An Chomhairle Pinsean
The Pensions Council

Report on Individual Buy Out Bond Charges

February 2017

Table of contents

Introduction

Dear Minister,

I hereby submit on behalf of the Pensions Council the Report on Charges for Buy-Out Bonds (BOBs), following our survey of insurers' charges for such products. This Report is the second of our reports on charges for individual pension products and follows our previous report on charges for Approved Retirement Funds or ARFs.

Both ARFs and BOBs are used in different circumstances for the investment of the proceeds of an individual's pension fund.

As for ARF products, we looked at insurers' own charges for BOBs sold through independent intermediaries because they are well-defined products sold with a clear distinction between insurer and intermediary charges. We are grateful to the six life assurance companies for providing lists of their charges for BOBs.

We found that insurer charges varied significantly between different but apparently similar BOBs. Other things being equal (an important caveat), on a BOB investment of €50,000 a consumer could save up to €2,250 in insurer charges over 10 years (in constant money terms) by choosing the BOB product with the lowest insurer charge over that period, rather than the one with the highest. This saving equates to 4.5% of the entire BOB value over that period. This saving could increase to €4,600 or 4.6% of the initial amount for an investment of €100,000 over 10 years under the same conditions.

Clearly, consumers can benefit from shopping around for their BOBs, but in practice, it may often be difficult or indeed impossible for them to do so. They may not know that cheaper options are available or may at best be only peripherally involved in the choice of a BOB as BOBs are often chosen by trustees of pension funds.

The Council's survey followed the projected evolution of a BOB contract over a ten-year period but in practice many consumers may hold BOBs for a very short period, sometimes even a matter of days, before maturing their BOB and taking a lump sum and/or transferring funds to an ARF. For these short-term BOBs, the initial charges are more important than the trailing charges in later years and there are substantial differences between these initial charges for different BOBs – ranging from 0.14% to 4.5%. A consumer who lost 4.5% of his or her investment to charges in a matter of days or months would be rightly aggrieved to find out that a charge as low as 0.14% might have been available.

A particularly unfortunate consumer would pay over the odds (approaching 4.5%) for a BOB and again (approaching 7 or 8% over ten years) on moving to an ARF.

Our survey was confined to insurers' charges only and did not include broker or intermediary charges that would normally be levied in such cases. In practice, intermediary charges are likely to be more than the insurers' charges, thereby reducing further the value of a consumer's investment in a BOB. It seems that the intermediary generally makes more from selling a BOB than the insurer.

The kind of comparative pricing information in this Report is not normally available to consumers, trustees or intermediaries. It would be helpful if such information were generally available on an on-going basis but we need to look more closely at how these products are sold to consumers, at what information is provided and at how and when that information is provided. This is the focus of the Council's follow up to this report.

We are of course ready, Minister, to provide any further information you may require on this report or on related issues.

Yours sincerely,

James M. Murray

Jim Murray
Chairman

Executive Summary

The Pensions Council has carried out a survey of the charges applied by life assurance companies (**"insurers"**) that offer individual Buy Out Bond[1] (**"BOB"**) 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 BOB product, the Survey covered 22 separate BOB products.

The Survey sought the projected annual Reduction in Yield (**"RIY"**) for all standard BOB product marketed by each insurer arising from the application of the insurer's own charges only (i.e. *excluding* intermediary commission or other third party charges), based on a €50,000 and a €100,000 investment amount for an individual aged exactly 55, using a typical (to that insurer's product) investment fund choice, and assuming the BOB is matured by way of paying out retirement benefits after specified durations ranging from 1 to 10 years from the date of investment.

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

- insurer,
- product version
- duration to maturity, and
- the amount of the investment; [charges are higher for lower investment amounts, particularly where the BOB 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 BOB 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 BOB is held.**

2. **Other things being equal (an important caveat), based on a BOB investment of €50,000 a consumer could save up to €2,250 in insurer charges over 10 years (in constant money terms) by choosing the BOB product with the lowest insurer charge over that period rather than the one with the highest, and holding it for 10 years . This saving equates to 4.5% of the entire BOB value over that period.**

3. **This saving could increase slightly to 4.6% of the initial BOB investment amount for a BOB investment of €100,000 over 10 years (or just over €4,600 in constant money terms), under the same conditions.**

The projected RIY sought from insurers did not include an allowance for commission payable to intermediaries or other additional investment charges that may arise (for example, as a result of

[1] *See Appendix 1 for description of a "Buy out Bond".*

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 BOB 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 BOB fund. Where the intermediary is remunerated via commission, the commission is funded by the insurer making a corresponding direct recovery from the consumer's BOB fund.

As part of this exercise, we have carried out some analysis on the impact of intermediary charges on overall BOB 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 BOB:

- For BOB holders who invest in cash or cash-type funds, the current absolute level of BOB 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 BOB holders who invest in a managed fund, the current absolute level of BOB 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 BOB products, appears counterintuitive in that the longer the consumer holds their BOB (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 BOB just after 5 years and reinvest in a new BOB with a similar charging structure (additional intermediary fees may however negate this benefit).

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

Observations:

This study is the second part of a work-in-progress on charges as requested by the Minister. The first part was the Pensions Council Report on ARF Charges, issued in February 2016.

