to sell and explain the product to potential customers with a limited grasp of the concepts. Unless consumers understand the risks they are running, there may be little demand for products that mitigate these risks.

How can communication and education be improved?

Communication and disclosure should be designed to be clear and concise. Clear and engaged communication with various stakeholders at the outset is often necessary. Alongside high quality communication, availability of financial education and access to good advice throughout life are vital. National Numeracy argues that tackling lack of numeracy will address issues of confidence and competence: *“That way we can enable a paradigm shift in the country’s engagement with their future finances, their financial decision-making and ultimately improving their financial wellbeing.”*

The role of regulation

Our call for evidence responses also help to build a picture of the role of regulation in tempering (or exacerbating) the effects of risk transfer in financial services. From a philosophical perspective, an ideal regulatory regime would reflect people’s preferences when their vested interests have been factored out. They would likely settle on some balance between having opportunities for increasing wealth and keeping some protection from downside risk. That balance would mask variations between individuals – reflecting that there is room for disagreement between reasonable people as to where the right balance lies.

Is prudential regulation too rigid?

For example, prudential regulation could be more lenient on capital requirements – if it simply focused on going-concern solvency, firms would be able to afford to mitigate their long-term risks. Consumer regulation could look at outcomes, but instead it tends to judge behaviour with the benefit of hindsight, with unrealistic expectations.

Is conduct regulation impeding innovation?

For example, the Financial Inclusion Commission highlighted “industry fear of giving ‘advice’ due to it being classed as a regulated activity, and finding that without a very substantial and expensive (but not valued by consumers) fact finding and report creation process, they incur substantial and unforeseeable costs and reputational damage.”

Some solutions suggested by respondents

The following are some comments and specific suggestions made by respondents and do not represent the IFoA’s views. We have mostly amended the wording of responses rather than directly quoting.

Pensions

Auto-enrolment has had the positive effect of opening up credible long-term saving to a wider market.

The Pensions Dashboard will provide accessible and comprehensive information to help consumers take control of their pensions. There are concerns about data sharing, such as poor quality data, tech-phobia and resistance to change.

One respondent argued that *“Collective Money Purchase Schemes should be encouraged as it provides risk sharing between members and employers. This can help provide better outcomes for members.”*²³

Pensions tax should be simplified, and made less subject to regulatory changes in the future. A new Pension Commission could be set up to carry out this task.

‘Investment pathways’ products are a good way to match the needs of groups of customers, but many customers may struggle to understand them. Other interventions are also helpful, such as charging caps on pension investments and the focus on ‘value-for-money’ for pension trustees.

23 | Fred Emden, Society of Pension Professionals

There is potential to remove the risk of inadequate pensions through compensation claims that the scheme didn't explain the investment risks clearly enough.

Improving consumer knowledge and understanding is a long term project that involves not only financial education but also basic numeracy and literacy. Customers need more compelling, engaging and involving disclosure.

Investment advice

Requiring transfer value advice is a good brake on transactions that are not in consumers' best interest.

PensionWise is a valuable source of trusted advice, while the Pensions Regulator has run helpful campaigns to protect consumers against scam advice. However, actuarial advice is not affordable for many consumers with smaller pots, and one solution could be to encourage more actuaries to work as financial advisers.

Regulation could also create 'safe harbours' where certain classes of advice could be given by providers and advisers which were simpler and easier to deliver.

A regulated IFA should be responsible for the actions of any unregulated introducer that it uses. The directors of the regulated IFA should be personally responsible for these actions; they should also not have limited liability allowing them to divorce themselves from the liabilities of their companies. This will increase the due diligence undertaken by regulated advisers before doing business with unregulated introducers.

Professional liability costs for financial advisers are too high. Operational costs of giving advice are also high because firms have silos from each other and there are still many manual processes. One proposal is that regulation could require the use of common frameworks for things like know your client and documenting advice.

Insurance

Reducing tax on annuities would encourage greater investment by individuals, improving the retirement planning for the population.

There are strong vested interests for insurers and product marketers to continue supporting unit-linked products.

Solvency II is a regulatory barrier. It requires firms to focus on 1 in 200 risks, but this encourages risk-averse behaviour. The result is that risks are actually transferred to the policyholder.

In general insurance, market forces will naturally move towards granular risk pricing. The only way to push back against this trend is through cross-subsidies backed up by regulatory force.

The idea of breaking down risk pooling has ethical ramifications. In some circumstances it may be appropriate not to use certain data that is easily available on ethical grounds, eg gender under EU rules.

