Financial Conduct Authority

Consultation Paper CP16/32***

Handbook changes to reflect the introduction of the Lifetime ISA

November 2016

Contents

We are asking for comments on this Consultation Paper by 25 January 2017.

You can send them to us using the form on our website at:
www.fca.org.uk/cp16-32-response-form.

Or in writing to:

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We have developed the policy in this consultation paper in the context of the existing UK and EU regulatory framework. We will keep the proposals under review to assess whether any amendments will be required due to changes in the UK regulatory framework, including as a result of any negotiations following the UK's vote to leave the EU.

We make all responses to formal consultation available for public inspection unless the respondent requests otherwise. We will not regard a standard confidentiality statement in an email message as a request for non-disclosure.

Despite this, we may be asked to disclose a confidential response under the Freedom of Information Act 2000. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the Information Commissioner and the Information Rights Tribunal.

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Abbreviations used in this paper

CASS	Client Assets Sourcebook
COBS	Conduct of Business Sourcebook
CP	Consultation Paper
DMD	Distance Marketing Directive
EU	European Union
FCA	Financial Conduct Authority
FSCS	Financial Services Compensation Scheme
FSMA	Financial Services and Markets Act 2000
HMRC	Her Majesty's Revenue and Customs
HM Treasury	Her Majesty’s Treasury
IFISA	Innovative Finance ISA
ISA	Individual Savings Account
KFD	Key Features Document
LISA	Lifetime Individual Savings Account
MiFID	Markets in Financial Instruments Directive

1. Overview

Introduction

1.1 The introduction of the Lifetime Individual Savings Account (LISA) was announced in the March 2016 Budget.[1] It is intended to help adults under age 40 to save or invest flexibly for two purposes:

- to provide a deposit for a first home, or
- to save for retirement

1.2 The government expects the LISA to be available to investors by April 2017 and this Consultation Paper (CP) sets out our proposed approach to regulating its promotion and distribution.

1.3 We have developed the policy in this CP in the context of the existing UK and EU regulatory framework. We will keep the proposals under review to assess whether any amendments will be required due to changes in the UK regulatory framework, including as a result of any negotiations following the UK's vote to leave the EU.

Who does this consultation affect?

1.4 This paper will primarily be of interest to those firms that currently provide ISAs and those planning to offer the LISA. It may also be of interest to:

- consumers and consumer organisations
- financial advisers
- trade bodies that represent stakeholders in this market, and
- compliance consultants and other firms that assist stakeholders

Is this of interest to consumers?

1.5 This paper will be of interest to consumers aged between 18 and 40 who are interested in saving towards a first home or for their retirement.

1 Shortly after the Budget HM Treasury published a document setting out the high-level design of the LISA: www.gov.uk/government/uploads/system/uploads/attachment_data/file/508176/Lifetime_ISA_final.pdf.

Context

1.6 The LISA is being legislated for through the Savings (Government Contributions) Bill, which was introduced to Parliament on Tuesday 6 September.[2] On 15 September 2016, following discussions with potential providers and other interested parties, HM Treasury published a document setting out the design of the LISA. We are consulting on our proposed approach on the basis that the legislation will be passed by Parliament and given Royal Assent.

1.7 From April 2017, investors under the age of 40 will be able to open a LISA account and do the following:

- Pay in up to £4,000 each tax year up to age of 50 (the Government will add a 25% bonus to these contributions).
- Use the accumulated funds, including the Government bonus, to help buy a first home worth up to £450,000 at any time from 12 months after first saving into the account.
- Withdraw the accumulated funds at any time to purchase a first home or in case of terminal illness, or after the age of 60.
- However, investors will lose 25% of any money they withdraw before age 60 for any other purpose.

Summary of our proposals

1.8 Our proposed approach to regulating the promotion and distribution of the LISA seeks to address the risks that it may present to our objectives – particularly our consumer protection objective.

1.9 We categorise these risks under five broad headings: complexity, contributions, investments, access and tax. We propose addressing these risks via an 'enhanced ISA' approach – that is, by amending our current Handbook requirements as they relate to ISAs in respect of communications, information disclosures, cancellation rights and client assets.

Equality and diversity considerations

1.10 We have considered the need to eliminate prohibited/discriminatory conduct, the need to advance equality of opportunity, and the need to foster good relations between those who share a protected characteristic and those who do not.

1.11 Due to Parliament legislating for the LISA through the Savings (Government Contributions) Bill, it is exempt from age discrimination legislation, and we do not consider that our proposals raise other concerns with regard to equality and diversity issues.

2 The bill and accompanying documents can be found at: services.parliament.uk/bills/2016-17/savingsgovernmentcontributions/documents.html.

1.12 We do not believe that they will result in direct or indirect discrimination for any of the other groups with protected characteristics: i.e. disability, sex, marriage and civil partnership, pregnancy and maternity, race, religion and belief, sexual orientation and gender reassignment.

1.13 We will continue to consider the equality and diversity implications of our proposals during the consultation period and will revisit them when we publish the rules for consultation. In the interim, we welcome feedback on these matters.

Q1: Do you have any comments about the impact of our proposals on equality and diversity?

Next steps

What do you need to do next?

1.14 We are asking for feedback on the proposals set out in this CP and, in particular, we would welcome responses to the consultation questions set out in Annex 1.

1.15 Please send your responses to us at: cp16-32@fca.org.uk by 25 January 2017.

How?

1.16 Use the online response form on our website or write to us at the address on page 2.

What will we do?

1.17 We will consider your feedback and publish our rules in a Policy Statement (PS) in March 2017.

2. The Lifetime ISA (LISA)

2.1 In this chapter, we summarise the main product features of the LISA, identify the risks its promotion and distribution could pose to our objectives, and set out our proposed regulatory approach to addressing these risks.

Background

Introduction

2.2 The introduction of the LISA was announced in the March 2016 Budget. It is intended to help people under 40 to save or invest flexibly for two purposes:

- to provide a deposit for a first home; or
- to save for retirement

2.3 The LISA will be the fourth type of ISA, after:

1. the cash ISA (including a Junior version and the Help to Buy ISA)
2. the stocks and shares ISA (including a junior version), and
3. the innovative finance ISA

All of the qualifying investments for the existing cash and stocks and shares ISA components will be qualifying investments for the purposes of the LISA – innovative finance ISA investments will not.

2.4 ISA managers (such as banks, building societies or investment managers) will be able to offer the Lifetime ISA from April 2017, subject to HM Revenue and Customs (HMRC) approval.

Product features

2.5 HM Treasury set out the design of the LISA in its document 'Lifetime ISA: updated design'[3], which was published on 15 September 2016. From April 2017, investors under the age of 40 will be able to open a LISA account and do the following:

- Pay in up to £4,000 each tax year up to age 50 (the Government will add a 25% bonus to these contributions).

3 www.gov.uk/government/uploads/system/uploads/attachment_data/file/553333/Lifetime_ISA_technical_note_September_2016_update.pdf.

- Accumulated funds, including the government bonus, can be used to help buy a first home[4] worth up to £450,000 at any time from 12 months after first saving into the account.

- Withdraw the accumulated funds at any time to purchase a first home or in case of terminal illness, or after the age of 60.

- However, investors will lose 25% of any money they withdraw before 60 for any other purpose ('early withdrawal charge').

2.6 From April 2017, investors will be able to contribute to one LISA in each tax year, as well as one or more of the three existing types of ISA, within the new overall ISA limit of £20,000. They will also be able to transfer to a LISA with a new ISA manager, with no limit on the amount that can be transferred.

Risks for investors

2.7 The LISA is part of the broader ISA wrapper[5] range. Our regulation of ISA wrappers is largely based on the underlying investments rather than the wrapper itself. However, there are additional features of the LISA wrapper that mean some risks are attached to the wrapper and not the underlying investment.

