An Chomhairle Pinsean
The Pensions Council

Report on ARF Charges

February 2016

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Introduction

Dear Tánaiste,

In your address to the inaugural meeting of the Council in March 2015, you asked the Council to pay particular attention to, inter alia, the question of charges and costs for pension products and services. While much of our first year has necessarily been devoted to establishing the Council on a firm footing, we have also; thanks in particular to the voluntary commitment of a number of Council members, compared charges for a range of Approved Retirement Fund (**"ARF"**) products offered by six different life assurance companies. It is also important to acknowledge and thank the life assurance companies who participated in the survey.

It was well recognised in the 2012 OECD/Department Report on Pension Charges that consumers, whether individuals, intermediaries or trustees, face challenges when comparing charges and making rational choices between the options on offer. That report also included a number of recommendations to improve transparency, comprehensibility and comparability of charges. While some progress has been made since that report, our survey underlines the need for further improvement in this context and the complexity of pension products remains a key obstacle preventing ordinary people from engaging in decisions regarding pension provision.

We decided first to look at charges for ARFs sold through intermediaries, because they are well-defined products with a relatively small number of providers. Our survey highlights the fact that there are significant differences in charges between providers. By way of example, other things being equal (an important caveat), a consumer could be better off by more than 7% over a ten-year investment period if he or she chooses an ARF with the lowest insurer charges compared to one with the highest charges. In cash terms, this could mean a difference of over 5,000 euro for an investment of 75,000 euro. The actual differences in practical cases will depend on the amount, period, and performance of the investment, the extent of withdrawals, intermediary charges, commission rates and many other factors.

Intermediaries sell the products we have surveyed, and two important issues arise here. Do intermediaries themselves have full information of the comparative funding charges as published in this report? If they do not, they cannot advise consumers accordingly. Secondly, is there a relationship between funding charges and intermediaries' commission? This is a more difficult question to resolve.

This Report is the first part of a work in progress. We hope to do further work on other forms of investment of the proceeds of pension plans and on the role of intermediaries, and their charges.

In conclusion, Tánaiste, I should add that that this survey could not have been done without the intense voluntary commitment and expertise of a few Council members, who took time from their professional tasks to devote to their work for the Council. They and the other members of the Council are fully committed to our work but of course the Council cannot develop as it should by relying only on the voluntary commitment of the members. I ask for your support therefore in moving to provide competent and professional full time staff for the Council as soon as possible.

I remain, Tánaiste,

Yours sincerely,

Jim Murray
Chairman

Executive Summary

The Pensions Council has carried out a survey of the charges applied by life assurance companies (**"insurers"**) that offer standard Approved Retirement Fund[1] ("**ARF"**) products through independent insurance intermediaries. Six insurers were invited to participate in the Survey and all responded. As each insurer offers more than one version of their ARF product, the Survey covered 23 separate ARF products.

The Survey sought the projected annual Reduction in Yield (**"RIY"**) for all standard ARF products marketed by each insurer arising from the application of the insurer's own charges only (i.e. excluding intermediary commission or other charges), based on a €75,000 and a €150,000 investment amount, using a typical (to that insurer's product) investment fund choice, and assuming the ARF is fully terminated after specified durations ranging from 1 to 10 years.

Findings: The Survey identified that ARF provider charges vary by:

- Insurer;
- Product version;
- ARF duration; and
- The amount of the ARF investment; [charges are higher for lower ARF investment amounts, particularly where the ARF is held for a period of less than 5 years].

The Survey results suggest that:

1. **Insurer charges generally tend to be at their highest if the ARF is terminated within the first 3 years, falling to a minimum on termination just after the expiry of 5 years, and then increasing gradually again the longer the ARF is held.**

2. **Other things being equal (an important caveat), based on an ARF investment of €75,000 a consumer could save up to €5,440 in insurer charges over 10 years (in constant money terms) by choosing the ARF product with the lowest insurer charge over that period rather than the one with the highest. This saving equates to over 7% of the entire ARF value over that period, or nearly two years' income withdrawal at 4% pa.**

3. **This saving could increase to €11,720 for an ARF investment of €150,000, over 10 years (or nearly 8% of the initial ARF investment amount) by choosing the ARF product with the lowest insurer charges over that period and holding it for the full 10 years.**

[1] *See Appendix 1 for description of what an Approved Retirement Fund (ARF) is.*

The projected RIY sought from insurers did not include allowance for commission payable to intermediaries or other additional investment charges that may arise (for example, as a result of the consumer selecting specialist investment funds, investment transaction fees or other fees that may apply to investment funds, such as audit/compliance fees).

The insurer's own charges could therefore be compared to wholesale charges, to which retail distribution/advice and other charges are added. A key additional charge is the intermediary's remuneration. This can be fee based and/or paid via commission.

The insurers provided details of the range of commission options available on their ARF products to independent insurance intermediaries. All offer independent intermediaries a wide range of commission options, combining an initial payment as a % of the initial investment amount, and/or a recurring payment related to the ongoing value of the ARF fund. Where the intermediary is remunerated via commission, the commission is funded by the insurer making a corresponding direct recovery from the consumer's ARF fund.

As part of this exercise, we have carried out some analysis on the impact of intermediary charges on overall ARF charges. **Our analysis suggests that intermediary remuneration may have as much, or even more impact on the total charges borne by the consumer as the choice of insurer or product.**

In a low inflation/interest rate/investment return climate, charges can significantly reduce or in some cases completely eliminate, the investment return earned by the ARF:

- For ARF holders who invest in cash or cash-type funds, the current absolute level of ARF charges (insurer plus intermediary) is likely to absorb all of the investment return currently provided by such funds and more, leading to a negative return after charges.

- For ARF holders who invest in a managed fund, the current absolute level of ARF charges (insurer plus intermediary) could absorb a significant proportion of their anticipated future investment returns.

The insurer charging structure, used by most but not all ARF products, appears counterintuitive in that the longer the consumer holds their ARF (after the first 5-year period expires), the higher the insurer's charges become. This could make it attractive (from a purely insurer charging perspective) for some consumers to terminate their ARF just after 5 years and reinvest in a new ARF with a similar charging structure (additional intermediary fees may however negate this benefit).

Intuitively ARFs moving regularly between providers and products must lead to higher charges for *all* ARF holders, than if ARFs were held for longer periods with the same QFM.

Observations:

This study is the first part of a work in progress on charges as requested by the Minister. It is too early to make policy recommendations at this stage, when further work is to be done. The following points therefore are observations:

- Charges have a material impact on the retirement income an ARF will produce for a retiree. It is clear that consumers can make significant savings if they “shop around”. However, the charging structures used in insurer ARF products are complex, making it extremely difficult for the average consumer (or even their intermediary) to determine the relative charge status of any ARF product compared with other similar ARF products in the marketplace.

- The practice of insurers having multiple charging structures for the same ARF product (where the charges vary by the length of time that the ARF is held for) further adds to the complexity. It also raises the question as to whether the consumer is and should be informed by the intermediary or insurer that there may be a lower charge (at particular benchmark durations, e.g. after 5 and 10 years) version of the same ARF product available, when a higher charge version (at those benchmark durations) is being recommended to the consumer.

