Consultation Paper

# CP11/3**

Financial Services Authority

# Product disclosure

## Retail investments – changes to reflect RDR Adviser Charging and to improve pension scheme disclosure

FSA
Financial Services Authority

February 2011

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The Financial Services Authority invites comments on this Consultation Paper. Comments should reach us by 3 May 2011.

Comments may be sent by electronic submission using the form on the FSA's website at: www.fsa.gov.uk/Pages/Library/Policy/CP/2011/cp11_03_response.shtml.

**Alternatively, please send comments in writing to:**


Anita Flannigan
Conduct Policy Department
Financial Services Authority
25 The North Colonnade
Canary Wharf
London E14 5HS

**Telephone:** 020 7066 0348
**Fax:** 020 7066 0349
**Email:** cp11_03@fsa.gov.uk


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# List of acronyms used in this Consultation Paper

| | |
|---|---|
| ABI | Association of British Insurers |
| BAS | Board of Actuarial Standards |
| CBA | Cost benefit analysis |
| CFEB | Consumer Financial Education Body |
| COBS | Conduct of Business sourcebook |
| CP | Consultation Paper |
| DWP | Department for Work and Pensions |
| ETFs | Exchange traded funds |
| FSMA | Financial Services and Markets Act 2000 |
| IMD | Insurance Mediation Directive |
| KFD | Key features document |
| KFI | Key features illustration |
| MiFID | Markets in Financial Instruments Directive |
| OEICs | Open-ended investment companies |
| PRIPs | Packaged Retail Investment Products |
| PWC | PricewaterhouseCoopers |
| PSD | Product Sales Data |
| RDR | Retail Distribution Review |
| RIY | Reduction in yield |
| SIPP | Self-invested personal pension |
| SMPIs | Statutory Money Purchase Illustrations |
| TM1 | Technical Memorandum 1 |
| UTs | Unit trusts |

# 1 Overview

## Introduction

1.1 Our product disclosure rules are designed to mitigate the information imbalance which exists between customers and providers of retail financial services. Retail products are often complex and opaque in terms of the way they work, a customers will typically have little or no experience of the products, since they do not buy them regularly. The rules seek to ensure that firms give consumers enough information about a product's charges, risks and main features to enable them to make an informed decision. This should be done in a way that makes it easier for consumers to compare similar products. To meet our 'fair, clear and not misleading' requirement, the information should be clearly presented and written in plain and succinct language. It should also give the customer key information but not overload them with detail.

1.2 Against this background, this Consultation Paper (CP) brings together various product disclosure issues, relating to:

- changes to the key features illustrations (KFIs) that firms are required to provide to clients arising from the Retail Distribution Review (RDR) rules on Adviser and Consultancy Charging;
- disclosures in relation to personal pension schemes; and
- the potential replacement of monetary projections by inflation-adjusted projections for personal and stakeholder pensions (both individual and group) – we are seeking views on this before consulting in the second half of 2011.

1.3 Draft rules for the first two issues are contained in Appendix 1.

## Background

**1.4** The final RDR rules on Adviser Charging were published in March 2010, in PS10/6. These apply to all investments falling under the new definition '*retail investment product*', including individual personal pensions. The final rules on Consultancy Charging, which apply to group personal pensions, were published in June 2010, in PS10/10. The Adviser Charging rules ban the payment of commission for advised sales of investments, and the Consultancy Charging rules ban commission for all sales of group personal pensions. Product providers will need to amend their KFIs to reflect this by the end of 2012.

**1.5** For the reasons set out in paragraphs 1.8 to 1.11, the proposed changes only apply to our disclosure rules for personal pensions. However, product providers will still need to amend their KFIs to reflect the RDR ban on commission, and Chapter 2 of this CP looks at the implications of the RDR rules for product providers.

**1.6** Our proposals on disclosure requirements applying to personal pension schemes intend to clarify what a self-invested personal pension (SIPP) is and improve the quality and usefulness of personal pension scheme disclosure. They include requiring personal pension scheme operators to provide KFIs for most SIPP assets and to disclose whether or not they receive commissions and/or retain bank account interest on money held within the personal pension scheme. We are making these proposals as a result of a significant increase in the sale of SIPPs and thematic work showing deficiencies in the disclosure of charges, and that some consumers have been switched into SIPPs without good reason, thereby incurring extra charges unnecessarily.

**1.7** We have already said, in PS07/10 (published in October 2007), that we accepted the principle of amending pension KFIs to give projections in inflation-adjusted rather than nominal terms, and that we would consult on changing the basis used when we knew the outcome of a consultation by the Board of Actuarial Standards (BAS). That consultation showed a wide degree of support for changing the calculation basis, to bring it into line with that used in Statutory Money Purchase Illustrations (SMPIs). We are now seeking views on different approaches in preparation for consultation in the second half of 2011.

## European Union context

**1.8** In PS 10/6, which contained the final RDR Adviser Charging rules, we said that we had not yet made any rules or guidance on product disclosure, but would continue to monitor the European Commission's (the Commission's) progress with the Packaged Retail Investment Products review (PRIPs) and consult if appropriate at a later date.

**1.9** The PRIPs timetable and scope are not yet finalised, but the intention, subject to the outcome of consultation by the Commission, is that any new requirements will not apply to most personal pensions. Their consultation document[1], published on 26 November 2010, says:

1 Consultation by Commission Services on legislative steps for the Packaged Retail Investment Products initiative – http://ec.europa.eu/internal_market/consultations/docs/2010/prips/consultation_paper_en.pdf

> '….the Commission services are considering excluding pensions from the scope of the PRIPs work at this time. There is one possible exception, however: investments packaged as variable annuities appear to occupy a grey area between pensions (as generally understood) and investments. Views are therefore sought on whether these should be excluded or not.'

**1.10** The Commission sought views by the end of January 2011, and intends to put forward detailed proposals in the context of the reviews of the Markets in Financial Instruments Directive (MiFID) and the Insurance Mediation Directive (IMD).

**1.11** In view of this, we are only proposing changes to our disclosure rules for personal pensions (individual and group, including SIPPs). We are not proposing any changes at this stage for other packaged products. However, as noted above, product providers will still need to amend their KFIs to reflect the RDR ban on commission.

## Equality and diversity issues

**1.12** We have assessed the equality and diversity impact of our proposals. We do not believe that our proposals will give rise to any issues. However, we would welcome any comments respondents may have on this.

**1.13** We have assessed whether our proposals could lead to discriminatory behaviour by regulated firms. Product providers in the life and pensions market take a number of factors into account when deciding whether to offer specific products to particular individuals. The extent to which these factors are taken into account will vary between firms. However, we do not consider that our proposals would lead firms to alter their behaviour in this respect.

**1.14** We would encourage firms (both product providers and adviser firms) to consider how they can make their product literature more accessible for people with disabilities, to meet their own responsibilities under the new legislation.

## Structure of this CP

**1.15** The CP chapters cover:

- Chapter 2 – changes to product disclosure arising from RDR Adviser and Consultancy Charging;
- Chapter 3 – disclosure requirements applying to personal pension schemes (including SIPPs); and
- Chapter 4 – possible future changes to pension illustrations to make an allowance for inflation.

**1.16** Annex 3 contains examples of key features illustrations using new formats described in Chapters 2 and 4.

## Timetable

**1.17** This consultation ends on 3 May. We plan to publish a Policy Statement giving feedback in the second half of 2011, and any final rules will come into force as follows:

- the rules to reflect the RDR Adviser and Consultancy Charging requirements – 31 December 2012; and
- the rules on pension scheme disclosures – 6 April 2012.

**1.18** We intend to consult on the move to inflation-adjusted projections in the second half of 2011.

## Who should read this paper?

**1.19** The whole of this CP will be of interest to pension scheme operators and firms advising on or arranging personal pensions, as well as consumers and consumer bodies. The sections of Chapter 2 on the impact of the RDR rules for investments generally will also be of interest to product providers whose products include retail investment products other than personal pensions.

# 2

# Changes to product disclosure arising from RDR Adviser and Consultancy Charging

## Introduction

2.1 The requirements for the preparation and provision of key features documents and key features illustrations in Chapters 13 and 14 of our Conduct of Business sourcebook (COBS) currently apply only to packaged products, and we are not proposing at this stage to change the scope of application to the wider definition in the RDR rules of *'retail investment product'*. The wider definition is explained in Chapter 2 of CP09/18, published in June 2009.[2]

2.2 This means that (in relation to product disclosure) products falling within the new wider definition, but not within the definition of 'packaged product', will continue to be subject only to the overarching 'fair, clear and not misleading' requirement in COBS 4.2.

2.3 The product disclosure rules for life policies, personal pensions and stakeholder pensions are set out in COBS 13 and 14. Subject to certain exemptions, Chapter 13 requires product providers to prepare a key features document (KFD) and key features illustration (KFI) for each product, and Chapter 14 sets out rules for providing product information to clients.

2.4 This chapter looks at the implications of the Retail Distribution Review (RDR) rules on Adviser Charging and Consultancy Charging for our product information rules and the changes product providers (including SIPP operators) will need to make if they facilitate these payments. These proposals are separate to the proposals we are making, in Chapter 3 of this CP, to amend certain disclosure requirements applying to personal pension schemes.

2 P09/18 – *Distribution of retail investments: Delivering the RDR* (June 2009).

**2.5** We expect that, due to the tax advantages of pensions, and because they are the most common regular payment product, the facilitation of adviser charges through the product will be most prevalent within personal pensions and will be offered by most personal pension providers. In turn, these will be the products where clarity on the effect of facilitated adviser and consultancy charges will be of most value to consumers. Providers of personal pensions will need to be able to cope with different Adviser and Consultancy Charging structures if they choose to facilitate the payment of adviser and consultancy charges.[3]

**2.6** The RDR Adviser Charging rules do not apply to Basic Advice or to non-advised sales, so the proposals in this chapter will not be relevant to such sales.

**2.7** Approximately 60% of stakeholder pensions are sold without advice, so many of these transactions will be unaffected by the Adviser Charging changes. In addition, the overall charge cap on stakeholder pensions means that it is likely to be difficult to facilitate an adviser or consultancy charge. However, if a stakeholder pension is sold with advice, and the advice does not fall under Basic Advice, the Adviser Charging rules apply in full.

**2.8** The text of the amendments to our product information rules can be found in Appendix 1. They will be of interest primarily to firms, but also to consumers and consumer bodies, as they will affect the information provided to clients before they buy investments, including personal pensions.

**2.9** The proposed rule changes would come into force at the end of 2012, at the same time as the Adviser Charging, Consultancy Charging and other RDR rules.

**2.10** A few proposed changes to both sets of rules were published in October 2010, in Chapter 5 of Quarterly CP10/22 (consultation ended on 6 December).

## Implications of the RDR rules for investments other than personal pensions if there are no changes to COBS 13 and 14

**2.11** COBS 13.4.1R currently requires a key features illustration to include ‘appropriate charges information’, as set out in COBS 13 Annex 3, 1.1R. This must include ‘a description of the nature and amount of the charges a client will or may be expected to bear’, together with an ‘effect of charges’ table and ‘reduction in yield’ information.

**2.12** Once the RDR rules are in force, product providers will need to make changes to their illustrations, to reflect the introduction of Adviser Charging and removing allocations of more than 100%:

- a product provider that chooses not to facilitate payment of adviser charges will only need to show product charges;

3 According to ABI statistics, GPPs account for 40% of life insurers’ regular premium business.

- a product provider that decides to facilitate payment of adviser charges will need to describe the product charges and adviser charges separately. They must also reflect total charges (i.e. product charges and the actual adviser charge for the customer in question) in the 'effect of charges' table and 'reduction in yield' statement. This is the baseline used for provider costs in the cost benefit analysis (CBA) in PS10/6 (paragraphs 16 to 19 of Annex 1).