2.8 The LISA combines elements of a short-to-medium-term deposit based savings product with a long-term retail investment product. We believe this combination – together with the early withdrawal charge – presents a number of risks to our objectives, particularly our consumer protection objective. These risks fall into the five broad categories below:

Category	Example risks
Complexity	• Investors may not understand the purpose, features and restrictions of a LISA, as these are more complex than the existing cash ISA and stocks and shares ISAs. • Investors may not sufficiently understand the differences between the features of a pension and a LISA in order to make informed decisions about the benefits and risks of each for their own circumstances.
Contributions	• Investors may lose out on an employer's pension contribution if they opt out of a workplace pension in favour of saving in an LISA. • Investors may fail to upscale 'other' savings upon reaching 50, when they cannot make any further contributions to a LISA.
Investments	• Investors will need to make investment decisions in line with their objectives and the investment strategies are likely to need to be different for saving for a deposit for a first home and saving for retirement. • Investors may remain invested in an inappropriate asset mix – e.g. they originally intended to use the LISA to save for a deposit to buy a home and later decide to use it to provide retirement savings.
Access	• Investors may not realise that, while they will be able to withdraw all of their funds from a LISA when they reach 60, they will be able to access funds accumulated in a personal pension at 58. • Investors may not fully understand the impact of the early withdrawal charge (see Table 1 below) and any additional charges that providers may levy. • Investors may not fully understand risks around any absence of Financial Services Compensation Scheme (FSCS) protection and limitations of client money rules.

4 The definition of a first-time buyer will be the same as that in the rules for the Help to Buy: ISA.
5 Tax efficient wrappers that shelter investments.

Category	Example risks
Tax	• Investors may not be able to compare the Government bonus with tax relief on pensions and higher rate taxpayers (with remaining available capacity for tax relief on pension contributions) may, therefore, not optimise their retirement savings from a tax perspective if they choose to invest in a LISA rather than a pension. • Investors may not understand the difference in how the proceeds of a LISA and a pension are taxed.

Table 1: Example impact of the early withdrawal charge

LISA consumer actions	Year 1	Year 2
A Consumer subscription	£4,000	
B Government bonus (25%)	£1,000	
C Total for year 1	£5,000	
D Consumer early withdrawal		£5,000
E Government charge (25%)		-£1,250
F Consumer receives		£3,750
Consumer loss of capital (F–A)		*-£250*

Note: Example LISA account bears no interest and does not take into account charges

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?

Proposal

2.9 Our Handbook contains relatively few specific rules for ISA wrappers, although many of our general rules that aim to ensure that consumers have the information and protections they need to make appropriate choices are engaged for firms offering ISA products. For investments held within a wrapper, the rules that apply are largely governed by requirements that relate to the underlying investments held in the wrapper rather than the wrapper itself. However, where we considered that it advances our objectives, we have made rules and issued guidance to specifically address risks posed by ISA wrappers, including in relation to cash deposit ISAs and innovative finance ISAs. We are proposing to follow a similar approach in relation to LISAs.

2.10 Regulated firms must continue to comply with our existing principles and rules in relation to the sale of LISAs. Firms and individuals involved in the promotion and distribution of LISAs that contain relevant investments[6] will also continue to be subject to our current requirements for those engaged in designated investment business and/or MiFID or equivalent third-country business in relation to those investments.

2.11 We propose to address the specific risks identified for the LISA wrapper through enhancing our existing approach for stocks and shares and cash deposit ISAs. That is, we are proposing amended or further requirements or additional guidance in the following areas:

6 Designated investments or MiFID financial instruments.

- Communications with retail clients.
- Preparation and provision of product information to retail clients.
- Cancellation.
- Safeguarding of client money associated with LISA business.

2.12 Our proposals recognise that some provider firms may decide to provide LISAs that are only able to accept investments that could be held in a cash deposit ISA (as defined in the FCA Handbook). To ensure a proportionate approach for this type of LISA, we propose to define this type of LISA separately as a 'cash-only LISA', and to put forward rules in respect of this type of LISA that are similar to those for cash deposit ISAs, but which take into consideration the additional risks to our objectives from the additional features of the LISA wrapper. The exception to this is our client asset proposals, which are based on the existing approach to stocks and shares ISAs for all LISAs.

Communications with retail clients

2.13 Our Handbook currently requires firms to include information about the risks of an investment, as well as the benefits when communicating with retail clients in relation to investment business.

2.14 Investors will need information about how a LISA works, e.g. eligibility, government bonus, early withdrawal charge, etc. We believe that investors in LISAs that include a relevant investment should also receive specific risk warnings in respect of:

- incurring the early withdrawal charge which may mean that they receive less from their LISA than they paid in, and
- potentially losing an employer contribution to a workplace pension for which they may be eligible, where they choose to open a LISA instead

2.15 We propose to add guidance to the Conduct of Business Sourcebook (COBS) to assist firms in highlighting the risk factors that are likely to be relevant to investors when considering their obligations under our existing rules, specifically in relation to disclosure of risks in communications with retail clients.

2.16 This guidance will not apply to communications about cash-only LISAs. The proposals we make for information to be provided at the point of sale for cash-only LISAs will provide equivalent warnings about relevant risks.

> **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?**

Preparing and providing product information

2.17 A retail investor opening a LISA will receive initial disclosure documents in relation to the underlying investments in the LISA. We believe that there is further important information – in relation to the way the wrapper itself works – which they should have before they open a LISA. This information will also be relevant to savers considering opening a cash-only LISA.

2.18 The information that we consider investors to need includes the following:

- An explanation of the key features and eligibility requirements of a LISA wrapper.
- A clear explanation of the early withdrawal charge, including the level of the charge and when it would apply, and a warning that a investor incurring the early withdrawal charge may get back less than they have put in.
- A warning that if an individual opts out of a workplace pension for which they are eligible in favour of saving in a LISA, they may lose out on an employer contribution to their retirement saving.
- The process for transferring a LISA to another provider.

2.19 Firms should also provide investors with an explanation of the different savings objectives for which a LISA can be used (house purchase and retirement saving) and the types of investments that can be held in the LISA offered by the firm. This explanation should encourage investors to think about their investment choices in relation to their individual savings objective, their proposed investment horizon, and their financial circumstances as a whole.

2.20 We are also proposing that investors be given an indication of what they might get back from a LISA at age 60 via a table to be included in the current point-of-sale disclosures.

2.21 The purpose of this table is to highlight the difference in outcome for different investment or saving returns. It will show how long-term savings can be eroded by inflation; this is intended to encourage investors to consider the investment options in line with their objectives and investment timescales. The table will also give information on charges of the LISA wrapper – intended to help investors compare different LISAs and allow them to make a comparison with charges on personal pensions.

Example table

Age saving in a LISA started	Investor contribution	Total amount invested (inc. Government bonus)	Estimated outcome from 0% return at age 60	Estimated outcome from x% return at age 60	Charges and estimated inflation would reduce a x% return to
18					
25					
30					
35					
40					

2.22 The table will be generic – i.e. not personalised – and should be completed on the following basis:

- Assume the maximum investment with Government bonus is made into the LISA at the beginning of each tax year until age 50 and no withdrawals are made before age 60.
- Show the real return based on a nominal investment return of 0% and an additional specified investment return. The rate of return and assumption for inflation will be based on existing FCA requirements for similar calculations.[7]
- Show how the charges on the LISA wrapper reduce the return.

2.23 Firms will also be asked to provide explanations to the investor giving further details on the purpose of the table and the assumptions used in preparing it. It will be for firms to present the table and accompanying information in a way that is accessible and engaging for consumers.

2.24 For a cash-only LISA we propose to require a key features document (KFD) as we do for a cash-deposit ISA. We will require this KFD to include the information proposed above. We consider that information on savings objectives and investment choices remains relevant.

