



Pension reforms - proposed changes to rules and guidance FCA CP15/30

A response from Altus Consulting

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1 EXECUTIVE SUMMARY

As a business and technology consultancy specialising solely in financial services, Altus has extensive experience working with clients in the UK market, including investment platform providers, life companies and retail banks. With practical involvement in both system and business issues across the pension and investment sector we welcome this opportunity to respond to the Financial Conduct Authority consultation on updates to the rules governing the new pension freedoms.

The paper covers a broad range of topics reflecting the FCA's wide remit and the tough balancing act the regulator has to weigh between protecting consumers and suffocating provider firms. Altus has written before, and continues to believe that prescriptive, rules-based regulation is fundamentally flawed. Such an approach leads to long and impenetrable rulebooks (COBS alone is 502 pages, with separate manuals for mortgages, consumer credit and insurance and 706 pages of perimeter guidance). As a result, firms must employ increasing numbers of compliance specialists at great cost, and product innovation suffers as these teams seek ever more clarity and certainty on how to interpret the rules.

Nonetheless we recognise the challenges the FSA's experiment with principles-based regulation encountered, and that the FCA must operate within the even tighter bounds of European Union directives. Our response therefore assumes that COBS will remain the primary regulatory instrument and attempts as far as possible to simplify or limit additional complexity of the Sourcebook.

Altus describes the following recommendations in this response:

- A less prescriptive approach to wake-up letters, with communications tailored to firms' specific client profiles
- Focus on making a holistic retirement options quotation tool available to the public on the MAS or Pension Wise websites
- No changes to the risk warnings process
- A change to self-certification for purchase of high risk investments, requiring clients to state they are not dependent on the capital or proceeds for living expenses
- A complete ban on commission for retirement income products including annuities and any form of drawdown
- Agreement between the FCA, the Ombudsman and professional indemnity insurers about the adviser's liability in respect of insistent clients
- A consumer survey on the impact of different compensation limits

2 ANSWERS TO QUESTIONS

Q1: Do you agree with the proposal to add these application and purpose provisions in COBS 19.4?

In our opinion, the new provisions add unnecessary extra length to an already long and prescriptive rulebook.

Q2: Do you agree with our proposal to add guidance on communications about retirement options?

We have observed that there is a clear disconnect between the customer communications delivered by many firms and the ability of most customers to understand these. The FCA's intentions to improve and simplify communications are well-intentioned, however we believe that COBS is internally inconsistent.

- DP15/5 "encourages firms to be mindful that overloading customers with information reduces the effectiveness of communications"
- COBS 19.4.6R insists that the 42-page MAS booklet "Your Pension" is included with the open market options pack. In this booklet, the 5 different withdrawal options are not listed until page 8.
- The ABI's template wake-up letter is a minimum 3 pages, but may have to be much longer to meet requirements of COBS 19.4.1A clauses 3(b) & 3(c) where GARs, exit charges, MVRs and other special features exist.

With the best will in the world, a wake-up pack of 45 pages or more is going to lead to disengagement of a large segment of customers.

Altus fully supports the FCA's objectives outlined in DP15/5 and believes that a less prescriptive approach where firms are encouraged to tailor their communications for their customers would benefit everyone.

Q3: Do you agree with our proposed rule to prevent application forms being sent in wake-up packs and reminders?

Yes. In the light of the recent exits from ABI membership by L&G and Aegon it seems sensible to embed this ABI code recommendation into COBS.

Q4: Do you agree with our proposal to restrict when firms can send illustrations?

Altus feels that further work is required to ensure that firms issue clear, consistent and comparable illustrations. In the meantime, these restrictions represent a pragmatic staging post.

Q5: Do you have any proposed alternatives?

We believe the customer needs access to a comparison engine, like MAS currently offers for annuities, which illustrates all decumulation options. Instead of providing unsolicited illustrations, firms would be required to point consumers to this tool for a full set of illustrations.

