PENSIONS AND LIFETIME SAVINGS ASSOCIATION

HANDBOOK CHANGES TO REFLECT THE INTRODUCTION OF THE LIFETIME ISA: PLSA RESPONSE

“THE CUSTOMER EXPERIENCE SHOULD BE SIMILAR ACROSS ALL RETIREMENT SAVINGS PRODUCTS.”

25 January 2017

PENSIONS AND LIFETIME SAVINGS ASSOCIATION

INTRODUCTION

We're the Pensions and Lifetime Savings Association; the national association with a ninety year history of helping pension professionals run better pension schemes. With the support of over 1,300 pension schemes and over 400 supporting businesses, we are the voice for pensions and lifetime savings in Westminster, Whitehall and Brussels.

Our purpose is simple: to help everyone to achieve a better income in retirement. We work to get more money into retirement savings, to get more value out of those savings and to build the confidence and understanding of savers.

THE ASSOCIATION'S VIEW OF THE LISA

The Association welcomes the FCA's consultation on the Handbook changes to reflect the introduction of the Lifetime ISA. This is a useful opportunity to answer the questions directly addressed in the consultation and also to address the broader issues raised by the design of the LISA product.

The Association welcomed the launch of the LISA. The Association believes that the LISA could be a valuable addition to the suite of products available to savers. As a vehicle for saving for a property purchase there are clear benefits for individuals investing in a LISA. The LISA may also benefit some self-employed people who lack the option of a workplace pension with employer contributions, as well as those individuals still accruing defined benefit scheme benefits (as an addition or alternative to additional voluntary contributions).

The LISA, though, raises some serious challenges. These pertain both to the way it will complement workplace pensions and automatic enrolment. They also pertain to the design philosophy behind the product and the way that approach has shaped the product itself. In particular the absence of product level governance compares poorly with the standards now required in workplace pensions. The FCA's proposed COBS rules should mitigate many of the problems raised by the LISA. But changes to COBS cannot overwrite or correct broader issues with the design of the LISA itself.

The Association does not believe that the launch of the LISA should be postponed. The LISA product could benefit many who are not currently saving into a workplace pension. But it is clear that there is a gap between the customer experience in workplace pensions and the likely experience with the LISA.

HM Treasury and the FCA should work with the industry to explore how this gap can best be closed. There is a wealth of experience in the industry in designing financial products that run with the grain of how people really take decisions about money and retirement. Government and regulators should make best use of this resource in order to ensure that the LISA becomes fit for purpose.

THE LISA AND AUTOMATIC ENROLMENT

We are pleased to see the FCA explicitly recognise the risks posed by the LISA and its relationship with automatic enrolment. The Government's view that the LISA should be a complementary product to workplace pensions is one that the PLSA endorses and it is welcome to see the FCA reiterate that view. We welcome the recognition that the LISA could, in theory, inappropriately depress workplace pension saving to the detriment of customers. It is crucial that this message is conveyed consistently to avoid the risk of savers diverting saving from workplace pensions and losing out on the value of matching employer contributions.

COMPARING LISA AND WORKPLACE PENSION GOVERNANCE

Whatever purpose a LISA is used for we believe that the governance around it should be comparable to that which workplace pension savers benefit from. The Association has worked hard to raise standards in workplace pensions through our Pension Quality Mark standards and, since the publication of the OFT report on workplace Defined Contribution pensions, similar standards have been extended to the entire sector[1]. As a result, there is now a broad consensus around what a good workplace retirement savings product looks like, and it may be helpful to outline this here while considering how the LISA can be made to work in the interests of savers. In short, a good scheme should offer:

- a high quality default fund. This should have an investment objective suitable for its target membership and be appropriately diversified and with a level of investment risk commensurate with that objective. We are concerned about the risks of "set and forget" for LISA customers, who may select funds on purchase and never review their choices. We are also concerned that LISA customers may choose to remain in cash;
- strong governance in the member interest. This should include governance of the default investment option. The interim report of the asset management market review eloquently and fully makes the case for the independence of those governing products. Furthermore, DC scheme governors now have to report annually on value for money, which we believe creates a strong pressure to justify the choices they make. Critically, the scheme should be designed such that it operates well with minimal or no decision-making input from the scheme member; and

[1]Office of Fair Trading (2013) Defined contribution workplace pension market study http://webarchive.nationalarchives.gov.uk/20131101164215/http:/www.oft.gov.uk/shared_oft/market-studies/oft1505

- value for money. Charges for workplace pension default funds are capped at 75 basis points. A competitive price for a master trust workplace pension product is much lower than this: circa 50 basis points. In addition, we expect trustees and Independent Governance Committees (IGCs) to focus increasingly on the level of transaction costs, the quality of investment advice received and the overall level of value for money provided by asset managers.