> **Q4: Do you agree with our proposals to require LISA-specific information disclosures? If not, please explain why.**

Cancellation

2.25 Existing stocks and shares and cash deposit ISAs attract cancellation rights (with some exemptions available). We considered mirroring these cancellation rights for LISAs. However, unlike existing ISAs, the LISA has restrictions on access through the early withdrawal charge until age 60, except in specified circumstances (purchase of first home or terminal illness). This makes it more important that an investor has the chance to reconsider their investment before they are locked in.

2.26 We propose that an investor will get 30 days to cancel when they open a LISA, except where the LISA is opened at a distance. In the latter circumstance, we propose to apply a 14-day cancellation right, consistent with requirements in the distance marketing directive (DMD).

2.27 It will be possible to open a LISA with new funds or via a transfer from another LISA. In practice, a transfer would need to remain in a LISA wrapper in the event of cancellation to avoid the early withdrawal charge.

2.28 Where additional investments are bought in an existing LISA, existing rules mean they will attract the relevant cancellation right for that underlying investment.

2.29 Our existing cancellation rules allow an ISA manager to replace the 14-day right to cancel a stocks and shares ISA with a pre-contract right to withdraw of seven days. We believe a pre-contract right to withdraw could allow a more practical cooling off period for a LISA in some situations, in particular where a new LISA is opened via a transfer. We propose, therefore, to allow a pre-contract right to withdraw of 14 days for a LISA in place of the 30-day cancellation period.

2.30 There are exemptions in place for stocks and shares ISAs such that in certain circumstances there is no cancellation right. Given the risk of being locked into a LISA until age 60, or triggering

7 See COBS 13 Annex 2

the early withdrawal charge, we do not feel this would be appropriate for a LISA. We therefore propose to exclude LISAs from these exemptions.

2.31 The Government regulations for LISAs allow for withdrawal of funds from a LISA without incurring the early withdrawal charge where this is done within 30 days of opening the LISA. This would not apply to funds transferred in from another LISA. This 30-day period operates in a way that means where an investor cancels under the rights provided by our proposals, they would not incur the early withdrawal charge.

Q5: Do you agree with our proposals on cancellation rights for LISAs?

Safeguarding client money

2.32 The introduction of the LISA has implications for our client money rules. These rules[8] apply to a firm that receives money from, or holds money for, or on behalf of, a client in the course of, or in connection with (among other types of business) its:

1. stocks and shares ISA business and/or
2. innovative finance ISA business

2.33 In PS14/10,[9] we permitted a firm to opt in[10] to complying with the client money rules for money that it receives or holds in respect of an ISA that contains only a cash deposit ISA.

2.34 Money within a LISA can be held for the purposes of investing in qualifying investments for a stocks and shares component (to which the client money rules already apply), qualifying investments for a cash component (to which the client money rules will not apply if the cash is held as a deposit), or a mixture of both. This may result in ambiguity as to the status of the monies investment firms hold within the LISA wrapper. The client money rules require firms to hold client money separately from money that is not client money.

2.35 We propose that all monies received or held by an investment firm for, or on behalf of, a client in the course of or in connection with a LISA should be held by the firm in accordance with the client money rules. This is a continuation of the policy set out in PS14/10 for stocks and shares ISAs.

2.36 If the client money rules remain unchanged, investment firms would be required to separate client money from non-client money within the LISA wrapper. If an investment firm offered both a deposit of the cash component and investing in qualifying investments in the stocks and shares component within a LISA, it would need to identify and separate the cash held on deposit from the client money held for qualifying investments under the stocks and shares component, as the client money rules currently only apply to monies held for investment purposes. In practice, this is likely to be difficult, as there will be ambiguity as to the status of the money held by the firm and the status of money held could change throughout the duration of the LISA.

2.37 This proposal affects investment firms that manage LISAs. Credit institutions that currently use the banking exemption[11] in the client money rules can continue to do so under these proposals.

8 Client Assets (CASS) 7.10.1R.

9 PS14/10: Client money held in Individual Savings Accounts and feedback to CP14/9 and final rules (June 2014).

10 CASS 7.10.3R(2A).

11 CASS 7.10.16R.

2.38 Bringing all money held within a LISA into the client money regime will mean that money is protected in trust, and subject to the client money distribution rules should the investment firm fail. Clients who hold cash in a LISA that is subject to the client money rules may therefore be exposed to any shortfall in the client money pool. Without our proposed changes, should the investment firm fail, clients would have a claim as a general creditor against the firm's estate alongside all other creditors. However, we consider that this risk is small given the ability under the ISA Regulations for consumers to transfer their ISAs to another provider.

FSCS

2.39 FSCS protection may be available under the Prudential Regulation Authority's rules (for claims for a deposit) or the FCA's (for claims in connection with protected investment business); in the same way as FSCS cover is available for cash ISAS or stocks and shares ISAs at present.

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.

Annex 1
List of questions

Q1: **Do you have any comments about the impact of our proposals on equality and diversity?**

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?**

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?**

Q4: **Do you agree with our proposals to require LISA-specific information disclosures? If not, please explain why.**

Q5: **Do you agree with our proposals on cancellation rights for LISAs?**

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.**

Q7: **Do you agree with the data and assumptions used in this CBA? If not, please explain why.**

Q8: **Do you agree with the description of the costs and benefits in our CBA? If not, please explain why.**

Annex 2
Cost benefit analysis

1. The Financial Services and Markets Act 2000 (FSMA), as amended by the Financial Services Act 2012, requires us to publish a cost benefit analysis (CBA) of our proposed rules. Specifically, section 138I requires us to publish 'an analysis of the costs together with an analysis of the benefits' that will arise if the proposed rules are made. It also requires us to quantify these costs and benefits, unless they cannot reasonably be estimated or it is not reasonably practicable to produce an estimate.

Market failure analysis

2. Markets for new products in particular often entail problems relating to asymmetric information – where investors find it difficult to assess how products may match their needs. These problems tend to be more pronounced where any benefits are realisable over the longer term – as is the case for the LISA, particularly in relation to the option to access funds at age 60 or later, as well as for the alternative saving vehicles that investors may choose.

3. The possibility of buying a house before age 60 may reduce the time between subscribing to a LISA and using the funds accumulated therein. However, this dual purpose may further hamper investors in assessing and comparing the LISA with other short-term and long-term saving options.

4. It also makes potential benefits subject to greater risks and uncertainties related to investors' circumstances (such as their employment status or income, family circumstances, etc.) and the housing market – which may impact on the feasibility of the purchase and, thereafter, the size and liquidity of the wealth it represents.

Behavioural biases

5. Given the design of the LISA, including its dual purpose of promoting house purchase and aiding retirement saving, and the 25% bonus from the Government, the following behavioural biases are likely to pose risks to investors:

Behavioural bias	Potential impact
Framing, salience and limited attention	It could be likely to make investors underestimate the benefits of other forms of retirement saving. In particular, investors may not be fully aware of employers' matching contributions in auto-enrolment and the tax relief associated with pension saving. Alternatively, investors may focus on the Government bonus when considering a new product like the LISA. Suppliers of the LISA would have a clear incentive to frame their offerings to reinforce further the potential benefits of LISA, and away from 'negative' characteristics like management charges and the 25% early withdrawal charge when withdrawing before age 60 or without buying their first home.
Present bias	It may lead investors to overestimate the potential benefit of accessing funds to buy a house in comparison to investing for retirement or, later, to deplete funds accumulated through the LISA and face inadequate resources during retirement.
Mental accounting, narrow bracketing and ambiguity avoidance	It may hinder investors from adequately considering future retirement incomes in comparison to the more 'visible' wealth that can be accumulated in the LISA and other ISAs.
Over-extrapolation	Combined with the ubiquity of the 'ISA' brand, investors may be led to miss the early withdrawal charge.
Overconfidence	Investors may be led to assign an excessive value to the flexibility of the LISA when compared to a pension scheme: in particular, if they underestimate the complexity of the choices in relation to LISA funds, such as the investment profile, whether to buy a house or wait till 60, or withdraw despite the 25% early withdrawal charge, and how to update behaviour when reaching 50.
Inertia	Investors who open LISAs may be prevented from reviewing their initial choices: in particular, when they turn 50 and can no longer contribute to the LISA but cannot realise the benefits until they turn 60 or buy their first home.