Q6: In what ways would the alternative be more beneficial for firms and consumers?

This would reduce consumers' behavioural bias and the tendency not to shop around.

Q7: Do you agree with our proposal to require firms to make customers aware of key factors relevant to the product the customer is seeking information for?

Yes.

Q8: Do you agree with the factors we propose these are likely to be in relation to this rule?

Yes. In addition we believe that whether a product purchase is irreversible is a key factor.

Q9: Do you agree with our proposals for providing product disclosures and information when accessing pensions flexibly? If not, what alternatives would you suggest?

Yes. It seems logical to apply similar disclosure requirements to both UFPLS and FAD.

Q10: Do you agree with our proposals for extending the rules and guidance in COBS 9 to UFPLS? If not, please explain why you consider this is not appropriate.

Yes.

Q11: Do you agree with our proposal to clarify that SIPP retained interest charges should be included in projections and charges information? If not, how would you suggest we level the playing field for disclosing charges between SIPP and other pensions?

Yes.

Q12: Do you agree with our proposal not to add guidance at this stage to support firms in meeting their obligations to review the operation and distribution of their products over time?

Yes. We believe existing guidelines continue to be relevant.

Q13: Do you agree that the rules in PS 15/4 should be retained? If not, please explain what change you would propose and why?

We see no reason to remove the requirement for risk warnings.

Q14: Do you agree with our proposal to remove the requirement on firms to go through step 2 of the risk warning process where the consumer's pension pot is below a minimum level and where there are no safeguarded benefits but that firms should still give the consumer relevant risk warnings? If not, why not and what alternative would you propose?

No. We believe that adding further conditionality to the process complicates the enforcement, monitoring and staff training needs for a firm.

Q15: Do you agree that the minimum level should be set at £10,000 or less? If not, what level do you think the minimum should be set at and why?

We see no reason to modify the minimum pot size.

Q16: Do you consider our cancellation rules expose some consumers to a risk that is not mitigated by any other measures? In what other ways might we reduce that risk and improve consumer outcomes?

All consumers are pointed at Pension Wise, most are given risk warnings and most have cancellation rights. We feel that any further controls on accessing pensions would introduce unnecessary delays to payments.

Q17: Do you agree that monitoring the evolving environment is an appropriate and proportionate FCA response in the pursuit of consumer protection? If not, what action do you think we should take and how would this alter consumer outcomes?

We consider that irreversibility is a key factor that should be disclosed to customers before accessing their freedoms, and that failure to disclose this information should represent a breach of existing fair treatment rules.

Q18: Do you agree that amendments to HNWI and RI certification statements are necessary to provide appropriate protection to consumers who access their pension savings?

No. These amendments seem designed to protect the interests of provider and adviser firms. The new definition introduces more complexity and makes it harder for the consumer to understand whether they fit the HNWI or RI categories. Insistent customers will sign anything they need to access the investments they want.

As you point out in 5.24, the source of investable assets becomes harder to identify and increasingly irrelevant to customers over time.

Q19: Do you agree that our proposals provide an appropriate initial safeguard for consumers accessing their pension funds? If not, what other measures could we consider?

We believe it would be clearer for a retail customer to self-certify that they were not dependent on the proceeds of these high risk investments to fund living expenses.

Q20: Should payments from pension savings only be excluded from the HNWI and RI criteria if they were accessed within a set period of time before the date on which the statement is signed? If so, what period of time would deliver the appropriate consumer protection?

No - see Q19. The acid test is whether the consumer is reliant on the funds for income, not when they withdrew it.

Q21: Do you agree that we should undertake a wider review of the promotion and distribution restrictions in our rules?

Yes – always with a view to simplification of COBS.

Q22: Do you agree with our proposal to add guidance to make explicit the application of existing rules on debt collection in relation to pension savings and remind both debt collection and advice firms that advising on conversion or transfer of pension benefits is a regulated activity?