- This is the first report on charges and is limited in scope. It covers only one product type for investing the proceeds of a pension plan (ARFs sold through intermediaries by insurance companies) and does not fully address intermediary charges, which may be as much or more than the charges studied here. As such additional charges are likely to be a significant proportion of the overall cost to consumers; further analysis in this area may be useful.

- The kind of comparative pricing information in this report is not normally available to consumers or to the intermediaries who advise them on their choice of ARF. If such information were to be made available and updated on a regular basis, the effect on charges and on consumer choice is likely to be positive.

Report on ARF Charges – Chapter 1 – The Survey

1.1 Information sought

A letter was sent by the Chair of the Pensions Council on 20th November 2015 to the Chief Executive Officers of the following life assurance companies (**"insurers"**) who act as Qualifying Fund Managers (**"QFMs"**) for ARFs:

Aviva Life
Friends First
Irish Life
Standard Life
New Ireland Assurance
Zurich Life

The letter (a sample of which is set out in Appendix 2), requested details of the insurer's charges, expressed as an annual RIY assuming the ARF is terminated in its entirety by way of a transfer to another QFM, at durations 1 to 10 years, for:

- Each *standard* ARF product *currently* distributed by that insurer through independent insurance intermediaries; and for
- ARF amounts of €75,000 and €150,000, assuming *no* intermediary remuneration is payable in each case.

While the Survey did not cover the entire ARF market (see next section for exclusions), the Council is satisfied that the Survey results present a highly representative picture of charges currently levied on new ARFs provided by life assurance companies in December 2015, for the surveyed amounts of €75,000 and €150,000.

1.2 ARF products *not* included in this Survey

This Survey of ARF charges did *not* cover:

1. MIFID investment firms who act as QFMs;
2. ARF products distributed by life assurance companies through direct distribution channels such as employees or tied insurance agents;
3. Bespoke ARF products which may be provided by life assurance companies through one or a limited number of independent insurance intermediaries; or
4. Past generations of ARF products with different charging structures, which are no longer available for sale.

1.3 Charges *not* included in Survey

The Survey did not directly cover the following ARF charges:

1. Intermediary remuneration payable by the consumer via deductions from their ARF fund. However, information on the range of commission options under each ARF product was

requested and the impact of intermediary remuneration on ARF charges is addressed in Chapter 1.4 and Chapter 3 of this report;

2. Investment transaction charges (cost of buying and selling the fund's investments) inside the fund or funds in which the ARF may invest;
3. Other operational charges levied inside the investment fund or funds in which the ARF may invest, such as auditing, legal and compliance fees; or
4. Additional fund charges that may arise in some cases as a result of a consumer choosing to invest in an actively managed or specialist fund. (The Survey requested insurers to calculate their charges based on a default fund selection or, where no such default applies, using a fund or funds typically chosen by consumers investing in that ARF product.)

1.4 Intermediary remuneration charges

All insurers offer independent intermediaries a wide range of commission options; combining an initial payment and/or a recurring payment related to the ongoing value of the ARF fund (the former payment is called "initial" commission while the latter is referred to as 'trail' commission). The remuneration chosen by the independent intermediary is then funded by the insurer making a corresponding direct recovery from the consumer's ARF fund.

A consumer who arranges an ARF is therefore likely to have two separate categories of charges (in addition to other investment related charges) applied to his or her ARF account:

- The insurer's own charges; and
- Recovery of intermediary/advice remuneration charges.

The combined impact of insurer own charges and intermediary remuneration charges are set out in *Chapter 3 – Intermediary Remuneration*.

In this Survey, the projected annual RIYs sought relate to the insurer's charges only (i.e. "nil commission"), on the basis that the same intermediary remuneration (and hence ARF charges related to payment of that remuneration) is likely to be payable on top of the insurer charges, regardless of which insurer or product is selected.

The insurer's charges are therefore analogous to wholesale charges, to which retail distribution/advice and other charges are added, i.e. the intermediary remuneration charges, to arrive at the total charges borne by the consumer.

1.5 Responses

We received responses from all six insurers surveyed.

It was noted that all respondents offer an ARF product (i.e. same/similar name/brand) with at least two different charging options to be selected by the intermediary/consumer.

Therefore, while six insurers responded to our Survey, in fact it covers 22 ARF products for a €75,000 ARF investment and 23 products for a €150,000 investment, with different insurer charging structures.

Report on ARF Charges – Chapter 2 – Survey Results

2.1 Insurer Charges

The Survey results and associated information provided by the insurers, show that insurers recover their own charges in one or more of the following ways:

1. An initial *allocation rate* (expressed as a % of the ARF investment amount). Typically, the allocation rate increases by the size of the initial ARF investment amount, in broad investment amount bands.

   Where the allocation rate is less than 100%, the reduction below 100% represents an initial charge. For example, based on an initial allocation rate of 99%, if €1,000 is contributed, this results in €990 being invested in the ARF account, with €10 being taken as an initial charge.

   An allocation rate of greater than 100% represents an initial bonus. For example, an initial allocation rate of 101% represents an initial bonus of 1% added to the value of the ARF (i.e. €1,000 contributed results in €1,010 being invested).

2. An *annual fund charge*, expressed as a % of the ongoing value of the ARF; this charge may vary by the unit fund or funds chosen by the consumer, although in many cases the same charge applies regardless of the individual fund or funds chosen. The deduction of this charge is already reflected in the unit prices published by the insurer.

   In some cases, there may be an annual fund rebate to reduce the annual fund charge, by way of adding units to the ARF value each year, e.g. the headline fund charge is 1.0% pa, but an annual rebate of 0.25% pa effectively reduces the annual fund charge to 0.75% pa.

3. An *annual plan charge*, expressed as a % of the ongoing value of the ARF; This charge is typically deducted by annual encashment of units by the insurer, but in some cases it may be added to the annual fund charge (and recovered inside the unit fund by way of a reduced unit price).

4. A monetary *policy fee*, deducted regularly from the consumer's ARF account.

5. An *early encashment charge* which only applies where the ARF is fully terminated during an initial period after its establishment (typically within the first five years) either through full encashment or transfer to another QFM. Typically, this charge does not apply to regular withdrawals or termination of the ARF on account of the death of the ARF holder within the early encashment charge period.