Consumer benefits of our proposals

6. Our rules aim to help investors make choices in relation to the LISA in line with their needs. More specifically, our rules aim to curb the following risks of:

- investors reducing savings in pension products over their working life below the level in line with their long-term needs
- investors losing an employer contribution when withdrawing from, or choosing not to enter, auto-enrolment schemes
- investors withdrawing money before age 60 without buying a home, hence paying the 25% early withdrawal charge; and
- investors entering saving or investment choices (e.g. shares, cash, hybrid) that are not in line with their long-term needs

7. Improving investors' understanding of LISAs compared with other options may modify choices. This could redistribute revenues among providers of LISA, pension funds, and other savings products.

8. The product itself, while sharing some characteristics and aims of other products (such as the Help to Buy: ISA), is sufficiently novel that we are cautious of drawing too directly on the experience of other products. In particular, it is difficult to determine the level of potential demand.

9. Comparisons with other savings vehicles provide some limited insights. The house purchase element of the LISA is similar to that of the Help to Buy: ISA, which is open to new investors until 30 November 2019, with any Government bonus having to be claimed by 1 December 2030.[1] The Government has stated that the Help to Buy: ISA has so far attracted over 500,000 investors.[2] Given that the bonus on the Help to Buy: ISA is more limited than that on the LISA, and that the LISA is not solely limited to house purchase, it seems reasonable to conclude that demand may be greater than for the Help to Buy: ISA, even though the early withdrawal charge is greater in the LISA.

10. As the market for the LISA is yet to begin, we cannot observe evidence of actual behaviour and outcomes for investors and providers. As a consequence, we cannot estimate the actual shift in choices arising from our proposals, nor their long-term consequences on future outcomes: such as the level and different forms of wealth held by UK investors, impacts on retirement resources, and redistribution of revenues and profits across the providers of financial services.

11. Given the arguments above, and following FSMA 138I (8)(a), we consider that the present CBA need not provide estimates of the cost and benefits of the proposed measures, as they cannot be reasonably estimated. We do provide a qualitative analysis of costs and benefits, supported with data on investors' current choices, to the extent that they inform the numbers of those potentially affected. We will also illustrate some of the most relevant impacts potentially arising from our interventions, through examples of outcomes for representative investors.

General risk of under-saving

12. One of the Government's aims for the LISA is to help those eligible to save for retirement.[3] One cause of consumer detriment would be if they were attracted to the LISA by the Government bonus over other retirement provisions that might better suit their needs. The limit for annual contributions of £4,000 and, especially, the 50-year age limit, may lead investors to under-save for their retirement, while assuming they are making adequate provision. Such under-saving would affect retirement income.

13. Our proposal to provide a table setting out the possible proceeds from a LISA at age 60 is intended to help prompt investors to consider whether their provision for retirement is adequate.

Loss of employers' auto-enrolment contributions

14. Another potential source of a reduction in retirement resources could materialise if investors opt out of pension auto-enrolment, or cease active membership once they have been enrolled, to use their individual contributions to fund a LISA instead. In doing so, they would forgo their employers' contributions, and suffer a direct monetary loss.

1 www.gov.uk/government/uploads/system/uploads/attachment_data/file/533284/h2b_isa_stats_publication_june_16_final.pdf.
2 www.gov.uk/government/news/help-to-buy-isas-opened-by-over-half-a-million.
3 www.gov.uk/government/uploads/system/uploads/attachment_data/file/508117/Lifetime_ISA_explained.pdf.

15. In April 2019 minimum employers' contributions will amount to 3% of the salary for individuals who do not opt out of the scheme, while they will individually contribute 5% to their pension.[4]

16. Investors may decide to opt-out or cease membership for several reasons. First they may undervalue (or be unaware of) the employer contributions provided in an auto-enrolled pension (including any future returns on those contributions). Furthermore, they may overvalue the government bonus provided within the LISA and the flexibility of a LISA when compared with a pension. The novelty of, and any media interest in, the LISA, and the relative visibility of the government bonus in comparison to tax relief benefits, may override the inertia of investors.

17. Given that the LISA is a new product, it is not reasonable to forecast what effect it will have on opt-out rates, both at enrolment and re-enrolment, or on the rate at which people cease to be members of a scheme.

Tax impacts

18. It is important to consider the difference in taxation between the LISA and a pension, as well as the government bonus. Those in an auto-enrolled pension are exempt from tax on contributions, exempt from tax on any gains in their fund, and then the income is taxed at retirement. Contributions to a LISA will be taxed, but any gains or authorised withdrawals will be exempt from tax. The government bonus has the effect, for those who currently pay their tax at the Basic Rate (at present 20%), of making contributions to the LISA tax exempt. However, for higher-rate earners, the value of tax relief provided by a pension exceeds the value of the bonus in a LISA.

19. Our proposals, based on warnings and information disclosures will benefit investors by reminding them not to overlook the potential loss of employers' contributions from opting-out of auto-enrolment.

The 25% early withdrawal charge

20. Survey evidence shows that some households lack adequate savings to cover unexpected expenses. The Money Advice Service's report on Financial Capability in the UK 2015 notes that 68% of all UK adults could pay an unexpected £300 bill from savings or cash without cutting back.[5] However, when split by housing tenure, the difference is marked. While 86% of those who own their house outright or 70% of those who have a mortgage could meet such an unexpected bill, only 55% of private renters or 50% of social renters could.

21. Unlike many of the ISAs currently on the market, the LISA imposes a 25% early withdrawal charge on any withdrawals outside of someone buying their first home, reaching the age of 60, or suffering from a terminal illness. This early withdrawal charge is equivalent to losing the whole of the Government bonus, the returns on that bonus, and paying a further 6.25% charge on one's contributions and the returns on those contributions of withdrawal.[6]

22. Rational investors would invest in a LISA only in the presence of a reasonable expectation of not needing the funds before age 60 or of buying a first home. It would therefore not be rational for a consumer to invest in a LISA without first having some liquid savings – savings that carry no withdrawal charge – to cover unforeseen expenses.

23. However, investors displaying behavioural biases may fail to anticipate a need for savings outside a LISA, since:

4 The Pensions Regulator http://www.thepensionsregulator.gov.uk/employers/contributions-funding-tax.aspx

5 https://masassets.blob.core.windows.net/cms/files/000/000/265/original/MAS_FinCap_UK_Survey_2015_AW.pdf

6 See Table 1

- Overconfident people may underestimate the chance that they will have to pay the early withdrawal charge, or borrow to prevent the charge applying

- Investors who pay limited attention when selecting a LISA may wrongly believe that the 25% early withdrawal charge would be roughly equivalent to giving up only the 25% government bonus.

24. Our proposal would highlight to investors that the charge will remove more than just the government bonus, and that therefore investors should be cautious when considering the LISA as a savings product. The potential benefit to investors of clear information pointing to the actual early withdrawal charge is twofold:

- When considering subscribing to a LISA, it allows for an easier assessment of the advantages and drawbacks, given any possible need for cash in the future

- After purchasing a LISA, it may avoid investors making early withdrawals when that is not an optimal choice, e.g. in the presence of a lower cost of credit.

Consumers saving/investment choices not in line with needs

25. The LISA allows investments to be held in qualifying investments for the cash or stocks and shares component of an ISA. As discussed above, the government have set two potential aims for an individual holding a LISA – house-purchase or saving for retirement.

