IMA RESPONSE TO FCA CONSULTATION

"*Retirement reforms and the guidance guarantee*"

September 2014

SUMMARY

1. The IMA[1] is a long-standing supporter of greater flexibility in the provision of retirement income, allowing pension savers access to the right product at the right time in their lives. We support the Government's reforms, announced in the 2014 Budget, of the decumulation phase of pension saving and look forward to working with Government, regulators and other stakeholders to secure this reform's effective implementation.

2. A key part of those reforms is the Government's proposal for a retirement guidance service and we welcome the detail on the proposed guidance standards set out in the FCA's consultation paper 'Retirement reforms and the Guidance Guarantee'. The proposed standards are the right ones but we note that the crucial point will be how these standards are translated into a useful and effective service that will benefit consumers.

3. A central observation is that guidance is not a 'one off' process, and that the complexity of choices many individuals will face means that developing the right framework is of significant importance. For most individuals, guidance will be an implicit feature of investment through the accumulation phase, given a widespread dependence on auto-enrolment and default strategies. Those strategies also need to make some assumption about retirement options, which may entail engagement by individuals some time before they access pension savings. Finally, accessing retirement savings will not, for many, take the form of a one-off product purchase and on-going support may be needed into retirement. To this end we suggest the Government considers how the guidance service could be used to support individuals through both the accumulation and decumulation phases of pension saving.

4. The creation of a formal retirement guidance service also highlights the need to clarify the boundary between guidance and regulated advice. Consumers need to understand the difference between guidance and advice and it needs to be clear to them how this service fits with regulated advice.

5. The cost of the new guidance service must be proportionate and not result in significantly increased costs to the industry. As long as this cost is proportionate to the benefits it brings, and there are clear mechanisms in place for the ongoing monitoring and control of these costs relative to the quality and usage of the service provided, it is reasonable to expect industry to pay for it. However, as the FCA itself notes, the proposed retirement guidance fee-blocks are rather wide-ranging categories that will catch some firms that will not provide retirement financial products and services. Equally, there are some beneficiaries of the guidance service – e.g. master trust workplace pension schemes run on a commercial basis – that are outside the FCA's regulatory ambit and therefore do not contribute to the levy. We are therefore concerned to avoid a situation where the proposed methodology results in an inconsistent distribution of the levy by imposing costs on some

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[1] The IMA represents the asset management industry operating in the UK. Our members include independent fund managers, the investment arms of retail banks, life insurers and investment banks, and the in-house managers of occupational pension schemes. They are responsible for the management of around £5 trillion of assets in the UK on behalf of domestic and overseas investors.

entities that will not benefit from the reforms, while avoiding passing on the costs to other entities that do benefit.

6. Our response is in two parts. The first provides general comments, the second more detailed answers to FCA questions.

PART ONE: General Comments

7. The IMA's response[2] to HM Treasury's 'Freedom and choice in pensions' consultation noted that one of the most immediate and significant consequences of the reforms announced in the Budget was to bring to the fore the issue of how individuals get guidance or advice. The effective removal of annuitisation as the default method of taking an income from a DC pension and its replacement by complete control for the individual over their pension fund opens up a significant range of choices for the consumer. Given the difficult nature of some of these choices, together with well –known behavioural biases that may not incline individuals towards optimal decisions – the question of access to guidance and/or advice is a critical one.

8. The Government's retirement guidance service is a key part of making these reforms work well for consumers and the subsequent detail set out by the FCA on the standards that delivery partners must adhere to in providing guidance is helpful. The standards look to be the right ones. However, the key point will be how these standards are translated into delivering a useful and effective guidance service that will aid consumer decision-making over how to access their DC pension funds.

9. One central observation that we made in our response to the 'Freedom and choice in pensions' consultation was that guidance is not a 'one-off' process. For most individuals, guidance will be an implicit feature of investment through the accumulation phase, given a widespread dependence on auto-enrolment and default strategies. Accessing retirement savings will not, for many, take the form of a one-off product purchase and on-going support may be needed into retirement.

10. For example, an individual might choose to access some of their pension fund via cash withdrawal or a drawdown strategy in the first years of retirement, with a view to possibly annuitising the residual fund at a later stage. In such a strategy, individuals might need guidance on the sustainability of income withdrawals over time as well as the optimal age to annuitise and the kind of annuity to purchase. While it might be appropriate to seek regulated advice in such circumstances, individuals may not choose this route and such a scenario suggests that the assumption behind the guidance guarantee cannot be that retirement income is a once-and-done decision at a given moment in time.