This CP presents no specific evidence to suggest that creditors and debt management firms are putting pressure on consumers to encash pension pots.

Our view is that, unless such evidence is available, there is no need to further complicate CONC.

Q23: Do you agree with our proposed guidance for providers and advisers on attachment orders? If not, what would you suggest and why?

Yes.

Q24: Do you agree that we should clarify the methodology as described? If not, what alternative would you propose which achieves similar outcomes?

Altus consultants did some analysis earlier in 2015 highlighting the massive variation in pension projections. The results can be found in this link.

www.altus.co.uk/consulting/downloads/download--disparity-in-online-pension-illustration-tools-infographic/

Differences were explained by use of stochastic vs. deterministic projections, as well as wide variation in the assumptions used for growth rates and other key factors.

While we feel that stochastic projections have the potential to provide a more meaningful and realistic range of outcomes for the consumer, we recognise that all actuarial models (and assumptions used) will differ. Therefore a standard methodology should be applied to all pre-sales deterministic projections for the purposes of illustrating the effect of charges and other provider-specific factors on a consumer's investment performance. This would make product comparison easier.

Q25: Do you agree with our proposals to show contractually obligated future values in projections, including GARs? If not, how could we amend it?

Yes.

Q26: Do you agree with our proposal to update the mortality table and timing of the improvement factors? If not, how could we amend it?

Yes.

Q27: Do you agree with our proposals to amend the definitions?

Yes.

Q28: Do you agree with the analysis of the issue? If not, what is your assessment of the situation?

Yes – except that ABI latest data suggest that average annuity premiums in Q3 2015 were much higher at just over £53,000. This is equivalent to a commission payment range of £530-£1590 (or exceeding £3000 at the 6% extreme). This potentially brings more non-advised clients into the zone where advice may be a more suitable and affordable choice.

The analysis otherwise adequately describes the issues.

Q29: Of the options above, which do you think is likely to be the most effective in dealing with the issue identified and why is that? Are there any alternatives that we should consider?

Time and experience shows us that disclosure alone simply does not work.

Altus believes that the omission of annuities from the commission ban is an anomaly that should be closed as soon as possible. The same should apply to any drawdown arrangements where commission may still apply.

Q30: What else do you think the FCA can and should do to make firms aware of their responsibilities in relation to lifestyling investment strategies?

Altus believes that this is an area where provider firms are aware of the dilemma and we are already seeing evidence of innovation. Many firms now have a range of different lifestyling profiles for consumers to choose based on how they expect to withdraw their pension pots. The key challenge for firms now is communicating these options at the right time.

The FCA is consulting in Q1 and Q2 about what type of communication to issue and when. If this is the case, we feel it is important that communications do not introduce behavioural bias; for example communication which reminds consumers that they can access their pension funds from age 55 may induce some customers to access funds earlier than they need to, with the risk of exhausting funds too early.

For those consumers who despite best efforts do not engage in their investment decisions, it can be argued that the 25% cash/75% bonds strategy is a suitable default, since it minimises investment volatility in the years preceding retirement. Other “volatility-managed” portfolios are gaining popularity among investors and could prove equally suitable for use in a lifestyling strategy.

Q31: Should we be reviewing the starting assumption for those over minimum retirement age that a pension transfer will be unsuitable unless it can be proven to be in the client’s best interests? How, if at all, does pension freedom change the interpretation of client’s best interests in respect of pension transfers?

No – defined benefit pensions provide valuable guarantees for most people. Those with different needs continue to have access to advice to free up their benefits by transfer to DC.

A client’s best interests should be examined by reference to the whole of their retirement savings and their personal circumstances, as well as the nature of the guarantees being given up. There are many clear examples where clients could demonstrate advantage in transferring out – typically where there are spouses and dependents benefits which the customer either does not need or does not qualify for under the trust deed and rules.