Report on BOB Charges

The following points observed in relation to the ARF charges surveyed by the Council in February 2016 apply equally to BOB products:

- Charges have a material impact on the retirement benefits a BOB 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 BOB products are complex, making it extremely difficult for the average consumer (or even their intermediary) to determine the relative charge status of any BOB product compared with other similar BOB products in the marketplace.

- The practice of insurers having multiple charging structures for the same BOB product (where the charges vary by the length of time that the BOB 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 BOB product available, when a higher charge version (at those benchmark durations) is being recommended to the consumer.

- This report on charges does not fully address intermediary charges, which may be as much or more than the insurer 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, pension scheme trustees, or to the intermediaries who advise them on their choice of BOB. 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.

Chapter 1 – The Survey

1.1 Information sought

A letter was sent by the Chair of the Pensions Council on 23rd July 2016 to the Chief Executive Officers of the following life assurance companies (**"insurers"**) who market individual BOB products through independent insurance intermediaries:

Aviva Life & Pensions Ireland

Friends First Life Assurance Company DAC

Irish Life Assurance plc

Standard Life Assurance Ltd

New Ireland Assurance Company plc

Zurich Life Assurance plc

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

- each *standard* BOB product *currently* distributed by that insurer through independent insurance intermediaries, and for
- BOB amounts of €50,000 and €100,000, assuming *no* intermediary remuneration is payable in each case.

While the Survey did not cover the entire BOB market (see next section for exclusions), the Council is satisfied that the Survey results present a representative picture of insurer charges levied on new BOBs provided by life assurance companies in August 2016, for the surveyed amounts of €50,000 and €100,000.

1.2 BOB products *not* included in this Survey

This Survey of BOB charges did *not* cover:

1. BOB products issued MIFID investment firms.
2. BOB products distributed by life assurance companies through direct distribution channels such as employees or tied insurance agents.
3. Bespoke and group BOB products which may be provided by life assurance companies through one or a limited number of independent insurance intermediaries.

4. Past generations of BOB 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 BOB charges:

1. Intermediary remuneration payable by the consumer via deductions from their BOB fund. However, information on the range of commission options under each BOB product was requested and the impact of intermediary remuneration on BOB 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 BOB may invest;

3. Other operational charges levied inside the investment fund or funds in which the BOB may invest, such as auditing, legal and compliance fees.

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 BOB 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 BOB 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 BOB fund.

A consumer who arranges a BOB is therefore likely to have two separate categories of charges (in addition to other investment related charges) applied to his or her BOB 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 BOB 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 a BOB 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 BOB products with different insurer charging structures.

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 BOB investment amount). Typically, the allocation rate increases by the size of the initial BOB investment amount, in broad investment amount bands.

   Where the allocation rate is less than 100%, the reduction below 100% represents an initial contribution charge. For example, based on an initial allocation rate of 99%, if €1,000 is contributed, this results in €990 being invested in the BOB 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 BOB. (i.e. €1,000 contributed results in €1,010 being invested)

2. A Bid/Offer spread which amounts to an effective *initial contribution charge.* For example, the initial contribution secures units at the Offer Price (typically 105% of the ruling Bid Price) but units are encashed at the lower Bid Price.

3. An *annual fund charge*, expressed as a % of the ongoing value of the BOB; 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 BOB 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.

4. An *annual plan charge*, expressed as a % of the ongoing value of the BOB. 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).

5. A monetary *policy fee*, deducted regularly from the consumer's BOB account.

6. An *early encashment charge* which only applies where the BOB is fully terminated during an initial period after its establishment (typically within the first five years) either through maturity or transfer to another BOB with a different insurer. Typically, this charge does not apply to termination of the BOB on account of the death of the BOB holder within the early encashment charge period.