**2.13** We do not propose to set out how these charges should be described. This will allow providers flexibility to meet the new regime in a way that is most appropriate and cost-effective for them.

## Requirement for new illustration if facilitated adviser or consultancy charges start or increase – all retail investment products, including pensions

**2.14** In PS10/6, it was confirmed that consumers may decide to terminate an ongoing advice service. Equally, it is possible that a consumer may decide to start an ongoing advice service or move to a different adviser and agree a new adviser charge, which is facilitated through an existing product. The start of facilitated adviser charges, or a non-contractual increase in such charges, will reduce the final benefit from a product. We propose to add COBS 13.1.1AR and COBS 14.2.1AR to require the issue of a KFI in these circumstances. The new rules also apply where there is a new or increased consultancy charge.

**2.15** Currently, the rules allow for in-force projections to omit a projection at the intermediate rate of return. In view of the additional requirement to provide a new illustration when facilitated adviser charges start or change, we propose to remove this concession. This will have the advantage of making pension re-projections more consistent with Statutory Money Purchase Illustrations (SMPIs).

## Proposed amendments for personal pensions

**2.16** Given that the European Commission's PRIPs consultation suggests that pensions are likely to be out of scope, we propose to make changes for individual personal pensions to reflect the new RDR rules, including changes to the structure of illustrations, which are set out in Appendix 1.

### Individual personal pensions

**2.17** Product providers that facilitate payment of adviser charges and consultancy charges will be required by our proposed new rules to describe product and adviser charges separately. The KFI must show the payments before any adviser charges or consultancy charges are deducted.

**2.18** We are proposing a new format for the charges information in the KFI, showing the effect of each type of charge in the 'effect of charges' table and 'reduction in yield' information. An example is given in Annex 3.1.

**2.19** Product providers that choose not to facilitate the payment of adviser charges for all or specific products will need to show only product charges in future for those products, using the proposed new format.

**2.20** The purpose of the additional requirement is to ensure that product charges are shown in the same way by providers that do and do not facilitate the payment of adviser charges. This will enable consumers to:

- compare product charges on a consistent basis; and
- understand the effects of facilitating payment through the product in comparison to payment of the adviser charge separately.

**2.21** The nature of these changes can be considered from both a calculation and presentational perspective. The proposal to show the combined effect of product and adviser charges in the 'effect of charges' table is comparable to the current (pre-RDR) position, where illustrations show the overall effect of charges, including the cost of adviser remuneration. At the same time, the requirement to show the effect of product charges separately is no different to a 'zero commission' KFI, which many firms currently provide. The costs of the requirement to show just product charges were included in PS10/6.

**2.22** Previous research[4] has shown that consumers have difficulty in understanding the 'effect of charges' tables, partly because of the column labelling. In 2003, Consumer Research 18 (CR18)[5] indicated that a four-column 'effect of charges' table was most effective in communicating messages about charges. It also suggested that changes to the columns and to their labelling would improve understanding. We were not able, because of the high costs of IT changes given to us by firms, to demonstrate that sufficient benefits would result from changing the 'effect of charges' table. Now, given that firms must amend their systems for Adviser Charging, we believe a strong case can be made. If we make proposals in future to introduce inflation-adjusted projections, this will reduce the overall costs of each change, as firms will be able to make the changes at the same time.

**2.23** We propose that the 'effect of charges' table shows the effect of product and total charges separately. The other changes described below mean that there will be no more than four compulsory columns. This will ensure that the table can continue to be presented using current printing formats and paper size.

**2.24** As we are proposing a change to the 'effect of charges' table, we are taking the opportunity to improve consumer understanding of it, in line with the findings of CR18 and other research, as follows:

4 For example *Key Features Documents – the practitioner's view* by H2B May 2000.
5 www.fsa.gov.uk/pubs/consumer-research/crpr18.pdf – The development of more effective product disclosure – see Chapter 6.

- provide better introductory explanations of what the tables are illustrating;
- use more descriptive headings – for example, consumers understand 'charges' better than 'deductions'; and
- reduce the length of the tables, by requiring rows only for the year of the chosen retirement date and the first five years of the pension. The first five years are included because this is the period when exit charges and adviser charges are likely to have most impact.

2.25 Where adviser charges are facilitated, we are also proposing that two reductions in yield are shown; one for just product charges and one for all charges.

2.26 The example of a KFI in Annex 3.1 reflects the proposed changes to COBS 13.

### Group personal pensions

2.27 PS10/10 set out our final rules for Consultancy Charging for GPPs. An industry-wide working group, under the chairmanship of the Society of Pension Consultants, is looking at the factors adviser firms might consider when agreeing consultancy charges with employers and the allocation of the charges between employees.

2.28 Our general proposal is that, where product providers provide personalised illustrations for prospective scheme members, this should be done in the same way as we propose for individual personal pensions. This would have the same benefits as set out in paragraph 2.20 for individual personal pensions.

### Generic illustrations

2.29 COBS 13.4.2R says that a KFI must not include a generic projection unless there are reasonable grounds for believing that the projection will be sufficient to enable a retail client to make an informed decision about whether to invest. Guidance in COBS 13.4.3G says that a generic illustration is unlikely to be sufficient to enable a retail investor to make an informed decision about whether to invest if the premium or investment returns on the product will be materially affected by the personal characteristics of the investor.

2.30 We consider that a generic KFI will not be appropriate where adviser charges are being facilitated and those charges vary from investor to investor. A generic projection will be unable to reflect appropriately the range of different charging arrangements possible. So we are proposing a new rule saying that generic projections cannot be used in these cases.

2.31 Where Consultancy Charging is used in the GPP market, it is possible that the charge could be taken in different ways for different members of a GPP, or that the impact of the charging structure could vary in relation to the characteristics of individual members – for example, their age or level of contributions. In such cases, the charges basis in a generic projection would not be appropriate for all the members, and a potentially large number of

variables would need to be projected to enable individual members to make an informed decision. So we consider that a generic projection would not be appropriate in such cases.

2.32 There may be circumstances where generic projections may be appropriate for GPPs – for example, if the consultancy charge is structured in the same way for all individuals in the arrangement. This would mean that projections that are generic at an arrangement level would allow the individual members to make informed decisions. It may also be appropriate to use generic projections for sub-groups of individuals within an arrangement. We propose to add a rule to say that generic projections can only be used for GPPs where any consultancy charge that is being facilitated from the product is being taken in a consistent way for all investors within the product.

2.33 However, we are not convinced that firms would wish to make use of such an option if it were permitted. From our discussions with the industry we understand that most use individualised projections within GPPs. So, we are also asking a broader question to find out whether firms consider there to be a need for generic projections to be permitted and, if so, in what circumstances.

2.34 Generic projections are currently allowed under COBS 13.4.2R for direct offer financial promotions. So financial promotions that specify the means of response (which can be an application form included in the communication, or an indication of how to access the application form – for example, online) can include generic projections. We have not identified any issues arising in this area. However, to ensure that this exemption is not used inappropriately once the Adviser Charging rules are in force, we are narrowing the exemption to cover only those cases where the direct offer financial promotion does not include a personal recommendation.

## Structured life products

2.35 We assume that a fee will be taken from lump sums before the purchase of structured products and so these products will not facilitate payment of adviser charges.

2.36 We are taking this opportunity to propose a simplification of our rules where a structured product has an underlying life policy. These products perform in a similar way to structured products with different underlying assets and are typically explained in the same way: by the use of example scenarios. However, in view of the underlying life policy, the KFD currently also has to include a KFI (three projections, an 'effect of charges' table and 'reduction in yield' information), which often does not aid understanding of the product. So, we propose to remove the current KFI requirements for structured life products.

## Moneymadeclear comparison tables

**2.37** A significant number of firms submit product price information to the Moneymadeclear comparative tables, which are now owned by the Consumer Financial Education Body (CFEB). These tables enable consumers to compare the costs of products. Currently, information is submitted to the tables using charges that make the assumption that the maximum rate of commission payable by the product provider will apply. Following the implementation of the RDR, product charges for advised sales of retail investment products will no longer include an allowance for commission payments. We have met CFEB to discuss possible changes to the tables, which would mean that only product charges would be shown from 2013. We would welcome feedback from the industry on this proposal.

## Questions

**2.38** We would welcome feedback on our proposals, in response to the questions below:

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

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

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

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

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

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

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

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

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

## Cost benefit analysis

**2.39** When proposing new rules, or amendments to rules, we are obliged (under section 155 of FSMA) to publish a cost benefit analysis (CBA), unless we consider that the proposals will give rise to no costs or to an increase in costs of minimal significance.

### The market

**2.40** Data from the Association of British Insurers (ABI) shows that 1.77 million personal pension contracts – including self-invested personal pensions (SIPPs) – and stakeholder pension contracts were issued in 2009. Single premium pension investments totalled £14.8 billion, while new regular premium contracts for £2.8 billion per annum were entered into. Note that not all providers and SIPP operators are members of the ABI and the data double counts contracts that are for both single and regular premiums.

**2.41** Our internal Product Sales Data (PSD) indicates that approximately 150 companies are active in the pension market. The top five pension providers account for more than half the market by number of sales and, together with the second tier providers, cover more than 80% of the market. The small providers share just under 20% of sales, with three-quarters of these writing fewer than 1000 policies each in 2009 and the smallest 50 companies each writing fewer than 100 pension contracts during 2009.

### Compliance costs to firms

#### *a) Initial one-off costs*

**2.42** We understand that the main cost driver for making changes to key features illustrations (KFIs), including those for GPPs, is the one-off system upgrade cost. The proposed regulatory requirements mean changes to illustrations systems for personal pension contracts and, if applicable, stakeholder pensions contracts. Previous surveys of compliance costs in this area, notably the 2006 PricewaterhouseCoopers (PWC) report *Compliance costs of proposed changes to the investment product disclosure regime*,[6] showed very wide

6 www.fsa.gov.uk/pubs/consumer-research/compliance_costs.pdf

cost estimations for various changes to life and pensions disclosure documents – some of which we are now proposing to require. The report reflected the wide differences in firms' systems – for example, some have different systems for pensions and life products. The costs will also have reflected the ease with which firms can change their systems, which in turn is partly dependent on the relative age of their KFI engines and printer software. In general, the older the system the more expensive it will be for firms to make changes.

**2.43** To inform our cost analysis, we obtained some high-level estimates from a number of firms based on our changes to point-of-sale KFIs. We received responses from some of the largest pension providers, which showed that wide variations in costs still exist. The estimates varied from £250k to £1.1m, with the average being £775,000. We increased these estimates to allow for the cost of the proposed changes to in-force projections as well. We have no evidence to suggest that the costs for making the appropriate adjustments to in-force projection systems should be any more than those for point of sale systems for the products that will be available post-RDR. We therefore doubled the point of sale estimates we received. However, we expect some consolidation of administrative systems for products in the marketplace post-RDR, which could have the effect of reducing overall costs.

**2.44** We used the costs from firms, together with the relevant revalued costs from the 2006 PWC report, to estimate the costs to industry of our proposals. The PWC figures included the cost of changes to both point-of-sale and existing business systems. The methodology behind the PWC report estimated costs separately for small, medium and large firms based on the value of business written. We have used the same methodology to split the costs by size of firm on this occasion. The relative size of these costs is therefore unchanged from the PWC report for changes of a similar nature. We have no reason to believe that the relative factors may have changed since 2006.

**2.45** Using PSD as a guide to the number of firms writing pensions contracts, we have applied the cost per firm to the number of firms in each category based on the relative number of pension contracts written. We therefore estimate the total one-off costs to the industry to be no more than £20m (see table below).