26. Those aiming for house purchase may choose to hold their LISA subscription in cash, since in general cash holdings are less volatile, and therefore more appropriate for a near-term savings goal. For those saving for retirement, especially for those at the start of their careers, we would expect their LISA subscriptions would be, at least in part, in qualifying investments for a stocks & shares ISA component. This is because of the higher returns that may be possible.

27. Our proposals require firms to remind investors to consider their asset mix when considering the outcome they are seeking through saving in a LISA. This should result in investment choices more in line with investors' needs.

Cancellation rights

28. The attraction of the government bonus may mean that investors do not properly consider whether the LISA adequately meets their needs, nor the risk of incurring the early withdrawal charge.

29. Our rules require other retirement savings products to have a 30 day cancellation period. Contracts for a Cash ISA can be cancelled within 14 days, as can the opening or transferring of an ISA.[7] In summary, we propose that an investor will get 30 days to cancel when they open a LISA (including a cash-only LISA) on an advised (not at a distance) basis or where the LISA investments include a life policy. For a LISA opened at a distance we propose to apply a 14 day cancellation right, consistent with requirements in the distance marketing directive.

30. Our proposal would provide more time for investors to consider whether the product matches their immediate needs, including whether they are prepared to accept the risks of the government withdrawal charge. Given that it is a new product, with a new set of rules for an ISA product, it is not practicable to forecast how many people may benefit from our proposed rules. This is especially important, since a LISA could be held for up to 42 years with the 25% government withdrawal charge applying.

7 COBS 15.2.1 R

Compliance costs to firms

Communications

31. Our proposals require firms to provide investors with some risk warnings and prompts around the LISA. Given that firms will have to develop new material to promote and explain the LISA, a new product, to investors regardless of our rules, we do not regard the provision of these risk warnings and prompts as a material additional compliance cost to firms.

Preparing and providing product information

32. Our proposals also require firms to provide some further information disclosures, particularly a table indicating what an investor might get back from a LISA at age 60. The latter will entail additional costs to firms, albeit these will be limited by the lack of personalisation in calculating the table.

33. Currently, 514 firms are on HMRC's list of authorised ISA managers.[8] HMRC has authorised 235 to provide only stocks & shares ISAs, 133 only cash ISAs, and 134 both cash and stocks & shares ISAs. Some firms in each of these categories will also be able to provide innovative finance ISAs, but peer-to-peer assets cannot be held in a LISA.

34. We estimate that our disclosures will require, at most, two additional A4 sheets. We estimate a printing cost of 2.67 pence per A4 sheet at today's prices. The Government estimate is that there will be 800,000 LISAs by tax year 2020-21. As such, we estimate printing costs at around £42,720 per year

Cancellation

35. Our proposals to set a 30-day cancellation period for some types of LISA contracts may result in firms experiencing a higher rate of cancellations without charge. However, given that this is a new product, we cannot reasonably estimate the number of people that may use the additional 16 days to cancel their LISA. We note that it's likely that most cancellations will result in shifting investment to other savings vehicles.

Safeguarding client money

36. Our proposed changes to CASS are intended to align the compatibility of the client money rules with changes to the ISA Regulations with minimal impact. As a result of our proposals, firms would not be required to implement extensive and potentially costly systems changes to identify, separate and monitor client money from non-client money held within a LISA. We expect our proposals will permit firms to operate largely as they do under current client money rules for stocks and shares ISA business and innovative finance ISA business.

Summary

37. As noted above, it would not have been reasonable to provide cost and benefit estimates for all our LISA proposals, given the significant uncertainty surrounding this new product. We have been able to provide an indication of the modest costs of proposed modifications on disclosure rules.

Direct costs to the FCA

38. We expect any direct costs to the FCA to be limited to processing any additional authorisations that firms may require to provide the LISA.

8 Source: HMRC

Q7: **Do you agree with the data and assumptions used in this cost-benefit analysis? If not, please explain why?**

Q8: **Do you agree with the description of the costs and benefits in our cost-benefit analysis? If not, please explain why?**

Annex 3
Compatibility statement

Compatibility with the FCA's general duties

1. We are required by section 138I(2)(d) of the FSMA to explain why we believe the making of our proposed rules is compatible with our duties under section 1B(1) and (5)(a): namely, to act so far as reasonably possible in a way which is compatible with our strategic objective, advances one or more of our operational objectives, and has regard to the regulatory principles in section 3B of the FSMA. We are also required by section 138K(2) of the FSMA to state whether the proposed rules will have a significantly different impact on mutual societies, as opposed to other authorised persons.

2. This annex also sets out our view of how the proposed rules are compatible with the duty on the FCA to discharge its general functions (which include rule-making) in a way that promotes effective competition in the interests of consumers (section 1B(4) of the FSMA). This duty applies in so far as promoting such competition is compatible with advancing our consumer protection and/or integrity objectives.

3. This annex must be read in conjunction with the rest of the CP and the CBA (in Annex 1) in demonstrating that we meet our statutory duties and objectives.

Compatibility with the FCA's regulatory objectives

4. In preparing the proposals set out in this consultation, we have had regard to the regulatory principles set out in section 3B of the FSMA.

The need to use our resources in the most efficient and economical way

5. We expect the costs to the FCA of these proposals to be minimal and limited to the additional cost of our having to process a marginally larger number of requests for new and updated permissions.

The principle that a burden or restriction should be proportionate to the benefits

6. We believe that our proposals represent a proportionate approach that achieves an appropriate level of consumer protection while minimising, as far as possible, burdens on firms and the impact on competition, including competitive entry.

7. The CBA in Annex 1 sets out these costs in more detail.

The desirability of sustainable growth in the UK economy in the medium or long term

8. Our proposals support the Government's policy objective of people saving more, thereby relieving the tax burden on future generations.

The general principle that consumers should take responsibility for their decisions

9. While we believe that consumers should take responsibility for their decisions, the existence of information asymmetries means that they often lack the knowledge to make appropriate decisions around house purchase and retirement saving.

10. They are, therefore, likely to be heavily reliant on information disclosures. Our proposals help ensure that these are of an appropriate quality.

The responsibilities of senior management

11. Our proposals create new rules and the senior management of provider firms are obliged to ensure compliance with the rules through existing regulatory requirements as to oversight and compliance. We believe that these obligations are appropriate and proportionate.

The desirability, where appropriate, of exercising our functions in a way that recognises differences in the nature and objectives of businesses carried on by different persons

12. We do not believe that our proposals discriminate against any particular business model or approach.

The desirability in appropriate cases of publishing information relating to persons on whom requirements are imposed

13. We not believe that our proposals affect or undermine this principle.

The principle that we should exercise our functions as transparently as possible

14. We believe that by consulting on our proposals, we are acting in accordance with this principle.

Compatibility with the duty to promote effective competition in the interests of consumers

15. In preparing the proposals in this CP, we consider we have met our duty under section 1B(4) of the FSMA. This provides that we must, so far as is compatible with acting in a way that advances the consumer protection objective or the integrity objective, carry out our general functions in a way that promotes effective competition in the interests of consumers.

16. Whilst it is difficult to assess as this stage the impact of the advent of the LISA on the general and retirement savings markets (see our CBA for further detail), our proposals will help investors make informed decisions and put them in a place to drive effective competition in these markets.

Expected effect on mutual societies

17. Section 138K of the FSMA requires us to state whether, in our opinion, our proposed rules have a significantly different impact on authorised persons who are mutual societies, in comparison with other authorised persons.

18. We do not expect the proposals in this paper to have a significantly different impact on mutual societies than other authorised persons or present them with any more or less of a burden than other authorised persons.

19. We would welcome any comments or information you have on any issues relating to mutual societies that you believe would arise from our proposals.