2.2 Results

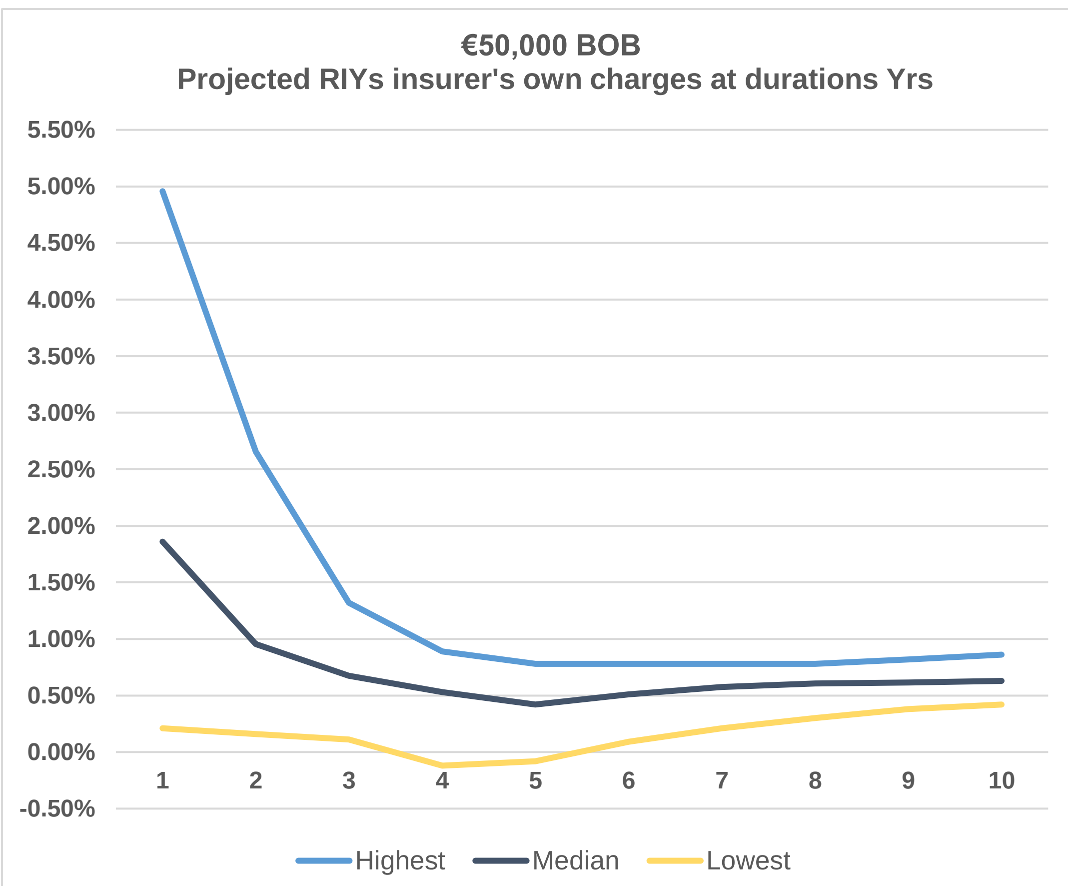
The Survey responses demonstrated that there is a wide variation in insurer BOB charges and that these charges vary by:

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

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

The charts below show the highest, lowest and median insurer RIY charge assuming the BOB is matured at each duration from 1 to 10 years for a €50,000 and for a €100,000 initial BOB investment. The detailed responses from each insurer are included in Appendix 3.

€50,000 BOB



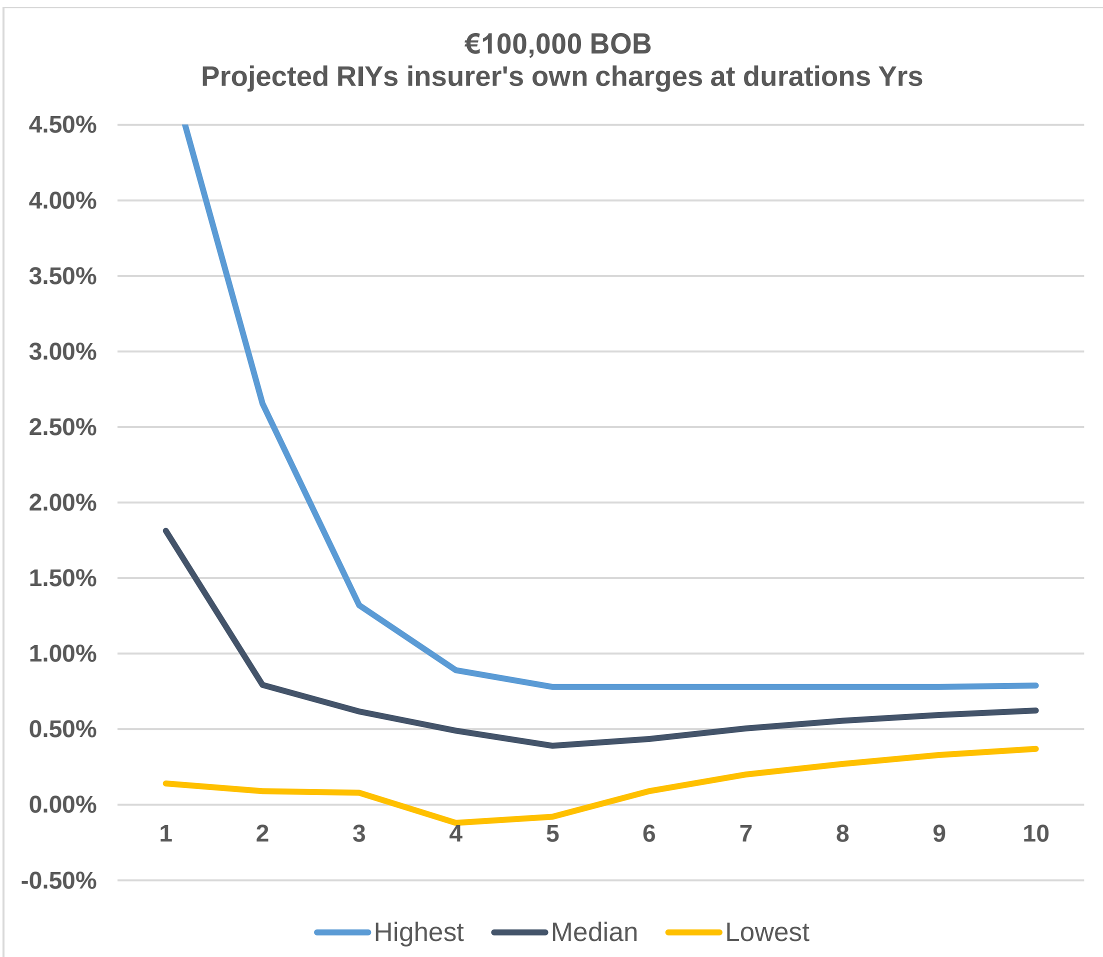
The spread between the highest and lowest annual RIY at each duration was as follows:

Table 2.1 – €50,000 BOB – Spread of charges between highest and lowest RIY

	BOB matured after Yrs									
	1	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**
Spread	4.75%	2.50%	1.21%	1.01%	0.86%	0.69%	0.57%	0.48%	0.44%	0.44%

For example, **based on a BOB investment of €50,000 a consumer could save up to €2,250 in insurer charges over 10 years** (in constant money terms) by choosing the BOB product with the lowest insurer charge over that period rather than the one with the highest. This saving equates to 4.5% of the amount invested in the BOB. Higher annual cash savings would apply where the BOB is matured earlier, albeit higher absolute charges would apply on earlier maturity.

€100,000 BOB



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

Table 2.2 – €100,000 BOB – Spread of charges between highest and lowest RIY

	BOB matured after Yrs									
	1	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**
Spread	4.82%	2.57%	1.24%	1.01%	0.86%	0.69%	0.58%	0.51%	0.45%	0.42%

For example, **based on a BOB investment of €100,000 a consumer could potentially save up to €4,600 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 just over 4.6% of the amount invested in the BOB.

We observed that in general, insurer charges for a €100,000 BOB investment tend to be marginally lower than for a €50,000 investment, particularly at shorter durations:

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

	Median RIY- BOB matured after Yrs									
	1	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**
50k BOB	1.86%	0.95%	0.68%	0.53%	0.42%	0.51%	0.58%	0.61%	0.62%	0.63%
100k BOB	1.81%	0.79%	0.62%	0.49%	0.39%	0.43%	0.51%	0.56%	0.60%	0.62%
Difference	-0.05%	-0.16%	0.06%	-0.04%	-0.03%	-0.08%	-0.07%	-0.05%	-0.02%	-0.00%

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 BOB investment amount:

Table 2.4 – €50,000 BOB - Spread of RIY charges between highest and lowest product

	BOB matured after Yrs									
	1	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**
Aviva	0.86%	0.13%	0.16%	0.30%	0.19%	0.13%	0.08%	0.05%	0.01%	0.01%

Friends First	2.24%	1.39%	0.58%	0.17%	0.28%	0.22%	0.19%	0.16%	0.13%	0.12%
Irish Life	2.39%	1.85%	0.96%	0.52%	0.26%	0.26%	0.26%	0.27%	0.26%	0.26%
New Ireland	4.24%	1.90%	0.70%	0.39%	0.56%	0.43%	0.33%	0.32%	0.32%	0.31%
Standard Life	4.56%	2.03%	1.17%	0.49%	0.43%	0.34%	0.29%	0.26%	0.27%	0.28%
Zurich	0.74%	0.33%	0.22%	0.16%	0.08%	0.08%	0.11%	0.13%	0.14%	0.15%

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 €100,000 BOB investment amount:

Table 2.5 – €100,000 BOB - Spread of RIY charges between highest and lowest product

	BOB matured after Yrs									
	1	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**
Aviva	0.86%	0.13%	0.16%	0.30%	0.19%	0.13%	0.08%	0.05%	0.01%	0.01%
Friends First	2.81%	1.75%	0.85%	0.15%	0.07%	0.03%	0.06%	0.11%	0.13%	0.16%
Irish Life	1.34%	1.33%	0.62%	0.26%	0.25%	0.26%	0.26%	0.26%	0.26%	0.26%
New Ireland	4.24%	1.90%	0.70%	0.39%	0.56%	0.43%	0.33%	0.32%	0.32%	0.31%
Standard Life	4.63%	2.10%	1.24%	0.55%	0.49%	0.36%	0.29%	0.26%	0.23%	0.21%
Zurich	0.74%	0.33%	0.22%	0.16%	0.08%	0.08%	0.11%	0.13%	0.14%	0.15%

There can therefore be a significant variation in insurer charges, depending on which charging version of an insurer's BOB 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 0.31% pa (or about 3% of the investment amount in constant money terms) can be achieved between the charges of different BOB products issued by the *same* insurer over that hold period.

Chapter 3 – Intermediary Remuneration

3.1 Intermediary remuneration

Intermediary remuneration can be paid by the consumer either by 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 BOB value.