11. In this context, we also note that the government envisages the retirement guidance service being targeted at individuals on retirement – on a per-fund basis. We are concerned that this approach does not give individuals the guidance they need throughout their savings lifecycle, and by focussing on the pension fund that triggers the guidance

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[2] 'IMA response to HMT consultation "Freedom and choice in pensions"', June 2014. Available to download at http://www.investmentfunds.org.uk/assets/files/consultations/2014/20140611-freedomandchoiceinpensions.pdf

discussion, risks giving individuals only a partial picture of their financial situation as they consider their retirement income options.

12. We recognise the costs of providing this guidance mean that limitations will necessarily have to be put on individuals' ability to access the service, but we think there is potential for greater benefit to be derived by re-thinking how the service is accessed. Allowing the individual access to the service each time they access a DC pension fund for the first time will not deliver the most benefit for the money being spent on the service – especially since the nature of guidance (as opposed to advice) means the information received is likely to be fairly generic. Crudely speaking, how much value is there to the individual of receiving the same generic guidance multiple times? Retirement planning should be holistic and the guidance service needs to be able to operate on such a basis. In this respect, while outside the scope of the FCA consultation, serious consideration needs to be given to the practicalities of facilitating a holistic approach, bringing together all private and state entitlements.

13. By re-thinking how the service is accessed – for example giving people a set number of sessions over their savings life-cycle e.g. in their 50s, on retirement and once or twice through the retirement period – greater benefit could be derived from the same expenditure by giving consumers the opportunity to benefit from guidance at other stages in their retirement savings life-cycle and not just at the point that they access a DC pension fund.

14. The other key issue arising from the creation of the retirement guidance service is the distinction between guidance and regulated advice and the boundary between them. For many individuals, guidance and advice will be seen to be the same thing – the distinction between them will not necessarily be appreciated. Consumers may access the guidance service thinking that they will be directed to specific products.

15. It is therefore important that the delivery partners for the guidance service make very clear to consumers what the difference is between the guidance they will receive and advice which they may choose to pay for. In particular, consumers must be helped to understand exactly what is provided under the guidance service and what is provided under paid-for advice. This should include the guidance service signposting people to regulated advice or other sources of information on retirement financial products where appropriate. Making sure this clarity exists will help avoid any disappointment with the service on the part of individuals.

PART TWO: Answers to Specific Questions

Standards for the delivery partners

Q1: Do you have any comments on the proposed standards for the delivery partners?

16. The standards set out the right high-level principles and we agree with them as drafted. However, it is how they are translated into operational terms that will be the crucial point and we look forward to working with the delivery partners to do this.

17. We have two specific comments about the proposed standards. The first relates to professional standards. In particular, it needs to be made clear what is meant by the requirement for those delivering the guidance to be 'competent and have sufficient knowledge and expertise'. Since this is a guidance service, by definition those delivering the guidance will not be regulated financial advisers. This raises the question of what the benchmark is for measuring competence and expertise. There needs to be clarity about the quality standards or levels of accreditation applied to those individuals delivering the guidance and more detail in this area would be welcome.

18. The second comment relates to the content of the guidance session. In our view 'relevant information about the consumer's financial and personal circumstances that would inform the discussion' should include information on the consumer's other savings and assets as well as any debts. When considering how pensions are decumulated, there should be a holistic approach to assessing an individual's financial circumstances because the choices made may be dependent upon other assets and liabilities that a consumer has. This links back to our earlier comment at paragraph 12 that a series of guidance discussions focussing on a specific DC pension fund on each occasion is likely to be of limited assistance to the consumer.

Levy to fund provision of the guidance

Q2: Do you agree with the proposed use of the FCA periodic fees framework to collect the retirement guidance levy? If no, please provide alternatives and set out how they would be implemented.

19. In principle the proposed approach – using the existing fee blocks to identify firms that may *potentially* benefit from the guidance service as a *starting point* to identify new 'retirement guidance fee-blocks' on which the cost of the retirement guidance is levied – is a sensible one since it builds on the FCA's existing model for collecting its Annual Funding Requirement. In general we agree with the FCA's conclusion that this approach minimises the burdens on affected firms of calculating the new retirement guidance levy.

20. However, we would note that careful consideration needs to be given to which firms actually end up paying the retirement guidance levy – it should only be those firms that are actively participating in/benefitting from the retirement financial products market. There may be some firms or entities within the existing fee blocks that won't be involved in the retirement financial products market and should therefore not have to bear the costs of the retirement guidance service.

21. Equally we have a concern that there may be some entities that are not covered at all by the FCA fee blocks that may benefit from the retirement guidance service – in particular workplace pension master trust arrangements, which may be in a strong position to offer retirement financial products to their own members or attract new business on this basis from other DC arrangements.

22. We elaborate further on these points in our answers to questions 3 and 4 below.

Q3: Do you agree that firms in the proposed five retirement guidance fee-blocks only should contribute to the retirement guidance levy? If no, please provide your reasons.