2.2 Results

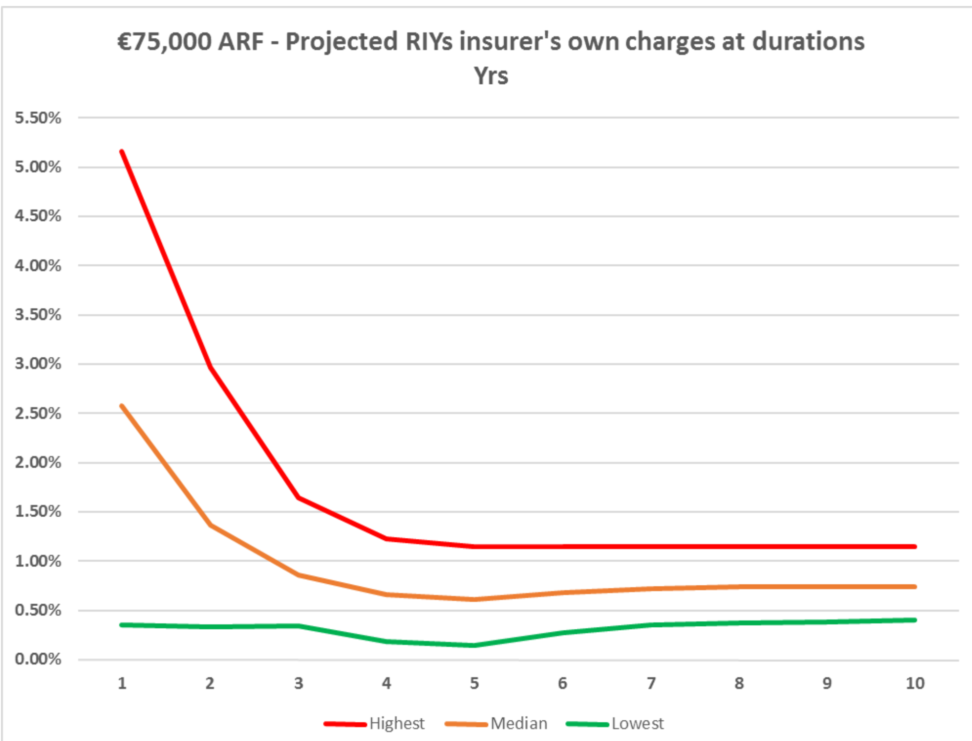
The Survey responses demonstrated that there is a wide variation in insurer ARF charges and that these charges vary by:

- Insurer;
- The version of the insurer's product chosen; all insurers offer at least two different charging versions of their ARF product;
- The length of time that the ARF is held for; and
- The amount of the ARF investment; charges are generally higher for lower ARF investment amounts.

Insurer charges generally tend to be at their highest if the ARF is terminated within the first 3 years, falling to reach a minimum on termination just after the expiry of 5 years, and then increasing gradually again the longer the ARF is held.

The charts below show the highest, lowest and median insurer RIY charge assuming the ARF is terminated at each duration from 1 to 10 years for a €75,000 and for a €150,000 initial ARF investment. The detailed responses from each insurer are included in Appendix 3.

€75,000 ARF



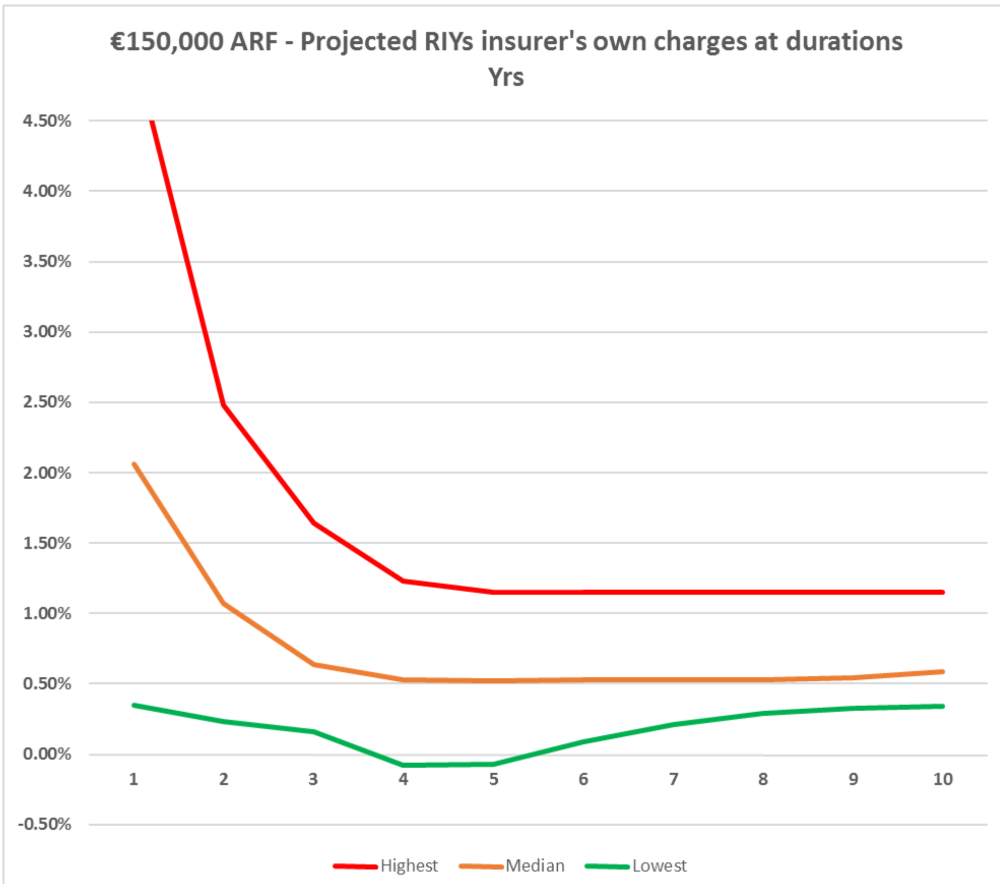
The spread between the highest and lowest annual RIY at each duration was as follows:

Table 2.1 – €75,000 ARF – Spread of charges between highest and lowest RIY

	ARF terminated after Yrs									
	1	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**
Spread	4.81%	2.63%	1.30%	1.05%	1.01%	0.88%	0.80%	0.78%	0.77%	0.75%

For example, **based on an ARF investment of €75,000 a consumer could save up to €5,440 in insurer charges over 10 years** (in constant money terms) by choosing the ARF product with the lowest insurer charge over that period rather than the one with the highest. This saving equates to 7.25% of the entire ARF value over that period, or nearly two year's income withdrawal at 4% pa. Higher annual cash savings would apply where the ARF is terminated earlier, albeit higher absolute charges would apply on earlier encashment.

€150,000 ARF



The spread between the highest and lowest RIYs at each duration was as follows:

Table 2.2 – €150,000 ARF – Spread of charges between highest and lowest RIY

	ARF terminated after Yrs									
	1	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**
Spread	4.65%	2.25%	1.48%	1.31%	1.22%	1.06%	0.94%	0.86%	0.82%	0.81%

For example, **based on an ARF investment of €150,000 a consumer could potentially save up to €11,720 in total charges over 10 years** by choosing the product with the lowest insurer charge over that period rather than the one with the highest. This saving equates to nearly 8% of the entire ARF value over that period, or more than two year's income withdrawal at 4% pa.