Simplicity of choice and clarity are also key considerations when assessing what a good retirement product looks like. Choice, particularly investment choice, should be an option for those who want to exercise it. Most people though will 'choose not to choose' and compulsory decision-making should be pared down for this group as far as is feasible. In general, investment decisions affecting the outcome for a scheme member should usually be the preserve of experts under the supervision of a trustee or an IGC. With regard to clarity, this should be reflected in communications which are clear, engaging and easy to understand.

This combination of simplicity of choice, clarity, low price and high quality governance has many attractions and the Association believes it has application outside of pensions. In our view, this is not just a template for workplace pensions, it is a template for long-term saving products in general. The customer experience should be similar across all retirement savings products.

APPLYING THIS POLICY MIX TO THE LISA

As things stand, the lifetime ISA is not likely to live up to these aspirations. The product structure is entirely different and is based around a notion of informed choice, which has been largely abandoned in workplace pensions. Indeed, automatically enrolling people into a pension product structured along the lines of the LISA would be unlawful. In the main, customers are not well equipped to make investment choices and the consultation document notes the range of biases they are exposed to, including a tendency to "set and forget" investment approaches: to make choices and never revisit them. This strikes as a particular risk in the context of a dual purpose product like the LISA. Saving for retirement and for a first home will require different thinking on investment.

Furthermore, charges in stocks and shares ISAs are typically some way above those common in workplace pensions. 75 basis points is the legal maximum for a qualifying default fund and 50 basis points is currently where the market is. The Association believes that the LISA is unlikely to disrupt automatic enrolment owing to the strength of the default effect. The prospect, though, of individuals exiting from modern, good value pension products into comparatively expensive LISAs is concerning.

The maximum annual saving limit allowed under the LISA regulations sends a strong 'anchoring' message to consumers that a contribution rate of no more than £4,000 per annum is sufficient to provide individuals with an adequate retirement income.

We are concerned that in setting this upper limit, the Government risks creating an inherent behavioural bias amongst savers that could result in them saving insufficient funds for their retirement.

Moreover, the dual purpose of the LISA could have a further impact of consumers' behaviour in regard to pension saving. There is a risk that savers may interpret the advent of the LISA as a signal that it is appropriate to save for a property *prior* to saving for retirement, as opposed to saving for both concurrently. This could have very serious implications for retirement income adequacy levels for those savers who opt to use the LISA, rather than a pension product, given that LISA savings would be depleted in the course of purchasing a property and would, subsequently, have to be replenished.

Last, the LISA product has some deeply undesirable features. Were any pension provider to label a 500 basis point charge on a withdrawal "small", the response would be hostile and the reputational damage long-lasting. This is not least because the government has rightly and effectively focused on the consumer detriment caused by such charges in legacy pension products. The Association believes this exit charge to be a reminder of a previous era in financial services.

The Association does not believe that the launch of the LISA should be postponed. The LISA product could benefit many who are not currently saving into a workplace pension. But it is clear that there is a gap between the customer experience in workplace pensions and the likely experience with the LISA.

HM Treasury and the FCA should work with the industry to explore how this gap can best be closed. There is a wealth of experience in the industry in designing financial products that run with the grain of how people really take decisions about money and retirement. Government and regulators should make best use of this resource in order to ensure that the LISA becomes fit for purpose.

Q1: DO YOU HAVE ANY COMMENTS ABOUT THE IMPACT OF OUR PROPOSALS ON EQUALITY AND DIVERSITY?

No

Q2: DO YOU AGREE THAT THE RISK CATEGORIES WE HAVE IDENTIFIED CAPTURE ALL OF THE RELEVANT RISKS THE LISA POSES TO OUR OBJECTIVES? IF NOT, WHICH CATEGORIES OR RISKS WOULD YOU ADD TO OR REMOVE FROM OUR LIST?

No, we do not agree that the chart captures all the relevant risks.

The interaction between the LISA and the benefits system is of increasing concern. We understand that that LISA will be treated as an ISA for the purposes of the universal credit means test. While universal credit is still being phased in, it is the Government's intention that it becomes the dominant form of income support for those entitled to in and out of work benefits. It is therefore the relevant one for the purposes of this example.