Appendix 1
Draft Handbook text

CONDUCT OF BUSINESS AND CLIENT ASSETS (LIFETIME INDIVIDUAL SAVINGS ACCOUNT) INSTRUMENT 2017

Powers exercised

A. The Financial Conduct Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 ("the Act"):

(1) section 137A (The FCA's general rules);
(2) section 137B (FCA general rules: clients' money, right to rescind etc);
(3) section 137R (Financial promotion rules);
(4) section 137T (General supplementary powers); and
(5) section 139A (Power of the FCA to give guidance).

B. The rule-making provisions listed above are specified for the purposes of section 138G (2) (Rule-making instruments) of the Act.

Commencement

C. This instrument comes into force on 6 April 2017.

Amendments to the Handbook

D. The modules of the FCA's Handbook of rules and guidance listed in column (1) below are amended in accordance with the Annexes to this instrument listed in column (2).

(1)	(2)
Glossary of definitions	Annex A
Conduct of Business sourcebook (COBS)	Annex B
Banking: Conduct of Business sourcebook (BCOBS)	Annex C
Client Assets sourcebook (CASS)	Annex D

Citation

H. This instrument may be cited as the Conduct of Business and Client Assets (Lifetime Individual Savings Account) Instrument 2017.

By order of the Board
[*date*]

Annex A

Amendments to the Glossary of definitions

In this Annex, underlining indicates new text, unless otherwise stated.

Insert the following new definitions in the appropriate alphabetical positions. The text is not underlined.

cash-only lifetime ISA a *lifetime ISA* which can include only those qualifying investments prescribed in paragraphs 8(2)(a), (b), (h), (j) and (n) to (q) of the *ISA Regulations*.

lifetime ISA an *individual savings account* as prescribed in regulation 4(1ZB) of the *ISA Regulations.*

lifetime ISA business a *firm's* activities, in its capacity as an *ISA manager*, in connection with a *lifetime ISA* which is not either or both *MiFID business* and *designated investment business*.

lifetime ISA charges any fee or charge made to a *retail client* in connection with the opening or operation of a *lifetime ISA*, whether levied by the *firm* or any other *person*, but excluding any fees or charges:

(a) payable by or on behalf of a *retail client* to a *firm* in relation to the provision of a *personal recommendation* by the *firm* in respect of the *lifetime ISA*; and

(b) relating to the qualifying investments held in the *lifetime ISA* (including in relation to the provision of a *personal recommendation* in respect of those investments).

lifetime ISA government bonus has the meaning given to "government bonus" in paragraph 1 of the Schedule to the *ISA Regulations.*

lifetime ISA government withdrawal charge has the meaning given to "withdrawal charge" in paragraph 9(4) of Schedule 1 to the Savings (Government Contributions) Act 2016.

Amend the following definition as shown.

client money …

(2A) …

<u>(bc) that a *firm* receives or holds for, or on behalf of, a *client* in</u>

the course of, or in connection with, its *lifetime ISA business*; or

…

Annex B

Amendments to the Conduct of Business sourcebook (COBS)

In this Annex, underlining indicates new text and striking through indicates deleted text, unless otherwise stated.

1.1 The general application rule

…

1.1.1A R This sourcebook does not apply to a *firm* with respect to the activity of *accepting deposits* carried on from an establishment maintained by it, or its *appointed representative*, in the *United Kingdom*, except for *COBS* 4.6 (Past, simulated past and future performance), *COBS* 4.7.1R (Direct offer financial promotions*)*, *COBS* 4.10 (Systems and controls and approving and communicating financial promotions), *COBS* 13 (Preparing product information), ~~and~~ *COBS* 14 (Providing product information to clients) and *COBS* 15 (Cancellation) which apply as set out in those provisions, *COBS* 4.1 and the Banking: Conduct of Business sourcebook (*BCOBS*).

…

4.5 Communicating with retail clients

…

4.5.10 G …

Lifetime ISA

4.5.11 G Examples of information about relevant risks (*COBS* 4.5.2R) that a *firm* should give a *retail client* in relation to a *lifetime ISA* include:

(1) an explanation of:

(a) a *retail client's* eligibility to subscribe to a *lifetime ISA* (including annual subscription limits) and to claim the *lifetime ISA government bonus*;

(b) the *lifetime ISA government withdrawal charge* and the circumstances in which it might arise; and

(c) the process by which a *retail client* can transfer a *lifetime ISA*; and

(2) a warning that, if the *retail client*:

(a) incurs a *lifetime ISA government withdrawal charge*, the *retail client* may get back less than they paid in to a *lifetime*

ISA; and

(b) saves in a *lifetime ISA* instead of enrolling in, or contributing to, a *qualifying scheme* or *occupational pension scheme* for which they are eligible, the *retail client* may lose the benefit of contributions by an employer to that scheme.

…

4.7 Direct offer financial promotions

4.7.1 R (1) Subject to (3) and (4), a *firm* must ensure that a *direct offer financial promotion* that is addressed to, or disseminated in such a way that it is likely to be received by, a *retail client* contains:

…

…

(4) If a communication relates to a *firm's* business that is not *MiFID or equivalent third country business*, this section does not apply:

(a) to the extent that it is an *excluded communication*;

(b) to the extent that it is a prospectus advertisement to which *PR* 3.3 applies;

(c) if it is *image advertising*;

(d) to the extent that it relates to a *deposit* that is not a *cash deposit ISA*, *cash-only lifetime ISA* or *cash deposit CTF*;

(e) to the extent that it relates to a *pure protection contract* that is a *long-term care insurance contract*.

…

…

13.1 The obligation to prepare product information

13.1.1 R A *firm* must prepare:

(1) a *key features document* for each *packaged product*, *cash-deposit ISA*, *cash-only lifetime ISA* and *cash-deposit CTF* it produces; and

(2) a *key features illustration* for each *packaged product* it produces;

in good time before those *documents* have to be provided.

…

13.3 Contents of a key features document

General requirements

13.3.1 R A *key features document* must:

(1) include enough information about the nature and complexity of the product, how it works, any limitations or minimum standards that apply and the material benefits and risks of buying or investing for a *retail client* to be able to make an informed decision about whether to proceed; ~~and~~

(2) explain:

(a) the arrangements for handling complaints about the product;

(b) that compensation might be available from the *FSCS* if the *firm* cannot meet its liabilities in respect of the product (if applicable);

(c) that a right to cancel or withdraw exists, or does not exist, and, if it does exist, its duration and the conditions for exercising it, including information about the amount a *client* may have to pay if the right is exercised, the consequences of not exercising it and practical instructions for exercising it, indicating the address to which any notice must be sent;

(d) (for a *CTF*) that *stakeholder CTFs*, *cash-deposit CTFs* and *security-based CTFs* are available and which type the *firm* is offering; and

(e) (for a *personal pension scheme* that is not an *automatic enrolment scheme*) clearly and prominently, that *stakeholder pension schemes* are generally available and might meet the *client's* needs as well as the scheme on offer; and

(3) (for a *cash-only lifetime ISA*) include the information set out in *COBS* 14 Annex 1.

…

14 Providing product information to clients

14.1 Interpretation

14.1.1 R In this chapter:

(1) '*retail client*' includes the trustee or *operator* of a *stakeholder pension scheme* or *personal pension scheme* and the trustee of a *money-purchase occupational pension scheme*; and

(2) 'sell' includes '*sell*, *personally recommend* or *arrange* the sale of' in relation to a *designated investment* and equivalent activities in relation to a *cash-deposit ISA*, *cash-only lifetime ISA* and *cash-*

deposit CTF.

14.2 Providing product information to clients

The provision rules

14.2.1 R A *firm* that sells:

…

(4) a *cash-deposit ISA*, a *cash-only lifetime ISA* or *cash-deposit CTF* to a *retail client*, must provide a *key features document* to that *client*;

(4A) a *lifetime ISA*, which is not a *cash-only lifetime ISA*, to a *retail client* must provide to that *client* the information in *COBS* 14 Annex 1;

…

…

After COBS 14.4 (Provision of information by an intermediate Unit holder) insert the following new Annex. The text is not underlined.