FloodRe is an interesting case study of how it is possible to enable the insurance of otherwise unaffordable risks to people.

Others

Credit Unions are a positive thing but need more publicity and government support.

Financial fraud – solutions could include direct targeting of scam phone callers and fake websites (this would need international agreements). The capacity of the criminal justice system is a barrier.

... an ideal regulatory regime would reflect people's preferences when their vested interests have been factored out.

Conclusions and next steps

This report has examined examples of the Great Risk Transfer as it manifests in various contexts.

We have touched on potential causes of this phenomenon before looking in detail at who is being impacted, and how. Finally, we have drawn on the many thoughtful submissions in response to our call for evidence in order to discuss potential remedies for the negative impacts. Some of these focus on reversing the trend while others look at ways of mitigating the harms.

We are pleased that our efforts to make this call for evidence international in scope resulted in submissions from India, Israel and Singapore, making the overall body of evidence more authentic and relevant.

Our call for evidence shows there is widespread agreement that the Great Risk Transfer is happening. More risk is landing with individuals. Consider someone who never had to pay attention to pension investments in the past because they were a member of a defined benefit scheme. The closure of the scheme was not their choice, but the outcome is that continuing to take no interest in investments carries much more risk than it did before. But if this individual never gave a thought to investments before, will they even realise this? This is just one example of how many people are unable to manage the new risks they face, and some are even unaware that these risks have been transferred to them.

This call for evidence illustrates that a range of similar changes has been taking place across different sectors, such as the shift from formal employment contracts to the 'gig economy', or the loss of guarantees for life insurance cover. Many individuals will have been affected, if not by all of these, then certainly by several of them. The evidence leads us to believe that only a minority of people is truly equipped to deal with the aggregate impact of these risks and make the most of the advantages they offer in terms of flexibility and choice.

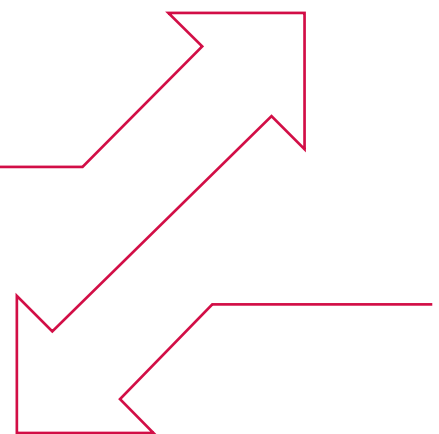
The need to rebuild the economy and society in the wake of the COVID-19 crisis gives us a unique opportunity to re-examine, and perhaps re-invent, the way risk is shared.

This trend is being influenced by a number of external factors, such as advancements in technology, longevity improvements and a persistent low interest-rate environment. Over recent decades governments and institutions have viewed the risks they face in a negative light and have made changes to regulatory and public policy in order to reduce or eliminate those risks. We suggest that these changes often reflect institutions aversion to risk more than consumer need or preference.

The need to rebuild the economy and society in the wake of the COVID-19 crisis gives us a unique opportunity to re-examine, and perhaps re-invent, the way risk is shared. We believe there has been a lack of public discussion about which risks are worth taking and who should stand behind those risks. Only when the risks are properly defined and understood can the public make a balanced judgement between different policy options.

In the UK, a key goal of the IFoA's Great Risk Transfer campaign is to make recommendations for decision makers such as ministers and regulators. The purpose of this interim report is to draw out the key themes from the call for evidence responses. We will draw on these themes when we run roundtables with stakeholders in the autumn, in order to generate the policy detail behind our eventual recommendations.

We aim to issue our final report at the end of 2020.





Institute
and Faculty
of Actuaries

Beijing

14F China World Office 1 · 1 Jianwai Avenue · Beijing · China 100004
Tel: +86 (10) 6535 0248

Edinburgh

Level 2 · Exchange Crescent · 7 Conference Square · Edinburgh · EH3 8RA
Tel: +44 (0) 131 240 1300

Hong Kong

1803 Tower One · Lippo Centre · 89 Queensway · Hong Kong
Tel: +852 2147 9418

London (registered office)

7th Floor · Holborn Gate · 326-330 High Holborn · London · WC1V 7PP
Tel: +44 (0) 20 7632 2100

Oxford

1st Floor · Park Central · 40/41 Park End Street · Oxford · OX1 1JD
Tel: +44 (0) 1865 268 200

Singapore

163 Tras Street · #07-05 Lian Huat Building · Singapore 079024
Tel: +65 6906 0889

www.actuaries.org.uk

© 2020 Institute and Faculty of Actuaries