**Table 1**

| Firm size | No of firms | Cost per firm £ | Total £ m |
|---|---|---|---|
| Large | 6 | 2,320,000 | 13.9 |
| Medium | 15 | 345,000 | 5.2 |
| Small | 128 | 7,000 | 0.9 |
| Total | 149 | | 20 |

**2.46** We consider that the costs shown in Table 1 are maximum possible costs, as we expect that costs are likely to be lower than the revalued figures reported by PWC for changes of this nature. Firms may potentially experience lower costs because:

- the PWC costs cover all contracts, not just pensions;
- the costs from these specific proposals incurred by firms may be lower, as other changes are being made to illustration systems simultaneously, which may lead to an overall consolidation of a firm's illustration systems post-RDR; and
- not all firms will choose to offer facilitated adviser charges.

**2.47** We have sought to minimise costs by basing our proposals on the existing calculation routines and print formats. As the changes will be implemented as part of the overall RDR Programme, which entails many firms making changes to their products to facilitate varying adviser charges, we believe there will be cost savings compared to making these changes independently.

**2.48** We will be consulting in the second half of 2011 on introducing inflation-adjusted projections from 1 January 2013. If these changes go ahead, firms will be able to make them at the same time as the RDR changes and so reduce the aggregate costs. The costs below ignore this effect.

**2.49** The costs fall into the following main categories:

- The cost of describing the product and adviser charges separately in life and pensions KFIs. Firms that facilitate payment of adviser charges will have to do this regardless of any changes to our disclosure rules, so these costs were part of the cost benefit analysis published in CP09/18 and PS10/6.
- The cost to show the impact of adviser charges for personal and stakeholder pensions in the 'effect of charges' table and 'reduction in yield' presentation. The PWC report provided indicative costs for amending the table and the column headings and for providing explanatory text, which we have adapted using recent data from firms. Some of the changes to reduce the size of the table are optional, so firms will be able to assess for themselves whether it is worthwhile to take advantage of this opportunity.
- Costs for changes to systems to illustrate the effect of the introduction of adviser charges and an increase in adviser charges for in-force products. We believe there are wide differences in current practice across firms, as well as in the systems they use. Some firms use the same KFI engines as used at the point of sale, whereas others have separate systems. For the former, the additional cost is likely to be minimal, whereas for the latter it will entail changes similar to those in the previous indent.
- Costs arising from the reduced scope to produce generic rather than personalised KFIs. However, we believe these to be negligible, because very few firms took advantage of the extra scope to produce generic KFIs that was allowed by the COBS rules introduced in 2007.
- The cost of removing KFIs from structured life product printed literature will be negligible, because firms already have to revise their literature for each issue (or tranche) of their product.

- We do not expect the proposal relating to the narrowing of the exemption for the use of generic projections for direct offer financial promotions to create incremental compliance costs, because we are not aware of firms making use of it currently.

*b) Ongoing costs*

2.50 Once KFI systems have been updated we expect the extra costs of maintaining the components we are proposing to change to be minimal, based on previous analysis of the cost of changes to KFIs in the 2006 PWC report.

### Direct costs to FSA

2.51 We do not expect any additional costs to be incurred by regulators as a result of these changes.

### Market impacts

2.52 The cost data in relation to the annual value of new policies does not suggest that smaller and/or medium-sized firms will be discouraged from providing policies with facilitated adviser charges. The costs shown in Table 1 indicate that costs vary in relation to the size of the firm, with small and medium-sized firms incurring substantially lower costs than larger firms. Further, the main cost is a one-off cost. This suggests that it is unlikely that the cost of these proposed changes would discourage firms from facilitating adviser charges.

### Benefits

2.53 From 2013, consumers will agree the adviser charge and can choose whether this should be paid as a fee (or fees) or be facilitated through a product. To enable effective price comparison between pension providers and advisers from 2013, KFIs will need to illustrate separately the impact of different adviser charging options. This can be done if the effect of product charges and total charges (including facilitated adviser charges) is shown in the 'effect of charges' table and corresponding 'reduction in yield' figures.

2.54 We consider that the changes proposed will deliver the following benefits.

- The proposed changes consistent with CR18 will improve clarity for consumers. CR18 indicated that figures showing the value of the pension fund, both with and without any charges, aided consumer understanding of the 'effect of charges' table. CR18 showed that consumers were clearly able to see that the difference between columns represented the effect of charges. We did not previously introduce this change because of the costs of making the change in isolation, but, as we are revising the table, there is a much stronger case to improve the content and the column headings now. CR18 also showed that consumers understand the word 'charges' more readily than 'deductions'. As part of the revamping of the table we are also proposing that firms explain what the table seeks to portray.

- The extension of the 'reduction in yield' statement is consistent with the changes to the 'effect of charges' table and will aid better consumer understanding in a similar way. This should help consumer decision making about product purchases and how to pay adviser charges.
- Ensuring consistency with Moneymadeclear comparative tables, which will show only product charges, will contribute to consumer comparability.
- Clarification on the use of generic projections in a RDR environment should assist in ensuring that they are only used where they are appropriate.
- Excluding structured life products from the KFI rules will enable more consistency across all types of structured products. This will also reduce the potential for confusion where a life structured product's possible performance is adequately explained – for example, through example scenarios – but then also has a generic KFI (three projections, an 'effect of charges' table and a 'reduction in yield' percentage).

**2.55** Overall, we expect that our proposals will support the aims of the RDR. They will enable a consumer to better understand the costs of different advice options that may become available in the market. Therefore, the separation of product manufacturing charges and adviser charges will improve transparency, which may facilitate better comparability of pension and adviser offerings by consumers.

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

# 3

# Disclosure requirements applying to personal pension schemes (including SIPPs)

**3.1** In recent years, the product sales data submitted by firms shows that sales of self-invested personal pension schemes (SIPPs) have grown significantly. They are no longer niche products. In particular, we have seen a dramatic increase in non-advised sales of SIPPs, which now outnumber advised sales of SIPPs. We attribute this to increased consumer interest in pension draw-down options, wider investment choice and marketing by firms inviting investors to take control of their pensions.

**3.2** Some personal pension schemes are marketed and sold as SIPPs, even if they offer only limited investor choice from within a restricted range of asset classes. Our view, reinforced by informal consultation with industry stakeholders, is that many SIPPs, once in use, are virtually indistinguishable from other personal pension schemes.

**3.3** Our pensions switching thematic review, published in December 2008, showed that some consumers were switched into SIPPs without good reason, thereby incurring extra charges unnecessarily. In addition, our reviews of the SIPP charges disclosure documents have revealed deficiencies.

**3.4** The Association of British Insurers and the Association of Member Directed Pension Schemes responded to our concerns about disclosure by publishing a joint good practice guide for improving the quality and comparability of SIPP fee schedules. We welcome this, but we believe it is also necessary to clarify firms' obligations and to update our rules to recognise the change in the marketplace. Our aim is to better help consumers or their advisers to identify the most appropriate pension option.

3.5 We propose to clarify what a SIPP is and amend the way the COBS disclosure rules apply to firms selling personal pension schemes. These proposals aim to help further improve the quality and usefulness of personal pension scheme disclosure, remove the distinction in our rules between comparable SIPPs and non-SIPP personal pension schemes, and reduce the potential for the mis-selling and mis-buying of SIPPs.

3.6 We propose to:

- amend the disclosure rules relevant to key features illustrations (KFIs) for personal pension schemes and replace the exemption applying to certain SIPPs with one that will apply to assets that are (or will be) commercial property, commodity investments, 'synthetic' exchange traded funds (ETFs), or shares (that are not shares in an investment trust);
- introduce a rule to require personal pension scheme operators to disclose whether or not they receive commissions and/or retain bank account interest on money held within the personal pension scheme, and to require this information to be disclosed alongside information about fees, costs and charges payable, and bank interest rates receivable, by the client; and
- amend the disclosure rules that apply to the effect of charges and the reduction in yield (RIY) information, so that disclosure of this information is required for personal pension schemes, but not for assets that are (or will be) commercial property, commodity investments, 'synthetic' ETFs or shares (that are not shares in an investment trust).

3.7 In proposing these amendments, we aim to encourage a more transparent personal pension scheme market, and to facilitate consumers or their advisers making better purchasing decisions. The text of the amendments to our rules can be found in Appendix 1. These amendments will be of interest both to firms operating or advising on SIPPs, and to consumers.

## The disclosure rules applying to personal pension schemes

3.8 A 'self-invested personal pension scheme' is defined in the FSA Handbook Glossary as: 'an arrangement which forms all or part of a personal pension scheme, which gives the member the power to direct how some or all of the member's contributions are invested'.

3.9 The scope of this definition is wide. It allows any pension scheme arrangement that is not an occupational pension scheme or stakeholder pension scheme, and that gives members even the most limited power to direct how contributions are invested, to be called a SIPP. So schemes that offer limited fund choice from a single provider, and schemes that offer an unrestricted (usually within HMRC limits) range of asset classes, can both be SIPPs. In practice, many non-SIPP personal pension schemes and some stakeholder pensions give access to a range of external funds (such as investments in open-ended investment companies (OEICs) and unit trusts (UTs)).

**3.10** We are not proposing to amend the existing SIPP definition. But we are clarifying that any personal pension scheme can be called a SIPP, unless the arrangement gives the member no investment choice at all.

**3.11** As SIPPs are a type of a personal pension scheme, and a 'designated investment' specified in the Regulated Activities Order[7], disclosure rules apply, unless an exception is available. At present, scheme operators who brand their scheme as a SIPP are exempted from disclosure rules that require a projection in a KFI (for most SIPPs[8]) and the provision of an 'effect of charges' table and RIY information (for any SIPP).

**3.12** The key disclosure requirements applying to pensions are in Chapters 2 and 13 of the Conduct of Business sourcebook (COBS). In Chapter 2 we require firms to disclose the costs and associated charges applying to all designated investments (including SIPPs) so a client can make informed investment decisions.[9] This high-level rule contains wide disclosure requirements, but does not require the disclosure of any bank-related commissions received or interest retained. In COBS, Chapter 13, we exempt SIPP operators from the requirement to include a projection in the KFI for most SIPPs.[10] When a projection is required, an 'effect of charges' table and RIY information are not required in a KFI for any SIPP.[11] Despite this, we have observed that most SIPP operators produce KFIs anyway.

## Firms to provide KFIs for most SIPPs

**3.13** As it is important for consumers to have the effect of charges and RIY information when assessing pension drawdown options, we consider that our regime should, in general, require all personal pension scheme disclosure documents to include this. We consider projections a useful tool for consumers. Even though they are clearly a speculation and not a prediction, they can show the potential for variable returns and may help consumers with planning for future needs. We also take the view that RIY information is one of the key figures intermediary firms must consider when comparing providers.

**3.14** We recognise that personal pension scheme operators may not always know exactly what the actual assets, and thus the investment costs, will be. However, this difficulty can be overcome by asking about a scheme member's intentions and making reasonable assumptions. This is the approach we expect personal pension scheme providers to adopt when meeting the existing requirement to produce KFIs for contracted-out or pension drawdown illustrations.

**3.15** To encourage greater clarity and comparability between KFIs, while taking a pragmatic approach in allowing exemptions where it may be awkward or costly to provide meaningful KFIs for certain investments, we are proposing to revise the existing

7 Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (SI 2001/544), article 82(2).
8 The 'projection' exemption does not apply if income withdrawals are being taken from the SIPP, or if the SIPP is being used to contract out of the State Second Pension.
9 COBS 2.2.1R
10 COBS 13.1.1R and 13.4.4R
11 COBS 13 Annex 3, 1.3 R (3)

exemptions. We are proposing that exemptions to the disclosure rules are only available for underlying assets that are (or will be): commercial property, commodity investments, shares (that are not shares in an investment trust), or units in a synthetic ETF (a synthetic ETF is one that does not physically replicate an index by acquiring shares).