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

3.2 Recovery of intermediary remuneration

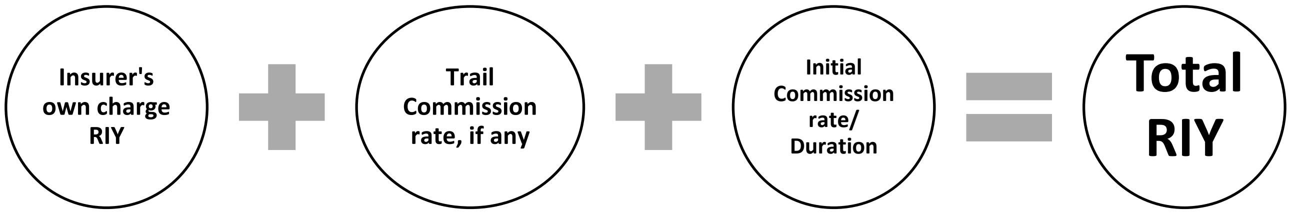
Where the consumer has opted to pay the intermediary through insurer commission, the insurer will deduct the remuneration payable to the intermediary directly from the consumer's BOB account. Therefore, every € of remuneration payable to the intermediary reduces the BOB value accordingly. As this represents 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 BOB 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:



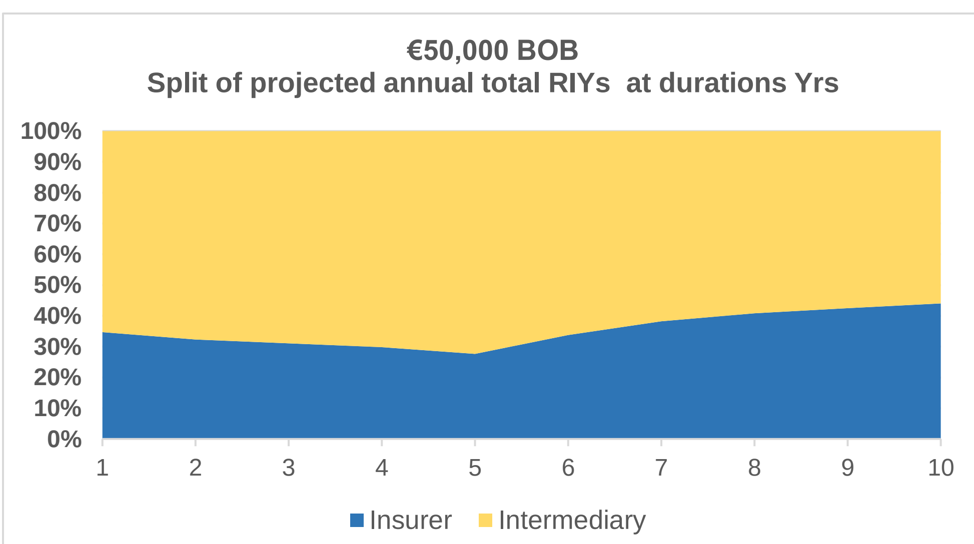
€50,000 BOB

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 BOB value, the total charges payable by the consumer (insurer charges + intermediary remuneration), based on the median insurer RIY charge would be:

Table 3.1 – €50,000 BOB - Insurer + Intermediary charges

	BOB matured after Yrs									
	1	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**
Insurer median charge	1.86%	0.95%	0.68%	0.53%	0.42%	0.51%	0.58%	0.61%	0.62%	0.63%
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	**5.36%**	**2.95%**	**2.18%**	**1.78%**	**1.52%**	**1.51%**	**1.50%**	**1.48%**	**1.45%**	**1.43%**

On this example commission structure, the intermediary charges represent between 56% and 72% of the total charges, varying by how long the BOB is held:



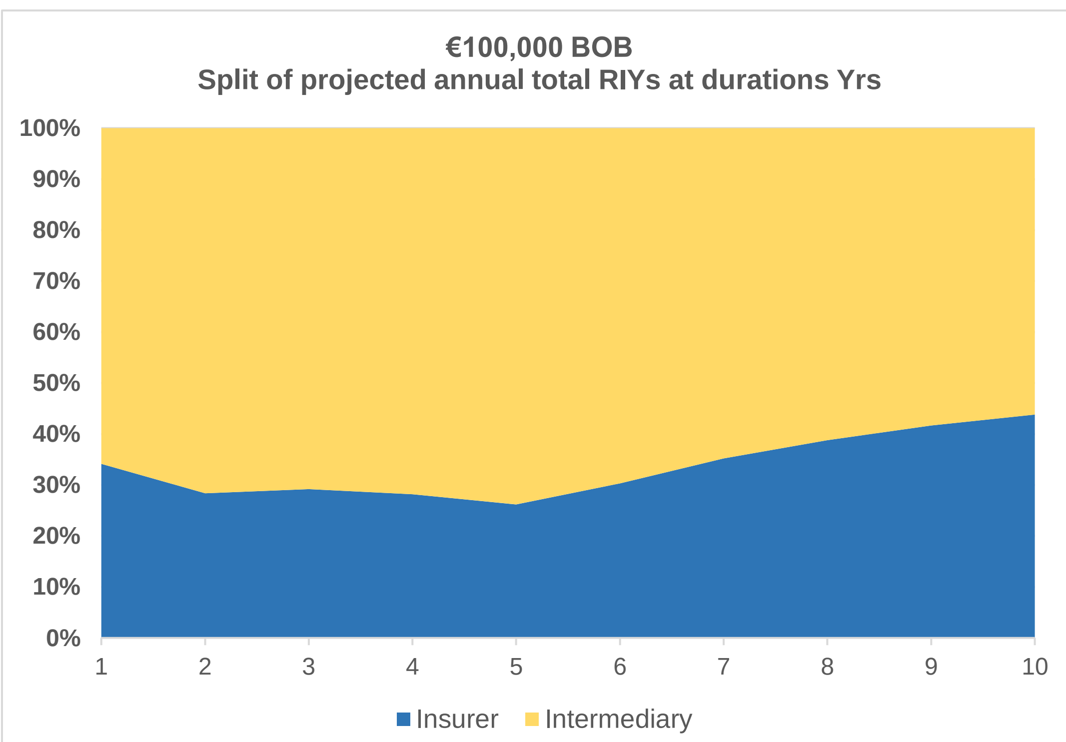
€100,000 BOB

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 – €100,000 BOB - Insurer + Intermediary charges