We observed that in general, insurer charges for a €150,000 ARF investment are marginally lower than for a €75,000 investment, particularly at shorter durations:

Table 2.3 – Difference in Median insurer RIY charge between €75k & €150k ARF

	ARF terminated after Yrs									
	1	2	3	4	5	6	7	8	9	10
€75k ARF	2.58%	1.36%	0.86%	0.66%	0.61%	0.68%	0.72%	0.74%	0.74%	0.74%
€150k ARF	2.06%	1.07%	0.64%	0.53%	0.52%	0.53%	0.53%	0.53%	0.54%	0.59%
Difference	-0.52%	-0.29%	-0.22%	-0.13%	-0.09%	-0.19%	-0.19%	-0.21%	-0.20%	-0.15%

2.3 Product charge variations

As mentioned already, all insurers offer at least two different charging versions of the same product, with some versions offering better value for money at shorter durations and others offering better value for money at longer durations.

Table 2.4 below shows, for each insurer, the spread of charges between that insurer's highest and lowest RIY charge product at each duration for a €75,000 ARF investment amount:

Table 2.4 – €75,000 ARF - Spread of RIY charges between highest and lowest product

	ARF terminated after Yrs									
	1	2	3	4	5	6	7	8	9	10
Aviva	1.07%	0.38%	0.16%	0.04%	0.04%	0.08%	0.11%	0.14%	0.16%	0.17%
Friends First	1.68%	1.00%	0.43%	0.50%	0.55%	0.42%	0.32%	0.27%	0.21%	0.19%
Irish Life	4.23%	1.99%	0.61%	0.03%	0.22%	0.19%	0.16%	0.14%	0.13%	0.12%
New Ireland	3.74%	1.26%	0.66%	0.39%	0.45%	0.33%	0.26%	0.26%	0.26%	0.26%
Standard Life	4.65%	2.15%	1.30%	0.67%	0.63%	0.49%	0.40%	0.33%	0.28%	0.25%
Zurich	0.75%	0.27%	0.26%	0.26%	0.09%	0.16%	0.21%	0.24%	0.28%	0.29%

Table 2.5 below shows, for each insurer, the spread of charges between their highest and lowest RIY charge product at each duration for a €150,000 ARF investment amount:

Table 2.5 – €150,000 ARF - Spread of RIY charges between highest and lowest product

	ARF terminated after Yrs									
	1	2	3	4	5	6	7	8	9	10
Aviva	2.05%	1.13%	0.17%	0.38%	0.42%	0.32%	0.25%	0.19%	0.15%	0.14%
Friends First	1.68%	0.74%	0.43%	0.67%	0.66%	0.50%	0.39%	0.31%	0.24%	0.21%
Irish Life	3.75%	1.74%	0.43%	0.18%	0.33%	0.28%	0.24%	0.22%	0.20%	0.18%
New Ireland	3.02%	1.25%	0.66%	0.38%	0.39%	0.24%	0.15%	0.13%	0.12%	0.16%

	ARF terminated after Yrs									
	1	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**
Standard Life	4.65%	2.15%	1.30%	0.67%	0.63%	0.49%	0.40%	0.33%	0.28%	0.25%
Zurich	0.95%	0.26%	0.09%	0.13%	0.06%	0.09%	0.13%	0.19%	0.21%	0.25%

There can therefore be a significant variation in insurer charges, depending on which charging version of an insurer's ARF product is chosen, and for how long the product is held.

As can be seen from the above tables, potential savings over 10 years of up to 0.29% pa (or about 2.9% of the investment amount in constant money terms) can be achieved between the charges of different ARF products issued by the *same* insurer over that hold period.

Report on ARF Charges – Chapter 3 – Intermediary Remuneration

3.1 Intermediary remuneration

Intermediary remuneration can be paid by the consumer either paying a fee directly to the intermediary or allowing commission to be paid by the insurer to the intermediary. There are currently two types of commission options offered by insurers to intermediaries:

1. Initial commission. This can range from 0% to 5% of the initial amount invested.
2. Recurring or “trail” commission. This can range from 0% pa to 1% pa of the annual ARF value.

For both initial and trail commission, the maximum commission available varies by insurer.

3.2 Recovery of intermediary remuneration

Where the consumer has opted to pay the intermediary through insurer commission, the insurer will deduct the remuneration payable to the intermediary directly from the consumer’s ARF account. Therefore, every € of remuneration payable to the intermediary reduces the ARF value accordingly. As this represents an additional charge to the consumer, it increases the annual RIY shown in Chapter 2 and Appendix 3 accordingly:

- The trail commission increases the annual RIY at each duration by the annual rate of trail commission.

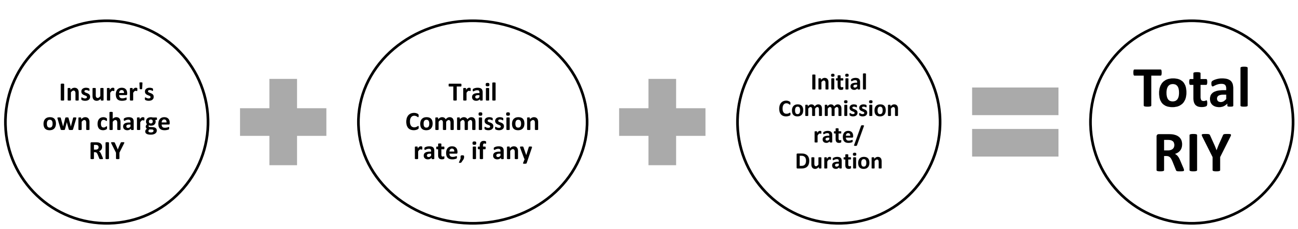
  (For example, a trail commission of 0.50% pa will increase the annual RIY by 0.50% pa at each duration.)

- The initial commission increases the annual RIY at each duration, on a reducing straight line scale varying by the duration.

  (For example, an initial commission of 3% broadly increases the annual RIY over 3 years by 3%/3 = 1% pa. However, if the ARF is held for 6 years, the impact of the initial commission is 3%/6 = 0.50% pa increased RIY over 6 years.)

3.3 Total RIY

Where intermediary remuneration is payable via commission, the total RIY (insurer’s charges + intermediary remuneration charges) at a particular duration can be calculated as:



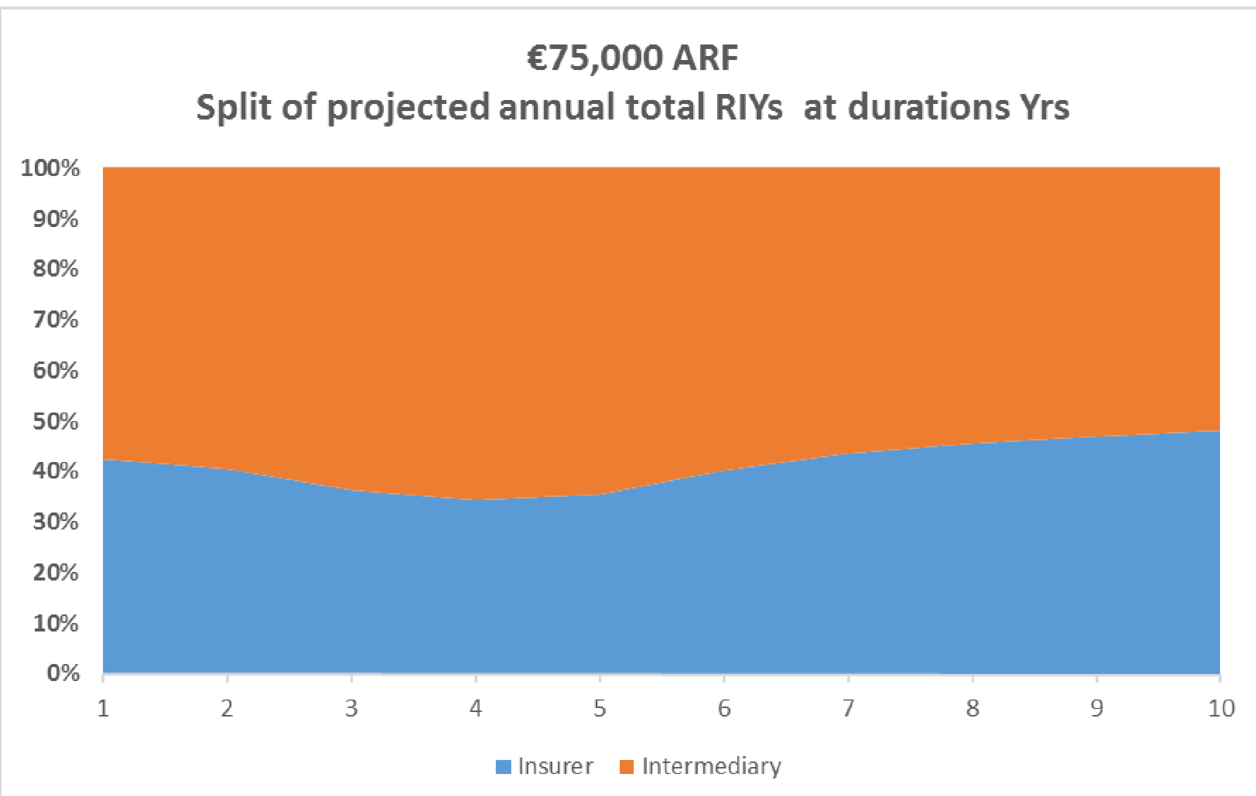
€75,000 ARF

For example, if we assume the intermediary agrees with the consumer an initial commission of 3% and trail of 0.5% pa to be deducted from their ARF value, the total charges payable by the consumer (insurer charges + intermediary remuneration), based on the median insurer RIY charge would be:

Table 3.1 – €75,000 ARF – Insurer + Intermediary charges

	ARF terminated after Yrs									
	1	2	3	4	5	6	7	8	9	10
Insurer median charge	2.58%	1.36%	0.86%	0.66%	0.61%	0.68%	0.72%	0.74%	0.74%	0.74%
Trail commission	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%
Initial commission	3.00%	1.50%	1.00%	0.75%	0.60%	0.50%	0.43%	0.38%	0.33%	0.30%
Total RIY	**6.08%**	**3.36%**	**2.36%**	**1.91%**	**1.71%**	**1.68%**	**1.65%**	**1.61%**	**1.57%**	**1.54%**

On this example commission structure, the intermediary charges represent between 52% and 66% of the total charges, varying by how long the ARF is held:



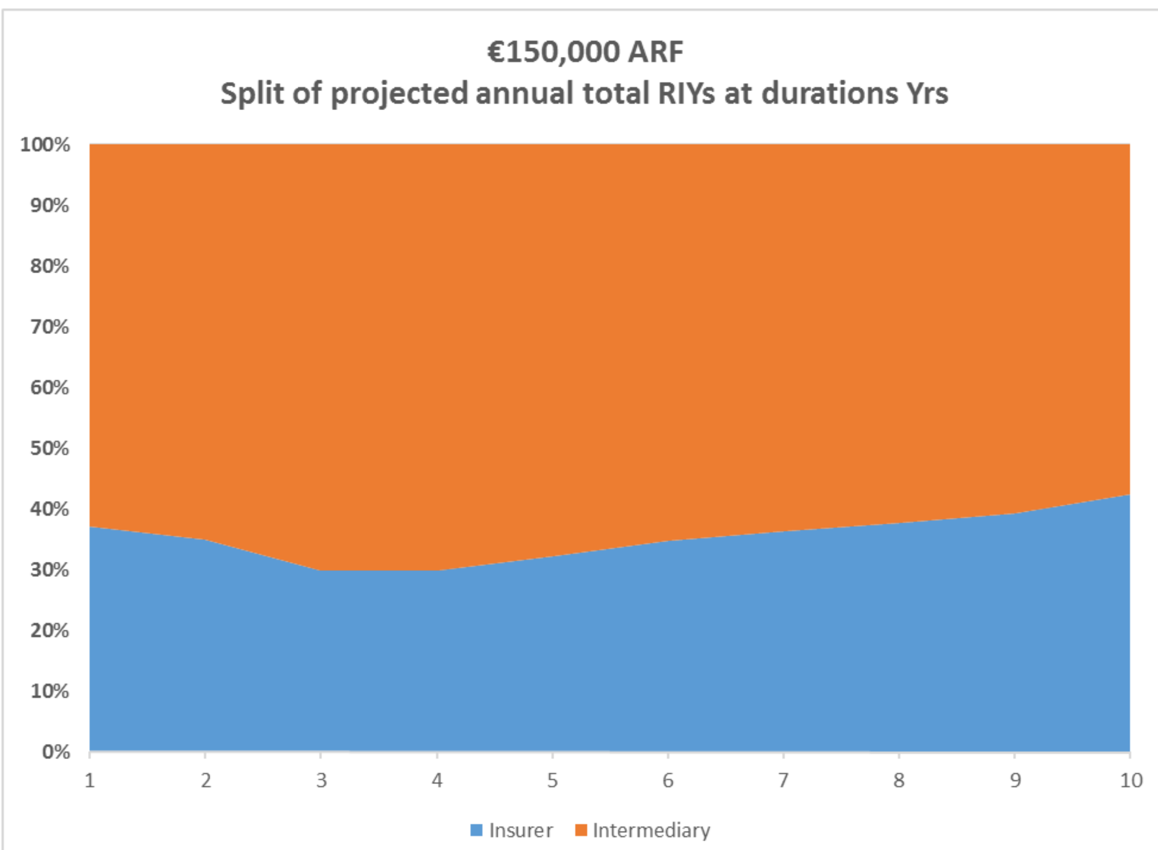
€150,000 ARF

Again assuming an initial commission of 3% and trail of 0.5% pa, the total charges payable by the consumer based on the median insurer charges are:

Table 3.2 – €150,000 ARF – Insurer + Intermediary charges

	ARF terminated after Yrs									
	1	2	3	4	5	6	7	8	9	10
Insurer median charge	2.06%	1.07%	0.64%	0.53%	0.52%	0.53%	0.53%	0.53%	0.54%	0.59%
Trail commission	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%
Initial commission	3.00%	1.50%	1.00%	0.75%	0.60%	0.50%	0.43%	0.38%	0.33%	0.30%
Total RIY	**5.56%**	**3.07%**	**2.14%**	**1.78%**	**1.62%**	**1.53%**	**1.46%**	**1.41%**	**1.37%**	**1.39%**

Based on this commission structure, the intermediary charges represent between 58% and 70% of the total charges, varying by duration.