Q33: Given that the main barriers to transacting insistent client business are external to the FCA, how do you consider that regulation could be amended in a way which facilitates such transactions more easily but still provides a satisfactory level of consumer protection?

First and foremost, the customer’s pension belongs to them and not the provider or the adviser. The FCA, the Ombudsman and professional indemnity insurers need to reach a consensus on what steps an adviser needs to take to satisfy all parties that an insistent customer has understood all risks, yet proceeded in spite of professional advice.

At some point, customers must be held to account for their own decisions. In almost every other purchasing decision outside of finance, there is some element of consumer protection beyond which “caveat emptor” applies.

Q34: How can TVA comparisons to members be improved to make them shorter, more meaningful and more likely to engage members in the TVA process? What changes,

if any, are necessary to FCA rules to ensure that TVA comparisons are fit for purpose?

Altus Consulting fully support all attempts to shorten and clarify consumer communication. While we do not feel suitably qualified to comment on which technical aspects of the TVA could be removed, we believe that using simple graphics can improve consumer understanding and reduce page count.

Q35: What advice options should we be considering to ensure that members receive good outcomes when considering a pension transfer?

We cannot see how an employer could have successfully “de-risked” their DB scheme if it is subsequently found to have paid for advice which has placed their scheme members in a worse position. Regulation should be completely clear that the responsibility for provision of suitable ETV advice rests with the scheme sponsor and their trustees.

Q36: Do you have any comments on possible future changes to our product disclosure regime? If there are any specific areas which you consider should be reviewed now, please include details of the changes you feel the FCA should introduce and those where firms should bring about improvements.

Clause 9.5 presents a long and valid list of issues with existing product disclosures. We would like to see particular focus on what has changed since April. Flexibilities and the increased uptake of drawdown increases longevity risk (so-called “risk of ruin”), and it should be a priority to identify ways of illustrating worst-case scenarios for customers.

This is where stochastic modelling is strong, being able to model a wide range of positive and negative factors and produce a simple fan diagram showing to a high degree of confidence how long funds in drawdown may last. In this respect we disagree with the majority of the industry who favour deterministic models, which have no capability to factor in sequencing risk.

See also our answer to Q24 relating to consistency of illustrations.

Q37: Do you have any evidence or analysis to offer in relation to the impact on firm or consumer behaviour, or possible consumer outcomes, of the current difference in compensation limits for investment and insurance provision in relation to pensions?

We have no evidence. We do believe it likely that the vast majority of consumers are unaware of the different protections offered by insured vs investment products. In both cases the limit is different from the more widely-publicised £85,000 deposit limit for bank deposits which is itself falling to £75,000 in January 2016. We believe this would be a subject worthy of a consumer survey to ascertain both awareness and attitudes.

Q38: Do you have any views on whether compensation limits should reflect the objectives of the consumer in making the investments? For example, regardless of the type of investment, if it is for the purposes of pension accumulation or decumulation, then the FSCS limit should be consistent between investment and insurance provision?

Theoretically, harmonised FSCS limits across investment types would make sense and be clearer for customers. In practice, funding this would be harder. In addition, for investment products, some level of consumer protection is afforded outside of FSCS by the client money rules.

Q39: Would you support an increase in the limit for some or all investment provision, and if so, do you have any views on what the new limit should be, which types of claim or business it should apply to, and how any increase should be funded?

We have no information on the numbers of consumers or value of investments annually affected by failure of firms on which to base an answer.

Q40: Do you have any comments on the cost benefit analysis?

No.



3 ABOUT ALTUS

Altus offers two unique and independent services to the financial services industry: **Altus Consulting** and **Altus Business Systems** solutions.

Altus Consulting is a specialist provider of consultancy services to the Financial Services sector. We help clients achieve operational excellence and improved returns via a combination of proven industry models, technology expertise and market insight.

Altus Business Systems offers a range of industry leading investment automation solutions, dedicated to improving operational efficiency of companies within the Financial Services sector to keep their business critical processes running smoothly.

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