14 Annex 1 Lifetime ISA information

This Annex belongs to *COBS* 13.3.1R(3) and *COBS* 14.2.1R(4A).

Information which comprises the following:

1 Features of a lifetime ISA

1.1 R An explanation to the *retail client* of the key features of a *lifetime ISA*, including:

(1) eligibility criteria to open and subscribe to a *lifetime ISA*;

(2) annual *lifetime ISA* subscription limits;

(3) tax treatment of qualifying investments held in a *lifetime ISA*;

(4) process for transferring a *lifetime ISA*;

(5) eligibility for the *lifetime ISA government bonus*; and

(6) the *lifetime ISA government withdrawal charge* and the circumstances in which this might be incurred.

1.2 R The explanation in *COBS* 14 Annex 1 1.1R(6) should include a warning that:

(1) the *lifetime ISA government withdrawal charge* recovers any *lifetime ISA government bonus*, any investment growth on that bonus plus an additional amount; and

(2) if the *lifetime ISA government withdrawal charge* is incurred, the *retail client* could receive back less than they paid in.

2 Additional factors for a retail client to consider when deciding whether to invest in a lifetime ISA

2.1 R An explanation to the *retail client* of:

(1) the different savings objectives for which the *lifetime ISA* is intended, being house purchase and/or saving for retirement, either in the alternative or in combination;

(2) the types of qualifying investments which can be held in the *lifetime ISA* being sold by the *firm*.

2.2 R A warning that if a *retail client* saves in a *lifetime ISA* instead of enrolling in, or contributing to, a *qualifying scheme* or *occupational pension scheme* for which they are eligible, the *retail client* may lose the benefit of contributions by an employer to that scheme.

2.3 G The explanation in *COBS* 14 Annex 1 2.1R should:

(1) encourage a *retail client* to consider their *lifetime ISA* subscription level and choice of qualifying investment in relation to their savings objectives, their expected investment horizon and their financial circumstances as a whole, including other provision for retirement; and

(2) inform the *retail client* that the factors in (1) may change over time and that the *retail client* should regularly review their *lifetime ISA* subscription and/or qualifying investments.

3 Example outcome of retirement saving by a retail client in a lifetime ISA

3.1 R A descriptive heading such as 'What a lifetime ISA might be worth at age 60?'

3.2 R A completed version of the table in *COBS* 14 Annex 1 3.5R.

3.3 R An explanation, positioned adjacent to this table on the same page, stating that:

(1) the table is designed to:

(a) help the *retail client* understand what the value of a *lifetime ISA* might be at age 60, depending on the age at which saving starts and assuming the maximum annual subscription at the beginning of each tax year up to age 50 and receipt of the *lifetime ISA government bonus*; and

(b) provide information for a *retail client* who is saving for retirement in a *lifetime ISA* and so may not be relevant to a *retail client* whose saving objective for a *lifetime ISA* is house purchase; and

(2) the estimated outcomes in Columns 4 and 5:

(a) are based on standardised rates of return which may not reflect the *retail client's* choice of qualifying investment for a *lifetime ISA*, accompanied by an indication of how the *retail client* can access information relating to the qualifying investments which the *retail client* may purchase from the *firm*; and

(b) include the effect of *lifetime ISA charges* and inflation on estimated outcomes from a *lifetime ISA*; and

(3) Column 6 shows the effect of *lifetime ISA charges* and inflation on the returns from a *lifetime ISA* which the *retail client* can use to compare the *lifetime ISA charges* applicable to other *lifetime ISAs* and charges applicable to longer term savings products.

3.4 R The explanations in *COBS* 14 Annex 1 3.3R(2) and *COBS* 14 Annex 1 3.3R(3) must include a statement that *lifetime ISA charges* taken into account in the table:

(1) may vary over time; and

(2) exclude any fee or charge:

(a) payable by or on behalf of a *retail client* to a *firm* in relation to the provision of a *personal recommendation* by the *firm* in respect of the *lifetime ISA*; and

(b) relating to the qualifying investments held in the *lifetime ISA* (including in relation to the provision of a *personal recommendation* in respect of those investments).

3.5 R This table belongs to *COBS* 14 Annex 1 3.2R.

1	2	3	4	5	6
Age saving in a lifetime ISA started	Total amount paid in by lifetime ISA saver/investor	Total amount paid in, plus lifetime ISA governme	Estimated outcome at age 60 from 0% return	Estimated outcome at age 60 from x% return	Charges and estimated inflation would reduce a x% return

		nt bonus			to
	£	£	£	£	%
18					
25					
30					
35					
40					

3.6 R In preparing the table in *COBS* 14 Annex 1 3.5R, *firms* must:

(1) Round all sterling amounts down to the nearest whole pound.

(2) Complete Column 2 on the basis of:

(a) the *retail client* attaining each age listed in Column 1 in the tax year in respect of which the *retail client* is proposing to make a *lifetime ISA* subscription; and

(b) a maximum annual *lifetime ISA* subscription being made on 6 April of that tax year and each subsequent tax year, up to and including the tax year in which the *retail client* would reach age 50 (based on each assumed age in (a)).

(3) Complete Column 3 on the basis of:

(a) subscriptions as calculated in Column 2; and

(b) receipt by the *retail client* of the *lifetime ISA government bonus* on:

(i) 5 April 2018 for the tax year 2017/18 (where relevant); and

(ii) 6 April of each subsequent tax year, up to and including the tax year in which the *retail client* would reach age 50 (based on each assumed age in 2 (a)).

(4) Complete Columns 4 and 5 on the basis of:

(a) investment of the *retail client's* assumed subscriptions and the *lifetime ISA government bonus*, as calculated for the purposes of Columns 2 and 3;

(b) (for Column 4) a nominal annual rate of return of 0%;

(c) (for Column 5) a nominal annual rate of return equal to the maximum intermediate rate of return 'x' given in *COBS* 13 Annex 2 2.3R; and

(d) the outcome in sterling in real terms:

(i) based on the nominal annual rate of return in the relevant column;

(ii) net of the intermediate rate of price inflation given in *COBS* 13 Annex 2 2.5R;

(iii) net of the effect of any *lifetime ISA charges*; and

(iv) compounded annually at the end of each tax year, up to and including the tax year in which the *retail client* would reach age 60 (based on each assumed age in 2(a)).

(5) Complete Column 6 on the basis of a percentage rate 'y' (rounded to the nearest tenth of 1%), where 'y' is the annual rate of return which must be applied to each amount shown in Column 3 and compounded annually over the relevant period to achieve the sterling amount shown in Column 5.

4 Projections

4.1 R Where a *firm* chooses to provide a *projection*, including a *personal projection*, in relation to a *lifetime ISA* in addition to the information in 3 (Example outcome of retirement saving by a retail client in a lifetime ISA), a *firm* must ensure that:

(1) the information in 3 is displayed at least as prominently as the *projection*;

(2) where a *firm* that communicates a *projection* for a *lifetime ISA* in relation to its *MiFID or equivalent third country business*, the *projection* complies with the future performance rule in *COBS* 4.6.7R; and

(3) where a *firm* that communicates a *projection* for a *lifetime ISA* which is not in relation to its *MiFID or equivalent third country business,* the *projection* must be either a *standardised deterministic projection* or a *stochastic projection* in accordance with *COBS* 13 Annex 2.

5 Qualifying investments

5.1 G The information which a *firm* provides to a *retail client* in accordance with this Annex is intended to inform the *retail client* about the implications of that *retail client* saving and/or investing in a *lifetime ISA* (as opposed to saving and/or investing outside a *wrapper* or in a different *wrapper* or *pension wrapper*). A *firm* must still take into account and comply with any other requirements of this sourcebook in connection with the sale by the *firm* of qualifying investments to be held in a *lifetime ISA*.