A higher commission structure will lead to higher overall charges for the consumer than shown above, while a lower structure would lead to lower charges.

A key conclusion is that **the level of intermediary remuneration is likely to have as much, or even more impact, on the total charges borne by an ARF holder than the choice of insurer or product, particularly over shorter durations.**

3.4 Transferring ARFs

An ARF holder is allowed to transfer the value of their ARF (less an early encashment charge, where applicable) to another ARF with the same or with a different QFM.

Of course moving to a different ARF/insurer will likely lead to a new set of charges, possibly including additional initial commission for the intermediary involved.

The total (median insurer + intermediary) charges RIY for a €150,000 ARF investment was set out above in Table 3.2 (assuming 3% initial commission plus 0.5% pa trail commission) as:

Table 3.3 – €150,000 ARF – Insurer + Intermediary charges

	ARF terminated after Yrs									
	1	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**
Insurer median charge	2.06%	1.07%	0.64%	0.53%	0.52%	0.53%	0.53%	0.53%	0.54%	0.59%
Trail commission	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%
Initial commission	3.00%	1.50%	1.00%	0.75%	0.60%	0.50%	0.43%	0.38%	0.33%	0.30%
Total RIY	**5.56%**	**3.07%**	**2.14%**	**1.78%**	**1.62%**	**1.53%**	**1.46%**	**1.41%**	**1.37%**	**1.39%**

For a hold period of 10 years, the total annual RIY is 1.39%, based on the median insurer RIY charge.

However, if the consumer were to terminate their ARF and reinvest in a new similar ARF product (with fresh 3% initial commission payable on each new ARF) first after 3 years and again after another 3 years, their total annual RIY charge pattern (based on the assumptions above) over 10 years would be:

RIY over first 3 year period	RIY over next 3 year period	RIY over last 4 year period	Average RIY over 10 years
2.14% pa	2.14%	1.78% pa	2.00% pa

So by moving their ARF twice (after 3 and 6 years) within the 10-year period, rather than staying in the same ARF product throughout that period, the consumer's annual charge increases in this example from 1.39% pa to 2.00% pa, i.e. an *increase* in the annual RIY of circa 0.6% pa.

However, this assumes that the intermediary takes 3% initial commission on each of the two new ARFs established, which may or may not be the case, and also assumes that current ARF product pricing will apply in 3 and 6 years from now, which also may or may not be the case.

It is noticeable that because average insurer charges are at their lowest just after 5 years and increase thereafter, that consumers in some ARF products might be better off (purely from an insurer charging perspective) to terminate their ARF every 5 years and reinvest in a new ARF with a similar charging structure, assuming such an ARF is available at that time, rather than hold the first ARF for the full 10-year period.

Take for example a fictional (but representative) ARF product with:

- 103% allocation;
- An annual fund charge of 1.0% pa; and
- An early encashment charge of 5% in year 1 running down to 1% in year 5, and zero thereafter.

This Table shows the annual RIY insurer charge of this product split between the first and second 5 year periods, assuming the ARF is held for the full 10-year period:

RIY over first 5 year period	RIY over next 5 year period	Average RIY over 10 years
0.4% pa	1.0% pa	**0.7% pa**

If this consumer could, after 5 years, find an identical ARF product with the same charging structure (called “ARF2”), they would be better off (purely from an insurer charging perspective) terminating the first ARF after 5 years and reinvesting in ARF2 for the second 5 years, as the annual RIY insurer charge split between the first and second ARFs would then be:

ARF 1 RIY over first 5 year period	ARF 2 RIY over second 5 year period	Average RIY over 10 years
0.4% pa	0.4% pa	**0.4% pa**

Of course some of the apparent savings in moving to the second ARF after 5 years would be absorbed, in the short run, by any new initial commission payable to an intermediary on the second ARF.

The insurer charging structure, used by most but not all ARF products, appears counterintuitive in that the longer the consumer holds their ARF (after the initial 5-year period expires), the higher the insurer's charges become.

Intuitively ARFs moving regularly between providers and products must lead to higher charges for *all* ARF holders, than if ARFs were held for longer periods with the same insurer.

4.1 Charges matter

The two main factors which will determine the retirement income outcome produced by an ARF for a retiree are:

- Investment return (the higher the return, the more retirement income) and
- Charges (the lower these charges are, the more retirement income the ARF will produce).

Our Survey has shown that median insurer charges RIYs are of the order of 0.74% pa if a €75k ARF is held for 10 years and then terminated (the median RIY for a €150k ARF is 0.59% pa over the same period). If, for example, intermediary commission of 3% initial and 0.5% pa trail is added, this will more than double the charges over the same period.

Therefore, **in a low inflation/interest rate/investment return climate, total charges can significantly reduce or in some cases completely eliminate, the investment return earned by the ARF**. The choice of investments is also relevant: an ARF holder is more likely to choose less risky investments as their investment horizon and appetite for risk is reduced (when compared to say, a 40 year-old saving for retirement, for example).

A recent Society of Actuaries paper[2] disclosed from information provided by some insurers, that in respect of some €2.6bn of ARF/AMRF funds held by insurers currently:

- 44% of funds were invested in cash or cash-like funds;
- 44% of funds were invested in managed type funds, where the asset allocation is determined by the fund manager;
- The balance was invested in single asset type funds.

The Society of Actuaries in Ireland provides guidance on future investment return assumptions to be used when projecting defined contribution pension fund values to consumers. Based on guidance applicable from April 2016[3], the table below shows anticipated investment returns and the impact of the median ARF charges on these returns, assuming a 10 year hold period:

Table 4.1 – ARF anticipated investment return absorbed by charges over 10 years

	Cash Fund	Managed Fund[4]
Anticipated investment return before charges	1.00% pa	3.75% pa
Assumed total ARF charges (insurer + intermediary)[5]	-1.46% pa	-1.46% pa
Anticipated net investment return, *after* charges	**-0.46% pa**	**2.29% pa**

[2] *A Review of Retirement Income choices available from Irish approved Defined Contribution pension arrangements in 2015*
[3] *ASP PEN-12, version 1.5*
[4] *Assuming an asset allocation of 50% fixed interest and 50% equities+ property assets.*
[5] *The average of the two median insurer RIYs over 10 years for a €75,000 and a €150,000 investment amount, plus an assumed 0.80% pa intermediary charge RIY.*

In the example above, if the ARF is invested in a cash fund, the assumed total annual ARF charge of 1.46% pa leads to an anticipated *negative* return, while if the ARF is invested in a managed fund with a 50%/50% split between fixed interest and equities/property, the assumed ARF charge level absorbs nearly 40% of the anticipated future investment return.

The % of investment return absorbed by charges would be even higher for shorter hold periods, as the RIY charge is higher at shorter hold periods, and for managed funds investing more than 50% in fixed interest and cash.