23. It is reasonable, as the FCA states, that those firms likely to benefit from more engaged and informed consumers purchasing their financial products and services should be the ones to contribute to the retirement guidance levy. However, the proposed retirement guidance fee blocks are wide-ranging in coverage and we have a concern – which the FCA also acknowledges – that they may capture some firms or entities that may not benefit from the retirement guidance service, for example investment managers that do not operate in the retirement financial products market at all. Such providers would be paying the retirement guidance levy without actually benefitting from it since their products would not be marketed as retirement financial products.

24. Meanwhile there are some firms operating in the retirement financial products market that are not FCA-regulated entities and will therefore not be liable for the retirement guidance levy, but may stand to benefit from the guidance service. One particular group of relevance here are master trust pension schemes – we elaborate further on this point in paragraphs 28 and 29 below.

25. In the first group – those firms that will be captured by the proposed retirement guidance fee-blocks despite not participating in the retirement financial products market – there is a particular issue in relation to OPS firms[3]. These are the in-house asset managers of large corporate pension schemes, typically Defined Benefit schemes. OPS firms are not behaving as product providers in the retirement financial products market and they won't be competing for or receiving any external business – indeed they are not allowed to take on third-party customers. They will not benefit from the retirement guidance service and therefore there is no clear rationale for them to pay the retirement guidance levy.

26. It might be argued that retirement guidance that resulted in members staying in the scheme rather than leaving would represent a benefit for the in-house manager. However, it is important to appreciate that OPS firms do not operate on a profit-maximising basis – they are instead run on a cost-recovery basis, so there is no incentive for them to maximise assets under management. Imposing a retirement guidance levy on them would increase their costs without any benefit for the in-house asset manager or member. Ultimately, any increase in the in-house asset manager's costs would have to be met by the sponsoring employer of the scheme – an entity which has nothing to do with the provision of retirement financial products and sees zero benefit from retirement guidance.

27. Therefore we believe that OPS firms should be exempted from being liable for the retirement guidance levy. OPS firms already have their own set of exemptions under FCA rules, as set out in COBS 18.8 so it should be possible to exempt them from payment of the retirement guidance levy.

28. In the second group of firms – those who stand to benefit from the guidance service but do not have to pay for it – a question does arise about the status of trust-based pension

[3] http://www.fshandbook.info/FS/glossary-html/handbook/Glossary/O?definition=G806

providers, in particular master trusts[4], run on a commercial basis. These entities are of course outside the FCA's regulatory ambit and are therefore exempt under current proposals from paying the retirement guidance levy. However, the new pensions flexibilities expand the opportunity for master trusts to continue to hold existing business and attract new pension business into the decumulation phase – rather than seeing this business depart for insurance companies as typically happens in the current environment. Therefore these entities may also derive commercial benefit from having more engaged customers – yet they will not have to pay the costs of the guidance levy.

29. We therefore believe that the Government should consider in addition how trust-based pension schemes *run on a commercial basis only* can contribute to the levy. This should ensure a fairer distribution of the costs. Since all trust-based pension schemes must register with the Pensions Regulator it should be possible to identify those who should make a contribution to the retirement guidance levy.

Q4: Do you agree that firms in the remaining fee blocks should not contribute to the retirement guidance levy? If no, please provide your reasons.

30. As far as the fee-blocks exempted from paying the retirement guidance levy are concerned, we agree with the FCA's proposals.

Q5: Do you have any comments on the three options for allocating the overall levy across the five retirement guidance fee-blocks? If you do not agree with any of these options please advise us of your proposed alternative allocation options.

31. We believe that option three is potentially the best option for allocating the overall levy across the five retirement-guidance fee blocks because it most closely links the benefits of the more informed consumers that the guidance could produce with the firms that will be most likely to benefit. Although simple by comparison, neither options one nor two achieve this – and option two in particular is likely to result in an inconsistent and arbitrary distribution of costs, since it bears so little resemblance to the overall proportion of FCA resources applied to meet its statutory objectives in relation to the regulated activities covered by the fee-blocks in question.

32. We are not currently in a position to provide a clear methodology to inform option three. However, as the market evolves, mechanisms could be developed to capture consumer behaviour. Indeed, we would imagine that such mechanisms will also be necessary for Government and regulators to monitor the impact of the policy shift announced this year. In the meantime, a transitional levy arrangement may be necessary.

FCA requirements for firms in the light of the reforms

Q6: Do you agree with the proposed content of the signposting information? If no, please provide alternative suggestions.

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[4] The Pensions Regulator defines a master trust as *"an occupational trust-based pension scheme established by declaration of trust which is or has been promoted to provide benefits to employers which are not connected and where each employer group is not included in a separate section with its own trustees. For this purpose, employers are connected if they are part of the same group of companies (including partially owned subsidiaries and joint ventures)".*

Q7: Do you have any thoughts on the standardisation of this information for the future?