The universal credit means test assumes that an individual will draw an income from any capital they hold above £6,000, other than a pension. As a result an individual's universal credit entitlement is reduced by £1 per week for every £250 they have over the £6,000 threshold. If an individual has more than £16,000 then they are entitled to no universal credit at all.

As such, anyone with a LISA who is entitled to universal credit will face the choice of drawing down from their LISA prematurely or a reduced benefit entitlement. This will mean the loss of any government bonus on the amount withdrawn and the imposition of the "small" 5 per cent exit fee. It is easy to see how someone temporarily eligible for benefits might significantly erode their retirement provision. Pension saving was deliberately exempted from the universal credit means test for exactly this reason.

Further complexity exists in regard to the impact that the use of the LISA, in place of workplace pension schemes, could have on eligibility of Universal Credit benefit. In particular, pension contributions are subject to an earnings disregard of 100% and, as a result, reduce the amount of income assessed for the purpose of allocating in work benefits. In moving from a workplace pension scheme to a LISA, for the purpose of retirement saving, an individual would lose this disregard and would, consequently, have a higher overall income.

This could result in such individuals being disqualified from receiving Universal Credit benefit or, perhaps, seeing their entitlement lowered. In many respects, these issues are similar to those that employers encounter in offering salary sacrifice schemes. In situations involving salary sacrifice, employers must take care to ensure that income is not lowered to the point where members become ineligible for National Insurance benefit purposes.

In our view this renders the LISA an unsuitable retirement savings product for anyone who is in receipt of universal credit or who might reasonably expect to become entitled to universal credit. That would include anyone whose family circumstances might change and thereby entitle them to the benefit.

This and any future relevant changes to benefit policy should be clearly flagged as a risk to the consumer at the point of sale.

Q3: DO YOU AGREE WITH OUR PROPOSAL TO ADD GUIDANCE ON INFORMATION ABOUT RISKS THAT SHOULD BE INCLUDED WHEN COMMUNICATING WITH RETAIL CLIENTS IN RELATION TO A LISA?

Yes

Q4: DO YOU AGREE WITH OUR PROPOSALS TO REQUIRE LISA-SPECIFIC INFORMATION DISCLOSURES? IF NOT, PLEASE EXPLAIN WHY.

We agree with the proposals. In practice, we think it unlikely that many customers will be able to select appropriate investments that match their savings goal irrespective of the quality of guidance given. Most will need some form of recommendation in order to arrive at an appropriate investment strategy. The ramifications of this really go beyond anything that might be done through changes to the Handbook.

This is a particular concern to the Association. A situation where many individuals opt out of a well-governed, charge capped default fund and switch to saving for retirement in a LISA in low risk assets or cash would not constitute success. We anticipate that LISAs will, in general, be higher charge products than modern workplace pensions.

Q5: DO YOU AGREE WITH OUR PROPOSALS ON CANCELLATION RIGHTS FOR LISAS?

Yes

Q6: DO YOU AGREE WITH OUR PROPOSAL TO REQUIRE ALL MONEY HELD WITHIN A LISA TO BE HELD AS CLIENT MONEY UNDER THE CLIENT MONEY RULES? IF NOT, PLEASE EXPLAIN WHY.

Yes.

Q7: DO YOU AGREE WITH THE DATA AND ASSUMPTIONS USED IN THIS CBA? IF NOT, PLEASE EXPLAIN WHY.

Yes

Q8: DO YOU AGREE WITH THE DESCRIPTION OF THE COSTS AND BENEFITS IN OUR CBA? IF NOT, PLEASE EXPLAIN WHY.

Yes. As we noted in the introduction, though, there is a difference in philosophy between pensions and ISAs. With pensions, it has been recognised that these are complex products with an insuperable and exploitable information asymmetry between purchaser and provider. For example, it is unrealistic to expect most people to be able to make a good quality product selection and then make an appropriate investment selection in the absence of financial advice.

This has led the sector to stress the importance of governance, including investment and product level governance and the importance of defaults. While it is possible to improve outcomes from pension savings through clear communications and engagement at the level of the employer, it has not so far been possible to achieve this at the system or population level. This is because of the degree of sophistication required in the communications approach and the level of resources and commitment required to ensure success.

The Handbook changes made in response to the CBA are sensible measures in the context of the powers that the FCA has. But they are not likely to be sufficient to ensure good retirement savings outcomes for those choosing a LISA.