Charges therefore have a material impact on the retirement income outcome for ARF holders. Where they can be reduced (e.g. by choosing an ARF with a lower charging structure and/or by negotiating lower intermediary remuneration) ARF holders will benefit from higher income in retirement.

4.2 Observations

This study is the first part of a work in progress on charges as requested by the Minister. It is too early to make policy recommendations at this stage, when further work is to be done. The following points therefore are observations:

- Charges have a material impact on the retirement income an ARF will produce for a retiree. It is clear that consumers can make significant savings if they “shop around”. However, the charging structures used in insurer ARF products are complex, making it extremely difficult for the average consumer (or even their intermediary) to determine the relative charge status of any ARF product compared with other similar ARF products in the marketplace.
- The practice of insurers having multiple charging structures for the same ARF product (where the charges vary by the length of time that the ARF is held for) further adds to the complexity. It also raises the question as to whether the consumer is and should be informed by the intermediary or insurer that there may be a lower charge (at particular benchmark durations, e.g. after 5 and 10 years) version of the same ARF product available, when a higher charge version (at those benchmark durations) is being recommended to the consumer.
- This is (first) report on charges and is limited in scope. It covers only one product type for investing the proceeds of a pension plan (ARFs sold through intermediaries by insurance companies) and does not fully address intermediary charges, which may be as much or more than the charges studied here. As such additional charges are likely to be a significant proportion of the overall cost to consumers; further analysis in this area may be useful.
- The kind of comparative pricing information in this report is not normally available to consumers or to the intermediaries who advise them on their choice of ARF. If such information were to be made available & updated on a regular basis, the effect on charges and on consumer choice is likely to be positive.

Appendix 1 – Approved Retirement Fund

The ARF option

The ‘ARF option’ was introduced on 6th April 1999 for retirement annuities and proprietary director members of occupational pension schemes. It was extended to AVCs in 2000, Personal Retirement Savings Accounts (PRSAs) in 2003, and to all members of defined contribution occupational pension schemes from February 2011.

The ARF option allows the retiree to take up to 25% of the maturing retirement fund as a lump sum. The balance of the fund can then be transferred to an Approved Retirement Fund (ARF) with a Qualifying Fund Manager (QFM), or taken as a taxable cash sum, subject to first complying with a €63,500 AMRF/annuity ‘set aside’ requirement if the retiree is not then in receipt of total pension/annuity income of €12,700 p.a.

QFMs

Section 784A (1)(a) taxes Consolidation Act 1997 defines a list of institutions which can act as QFMs in relation to ARFs, which includes life assurance companies, MIFID investment firms and credit institutions. The main providers of ARFs currently are life assurance companies and MIFID investment firms.

The ARF

An ARF is simply a fiscal ‘wrapper’ on a personally held investment product or portfolio, with the wrapper being required to ensure tax is deducted at certain rates from certain payouts or distributions from the ARF. The ARF is a way of segregating personal assets which have arisen from the exercise of a retirement option, from the individual’s other personal assets, in order that a different taxation treatment can be applied to the ARF assets.

There is no separate legal entity called an ARF, as the ‘fund’ must be held in the name of the individual beneficially entitled to the assets of the fund.

Taxation

ARFs are exempt from Irish taxation on their investment returns.

ARF imputed distribution

An income tax charge on an ARF is applied annually unless the ARF holder withdraws at least 4% pa (between ages 60 and 70) or 5% pa (over 70) of the value of their ARF in that year. Where an individual holds ARFs and vested PRSAs of more than €2m, the minimum withdrawal to avoid an imputed distribution is 6% pa at all ages from 60 onwards.

In practice virtually all ARF holders withdraw sufficient funds each year to avoid an imputed distribution applying to their ARF for that year, i.e. once over 60, at least 4% pa.

All ARF withdrawals are subject to PAYE and USC.

The AMRF

The AMRF is like an ARF except that:

- The maximum investment in an AMRF is €63,500;
- There is no obligation to make any withdrawal from an AMRF before age 75 as imputed distributions do not apply to AMRFs. However, AMRF holders can opt to take one withdrawal a year, up to a maximum of 4% of the value of their AMRF.

Appendix 2 – Survey letter sent to insurers

The Pensions Council (An Chomhairle Pinsean)

Established under Section 26B of the Pensions Act, 1990

20 November 2015

Approved Retirement Fund (ARF) charges

Dear CEO,

I write on behalf of the Pensions Council which was set up to advise the Minister for Social Protection on matters relating to policy on pensions (commenced under Section 29 of the Social Welfare and Pensions (Miscellaneous Provisions) Act 2013). At our inaugural meeting in March 2015, the Tánaiste requested that we give special attention to charges for pensions and related products.

In part discharge of our mandate we are conducting a survey of Qualifying Fund Manager (**“QFM”**) charges for ARF’s currently offered by all life assurance companies though independent insurance intermediaries, i.e. not tied insurance agents.

To this end, can you please provide Reduction In Yield (**“RIY”**) figures (expressed as %, rounded to two decimal places) for all of your ARF products (and variations of the same product with distinct different charging structures) currently offered through independent insurance intermediaries, on the following basis:

- RIYs to be shown separately for a €75,000 and a €150,000 investment amount;
- Age attained at inception of the ARF policy: 60;
- Assume no intermediary initial premium based commission and no trail/fund based commission;
- since inception + 1 day, i.e. the duration 1 RIY assumes the policy is terminated and a transfer value paid to another ARF with a different QFM 12 months and 1 day after its inception;
- Assume a single annual withdrawal rate of 4% pa for the relevant durations, the withdrawal occurring at the end of each year;
- Use the same assumptions and principles as currently apply to the preparation of the Illustrative Table of Projected Benefits and Charges and the projected RIY, under article 6 and Schedule 2 paragraph 6, respectively, of the Life Assurance (Provision of Information) Regulations 2001 and associated Society of Actuaries Guidance ASP LA 8.

  In particular, in relation to the assumed annual fund charge, please base your response on the typical fund or combination of funds you currently use or would use to prepare a generic table of Illustrative Table of Projected Benefits and Charges and associated RIY, under article 7(2) of the Life Assurance (Provision of Information) Regulations 2001 and associated Society of Actuaries Guidance ASP LA 8 (article 3.11).

The relevant details should be inserted into the enclosed sheet, signed and mailed to the Council at the address on the previous page. I ask particularly that the information be provided by 8th December 2015, in good time for the next meeting of the Council later that month. Please also enclose a PDF of the technical guide/explanation of the charging and intermediary remuneration structures for all your current ARF products offered through independent insurance intermediaries.

Your participation in this exercise is greatly appreciated.