**3.16** This approach takes account of the inherent volatility of ETF and share prices, and the unpredictable market trends that apply to commercial property and commodity investments. It means that scheme operators, offering schemes investing only in commercial property, commodity investments, shares (that are not shares in an investment trust), or units in a synthetic ETF, will not need to produce KFIs. However, if an operator offers schemes investing in cash, life policies, property funds, units trusts and shares, then KFIs will need to be prepared, but only for those investments that are not investments in shares.

**3.17** Scheme operators will remain free to produce KFIs for investments in commercial property, commodity investments, shares (that are not shares in an investment trust), or units in a synthetic ETF should they wish to do so.

**3.18** This approach allows firms to continue to describe their personal pension schemes as SIPPs. It also maintains the position for bespoke SIPPs that invest in specific commercial property or commodity investments and/or individual shares or ETFs tailored to individual SIPP scheme members. However, providers that offer more mainstream SIPP products may need to provide projections to a greater extent than currently.

**Q11:** Do you agree that it is proportionate and appropriate to revise our rules so that KFIs and projections are required for all investments held within a personal pension scheme, other than investments in commercial property, commodity investments, synthetic ETFs or shares (that are not shares in an investment trust)? Do you think that other investment categories, including investments that are not also specified in the Regulated Activities Order, should also be able to benefit from this exemption? If so, which ones and why?

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

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

## Disclosure of bank commissions received and bank interest retained

**3.19** In conducting our reviews, we saw no KFIs/ projections that catered for the significant funds held in bank accounts. If cash funds had been included, given the low interest rates offered (less than 0.05% is typical), the growth rates shown would have been near zero, or negative. This finding is in line with the generally inadequate projections and effect of charges/RIY information we saw in KFIs for SIPPs, where it appeared that optimistic assumptions were often made about investment growth and charges.

**3.20** When cash is held within a SIPP scheme, members are not always offered a choice of bank accounts. Cash can be pooled and held across one or more accounts, which may have differing terms depending on the commercial arrangement between the SIPP operator and deposit-taker. In addition to receiving commissions and account set-up fees, some SIPP operators retain some or all of the interest paid on money held in these accounts, although others pass on interest in full. Most firms explain the interest position to scheme members, but this does not always adequately disclose the interest rate, how it is determined, or where it can be found. This lack of information can mislead consumers and make it difficult to shop around. Also, firms do not always detail interest rates in printed literature, although they may show it on their websites. And, currently, our rules impose no express requirement on firms to disclose that interest is retained, or the amount retained.

**3.21** There have been times when around 30% of SIPP funds have been held in cash, either on an interim basis or as an investment choice. Even in a low-interest environment, this money will generate significant interest. SIPP operators that retain interest earned on cash funds may either treat it as additional income or use this money to offset other explicit SIPP charges. If opting to offset the interest retained, this can mean a SIPP operator can market its product as one with low charges.

**3.22** Personal pension scheme operators receiving commission from third parties (such as banks, in relation to SIPP banking arrangements) must comply with the inducement requirements in COBS.[12] This obliges a firm to ensure that fees or commissions do not impair its duty to act in the best interests of the client. A firm that wishes to retain any interest derived from its holding of client money is likely to need to obtain a client's informed consent (see our rules in the Client Assets sourcebook[13] – the general law's position is similar).

**3.23** A personal pension scheme operator will typically act as an agent of the customer. As such, they have a fiduciary duty not to act for their own benefit by making and retaining a secret profit from the customer's money – which would otherwise be due to the customer – without disclosing this and getting the customer's informed consent.

**3.24** In our view, where this happens, there should be clear disclosure of the fact that interest is retained and the amount, which is not always the case at the moment. If disclosed, a customer's consent to this arrangement would be demonstrated by that customer entering into the personal pension scheme arrangement on that basis.

12 COBS 2.3.1R
13 CASS 5.5.30R

**3.25** To ensure that firms deliver fair outcomes to all consumers, we propose to introduce a rule, as part of the disclosure of all costs and associated charges, that firms must show whether or not they retain interest or receive commissions on cash held within a personal pension scheme. For it to be most useful, we propose that this information, about commissions and whether or not bank interest is retained, should be disclosed alongside the information about the interest consumers will receive and information about other costs and associated charges.

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

## Transition period

**3.26** As a result of these proposals, some firms will need to revise their literature and websites. Some firms may also want to reconsider their business models and charging structures where, for example, profitability relies on interest retention. To give firms sufficient time, we are proposing that these rules come into force on 6 April 2012.

## Cost benefit analysis

**3.27** Section 155 of FSMA requires us to perform a cost benefit analysis (CBA) of our proposed requirements and to publish the results.

### Firms to provide enhanced disclosure for most SIPPs

**3.28** Extending the applicability of the COBS projection rules will result in one-off and ongoing costs for firms that operate self invested personal pension schemes (where the investment is not in commercial property, commodity investments, synthetic ETFs or shares (that are not shares in an investment trust)). We estimate that up to 120 firms will be affected by these proposals. We also consider that some of these firms will be affected more than others, given their different business models.

*One-off costs*

**3.29** Some 50-60% of SIPP operators already produce KFIs. In addition, as most personal pension scheme or SIPP operators offer products that facilitate pension drawdown or accept contracted-out funds, to comply with existing requirements they should already have the ability to produce compliant KFIs. So, we estimate that almost all affected firms will, or

should, already have the means of producing these KFIs, therefore we estimate one-off additional costs to the industry to be minimal.

*Ongoing costs*

**3.30** SIPP operators will incur additional ongoing costs, as they will need to prepare additional KFIs. It is difficult to predict the future size of the SIPP market. Industry commentators indicate that this market is expected to continue growing, and the number of SIPPs sold (around 600,000 in total in 2010) may reach 1,000,000 by 2015. These figures indicate that up to 80,000 SIPPs may be sold annually. If we assume that around 20,000 of these SIPPs will not be affected by the proposal (because they involve contracting out or drawdown) this leaves 60,000 additional KFIs that will need to be produced. Assuming the average cost of preparing each KFI is £2[14], we estimate the ongoing cost to the industry to be in the region of £120,000 per annum. Depending on industry competition, some or all these costs could be passed to consumers. However, as 50-60% of SIPP operators provide their clients with KFIs already, this figure is an over-estimate.

*Benefits*

**3.31** For the benefits of this proposal to arise, consumers or their advisers compare SIPPs and other products, and this, in turn, may lead to more suitable decisions, so consumers should benefit. However, we do not expect this effect to be significant, as more than half of the providers already provide KFIs and we do not have conclusive evidence that those who take out a SIPP from providers who currently provide KFIs have systematically made better purchasing choices than those who take out a SIPP from providers who currently do not provide KFIs. Therefore, we are making a conservative assessment of the magnitude of the benefits.

### Firms to disclose commissions and retained SIPP bank account interest

**3.32** Requiring SIPP operators to provide specific disclosure of commissions and retained SIPP bank account interest (alongside information about charges payable and bank interest rates receivable) will incur costs.

*One-off costs*

**3.33** This disclosure requirement will not affect SIPP operators that do not retain bank interest or accept commissions, other than the minimal cost of revising KFIs to say that they do not retain interest, if they do not say this already. Our initial assessment indicates that around 75 firms may retain interest or receive commission and that these firms handle around 50% of the SIPPs sold (around 600,000 in total) and will incur one-off costs. Some firms' disclosure documents will need to be revised and reprinted. The estimated cost of revising these documents is £800 per firm (total industry cost: 75 x £800 = £60,000); and the estimated cost of reprinting these documents is £2 (total industry cost: 300,000 x £2 = £600,000).

14 FSA estimate based on industry responses.

*Ongoing costs*

3.34 There will be additional ongoing costs associated with providing new consumers with up-to-date information on commission and/or bank interest retention along with the KFI. The cost of providing KFIs was estimated in the previous section.

*Benefits*

3.35 The disclosure of bank commissions and retained interest will help consumers and their advisers gain a better understanding of the overall costs and benefits applying to different SIPPs. As a result, some consumers may make better-informed purchasing decisions. However, we do not expect this effect to be large, as research indicates that consumers typically do not pay sufficient attention to product charges when purchasing investment products. In addition, some consumers are already aware of what interest they receive on the cash they hold in SIPPs (but currently, they do not necessarily know how much operators retain).

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

# 4

# Possible future changes to pension illustrations to make an allowance for inflation

## Introduction

**4.1** Statutory Money Purchase Illustrations (SMPIs) were introduced in 2003 by the Department for Work and Pensions (DWP). Members of defined contribution pension schemes must receive one each year. Like the point of sale projections required by our rules, they seek to give an indication of the possible pension income at retirement. The SMPI is intended to stimulate an existing member to consider the adequacy of their pension provision.

## Differing assumptions

**4.2** The assumptions used in SMPIs are set on behalf of the DWP by the Board of Actuarial Standards (BAS) and are contained in their Technical Memorandum 1 (TM1). BAS review the memorandum regularly and their last consultation ended in June 2010.

**4.3** TM1 requires a single pensions figure in 'today's money' by using a maximum growth rate of 7% that is discounted by 2.5% inflation. This is intended to help members of defined contribution pension schemes consider the adequacy of their pension provision. Although the growth rate matches our central assumption, the allowance for inflation means that the projected pension is usually significantly lower than that provided at point of sale. In addition, TM1 allows little personalisation – for example, it requires that both contributions and the annuity increase in line with inflation.

4.4 Our rules (in Chapter 13 of COBS) apply to personal pension schemes and stakeholder pension schemes. They require projections using three different rates of growth, with maximum rates of 5%, 7% and 9%. Subject to this, we allow projections to be personalised to reflect intended retirement age, spouse's pension provision, rate of contribution growth (if any), annuity format and the option of taking tax-free cash. In practice they usually use less expensive annuity assumptions than those required for SMPIs.

4.5 The mortality assumptions required by our COBS rules and TM1 are the same, although we and BAS accept that they need to be updated.

## The impact of the differing assumptions

4.6 The different assumptions have inevitably led to confusion. The inconsistencies are most marked where an SMPI achieves its purpose by stimulating a member to request an illustration of the possible pension resulting from an increased contribution. As the resulting illustration can use a range of different assumptions, the member will not be able to assess the impact of the increased contribution on their SMPI.

4.7 We have already said in PS07/18[15] (paragraph 16.12) that we accepted the principle of amending pension KFIs to give projections in inflation-adjusted rather than nominal terms. However, we were mindful of the costs of changing our basis at a time when the DWP were reviewing their approach to disclosure. In the meantime, we allowed inflation-adjusted projections to be added to illustrations containing our three standard projected figures.

## Our proposed approach

4.8 We said that we would consult on changing the basis used for projections when we knew the outcome of the DWP's review and of the associated BAS consultation.

4.9 Most respondents to the BAS consultation on the calculation basis for Statutory Money Purchase Illustrations (SMPIs) emphasised the need for greater consistency between our projection rules and post-sale SMPI requirements. The Feedback Statement[16] said:

> 'There was overwhelming support for harmonising the basis used for the FSA's point of sale projections and the TM1 basis. Many respondents noted harmonisation would make it easier for members to understand and compare their statements before and after sale. Many respondents suggested that the FSA basis needed to be brought in line with the TM1 basis. Throughout their responses to the other questions posed in the consultation, respondents advocated a consistent approach for projections.'

15 PS 07/18 – *Conduct of Business Regime* – October 2007.
16 www.frc.org.uk/images/uploaded/documents/TM1_Feedback_Oct2010.pdf

**4.10** Updated mortality assumptions can be included in illustrations relatively easily. But, because of the significant change entailed by requiring projections in inflation-adjusted rather than nominal terms, we would like to test potential approaches with consumers before consulting in the second half of 2011. We propose testing one version giving both nominal and inflation-adjusted effect of charges figures (Annex 3.2) and one version giving just the inflation-adjusted effect of charges figures (Annex 3.3).

