

Financial Services Authority

Consultation Response

Product Disclosure - CP11/3



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1 EXECUTIVE SUMMARY

CP11/03 provides a welcome clarification on the FSA's thinking in regard to several practical issues concerning the Retail Distribution Review. Altus has been trying to resolve these issues for some time and on that basis we welcome the publication of this paper.

Unfortunately this clarification has come far too late in the RDR timetable for product providers to adequately incorporate some of the serious architectural consequences into their RDR design. Some providers have already issued their requirements for adviser charging solutions to which CP11/03 now adds considerable complexity with the proposal to require a new illustration for any change to an adviser charge.

Given the typically complex interactions between systems to produce in-force illustrations currently and the very significant impact of requiring providers to produce more of them and in new circumstances, it is surprising that there is no specific question in the consultation on this point. In the absence of a direct question, Altus has summarised the problems it sees with this specific proposal in response to questions 8 and 10.

In addition, Altus notes that the FSA still seems to be working on the simple assumption of a "one product one charge" model. This is fine for sales commission but seems far less appropriate in a world where a charge is supposed to relate to the value of the advice provided. Many advisers look after complex investment portfolios for their clients and may feel that their most appropriate remuneration model should reflect the value of a portfolio. The client meanwhile may, for tax reasons, wish to facilitate the charge from a particular product. That means providers may need to calculate a charge based on the value of multiple products whilst deducting it from a single product; it is not clear to us that the FSA has considered this complication in its proposals or in the CBA.

Aside from these comments, Altus believes the rest of the proposals are broadly sensible and should make disclosure more useful to consumers in future.

2 INTRODUCTION

As an enterprise architecture consultancy specialising solely in Financial Services, Altus has extensive experience working with clients in the LP&I sector. With practical involvement in both system and business issues throughout the sales process we welcome this opportunity to respond to the FSA's latest consultation paper on the Retail Distribution Review.

Our focus is primarily on the operational aspects of financial services and we have sought in the following sub-sections to answer those questions raised in CP11/3 where we feel our experience and expertise particularly qualifies us to do so.

3 RESPONSE TO PARTICULAR QUESTIONS

Q1: Do you have any comments on the proposed new 'effect of charges' format for personal pensions, where providers choose not to facilitate payment of adviser or consultancy charges?

Where a provider is not facilitating charges the last two columns (after product charges and after all charges) would contain the same value. This might confuse some consumers so the final column should perhaps only be shown for projections where an adviser or consultancy charge is being facilitated, or should display text to the effect that no additional charges are being taken.

Q2: Do you have any comments on the proposed new 'effect of charges' format in COBS 13 Annexes 3 and 4 for investments and personal pensions where providers choose to facilitate payment of adviser or consultancy charges and will need to show the effect of these charges as well as product charges?

The proposed format does not distinguish between consultancy and adviser charges although it is our understanding that both may be levied on the same contract. Consumers may therefore find it confusing to be told their "adviser" charges are more than they thought. Consideration should be given to an additional column where both forms of charge apply.

Q3: Do you agree that a generic KFI will not be appropriate for individual pensions where the product provider facilitates payment of the adviser charge, and our proposal to add a rule to this effect?

We agree that a generic KFI would not be appropriate for adviser charge facilitated products and a rule should be added to this effect.

Q4: Do you have any comments on our proposal that, where personalised illustrations are provided for prospective members of GPPs, they should be set out in the same way as for individual personal pensions?

We agree with the proposal that GPP illustrations should follow the same format as individual personal pension illustrations; this will give better transparency to customers comparing Group and Individual options. There may be a need for GPP illustrations to present both Consultancy Charges and Adviser Charges where a customer also has their own adviser.

Q5: Do you agree with our proposal to add a rule to say that generic projections for GPPs will only be appropriate where any consultancy charge is structured such that its effect is consistent across the group of individuals being given the generic projection?

We agree with this proposal, an inconsistent application of consultancy charging would cease to make the illustrations generic.

Q6: Is there a need to allow generic projections for GPPs in these circumstances and are there any other circumstances in which you consider that generic illustrations should be permitted for prospective GPP members?

We do not feel there is a need to allow generic projections for GPPs; the cost of producing personalised illustrations does not seem a significant barrier to production. A key part of the value of an illustration, either Group or Individual lies in presentation of the likely outcome at retirement. Only

a personalised illustration will enable a consumer to assess this and, in the case of Group pensions, to understand the level of contribution they might need to make in addition to their employer.

Q7: Do you agree that we should remove the requirement for a KFI for structured life products? If so, does our proposed rule in COBS 13.1.3R(3) (b) satisfactorily exclude such products?

Yes – assuming no adviser charge deductions occur on those products.

Q8: Do you have any other comments on the draft rules in Appendix 1?

Altus believes that the introduction of rule 13.1.1.A requiring production of a KFI for changes to an adviser charge will have a significant operational impact on product providers. We believe that, as advisers move to an ongoing service model, the frequency of changes to an adviser charge will increase, leading to a corresponding growth in the volume of illustrations and associated costs. Add to this the potential for bulk changes to charge agreements, e.g. when the VAT rate changes, and the peaks in demand could be very difficult to manage.

More significantly in the short term, we believe that the assumptions on charging bases which underpin the proposals are too simple and that the complexity of change to support adviser charging is therefore likely to have been underestimated. Based on our reading of the proposed new rules, the FSA appears to be working on an assumption that adviser charges will always relate to the single product from which they are deducted.