Yours sincerely,

____

Jim Murray
Chairman

Appendix 3 – Insurer own charge RIY responses

Table 1
Projected annual RIYs for insurer own charges for €75,000 ARF for durations (yrs)

	QFM	Product	1	2	3	4	5	6	7	8	9	10
1	Aviva	Option A	2.53%	1.73%	0.81%	0.38%	0.32%	0.43%	0.50%	0.56%	0.61%	0.64%
2	Aviva	Option B	3.60%	2.11%	0.97%	0.42%	0.28%	0.35%	0.39%	0.42%	0.45%	0.47%
3	Friends First	Financed - A	3.68%	2.16%	1.00%	0.45%	0.32%	0.39%	0.43%	0.47%	0.49%	0.52%
4	Friends First	Financed - B	2.00%	1.41%	0.57%	0.18%	0.14%	0.27%	0.37%	0.43%	0.49%	0.53%
5	Friends First	Non Financed	2.14%	1.16%	0.68%	0.68%	0.69%	0.69%	0.69%	0.70%	0.70%	0.71%
6	Irish Life	Complete Solutions 1	5.16%	2.96%	1.60%	0.96%	0.78%	0.81%	0.84%	0.86%	0.87%	0.89%
7	Irish Life	Complete Solutions 2	0.93%	0.97%	0.99%	0.99%	1.00%	1.00%	1.00%	1.00%	1.00%	1.01%
8	New Ireland	Structure A	1.48%	0.74%	0.50%	0.38%	0.32%	0.44%	0.52%	0.59%	0.63%	0.67%
9	New Ireland	Structure B	3.25%	1.49%	0.91%	0.63%	0.47%	0.52%	0.55%	0.58%	0.60%	0.62%
10	New Ireland	Structure C	4.51%	2.00%	1.16%	0.75%	0.51%	0.51%	0.51%	0.51%	0.51%	0.51%
11	New Ireland	Structure D	0.77%	0.77%	0.77%	0.77%	0.77%	0.77%	0.77%	0.77%	0.77%	0.77%
12	Standard Life	Option A	0.35%	0.33%	0.34%	0.59%	0.74%	0.84%	0.91%	0.97%	1.01%	1.04%
13	Standard Life	Option B	1.41%	0.82%	0.64%	0.56%	0.52%	0.66%	0.75%	0.82%	0.87%	0.92%
14	Standard Life	Option C	2.11%	1.11%	0.79%	0.87%	0.93%	0.96%	0.98%	1.00%	1.02%	1.03%
15	Standard Life	Option D	3.13%	1.58%	1.08%	0.83%	0.70%	0.77%	0.82%	0.85%	0.88%	0.90%
16	Standard Life	Option E	4.10%	2.06%	1.39%	1.06%	0.88%	0.91%	0.93%	0.95%	0.97%	0.98%
17	Standard Life	Option F	3.05%	1.54%	1.05%	1.05%	1.05%	1.05%	1.05%	1.05%	1.05%	1.05%
18	Standard Life	Option G	5.00%	2.48%	1.64%	1.23%	0.99%	0.99%	0.99%	0.99%	0.99%	0.99%
19	Standard Life	Option H	1.15%	1.15%	1.15%	1.15%	1.15%	1.15%	1.15%	1.15%	1.15%	1.15%
20	Zurich	Option A	2.17%	1.05%	0.67%	0.49%	0.38%	0.49%	0.56%	0.61%	0.66%	0.69%
21	Zurich	Option B	2.92%	1.31%	0.76%	0.50%	0.34%	0.40%	0.45%	0.49%	0.52%	0.54%
22	Zurich	Option C	2.63%	1.04%	0.50%	0.24%	0.29%	0.33%	0.35%	0.37%	0.38%	0.40%

Table 2
Projected annual RIYs for insurer own charges for €150,000 ARF for durations (yrs)

	QFM	Product	1	2	3	4	5	6	7	8	9	10
1	Aviva	Option A	1.62%	1.27%	0.51%	0.15%	0.14%	0.28%	0.38%	0.45%	0.51%	0.55%
2	Aviva	Option B	2.58%	1.66%	0.68%	0.20%	0.11%	0.21%	0.28%	0.34%	0.38%	0.41%
3	Aviva	Option C	0.53%	0.53%	0.53%	0.53%	0.53%	0.53%	0.53%	0.53%	0.53%	0.53%
4	Friends First	Financed A	2.72%	1.66%	0.66%	0.19%	0.10%	0.20%	0.27%	0.32%	0.36%	0.39%
5	Friends First	Financed B	1.04%	0.92%	0.23%	-0.08%	-0.07%	0.09%	0.21%	0.29%	0.36%	0.41%
6	Friends First	Non Financed	2.06%	1.07%	0.59%	0.59%	0.59%	0.59%	0.60%	0.60%	0.60%	0.60%
7	Irish Life	Complete Solutions 1	4.12%	2.44%	1.24%	0.68%	0.56%	0.63%	0.68%	0.71%	0.74%	0.76%
8	Irish Life	Complete Solutions 2	0.37%	0.70%	0.81%	0.86%	0.89%	0.91%	0.92%	0.93%	0.94%	0.94%
9	New Ireland	Structure A	0.47%	0.23%	0.16%	0.13%	0.12%	0.27%	0.38%	0.46%	0.52%	0.57%
10	New Ireland	Structure B	2.23%	0.98%	0.57%	0.37%	0.26%	0.34%	0.40%	0.45%	0.48%	0.51%
11	New Ireland	Structure C	3.49%	1.48%	0.82%	0.49%	0.31%	0.34%	0.36%	0.38%	0.40%	0.41%
12	New Ireland	Structure D	0.51%	0.51%	0.51%	0.51%	0.51%	0.51%	0.51%	0.51%	0.51%	0.51%
13	Standard Life	Option A	0.35%	0.33%	0.34%	0.59%	0.74%	0.84%	0.91%	0.97%	1.01%	1.04%
14	Standard Life	Option B	1.41%	0.82%	0.64%	0.56%	0.52%	0.66%	0.75%	0.82%	0.87%	0.92%
15	Standard Life	Option C	2.11%	1.11%	0.79%	0.87%	0.93%	0.96%	0.98%	1.00%	1.02%	1.03%
16	Standard Life	Option D	3.13%	1.58%	1.08%	0.83%	0.70%	0.77%	0.82%	0.85%	0.88%	0.90%
17	Standard Life	Option E	4.10%	2.06%	1.39%	1.06%	0.88%	0.91%	0.93%	0.95%	0.97%	0.98%
18	Standard Life	Option F	3.05%	1.54%	1.05%	1.05%	1.05%	1.05%	1.05%	1.05%	1.05%	1.05%
19	Standard Life	Option G	5.00%	2.48%	1.64%	1.23%	0.99%	0.99%	0.99%	0.99%	0.99%	0.99%
20	Standard Life	Option H	1.15%	1.15%	1.15%	1.15%	1.15%	1.15%	1.15%	1.15%	1.15%	1.15%
21	Zurich	Option A	1.17%	0.54%	0.34%	0.24%	0.18%	0.32%	0.41%	0.49%	0.54%	0.59%
22	Zurich	Option B	1.92%	0.80%	0.42%	0.24%	0.13%	0.23%	0.31%	0.36%	0.41%	0.44%
23	Zurich	Option C	2.12%	0.78%	0.33%	0.11%	0.19%	0.24%	0.28%	0.30%	0.33%	0.34%