**4.11** Both of these versions continue with our approach of using three growth rates for projections. This is also a requirement of Article 185 of the Solvency II directive.[17] We also propose to use the same inflation rate for all three growth rates so as not to negate the effect of the variable outcomes which the growth rates demonstrate.

**4.12** To help us prepare for the consultation, it would be helpful to have information from firms on the following questions:

## Questions

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

**Q17:** If the answer to question 15 is 'Yes':

a. should the 2.5% SMPI inflation assumption be used with all three projections; and

b. do you wish to retain the flexibility to illustrate various spouses' pensions and annuity formats rather than following standard SMPI assumptions?

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

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

17 Directive 2009/138/EC.

# Annex 1
# Compatibility statement

## Introduction

1. In this annex, we set out our view on how the proposals and draft rules in this CP are compatible with our general duties under Section 2 of the Financial Services and Markets Act 2000 (FSMA) and our regulatory objectives set out in Sections 3 to 6 of FSMA. This section also outlines how our proposals are consistent with the principles of good regulation (also in Section 2 of FSMA) to which we must have regard.

## Compatibility with our statutory objectives

2. The proposals in this Consultation Paper are consistent with our statutory objectives of securing the appropriate degree of protection for consumers and improving confidence in the financial system.

3. Our proposals in Chapter 2 implement changes to illustrations needed as a result of the RDR. For investments other than personal pensions, they do this by introducing the minimum changes necessary. For personal pensions, our proposed changes are designed to improve disclosure of charges by taking into account the results of consumer research, while also minimising costs for firms, because the changes can be implemented at the same time as other changes to illustrations. Combined with the new RDR requirement for advisers to set and disclose their own charges instead of receiving commission, the changes to illustrations should enable consumers to understand better how a particular pension contract may perform, and so allow better buying decisions.

4. The changes proposed in Chapter 3 to disclosures for personal pension schemes, including SIPPs, are designed to improve the quality and usefulness of disclosures to consumers and reduce the potential for mis-selling and mis-buying of SIPPs. So, they will help us to meet our consumer protection objective, by ensuring that consumers are provided with relevant information at the time that they take out a SIPP.

### Compatibility with the Principles of Good Regulation

5. Section 2(3) of FSMA requires that, in carrying out our general functions, we consider the principles of good regulation. The proposals we set out in Chapters 2 and 3 fulfil all seven of our principles of good regulation.

### The need for us to use our resources in the most efficient and economic way

6. We expect there to be little impact on the use of FSA resources. In line with our approach elsewhere, we will use contacts with trade bodies and thematic tools to ensure efficient use of our resources.

### The responsibilities of those who manage the affairs of authorised firms

7. The proposals do not have an effect on the responsibilities of the senior management of authorised firms beyond those currently required by our Principles for Businesses and Senior Management arrangements. Our proposals form rules and guidance in the Handbook and it remains the responsibility of senior management to ensure the rules are effectively implemented.

### The principle that a burden or restriction imposed on a firm, or on the carrying on of an activity, should be proportionate to the benefits, considered in general terms, which are expected to result from the imposition of that burden or restriction

8. We have had regard to this principle when considering different options. For example, in Chapter 2 we are not proposing to prescribe how product providers should describe product and adviser charges when they facilitate the payment of adviser charges. And we have deferred introducing changes to personal pension illustrations to reflect consumer research (CR18) until the need for changes to reflect the RDR has made introduction of these other changes economic for firms.

9. We have carried out an estimate of the costs and an analysis of the mechanisms through which benefits could arise for all the proposals in Chapters 2 and 3 and consider that the benefits are proportionate to the costs. The benefits are that consumers should be able to take better informed decisions at the point of sale, as they will:

   a) be able to compare product charges for investments on a consistent basis;

   b) understand the effects of facilitating payment of adviser charges through the product compared to payment of the adviser charge separately; and

   c) know whether a personal pension provider receives commissions and/or retains bank account interest on money held within personal pension scheme, as this

information will be disclosed alongside information about fees, costs and charges payable, and bank interest rates receivable, by the client.

### The desirability of facilitating innovation in connection with regulated activities

10. These proposals are not expected to have a material effect on facilitating innovation.

### The international character of financial services and markets and the desirability of maintaining the competitive position of the UK

11. Our proposals are designed to improve the transparency and operation of the market, while not imposing undue costs on firms, and so should have only a beneficial impact on the competitive position of the UK.

### The need to minimise the adverse effects on competition that may arise from anything done when making rules

12. Our proposals should contribute to competition between firms, by improving transparency, and so allow some consumers to make better buying decisions.

13. We also consider that the proposals will not discourage product providers from facilitating adviser charges.

### The desirability of facilitating competition between those who are subject to any form of regulation by us

14. Our proposals should contribute to some extent to facilitating competition; however, we do not expect this effect to be material.

### Acting in a way which we consider most appropriate for the purpose of meeting our statutory objectives

15. When developing our proposals, we held discussions with trade bodies and individual firms to assess the impact on their business of different options. The proposals in this CP are designed to provide consumers with the tools to make better buying decisions, while at the same time minimising costs for firms. We have tried to ensure, so far as is possible, that the proposed changes are consistent with forthcoming changes within the EU. So, we consider that the proposals are the most appropriate for meeting our statutory objectives.

# Annex 2

# List of questions

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

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

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

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

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

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

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

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

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

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

**Q11:** Do you agree that it is proportionate and appropriate to revise our rules so that KFIs and projections are required for all investments held within a personal pension scheme, other than investments in commercial property, commodity investments, synthetic ETFs or shares (that are not shares in an investment trust)? Do you think that other investment categories, including investments that are not also specified in the Regulated Activities Order, should also be able to benefit from this exemption? If so, which ones and why?

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

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

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

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

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

**Q17:** If the answer to question 15 is 'Yes':

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

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

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

## Annex 3

# Examples of key features illustrations

**Example KFI with adviser charges and projection in nominal terms**

10 January 2011.
Illustration reference number A15620.

Firm Logo

keyfacts®

# Personal Pension Plan

## Personal illustration for Mr Alan Smith

**The Financial Services Authority is the independent financial services regulator. It requires us, Example Life, to give you this important information to help you to decide whether our Personal Pension is right for you. You should read this document carefully so that you understand what you are buying, and then keep it safe for future reference.**

## Purpose of this illustration

This illustration helps you decide how much to pay in and to choose which company to take out a pension plan with.

It illustrates how investment performance affects your eventual monthly pension. It also shows the effect of our charges and your adviser's charges. Please read this along with the 'Key Features of the Personal Pension Plan' so that you understand the important information about benefits, charges, risks, tax, your rights and your commitments.

### *Who the plan covers*

| | |
|---|---|
| Your details | Male, born 1 March 1966 |
| Intended date for pension to start | 1 March 2031, aged 65 |

### *Payments to my plan*

We've assumed that your payments will:
- start on 1 March 2011
- be paid monthly for 20 years
- not increase.

| | **Monthly amounts** |
|---|---|
| You pay | £100.00 |
| Basic rate tax relief | £25.00 |
| Your employer pays | - |
| **Total** | **£125.00** |

### *Where will the payments be invested?*

We've assumed that the payments will be invested in the following funds:

| **Fund** | **Percentage** |
|---|---|
| Pension UK Equity Fund | 70% |
| Pension UK Bond Fund | 30% |

10 January 2011.
Illustration reference number A15620.

# *The charges we take from your plan*

Our charges for setting up and managing your plan and also the adviser charges you have agreed are below.

We show the possible effect of just Our Charges on the way your fund grows on page 4, along with the possible effect when all charges are taken.

## Our Charges

### Plan charge

We charge £5 each month. This will change each January in line with the Retail Prices Index published for the preceding 1 September.

### Fund charges

The charges depend upon the investment funds you choose and may vary in the future. These charges are allowed for when we calculate the unit prices for the funds, so they will not be shown on your yearly statements.

The yearly rates of charge are as follows:

| **Fund** | |
|---|---|
| Pension UK Equity Fund | 0.6% |
| Pension UK Bond Fund | 0.5% |

## Adviser Charges

You have agreed with your adviser that the cost of their services will be taken from this Plan, as follows:

- **From the monthly payments**
  We will take 15.0% from each payment for the first 36 months; a total of £675.

**Example KFI with adviser charges and projection in nominal terms**

10 January 2011.
Illustration reference number A15620.

## *What your pension might be when you retire*

We can't predict what your pension fund might be worth when you retire because it depends on how well the investments do. But to give you an idea, we show how different investment growth rates can affect the income you eventually get. These are not maximum or minimum amounts - in some conditions you may even lose money.

Underneath these figures we show the other assumptions we've used.

**How your fund might grow**

| | | | |
|---|---|---|---|
| If your pension fund grows each year by: | 4.5% | 6.5% | 8.5% |
| When you reach age 65 it would grow to: | £41,500 | £51,500 | £64,400 |

**What pension your fund might give you when you retire**

| | | | |
|---|---|---|---|
| A monthly income of: | £129 | £160 | £200 |

You can normally choose to take up to a quarter of your fund as a tax-free lump sum, with a reduced monthly income.

Remember that inflation will reduce what you can buy with the amounts shown.

**Our other assumptions**

- You and your employer keep paying the monthly contributions shown on page 1.
- You keep the same choice of investment funds.
- When you retire you decide to buy:
  - a monthly income that will be paid for at least 5 years, or until you die if later. This pension will not increase once it starts.
  - a spouse's pension of 50% of your income, which starts after you die. We have assumed that your spouse is three years younger than you.
- The cost of the monthly income we use for illustrations is based on a price set by our regulator for use in illustrations. You'll have many choices when you retire and you can shop around for the best deal.

**Keeping track of your pension fund**

We'll send you a statement each year. The assumptions for these statements are set by law and apply to all members of pension plans like this. So the statements aren't personalised in the same way as the information given above. The statements use only one assumed growth rate for your pension and then reduce this with an allowance for inflation. This is to give you an idea of the buying power of your pension when you retire.

**Example KFI with adviser charges and projection in nominal terms**

10 January 2011.
Illustration reference number A15620.

## *How the charges reduce the growth of your pension fund*

All pension plans give this information to help you compare their charges.

Below we show the effect of Our Charges and your Adviser's Charges in two ways based on the assumed growth rate shown. The growth rate could turn out to be less than this and you may get back less than you paid in.

**1. How the charges can affect the value of your fund**

The fourth column shows how just our charges can reduce the value of your fund and the fifth column shows how all charges affect it. So the difference between the fourth and fifth columns illustrates the effect of your Adviser's Charges.

The last column also illustrates what you could transfer to another pension plan.

| | | **Assuming your fund grows by 6.5% a year** | | |
|---|---|---|---|---|
| **At the end of year** | **Total paid in to date £** | **If there were no charges £** | **If only Our Charges are taken £** | **After all charges are taken £** |
| 1 | 1,500 | 1,550 | 1,480 | 1,250 |
| 2 | 3,000 | 3,200 | 3,050 | 2,570 |
| 3 | 4,500 | 4,960 | 4,710 | 3,980 |
| 4 | 6,000 | 6,840 | 6,470 | 5,690 |
| 5 | 7,500 | 8,830 | 8,330 | 7,510 |
| **At age 65** | 30,000 | 60,200 | 53,500 | 51,500 |

**2. How the charges can reduce the growth rate of your fund**

The reduction from £60,200 to:

- £53,500 means that just Our Charges take the growth rate down to 5.5%. This is a reduction in growth of 1.0% a year.
- £51,500 means that all the charges take the growth rate down to 5.1%. This is a reduction in growth of 1.4% a year.