	BOB matured after Yrs									
	1	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**
Insurer median charge	1.81%	0.79%	0.62%	0.49%	0.39%	0.43%	0.51%	0.56%	0.60%	0.62%
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	**5.31%**	**2.79%**	**2.12%**	**1.74%**	**1.49%**	**1.43%**	**1.43%**	**1.43%**	**1.43%**	**1.42%**

Based on this commission structure, the intermediary charges represent between 56% and 72% 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 a BOB holder than the choice of insurer or product, particularly over shorter durations.**

3.4 Transferring from one BOB to another

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

Of course, moving to a different BOB/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 €100,000 BOB investment is set out in Table 3.2 (assuming 3% initial commission plus 0.5% pa trail commission) as:

Table 3.2 – €100,000 BOB - Insurer + Intermediary charges

	BOB matured after Yrs									
	1	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**
Insurer median charge	1.81%	0.79%	0.62%	0.49%	0.39%	0.43%	0.51%	0.56%	0.60%	0.62%
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	**5.31%**	**2.79%**	**2.12%**	**1.74%**	**1.49%**	**1.43%**	**1.43%**	**1.43%**	**1.43%**	**1.42%**

For a hold period of 10 years, the total annual RIY is 1.42% pa, based on the median insurer RIY charge.

However, if the consumer were to terminate their BOB and reinvest in a new similar BOB product (with fresh 3% initial commission payable on each new BOB) 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
2.12% pa	2.12%	1.74% pa	2.00% pa

So by moving their BOB twice (after 3 and 6 years) within the 10-year period, rather than staying in the same BOB product throughout that period, the consumer's annual charge increases in this example from 1.42% 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 BOBs established, which may or may not be the case, and also assumes that current BOB 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 BOB products might be better off (purely from an insurer charging perspective) to terminate their BOB every 5 years and reinvest in a new BOB with a similar charging structure, assuming such an BOB is available at that time, rather than hold the first BOB for the full 10-year period.

Take for example a fictional (but representative) BOB 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 BOB 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 BOB product with the same charging structure (called "BOB2"), they would be better off (purely from an insurer charging perspective) terminating the first BOB after 5 years and reinvesting in BOB2 for the second 5 years, as the annual RIY insurer charge split between the first and second BOBs would then be:

BOB 1 RIY over first 5 year period	BOB 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 BOB after 5 years would be absorbed, in the short run, by any new initial commission payable to an intermediary on the second BOB.

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

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

Chapter 4 – Commentary

4.1 Charges matter

The two main factors which will determine the retirement outcome produced by a BOB 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 BOB will produce).

Our Survey has shown that median insurer charges RIYs are of the order of 0.63% pa if a €50k BOB is held for 10 years and then matured (the median RIY for a €100k BOB is 0.62% 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 BOB**. The choice of investments is also relevant: a BOB holder is more likely to choose less risky investments as their investment horizon and appetite for risk may be reduced as the individual gets closer to their anticipated benefit age.

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

4.2 Observations

The following points observed in relation to the ARF charges surveyed by the Council in February 2016 apply equally to BOB contracts:

- Charges have a material impact on the retirement benefits a BOB 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 BOB products are complex, making it extremely difficult for the average consumer (or even their intermediary) to determine the relative charge status of any BOB product compared with other similar BOB products in the marketplace.

- The practice of insurers having multiple charging structures for the same BOB product (where the charges vary by the length of time that the BOB 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 BOB product available, when a higher charge version (at those benchmark durations) is being recommended to the consumer.

- This is report on charges does not fully address intermediary charges, which may be as much or more than the insurer 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, pension scheme trustees, or to the intermediaries who advise them on their choice of BOB. 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 – Buy Out Bonds

Buy Out Bonds/Personal Retirement Bonds

A Buy Out Bond (also known as a Personal Retirement Bond or PRB) is an individual contract arrangement with a life assurance company or a MIFID investment firm, to provide retirement benefits at a specified future retirement age (or earlier on early retirement). The Buy Out Bond can only accept:

- A transfer value paid from an occupational pension scheme in lieu of maintaining a preserved retirement benefit in the scheme for the individual; and/or
- A transfer from another Buy Out Bond held by the same individual.