That model is fine in a world of product sales commission but seems overly simplistic when charges are supposed to relate to the value of advice given – potentially across a broad portfolio of investment products. Advisers may well feel that the value of their advice is proportional to the size of that portfolio and adopt charging models which reflect this, e.g. a percentage of the assets on which they advise. The client, however, may wish to deduct charges from one particular product, e.g. for tax reasons. The draft rules do not appear to support a model where charges can be facilitated from one product but based on the value of several; there is no guidance on explaining the basis of calculation and all the examples provided deal with very simple bases.

Modifying provider systems to deal with this extra complexity will be a significant challenge and is likely to require new adviser charging components, substantial change to illustrations systems and a great deal of integration between the two. Given how late these changes have come in the RDR timeline, it is not clear that the FSA appreciates the scale of change involved.

Q9: Do you have any comments on the proposal that Moneymadeclear comparative tables should contain only product charges after the RDR rules come into force?

Altus agrees that Moneymadeclear comparative tables should only show core product charges – the value add of the advice charge can then be determined by the consumer.

Q10: Do you have any comments on the analysis of the cost and benefits as they affect your firm?

Whilst the CBA section of the consultation does acknowledge the cost of modifying in-force illustration systems, there is no mention of increased ongoing costs to issue these illustrations. If, as Altus believes, the future trend is towards ongoing service charges then advisers will inevitably look to sell additional services to their clients leading to more adviser charges and a proliferation of in-force illustrations where these are provider facilitated.

Q11: Do you agree that it is proportionate and appropriate to revise our rules so that KFIs and projections are required for all investments held within a personal pension scheme, other than

investments in commercial property, commodity investments, synthetic ETFs or shares (that are not shares in an investment trust)? Do you think that other investment categories, including investments that are not also specified in the Regulated Activities Order, should also be able to benefit from this exemption? If so, which ones and why?

Altus agrees that the rules should be revised to require KFIs and projections for all investments held within a personal pension scheme. However, we do not agree that all the investments listed should be exempted from projection; for example both physical and synthetic ETFs may track an index and therefore have a similar basis for projection.

We do accept that some investments, such as some complex synthetic ETFs and commercial property, are more difficult to project but they could still be illustrated using a set of reduced growth assumptions to reflect their volatility; the FSA could use such varying growth rates to protect less sophisticated investors from riskier asset classes.

As a point of policy we would question whether it is appropriate to permit investments within a personal pension which are deemed too volatile to illustrate; if it is not possible to adequately project a future value for an investment (within tolerance) is it appropriate for use in funding for retirement income?

Q12: Do you think that, rather than identifying investment categories that are exempted, the rules should identify the investment categories for which KFIs and projections are required?

We feel that all investments within a personal pension should be subject to projection/illustration; if any are not to be illustrated this should be an explicit list of exempted investments.

Q13: Current pension projection requirements, where they apply, are mandatory. Do you agree with this? As an alternative approach, do you think there is merit in considering making pension projections optional, in line with MiFID standards, and only applying certain disclosure requirements when projections are provided? If so, please explain why you think this approach would achieve better results for consumers.

We agree pension projection requirements should be mandatory and do not think the alternative approach suggested is appropriate.

Q14: Do you agree that firms should disclose whether or not they receive commissions or retain bank interest earned on cash held in SIPP wrappers? If so, do you agree that firms should be required to disclose this information alongside information about interest rates payable to, and costs and charges payable by, scheme members?

We agree that commission/interest retention should be disclosed.

Q15: Do you have any comments on the analysis of costs and benefits as they affect your firm?

We have no comment on the CBA.

Q16: Do you agree that we should be seeking to consult on moving our projection basis for pensions to be more consistent with the SMPI requirements?

Yes.

Q17: If the answer to question 16 is 'Yes':

- a. should the 2.5% SMPI inflation assumption be used with all three projections; and
- b. do you wish to retain the flexibility to illustrate various spouses' pensions and annuity formats rather than following standard SMPI assumptions?

- a. Where inflation is to be a factor the same rate should be used for all projections.
- b. We feel that a pension illustration should include annuity projections using the SMPI basis to give consistency for product comparison at the point of sale as well as against future annual statements. Providers should also be able to illustrate based on the information known about the client at the point of sale, e.g. marital status, requested retirement age, etc.

Q18: Do you have any comments on the costs and benefits of moving to inflation-adjusted projections for personal pensions and stakeholder pensions? If possible, please provide information on the likely costs and benefits for your firm.

We have no comment on the CBA.

Q19: Do you have any comments on the design and content of the examples in Annexes 3.2 and 3.3 we have prepared for future consumer testing?

Our preference is for the layout used in Annex 3.2. We also feel that the Reduction in Yield information should be incorporated into the effect of charges table via additional rows. The RIY is a key piece of information to compare different products/providers and Altus would like to see it adopted in the same way that APR has been for loan comparisons.

4 ABOUT ALTUS

Altus is a business and systems solutions company focused exclusively on the needs of the financial services industry. Our practical experience of both the business of financial services and the supporting IT systems means that we can help solve the right problems with the right technology. Our mission is to be at the forefront of the networked financial services business of the future.

Our management team has extensive experience across a wide range of financial services activities, our staff are highly-skilled and enthusiastic and our client list includes some of the largest financial services companies in the UK and Europe.

Further details are available from our website at www.altus.co.uk or by contacting us.



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