33. The proposed content of the signposting information is fine but we think in addition it needs to make clear that what is being offered is guidance and not regulated advice. In particular, the signposting should distinguish very clearly between the two, explaining what is meant by each one and how they differ from one another. Consumers should have clear expectations at the outset of what the guidance service will and will not do.

34. We think the FCA is right not to standardise the format of this information and to leave it to industry and delivery partners to develop the format for now.

Q8: Do you agree with the proposal to align the timing of the signpost with the existing timing requirements for wake-up packs?

35. Within the confines of the existing system, we agree that this proposal is the one that is most appropriate, being easily adaptable to current arrangements and giving consumers sufficient notice to prepare for a guidance discussion in advance of accessing their DC pension fund.

36. However, we would note here our earlier comments that guidance and advice where relevant need to be part of an engagement with the consumer that takes place over the course of their retirement saving life-cycle.

Q9: Do you agree with the proposal to introduce a transitional provision to ensure that those receiving wake-up packs before April 2015 do not miss out on being signposted to the guidance?

37. Yes, we agree with the proposal for this particular transitional provision.

Q10: Do you agree with the proposal to add this guidance?

38. Although we would not anticipate pension providers actively undermining retirement guidance, we agree that the FCA's proposed additional guidance setting out that firms should not do anything to actively discourage their customers from taking the retirement guidance is helpful clarification.

Q11: Do you agree with the proposal that firms should refer to the availability of the guidance whenever they are communicating with a customer about retirement options?

39. Yes, we agree with this proposal.

Q12: Do you agree with our proposal to clarify the information provision requirement and add guidance on information that should be included?

40. Yes, we agree with both the proposed clarification of the information provision requirement and the additional guidance on further information to be included about the value of the pension fund and any special features/conditions that apply to it.

Q13: Do you have any comments on whether further requirements should be placed on provider behaviour and communications?

41. We have no further comments here.

Q14: Do you agree with the proposal to remove the reference to maximum withdrawals and require a general statement about sustainability of income and to add to the guidance that the suitability letter should include a description of the potential tax implications?

42. We agree that the reference to maximum withdrawals can be removed from the suitability report for drawdown products on sale from 6th April 2015. We also agree that requiring suitability reports to cover the sustainability of income withdrawals and the potential tax implications of withdrawals would be helpful context for the consumer to understand the potential impacts of their choices in this area. We also believe that sustainability of income withdrawals should be covered as part of the guidance service and not just the formal pre-sale process. With the introduction of 'flexi-access' drawdown, these are likely to be more significant issues for consumers to think about in their retirement income planning so it is entirely sensible that these should be highlighted.

Q15: Do you agree with our proposal to remove the reference to maximum withdrawals in COBS 13 Annex 2 2.9R?

43. Yes, we agree that the reference to maximum withdrawals can be removed from COBS 13 Annex 2 2.9R.

Q16: Do you agree that there do not need to be any changes to the key features contents rules? If no, please explain why.

44. We agree that no further changes are required to the content requirements for a Key Features Document.

Q17: Do you agree that the projection of an annual income in retirement and a projection of the total fund are still useful and therefore this rule should not be amended?

45. We agree with the principle that fund and retirement income projections are useful tools in helping people understand the nature of the product they are purchasing. However, we do not think that deterministic projections are especially helpful or meaningful beyond simple illustrative purposes. We would like to see further exploration of the potential for projections of both fund value on retirement and income in retirement to be shown on a stochastic basis. Stochastic projections, if accompanied by information that aids consumers in interpreting them, can provide a more meaningful illustration of the nature of the product and would be a more useful decision making tool for the consumer.

Q18: Do you agree with the proposal to add a requirement for providers to provide their customers with a description of the possible tax implications when they are applying to access some or all of their pension fund using any of the options available?

46. Given the differing tax implications of accessing DC pensions in different ways, we agree that it is not unreasonable for the provider to provide a description of the possible tax

implications of the product in question. However, this should be generic, standardised information that the provider can provide easily and without significant cost. The information should not be specific to the individual; it may also be appropriate for the tax implication information to direct the consumer to the Guidance Service or regulated advice for more specific information.

Cost-benefit analysis

Q19: What are your views taken on the approach to costs and benefits?

47. We agree that the proposed changes to FCA rules are minor and that it is therefore likely that any increased costs should be minimal. However, it would be helpful to see the FCA's considerations of this matter and we would urge the FCA to publish its considerations.

48. On the costs of the Guidance standards and the size of the levy, further detail is needed before a judgement can be made on the adequacy of the cost-benefit analysis and we await with interest more detail on these costs from the Treasury and the FCA.