Transfers from an occupational pension scheme to a Buy Out Bond occur in one of following circumstances:

- Where an individual with a preserved benefit in the occupational pension scheme voluntarily opts to take a transfer value from the scheme, in lieu of maintaining a preserved retirement benefit in the scheme;

- Where the trustees of a defined contribution occupational pension scheme compulsorily make a transfer value payment from the scheme to a Buy Out Bond for a member with a preserved retirement benefit in the scheme, in lieu of maintaining a preserved retirement benefit in the scheme, under section 35 Pensions Act 1990;

- Where the trustees of a scheme make a compulsory transfer value payment from the scheme to a Buy Out Bond for a member with a preserved retirement benefit in the scheme, on winding up of the scheme; or

- Where an individual with an entitlement to a prospective designated retirement benefit in an occupational pension scheme under a Pensions Adjustment Order, opts to take a transfer value from the scheme to a Buy Out Bond in their own name, in lieu of their prospective designated retirement benefit in the scheme.

Taxation

BOBs are exempt from Irish taxation on their investment returns.

Appendix 2 – Survey email sent to insurers

July 2016

Personal Retirement Bond (also known as Buy Out Bond) charges

Dear CEO,

I write on behalf of the Pensions Council, set up to advise the Minister for Social Protection on policy matters relating to pensions (commenced under Section 29 of the Social Welfare and Pensions (Miscellaneous Provisions) Act 2013). At our inaugural meeting in March 2015, the Minister 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 insurer charges for individual Personal Retirement Bond (PRB) policies (also known as Buy Out Bonds) currently offered by life assurance companies though independent insurance intermediaries, i.e. not through tied insurance agents, for accepting transfer values from occupational pension schemes in respect of an individual scheme member (i.e. not bulk cases) on scheme wind up, voluntary transfer by the scheme member or compulsory transfer by the scheme trustees.

*To this end, can you please provide on the enclosed Excel sheet the information requested which includes the projected Reduction In Yield (**"RIY"**) figures (expressed as %, rounded to two decimal places) for all of your individual PRB products (including any variations of the same product with distinct different charging structures) currently offered through independent insurance intermediaries, on the following basis:*

- *RIYs to be returned for durations 1,2,3,4,5,6,7,8,9 and 10 years; the RIY for each duration is to be calculated on the basis that the policy pays out retirement benefits at that duration elapsed since policy inception plus 1 day, i.e. the RIY for duration 1 year should assume the PRB policy pays out retirement benefits to the policyholder exactly 12 months and 1 day after inception of the policy;*
- *RIYs to be shown separately for a €50,000 and a €100,000 investment amount, at each duration;*
- *Age at inception of the PRB policy: 55 exact;*
- *Assume a Normal Retirement Age (NRA) of 65; for durations 1 to 9 years inclusive, the RIYs will therefore relate to the taking of retirement benefits on early retirement from NRA 65, while for duration 10 years the RIY relates to benefits taken at NRA 65.*
- *Assume no intermediary initial premium based commission and no trail/fund based commission applies;*
- *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 to be assumed, please base your response on the typical fund or combination of funds you currently use or would use (if you do not currently prepare a generic table for PRB policy disclosure) to prepare a generic table of Illustrative Table of Projected Benefits and Charges and associated RIY for individual PRB contracts with the characteristics outlined above, 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 Excel sheet and emailed to me at chariman@pensionscouncil.ie . I ask particularly that the information be provided by Friday 26th August 2016. Please also attach a PDF of the technical guide/explanation of the charging and intermediary remuneration structures for all your individual PRB policies currently offered through independent insurance intermediaries.

Your participation in this exercise is greatly appreciated.

Yours sincerely,

Jim Murray
Chairman

Appendix 3 – Insurer own charge BOB RIY responses

Table 1

Projected annual RIYs for insurer own charges for €50,000 BOB for durations (yrs)

Insurer	Product	1	2	3	4	5	6	7	8	9	10
Aviva	PRB 1	1.60%	0.61%	0.30%	0.18%	0.11%	0.22%	0.29%	0.35%	0.39%	0.42%
Aviva	PRB 2	0.74%	0.74%	0.14%	-0.12%	-0.08%	0.09%	0.21%	0.30%	0.38%	0.43%
Friends First	Financed - A	4.13%	2.50%	1.25%	0.63%	0.46%	0.53%	0.57%	0.61%	0.64%	0.66%
Friends First	Financed - B	3.08%	2.10%	1.06%	0.54%	0.45%	0.56%	0.63%	0.69%	0.74%	0.77%
Friends First	Non Financed	1.89%	1.11%	0.67%	0.71%	0.73%	0.75%	0.76%	0.77%	0.77%	0.78%
Irish Life	Retail	3.26%	2.15%	1.07%	0.53%	0.43%	0.53%	0.60%	0.66%	0.70%	0.73%
Irish Life	Corporate	0.87%	0.30%	0.11%	0.01%	0.17%	0.27%	0.34%	0.39%	0.44%	0.47%
New Ireland	Structure A	1.80%	1.33%	0.56%	0.43%	0.21%	0.35%	0.45%	0.52%	0.58%	0.63%
New Ireland	Structure B	3.63%	2.12%	0.99%	0.69%	0.36%	0.43%	0.48%	0.52%	0.55%	0.57%
New Ireland	Structure C	4.96%	2.66%	1.26%	0.82%	0.41%	0.43%	0.44%	0.45%	0.46%	0.47%
New Ireland	Structure D	0.72%	0.75%	0.76%	0.77%	0.77%	0.77%	0.78%	0.78%	0.78%	0.78%
Standard Life	Option A	0.21%	0.16%	0.15%	0.40%	0.56%	0.66%	0.73%	0.78%	0.82%	0.86%
Standard Life	Option B	1.34%	0.72%	0.51%	0.41%	0.35%	0.49%	0.58%	0.66%	0.71%	0.76%
Standard Life	Option C	1.83%	0.79%	0.44%	0.52%	0.57%	0.61%	0.63%	0.65%	0.67%	0.68%
Standard Life	Option D	2.93%	1.33%	0.79%	0.53%	0.37%	0.44%	0.49%	0.52%	0.55%	0.58%
Standard Life	Option E	3.87%	1.78%	1.08%	0.73%	0.52%	0.56%	0.58%	0.60%	0.61%	0.63%
Standard Life	Option F	2.75%	1.20%	0.68%	0.68%	0.68%	0.68%	0.68%	0.68%	0.68%	0.68%
Standard Life	Option G	4.77%	2.19%	1.32%	0.89%	0.63%	0.62%	0.62%	0.63%	0.62%	0.62%
Standard Life	Option H	0.78%	0.78%	0.78%	0.78%	0.78%	0.78%	0.78%	0.78%	0.78%	0.78%
Zurich	Option A	1.24%	0.47%	0.21%	0.08%	0.22%	0.31%	0.37%	0.42%	0.45%	0.48%
Zurich	Option B	1.91%	0.80%	0.43%	0.24%	0.14%	0.24%	0.31%	0.37%	0.41%	0.44%
Zurich	Single Save	1.17%	0.55%	0.34%	0.24%	0.19%	0.32%	0.42%	0.49%	0.55%	0.59%