**Example KFI with adviser charges showing inflation-adjusted projection and effect of charges information plus effect of charges information in nominal terms.**

10 January 2011.
Illustration reference number A15620.

Firm Logo

**Your personal illustration**

# Personal Pension Plan

**The Financial Services Authority is the independent financial services regulator. It requires us, Example Life, to give you this important information to help you to decide whether our Personal Pension is right for you. You should read this document carefully so that you understand what you are buying, and then keep it safe for future reference.**

This is an illustration of what you might get back from your plan when you retire. **Please read it along with the 'Key Features of the Personal Pension Plan'** so that you understand the important information about benefits, risks, tax and your rights and your commitments.

## *Who the plan covers*

| | |
|---|---|
| You | Mr Alan Smith |
| Your details | Male, born 1 March 1966 |
| Intended date for pension to start | 1 March 2031, aged 65 |

## *Payments to my plan*

We've assumed that your payments will:
- start on 1 March 2011
- be paid monthly for 20 years
- not increase.

| | **Monthly amount** |
|---|---|
| You pay | £100.00 |
| Basic rate tax relief | £25.00 |
| Your employer pays | - |
| **Total** | **£125.00** |

## *Where will the payments be invested?*

We've assumed that the payments will be invested in the following funds:

| **Fund** | **Percentage** |
|---|---|
| Pension UK Equity Fund | 70% |
| Pension UK Bond Fund | 30% |

**Example KFI with adviser charges showing inflation-adjusted projection and effect of charges information plus effect of charges information in nominal terms.**

10 January 2011.
Illustration reference number A15620.

## *The charges we take from your plan*

Our Charges for setting up and managing your plan and also the Adviser Charges you have agreed are below.

We show the possible effect of just Our Charges on the way your fund grows on page 4, along with the possible effect when all charges are taken.

### Our Charges

**Plan charge**

We charge £5 each month. This will change each January in line with the Retail Prices Index published for the preceding 1 September.

**Fund charges**

The charges depend upon the investment funds you choose and may vary in the future. These charges are allowed for when we calculate the unit prices for the funds, so they will not be shown on your yearly statements.

The yearly rates of charge are as follows:

| Fund | |
|---|---|
| Pension UK Equity Fund | 0.6% |
| Pension UK Bond Fund | 0.5% |

### Adviser Charges

You have agreed with your adviser that the cost of their services will be taken from this Plan, as follows:

- **From the monthly payments**
  We will take 15.0% from each payment for the first 36 months. This totals £675.

**Example KFI with adviser charges showing inflation-adjusted projection and effect of charges information plus effect of charges information in nominal terms.**

10 January 2011.
Illustration reference number A15620.

## *What your pension might be worth when you retire*

We can't predict what your pension fund might be worth when you retire because it depends on how well the investments do. But to give you an idea, we show below two sets of figures.

1) The first set shows how different investment growth rates can affect what you get back. These are not maximum or minimum amounts - in some conditions you may even lose money.
2) The second set shows the value of your pension in "today's money". In other words it illustrates how inflation will reduce the buying power of the pension you can buy when you retire.

Underneath these figures we show the other assumptions we've used.

**1) How your fund might grow**

| | | | |
|---|---|---|---|
| If your pension fund grows each year by: | 4.5% | 6.5% | 8.5% |
| When you reach age 65 it would be: | £41,500 | £51,500 | £64,400 |
| **2) How inflation might reduce your fund's buying power** | | | |
| If inflation was 2.5% each year it would reduce the buying power of your fund in "today's money" to: | £25,300 | £34,400 | £39,300 |
| This might buy you either: | | | |
| - A monthly pension worth: | £79 | £98 | £122 |
| or | | | |
| - A tax-free lump sum worth: | £6,340 | £7,870 | £9,830 |
| and a reduced monthly pension worth: | £59 | £74 | £92 |

**Our other assumptions**

- You and your employer keep paying the monthly contributions shown on page 1.
- You keep the same choice of investment funds.
- When you retire you decide to buy:
  - a monthly pension that will be paid for at least 5 years, or until you die if later. This pension will not increase once it starts.
  - a spouse's pension of 50% of your pension, which starts after you die. We have assumed that your spouse is three years younger than you.
- The cost of the monthly pension we use for illustrations is based on a price set by our regulator for use in illustrations. You'll have many choices when you retire and you can shop around for the best deal.

**Keeping track of your pension fund**

We'll send you a statement each year. This will show how your pension fund is doing and what your pension might be worth after allowing for inflation. The assumptions for these statements are set by law and apply to all members of pension plans like this one. So the statements aren't personalised in the same way as the information we've given above.

**Example KFI with adviser charges showing inflation-adjusted projection and effect of charges information plus effect of charges information in nominal terms.**

10 January 2011.
Illustration reference number A15620.

## *How the charges reduce your pension fund*

Below we show the effect of Our Charges and your Adviser's Charges in two ways based on the assumed growth rate shown. All pension plan providers have to give you these figures to help compare the charges for their plans.

The growth rate could turn out to be less than this and you may get back less than you paid in.

**1) How charges reduce the growth of your fund**

This table shows how the charges affect the value of your fund.

The difference in the last two columns illustrates the effect of your Adviser's Charges when added to our charges.

| | | Assuming your fund grows by 6.5% a year | | |
|---|---|---|---|---|
| **At the end of year** | **Total paid in to the plan £** | **If there were no charges £** | **If only Our Charges are taken £** | **After all charges are taken £** |
| 1 | 1,500 | 1,550 | 1,480 | 1,250 |
| 2 | 3,000 | 3,200 | 3,050 | 2,570 |
| 3 | 4,500 | 4,960 | 4,710 | 3,980 |
| 4 | 6,000 | 6,840 | 6,470 | 5,690 |
| 5 | 7,500 | 8,830 | 8,330 | 7,510 |
| **At age 65** | **30,000** | **60,200** | **53,500** | **51,500** |

The reduction from £60,200 to:

- £53,500 means that just Our Charges reduce the yearly growth rate to 5.5%. This is a reduction in the growth rate of 1.0%.
- £51,500 means that all the charges reduce the yearly growth rate to 5.1%. This is a reduction in the growth rate of 1.4%.

**2) How inflation can further reduce the buying power of your fund**

This shows what your pension fund would be worth in "today's money" after allowing for inflation at 2.5% a year. We also show the value in "today's money" of the amounts paid in.

The difference in the last two columns illustrates the effect of your Adviser's Charges in "today's money" and so may help you compare this with the cost of paying fees directly to your adviser.

| | | Assuming your fund grows by 6.5% a year and inflation is 2.5% a year | | |
|---|---|---|---|---|
| | **Value of payments made after allowing for inflation** | **If there were no charges** | **If only Our Charges are taken** | **After all charges are taken** |
| **At age 65** | **£23,600** | **£36,700** | **£32,600** | **£31,400** |

The reduction from £36,700 to:

- £32,600 means that Our Charges reduce the assumed yearly growth rate after inflation by 1.0% to 2.9%.
- £31,400 means that all charges will reduce the assumed yearly growth rate after inflation by 1.4% to 2.5%.

**Example KFI with adviser charges and inflation-adjusted projection and effect of charges information**

10 January 2011.
Illustration reference number A15620.

Firm Logo

Personal Pension Plan

# Personal illustration for Mr Alan Smith

**The Financial Services Authority is the independent financial services regulator. It requires us, Example Life, to give you this important information to help you to decide whether our Personal Pension is right for you. You should read this document carefully so that you understand what you are buying, and then keep it safe for future reference.**

## *Purpose of this illustration*

This illustration helps you decide how much to pay in and to choose which company to take out a pensions plan with.

It illustrates how investment performance affects your eventual monthly pension and how inflation will reduce its buying power. It also shows the effect of our charges and your adviser's charges. Please read this along with the 'Key Features of the Personal Pension Plan' so that you understand the important information about benefits, charges, risks, tax, your rights and your commitments.

## *Your details*

| | |
|---|---|
| Personal details | Male, born 1 March 1966 |
| When you want your pension to start | 1 March 2031, aged 65 |
| Your current gross yearly earnings | £30,000 |

## *Payments into my plan*

| | Monthly amounts | One-off amounts |
|---|---|---|
| You pay | £100.00 | None |
| Basic rate tax relief from the Government | £25.00 | |
| Your employer pays | Zero | None |
| **Total** | **£125.00** | |

We've assumed that payments into your plan will:
- start on 1 March 2011
- be paid monthly for 20 years.

You have decided not to pay any one-off amounts although you can at any time.

## *Where will the payments be invested?*

We've assumed that the payments will be invested in the following funds:

| **Fund** | **Percentage** |
|---|---|
| Pension UK Equity Fund | 70% |
| Pension UK Bond Fund | 30% |

**Example KFI with adviser charges and inflation-adjusted projection and effect of charges information**

10 January 2011.
Illustration reference number A15620.

## *The charges we take from your plan*

Our charges for setting up and managing your plan and also the adviser charges you have agreed are below.

We show the possible effect of just Our Charges on the way your fund grows on page 4, along with the possible effect when all charges are taken.

### Our Charges

**Plan charge**

We charge £5 each month.  This will change each January in line with the Retail Prices Index published for the preceding 1 September.

**Fund charges**

The charges depend upon the investment funds you choose and may vary in the future.  These charges are allowed for when we calculate the unit prices for the funds, so they will not be shown on your yearly statements.

The yearly rates of charge are as follows:

| Fund | |
|---|---|
| Pension UK Equity Fund | 0.6% |
| Pension UK Bond Fund | 0.5% |

### Adviser Charges

You have agreed with your adviser that the cost of their services will be taken from this Plan, as follows:

– **From the monthly payments**
  We will take 15.0% from each payment for the first 36 months – a total of £675.

**Example KFI with adviser charges and inflation-adjusted projection and effect of charges information**

10 January 2011.
Illustration reference number A15620.

## *What your pension might be worth when you retire*

We can't predict what your pension fund might be worth when you retire because it depends on how well the investments do. But to give you an idea, we show below two sets of figures.

1) The first set shows how different investment growth rates lead to large differences in the size of your fund. You could get more or less than this - in some conditions you may even lose money.
2) The second set shows the value of your pension in "today's money". In other words it illustrates how inflation will reduce the buying power of the pension you can buy when you retire.

Underneath these figures we show the other assumptions we've used.

**1) How your fund might grow**

| If your pension fund grows each year by: | **4.5%** | **6.5%** | **8.5%** |
|---|---|---|---|
| When you reach age 65 it would be: | £41,500 | £51,500 | £64,400 |

**2) How inflation might reduce your fund's buying power**

| | | | |
|---|---|---|---|
| If inflation was 2.5% each year it would reduce the buying power of your fund to: | £25,300 | £31,400 | £39,300 |
| In "today's money" money this might buy you a monthly pension worth: | £79 | £98 | £122 |

You can normally choose to take a quarter of your fund as a tax-free lump sum. This would therefore reduce the above monthly pension figures by a quarter.

**Our other assumptions**

- You and your employer keep paying the monthly contributions shown on page 1.
- You keep the same choice of investment funds.
- When you retire you decide to buy:
  - a monthly pension that will be paid for at least 5 years, or until you die if later. This pension will not increase once it starts.
  - a spouse's pension of 50% of your pension, which starts after you die. We have assumed that your spouse is three years younger than you.
- The cost of the monthly pension we use for illustrations is based on an average price set by our regulator for use in illustrations. You will have many choices when you retire and you can shop around for the best deal.

**Keeping track of your pension fund**

We'll send you a statement each year that shows how your pension fund is doing and what your pension might be worth after allowing for inflation. Remember there could be large ups and downs in the value of your investments. The assumptions for these statements are set by law and apply to all members of pension plans like this one. So the information isn't personalised in the same way as the information we've given above.