Amend the following as shown.

15.2 The right to cancel

Cancellable contracts

15.2.1 R A *consumer* has a right to cancel any of the following contracts with a *firm*:

Cancellable contract	**Cancellation period**	**Supplementary provisions**
Life and pensions		
• a *life policy* (including a *pension annuity*, a *pension policy* or within a *wrapper*) • a contract to join a *personal pension scheme* or a *stakeholder pension scheme* • a *pension contract* • a contract for a *pension transfer* • a contract to vary an existing *personal pension scheme* or *stakeholder pension scheme* by exercising, for the first time, an option to make *income withdrawals*~~,~~	30 calendar days	For a *life policy* effected when opening or transferring a *wrapper*, the 30 calendar day right to cancel applies to the entire arrangement For a contract to buy a *unit* in a *regulated collective investment scheme* within a *pension wrapper*, the cancellation right for 'non-life/pensions (advised but not at a distance)' below may apply Exemptions may apply (see *COBS* 15 Annex 1)
<u>**Lifetime ISAs (advised but not at a distance):**</u>		
<u>a non-*distance contract* to open or transfer a *lifetime ISA*</u>	<u>30 calendar days</u>	<u>These rights arise only following a *personal recommendation* of the contract (by the *firm* or any other *person*).</u> <u>Exemptions may apply (see *COBS* 15 Annex 1)</u>

Cash deposit ISAs:		
~~•~~a contract for a *cash deposit ISA*	14 calendar days	Exemptions may apply (see *COBS* 15 Annex 1)
Non-life/pensions (advised but not at a distance): a non-*distance contract* …		
• to *buy* a *unit* in a *regulated collective investment scheme* (including within a *wrapper* or *pension wrapper*) • to open or transfer a child trust fund (*CTF*) • to open or transfer an *ISA* (other than a *lifetime ISA*) • for an *Enterprise Investment Scheme*	14 calendar days	These rights arise only following a *personal recommendation* of the contract (by the *firm* or any other *person*). For a *unit* bought when opening or transferring a *wrapper* or *pension wrapper*, the 14 calendar day right to cancel applies to the entire arrangement. Exemptions may apply (see *COBS* 15 Annex 1).
Non-life/pensions (at a distance): a *distance contract*, relating to …		
• *accepting deposits* • *designated investment business* • *issuing electronic money*	14 calendar days	Exemptions may apply (see *COBS* 15 Annex 1)

…

15.3 Exercising the right to cancel

…

Record keeping

15.3.4 R The *firm* must make adequate records concerning the exercise of a right to cancel or withdraw and retain them:

(1) indefinitely in relation to a *pension transfer*, *pension opt-out* or *FSAVC*;

(2) for at least five years in relation to a *life policy*, *pension contract*, *personal pension scheme*, ~~or~~ *stakeholder pension scheme* or *lifetime ISA*; and

(3) for at least three years in any other case.

15.4 Effects of cancellation

…

Payment for the service provided before cancellation

15.4.2 R (1) This *rule* applies in relation to a *distance contract* that is not a *life policy*, *personal pension scheme*, *cash deposit ISA*, <u>*cash-only lifetime ISA*</u> or *CTF*.

(2) When the *consumer* exercises ~~his~~ <u>their</u> right to cancel ~~he~~ <u>they</u> may be required to pay, without any undue delay, for the service actually provided by the *firm* in accordance with the contract. The performance of the contract may only begin after the *consumer* has given ~~his~~ <u>their</u> approval. The amount payable must not:

(a) exceed an amount which is in proportion to the extent of the service already provided in comparison with the full coverage of the contract;

(b) in any case be such that it could be construed as a penalty.

(3) The *firm* may not require the *consumer* to pay any amount on the basis of this *rule* unless it can prove that the *consumer* was duly informed about the amount payable, in conformity with the distance marketing disclosure rules. However, in no case may the *firm* require such payment if it has commenced the performance of the contract before the expiry of the cancellation period without the *consumer's* prior request.

[**Note:** article 7(1), (2) and (3) of the *Distance Marketing Directive*]

…

15 Annex 1 Exemptions from the right to cancel

…

	Exemptions for ISAs, CTFs and EISs (non-distance)		
1.9	R	There is no right to cancel a non-*distance contract*:	
		(1)	to open or transfer an *ISA* (mini or maxi and including all components whatever the underlying investment, but not a *cash deposit ISA* or an *ISA* containing a *life policy*); or
		(2)	to open or transfer a *CTF*; or

	(3)	[deleted]
	(4)	for an *EIS*;
	provided that:	
	(5)	(for an *EIS* or an *ISA* which is not a *lifetime ISA*) the right to cancel is replaced with a seven calendar day, pre-contract right to withdraw the *consumer's* offer; or
	(5A)	(for a *lifetime ISA*) the right to cancel is replaced with a fourteen calendar day, pre-contract right to withdraw the *consumer's* offer; or
	(6)	the contract relates to an *EIS* or a non-*packaged product ISA* (which is not a *lifetime ISA*) or *CTF* and is entered into following an explanation that neither a right to cancel nor a right to withdraw will apply given in accordance with the relevant rules on pre-contractual disclosure; or
	(7)	(for an *ISA* or *EIS*) the contract entered into is a second or subsequent *ISA* or *EIS* on substantially the same terms (such as mini-to-mini *ISA* or maxi-to-maxi *ISA*) as an *ISA* or *EIS* purchased from the same *ISA manager* or *EIS manager* in the previous tax year.
…		

Annex C

Amendments to the Banking Conduct of Business sourcebook (BCOBS)

In this Annex, underlining indicates new text.

2.4 Structured deposits, cash deposit ISAs and cash deposit CTFs

…

2.4.2 G If a *financial promotion* relates to a *cash deposit ISA*, *cash-only lifetime ISA* or *cash deposit CTF*, *COBS* 4.7.1R (Direct offer financial promotions) also applies.

…

4.1 Enabling banking customers to make informed decisions

…

4.1.2 G …

(2A) …

(c) In the case of a *savings account* that is a *cash deposit ISA*, *cash-only lifetime ISA* or a *cash deposit CTF*, the *firm* may include the summary box in a *key features document* provided to the *banking customer* in line with the *rules* and *guidance* in *COBS* 13 and *COBS* 14.

(d) In preparing the summary box, a *firm* should have regard to the provisions of *BCOBS* 2.2A.1R as if they were guidance.

…

…

4.1.7 G If the *retail banking service* is a *cash deposit ISA*, a *cash-only lifetime ISA* or a *cash deposit CTF*, the rules in *COBS* 13.1 (Preparing product information) and *COBS* 14.2 (Providing product information to clients) also apply.

…

6.1 The right to cancel

Introduction

6.1.1 R Except as provided for in *BCOBS* 6.1.2R, a *banking customer* has a right to cancel a contract for a *retail banking service* (including a *cash deposit ISA* but excluding a *cash-only lifetime ISA*) without penalty and without giving any reason, within 14 calendar days.

[Note: article 6(1) of the *Distance Marketing Directive* in relation to *distance contracts*]

…

6.1.3 G …

6.1.3A G *Firms* are reminded that the cancellation rules in *COBS* 15 apply to the cancellation by a *banking customer* of a *cash-only lifetime ISA*.

…

Annex D

Amendments to the Client Assets sourcebook (CASS)

In this Annex, underlining indicates new text.

7 Client money rules

…

7.10 Application and purpose

7.10.1 R This chapter applies to a *firm* that receives *money* from or holds *money* for, or on behalf of, a *client* in the course of, or in connection with, its:

…

(4) *innovative finance ISA business*; <u>and/or</u>

<u>(5) *lifetime ISA business*;</u>

unless otherwise specified in this section.

…

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