Table 2

Projected annual RIYs for insurer own charges for €100,000 BOB for durations (yrs)

Insurer	Product	1	2	3	4	5	6	7	8	9	10
Aviva	PRB1	1.60%	0.61%	0.30%	0.18%	0.11%	0.22%	0.29%	0.35%	0.39%	0.42%
Aviva	PRB2	0.74%	0.74%	0.14%	-0.12%	-0.08%	0.09%	0.21%	0.30%	0.38%	0.43%
Friends First	Financed A	4.08%	2.48%	1.23%	0.61%	0.45%	0.52%	0.57%	0.60%	0.63%	0.65%
Friends First	Financed B	3.03%	2.07%	1.04%	0.53%	0.44%	0.55%	0.63%	0.69%	0.73%	0.77%
Friends First	Non Financed	1.27%	0.73%	0.38%	0.46%	0.51%	0.54%	0.57%	0.58%	0.60%	0.61%
Irish Life	Retail	2.28%	1.66%	0.74%	0.28%	0.22%	0.36%	0.46%	0.53%	0.59%	0.63%
Irish Life	Corporate	0.94%	0.33%	0.12%	0.02%	-0.03%	0.10%	0.20%	0.27%	0.33%	0.37%
New Ireland	Structure A	1.80%	1.33%	0.56%	0.43%	0.21%	0.35%	0.45%	0.52%	0.58%	0.63%
New Ireland	Structure B	3.63%	2.12%	0.99%	0.69%	0.36%	0.43%	0.48%	0.52%	0.55%	0.57%
New Ireland	Structure C	4.96%	2.66%	1.26%	0.82%	0.41%	0.43%	0.44%	0.45%	0.46%	0.47%
New Ireland	Structure D	0.72%	0.75%	0.76%	0.77%	0.77%	0.77%	0.78%	0.78%	0.78%	0.78%
Standard Life	Option A	0.14%	0.09%	0.08%	0.34%	0.49%	0.59%	0.67%	0.72%	0.76%	0.79%
Standard Life	Option B	1.27%	0.65%	0.45%	0.35%	0.29%	0.42%	0.52%	0.59%	0.65%	0.69%
Standard Life	Option C	1.83%	0.79%	0.44%	0.52%	0.57%	0.61%	0.63%	0.65%	0.67%	0.68%
Standard Life	Option D	2.93%	1.33%	0.79%	0.53%	0.37%	0.44%	0.49%	0.52%	0.55%	0.58%
Standard Life	Option E	3.87%	1.78%	1.08%	0.73%	0.52%	0.56%	0.58%	0.60%	0.61%	0.63%
Standard Life	Option F	2.75%	1.20%	0.68%	0.68%	0.68%	0.68%	0.68%	0.68%	0.68%	0.68%
Standard Life	Option G	4.77%	2.19%	1.32%	0.89%	0.63%	0.62%	0.62%	0.63%	0.62%	0.62%
Standard Life	Option H	0.78%	0.78%	0.78%	0.78%	0.78%	0.78%	0.78%	0.78%	0.78%	0.78%
Zurich	Option A	1.24%	0.47%	0.21%	0.08%	0.22%	0.31%	0.37%	0.42%	0.45%	0.48%
Zurich	Option B	1.91%	0.80%	0.43%	0.24%	0.14%	0.24%	0.31%	0.37%	0.41%	0.44%
Zurich	Single Save	1.17%	0.55%	0.34%	0.24%	0.19%	0.32%	0.42%	0.49%	0.55%	0.59%