**Example KFI with adviser charges and inflation-adjusted projection and effect of charges information**

10 January 2011.
Illustration reference number A15620.

## *How the charges reduce your pension fund*

We show the effect of Our Charges and your Adviser's Charges in two ways. All pension providers give you these figures so that you can use them to compare costs.

**1) How charges and inflation reduce the buying power of your fund**

In this table we show both the effect on the value of your fund of Our Charges and also of all the charges.

We have assumed that your fund grows by 6.5% a year but that its buying power is reduced by inflation of 2.5% a year. The combined effect means the growth rate above inflation is 3.9%.

The growth rate could turn out to be less than this and you may get back less than you paid in.

| At the end of year | The buying power of your fund if there were no charges £ | The fund's buying power after: | |
|---|---|---|---|
| | | - only Our Charges are taken £ | - all charges are taken £ |
| 1 | 1,510 | 1,440 | 1,220 |
| 2 | 3,050 | 2,900 | 2,450 |
| 3 | 4,610 | 4,380 | 3,690 |
| 4 | 6,190 | 5,860 | 5,160 |
| 5 | 7,810 | 7,370 | 6,630 |
| At age **65** | **36,700** | **32,600** | **31,400** |

**2) How charges and inflation reduce the real rate of investment growth of your fund**

Using the table above we can show what the real rate of growth would be; that is after allowing for the charges and inflation at 2.5% a year. The reduction from £36,700 to:

- £32,600 means that just Our Charges reduce the assumed yearly growth rate after inflation by 1.0% to 2.9% a year.
- £31,400 means that all charges will reduce the assumed yearly growth rate after inflation by 1.4% to 2.5% a year.

# Appendix 1

# Draft Handbook text

**RETAIL DISTRIBUTION REVIEW (KEY FEATURES ILLUSTRATIONS) INSTRUMENT 2011**

**Powers exercised**

A. The Financial Services Authority makes this instrument in the exercise of:

(1) the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):

(a) section 138 (General rule-making power);
(b) section 156 (General supplementary powers);
(c) section 157(1) (Guidance); and

(2) the other powers and related provisions listed in Schedule 4 (Powers exercised) to the General Provisions of the Handbook.

B. The rule-making powers referred to above are specified for the purpose of section 153(2) (Rule-making instruments) of the Act.

**Commencement**

C. This instrument comes into force on 31 December 2012.

**Amendments to the Handbook**

D. The Glossary of definitions is amended in accordance with Annex A to this instrument.

E. The Conduct of Business sourcebook (COBS) is amended in accordance with Annex B to this instrument.

**Citation**

F. This instrument may be cited as the Retail Distribution Review (Key Features Illustrations) Instrument 2011.

By order of the Board
[*date*]

## Annex A

## Amendments to the Glossary of definitions

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

| | |
|---|---|
| *appropriate charges information* | (in *COBS*) information about charges which is calculated and presented in accordance with the charges *rules* in *COBS* 13.4.1R and *COBS* 13 ~~Annex~~ Annexes 3 and 4. |

## 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.

### 13.1 The obligation to prepare product information

…

Key features illustrations for facilitated adviser and consultancy charges for in-force packaged products

13.1.1A R A *firm* must also prepare a *key features illustration* in good time before that document has to be provided if:

(1) it agrees to start facilitating an *adviser charge* or a *consultancy charge* from an in-force *packaged product*; or

(2) there is an increase in an *adviser charge* or *consultancy charge* which is being facilitated from an in-force *packaged product*:

Information on life policies

13.1.2 R …

...

Exceptions

13.1.3 R A *firm* is not required to prepare:

...

(3) a *key features illustration*~~,~~:

(a) if it includes the information from the *key features illustration* in a *key features document*; or

(b) for a *packaged product* which, at the end of its fixed-term, provides for the return of the initial capital invested and a specified level of growth linked by a pre-set formula to the performance of a specified index or combination of indices; or

…

### 13.4 Contents of a key features illustration

...

Exceptions

13.4.2 R A *key features illustration* must not include a *generic projection* unless:

(1) there are reasonable grounds for believing that that *projection* will be sufficient to enable a *retail client* to make an informed decision about whether to invest; or

(2) it is a *direct offer financial promotion* which does not contain a *personal recommendation*; or

(3) (for a *personal pension* or a *stakeholder pension*) the product is not facilitating the payment of an *adviser charge*; or

(4) (for a *group personal pension*) any *consultancy charge* which is being facilitated from the product is being taken in a consistent way for all investors within the product.

...

13.4.3A G For a *group personal pension*, a generic projection may be appropriate for groups of employees where the *consultancy charges* are being taken in a consistent way for each employee within the group.

...

**13 Annex 2 Projections**

This annex belongs to *COBS* 13.4.1R (Contents of a key features illustration), *COBS* 13.5.1R (Projections for in-force products) and *COBS* 13.5.2R (Projections: other situations).

...

| R | |
|---|---|
| 1.8 | In the case of a *stakeholder pension scheme* in circumstances where a *generic projection* is permitted under *COBS* 13.4.2R, the specimen benefits table, contained within the "Stakeholder pension decision tree" factsheet available on *www.moneymadeclear.org.uk* and headed "Pension Table...How much should I save towards a pension?" which sets out initial monthly pension amounts, may be used instead of a *standardised deterministic projection* but only if it is accompanied by an explanation of the caveats and assumptions behind the table. |

…

**13 Annex 3** **Charges information for a packaged product – except for a personal pension scheme and a stakeholder pension scheme**

This annex belongs to *COBS* 13.4.1R (Contents of a key features illustration)

| R | | | |
|---|---|---|---|
| Charges | | | |
| 1 | Appropriate charges information | | |
| 1.1 | ~~Appropriate~~ *Appropriate charges* ~~information~~ *information* comprises: | | |
| | (1) | (a) | a description of the nature and amount of the *charges* a *client* will or may be expected to bear in relation to the product and, if applicable, any investments within the product; |
| | | (b) | if applicable, a description of the nature and amount of the *adviser charges* a *retail client* has agreed may be paid from the product; |
| | (2) | an 'effect of charges' table; and | |
| | (3) | 'reduction in yield' information. | |
| … | | | |
| Exceptions | | | |
| 1.3 | An effect of charges table and reduction in yield information are not required for: | | |
| | … | | |
| | (3) | ~~a *stakeholder pension scheme*, if the following is included instead:~~<br>~~"There is an annual charge of y% of the value of the funds you accumulate. If your fund is valued at £500 throughout the year, this means we deduct [£500 x y/100] that year. If your fund is valued at £7500 throughout the year, we will deduct [£7500 x y/100] that year."~~ [deleted] | |
| | (4) | a *stakeholder product* ~~that is not a *stakeholder pension scheme*,~~ or a product that will be held in a *CTF* where the relevant product and the *CTF* levy their *charges* annually, if the following is included instead:<br>"There is an annual charge of y% of the value of the funds you accumulate. If your fund is valued at £250 throughout the year, this means we deduct [£250 x y/100] that year. If your fund is | |

| | | |
|---|---|---|
| | | valued at £500 throughout the year, this means we deduct [£500 x y/100] that year. [After ten years these deductions reduce to [£250 x r/100] and [£500 x r/100] respectively.]"<br>where (in the case of (3) and (4)) 'y' is the annual charge and 'r' is the reduced annual charge (if any). |
| … | | |

| R | |
|---|---|
| 2 | Effect of charges table |
| ... | |

2.2 The effect of charges table:

(1) for a *life policy* ~~*personal pension scheme*~~ or a ~~*stakeholder pension scheme*~~ must be in the following form:

| R | | | | | |
|---|---|---|---|---|---|
| Note 1A | Note 2 | Note 3 | Note 4 | Note 5 | Note 6 |
| At end of year | Total paid in to date | With-drawals | Total actual deductions to date | Effect of deductions to date | What you might get back |
| | £ | £ | £ | £ | £ |
| 1 | | | | | |
| … | | | | | |
| 5 | | | | | |
| 10 | | | | | |
| ... | | | | | |

(2) for any other *packaged product* must be in the following form:

| R | | | | |
|---|---|---|---|---|
| Note 1B | Note 2 | Note 3 | Note 5 | Note 6 |
| At end of year | Investment to date | Income | Effect of deductions to date | What you might get back |
| | £ | £ | £ | £ |

| 1 | | | | |
|---|---|---|---|---|
| 5 | | | | |
| 10 | | | | |
| … | | | | |

(3) must be completed in accordance with the following notes:

<table>
<tr><td colspan="3">R</td></tr>
<tr><td>Note 1A</td><td>(a)</td><td>This column must include the first five years, every subsequent fifth year and the final year of the projection period.</td></tr>
<tr><td></td><td>(b)</td><td>Figures may be shown for every subsequent tenth year rather than subsequent fifth year where the projection period exceeds 25 years, or for whole of life policies.</td></tr>
<tr><td></td><td>(c)</td><td>For whole of life policies, should the projected fund reach zero before the end of the projection period this must be highlighted.</td></tr>
<tr><td></td><td>(d)</td><td><s>For an alternatively secured pension figures must be included for each year for a term of ten years.</s> [deleted]</td></tr>
<tr><td></td><td>(e)</td><td>If there is discontinuity in the trend of surrender values, the appropriate intervening years must also be included.</td></tr>
<tr><td></td><td>(f)</td><td>Figures for a longer term may be shown.</td></tr>
<tr><td>Note 1B</td><td>(a)</td><td>This column must include the first year, the fifth year and every subsequent fifth year of the projection period.</td></tr>
<tr><td></td><td>(b)</td><td><s>For an alternatively secured pension figures must be included for each year for a term of ten years.</s> [deleted]</td></tr>
<tr><td></td><td>(c)</td><td>Figures for a longer term may be shown.</td></tr>
<tr><td>Note 2</td><td colspan="2">This column must show the cumulative contributions paid to the end of each relevant year.</td></tr>
<tr><td>Note 3</td><td colspan="2">This column must show the cumulative withdrawals taken or income paid to the end of each relevant year (if any). The column may be omitted if withdrawals or income are not anticipated or allowed.</td></tr>
<tr><td>Note 4</td><td colspan="2">This column is optional. If it is retained, it must show the total actual deductions to the end of each relevant year calculated using the following method:</td></tr>
<tr><td></td><td>(a)</td><td>apply the intermediate rate of return for the relevant product to the figure in the ‘effect of deductions to date’ column for the</td></tr>
</table>

| | | |
|---|---|---|
| | | previous year; |
| | (b) | subtract this figure from the figure in the ‘effect of deductions to date’ column for the year being shown; and |
| | (c) | add the resulting figure to the figure in the ‘total actual deductions to date’ column for the previous year (if any). |
| <u>Note</u> 5 | This column may be deleted if the product is a without profits *life policy* with benefits that are guaranteed except on surrender or variation, a *life policy* with a term not exceeding five years, or a *life policy* that will be held in a *CTF*. | |
| | If this column is not deleted, the ‘effect of deductions to date’ figure must be calculated by taking the accumulated value of the fund without reference to *charges* and then subtracting from this figure the figure in the ‘what you might get back column’ for the same year. | |
| <u>Note</u> 6 | This column must show *standardised deterministic projection* of the surrender value, cash-in value or transfer value, calculated in accordance with the *rules* in *COBS* 13 Annex 2 (Projections) at the appropriate *intermediate rate of return* to the end of each relevant year. | |

---

...

| G | |
|---|---|
| 2.4 | The effect of 2.3R is that, for example, the column labels and explanatory text may be adjusted to reflect the nature of the contract. ~~For instance:~~ |
| | ~~The column titled ‘What you might get back’ might be replaced with ‘What the transfer value might be’ for personal pensions, or ‘Open market value’ for *income withdrawals* or *short-term annuities*.~~ |
| | ~~The withdrawals column may be called ‘Total income taken’ for *income withdrawals* or *short-term annuities*.~~ |
| | ~~The table may be titled ‘What effect will the deductions have?’ for *income withdrawals* or *short-term annuities*.~~ |

…

After Annex 3 insert the following new annex. The text is not underlined.

**13 Annex 4 Charges information for a personal pension scheme and a stakeholder pension scheme**

This annex belongs to *COBS* 13.4.1R (Contents of a key features illustration)

---

| R | | | |
|---|---|---|---|
| Charges | | | |
| 1 | Appropriate charges information | | |
| 1.1 | *Appropriate charges information* comprises: | | |
| | (1) | (a) | a description of the nature and amount of the *charges* a *client* will or may be expected to bear in relation to the product and, if applicable, any investments within the product; |
| | | (b) | if applicable, a description of the nature and amount of the *adviser charges* or *consultancy charges* a *retail client* or employer has agreed may be paid from the product; |
| | (2) | an 'effect of charges' table; and | |
| | (3) | 'reduction in yield' information. | |
| | Exception | | |
| 1.2 | An effect of charges table and reduction in yield information are not required for a *stakeholder pension scheme*, where *adviser charges* or *consultancy charges* are not being facilitated by the scheme, if the following is included instead:<br>"There is an annual charge of y% of the value of the funds you accumulate. If your fund is valued at £500 throughout the year, this means we deduct [£500 x y/100] that year. If your fund is valued at £7500 throughout the year, we will deduct [£7500 x y/100] that year." | | |

| R | | |
|---|---|---|
| 2 | Effect of charges table | |
| 2.1 | Each effect of charges table must be accompanied by: | |
| | (1) | an explanation of what the table shows; |
| | (2) | a statement that all relevant guarantees have been taken into account (if there are any); |
| | (3) | a warning that one effect of the *charges* referred to is that a *retail client* could get back less than they invest (if that is the case); and |
| | (4) | the rate of return used to calculate the figures in the table. |

<table>
<tr><td>2.2</td><td colspan="6">Subject to Note 2 below, an effect of charges table must include the following:</td></tr>
<tr><td>Note 1</td><td>Note 2</td><td>Note 3</td><td>Note 4</td><td>Note 5</td><td>Note 6</td></tr>
<tr><td>At end of year</td><td>Total paid in to date</td><td>With-drawals</td><td>If there were no charges</td><td>If only product and investment charges are taken</td><td>After all charges are taken</td></tr>
<tr><td></td><td>£</td><td>£</td><td>£</td><td>£</td><td>£</td></tr>
<tr><td>1</td><td></td><td></td><td></td><td></td><td></td></tr>
<tr><td>…</td><td></td><td></td><td></td><td></td><td></td></tr>
<tr><td>5</td><td></td><td></td><td></td><td></td><td></td></tr>
<tr><td>At age [xx]</td><td></td><td></td><td></td><td></td><td></td></tr>
<tr><td>Note 1</td><td colspan="6">This column must include at least the first five years and the anticipated date of retirement.</td></tr>
<tr><td></td><td colspan="6">For an alternatively secured pension figures must be included for each year for at least ten years.</td></tr>
<tr><td>Note 2</td><td colspan="6">This column is optional. If it is retained it must show the cumulative contributions paid to the end of each relevant year.</td></tr>
<tr><td>Note 3</td><td colspan="6">This column must show the cumulative withdrawals intended to be taken to the end of each relevant year. The column may be omitted if withdrawals are not anticipated or allowed.</td></tr>
<tr><td>Note 4</td><td colspan="6">This column must show a standardised deterministic projection of the benefits, calculated in accordance with the rules in COBS 13 Annex 2 (Projections) at the appropriate intermediate rate of return to the end of each relevant year, but without taking any charges into account.</td></tr>
<tr><td>Note 5</td><td colspan="6">This column must show a standardised deterministic projection of the benefits, calculated in accordance with the rules in COBS 13 Annex 2 (Projections) at the appropriate intermediate rate of return to the end of each relevant year, but taking into account only the charges described in COBS 13 Annex 4R paragraph 1.1(1)(a).</td></tr>
<tr><td>Note 6</td><td colspan="6">This column must show a standardised deterministic projection of the benefits, calculated in accordance with the rules in COBS 13 Annex 2 (Projections) at the appropriate intermediate rate of return to the end of each relevant year taking into account all charges described in COBS 13</td></tr>
</table>

| | |
|---|---|
| | Annex 4R paragraph 1.1(1)(a) and (b). |

| R | |
|---|---|
| Exception | |
| 2.3 | An effect of charges table may be amended, but only if and to the extent that that is necessary to properly reflect the nature and effect of the *adviser charges*, *consultancy charges* or the *charges* inherent in a particular product. |

| G | |
|---|---|
| 2.4 | The effect of *COBS* 13 Annex 4 paragraph 2.3R is that, for example, the column labels and explanatory text may be adjusted to reflect the nature of the contract or the terminology used. |
| 2.5 | An effect of charges table must be appropriately titled, for example, 'How the charges reduce the value of your pension fund'. |

| R | | | |
|---|---|---|---|
| 3 | Reduction in yield | | |
| 3.1 | Product reduction in yield ('A') is 'B' less 'C' where: | | |
| | (1) | 'B' is the *intermediate rate of return* for the relevant product; and | |
| | (2) | 'C' is determined by: | |
| | | (a) | carrying out a *standardised deterministic projection* to the *projection date*, but without taking any *adviser charges* or *consultancy charges* into account, using 'B'; and then |
| | | (b) | calculating the annual rate of return ('C') (rounded to the nearest tenth of 1 %) required to achieve the same projection value if *charges* are excluded. |
| 3.2 | Total reduction in yield ('D') is 'B' less 'E' where: | | |
| | (1) | 'B' is the *intermediate rate of return* for the relevant product; and | |
| | (2) | 'E' is determined by: | |
| | | (a) | carrying out a *standardised deterministic projection* to the *projection date* taking all *charges* into account, using 'B'; |

| | | | |
|---|---|---|---|
| | | | and then |
| | | (b) | calculating the annual rate of return ('E') (rounded to the nearest tenth of 1 %) required to achieve the same projection value if *charges* are excluded. |
| 3.3 | (1) | A *firm* must present the product reduction in yield as 'A%', as part of a statement which explains that 'product charges reduce your anticipated rate of returns from 'B%' to 'C%'', or in some other appropriate way. | |
| | (2) | If *adviser charges* are to be facilitated by the product, a *firm* must also present the reduction in yield as 'D%', as part of a statement which explains that 'all charges reduce your anticipated rate of returns from 'B%' to 'E'%'', or in some other appropriate way and explain the difference between the two reduction in yield figures. | |
| 3.4 | If contributions will be invested in more than one fund in a single designated investment or made by an initial lump sum payment that is followed by regular contributions, the reduction in yield must be: | | |
| | (1) | calculated separately for each fund or for the single contribution and the regular contributions, as applicable; and | |
| | (2) | presented: | |
| | | (a) | on a fund-by-fund, or single contribution and regular contribution, basis, together with a statement which explains the nature and effect of a reduction in yield, the reason for the inclusion of more than one reduction in yield figure and the reason for the differences between them; or |
| | | (b) | (if the reduction in yield results are so similar that one figure could reasonably be regarded as representative of the others) as a single figure together with a statement which explains the nature and effect of a reduction in yield, and that the reduction in yield figure given is representative of the reduction in yield figures for each of the funds or for the single and regular contributions, as applicable; or |
| | | (c) | through a single figure combining the separate figures for each fund or contribution in a proportionate manner, with an appropriate description. |

Amend the following as shown.

**14.2 Providing product information to clients**

...

14.2.1A R A *firm* must provide a *key features illustration* to its *client*:

(1) if it agrees with a *retail client* to start facilitating or to increase an *adviser charge* and that charge is being facilitated from an in-force *packaged product*;

(2) if it agrees with an *employer* to start facilitating or to increase a *consultancy charge* and that charge is being facilitated from an in-force *group personal pension scheme* or a *group stakeholder pension scheme*.

14.2.2 R The documents or information required to be provided or offered by the first provision *rule* (*COBS* 14.2.1R and *COBS* 14.2.1AR) must be in a *durable medium* or made available on a website (where that does not constitute a *durable medium*) that meets the *website conditions*.

...

14.2.14 R When the *rules* in this section require a *firm* to:

(1) offer a *simplified prospectus* or an *EEA simplified prospectus* to a *client*, that prospectus must be offered free of charge before the conclusion of the contract; or

(2) provide a *key features document*, a *simplified prospectus*, an *EEA simplified prospectus* or any other *document* or information to a *client*, the *document* or information must be provided free of charge and in good time before the *firm* carries on the relevant business or agrees to any of the charging provisions in *COBS* 13.1.1AR.

# CONDUCT OF BUSINESS SOURCEBOOK (SIPP DISCLOSURE) INSTRUMENT 2011

**Powers exercised**

A. The Financial Services 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 138 (General rule-making power).

B. The rule-making powers listed above are specified for the purpose of section 153(2) (Rule-making instruments) of the Act.

**Commencement**

C. This instrument comes into force on 6 April 2012.

**Amendments to the Handbook**

D. The Conduct of Business sourcebook (COBS) is amended in accordance with the Annex to this instrument.

**Citation**

E. This instrument may be cited as the Conduct of Business sourcebook (SIPP Disclosure) Instrument 2011.

By order of the Board
[*date*]

**Annex**

**Amendments to the Conduct of Business sourcebook (COBS)**

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

13.4.1 R (1) A *key features illustration* must include *appropriate charges information* and information about any interest that will be paid to *clients* on money held within a personal pension scheme bank account, if it is a *packaged product* which is not a *financial instrument*:

…

…

13.4.4 R There is no requirement under *COBS* 13.1.1R to include a *projection* in a *key features illustration*:

(1) …; ~~or~~

(2) if the product is~~:~~

(a) ~~a *SIPP* from which no *income withdrawals* are being taken (but if the *SIPP* is being used to contract out of the State Second Pension, the *key features illustration* must include a *projection* for an *appropriate personal pension* and a *contracting-out comparison*, for those benefits); or~~ [deleted]

(b) a *life policy* that will be held in a *CTF* or sold with *basic advice* (unless the *policy* is a *stakeholder pension scheme*)~~.~~;

(3) in relation to investments, held within a *personal pension scheme* other than one from which *income withdrawals are being taken*, that comprise: commercial property (being freehold, heritable or leasehold property), direct or indirect investment in commodities, shares (that are not shares in an investment trust), or units in an *exchange traded fund* that does not physically replicate an index by acquiring shares.

…

COBS 13 Annex 3 Charges

This annex belongs to COBS 13.4.1R (Contents of a key features illustration)

R

Charges

1 Appropriate charges information

1.1 Appropriate charges information comprises:

(1) a description of the nature and amount of the *charges* a *client* will or may be expected to bear;

(2) an 'effect of charges' table; ~~and~~

(3) 'reduction in yield' information~~.~~; and

(4) in relation to a *personal pension scheme*, the amounts (or if the amounts cannot be given, the formula by which the amounts can be calculated), if any, which the personal *pension scheme operator* will receive in commissions or retained interest on money held within a *personal pension scheme* bank account.

1.2 …

1.3 The appropriate charges information described in 1.1 (4) must be disclosed alongside information about any other *charges* the *client* will be expected to bear, and information about any interest that will be paid to *clients* on money held within a personal pension scheme bank account.

Exceptions

1.3 An effect of charges table and reduction in yield information are not required for:

(1) …

(2) ~~a *SIPP*~~[deleted];

(3) …

…

1.5 An effect of charges table and reduction in yield information are not required in relation to investments held within a *personal pension scheme* that comprise commercial property (being freehold, heritable or leasehold property), direct or indirect investment in commodities, shares (that are not shares in an investment trust), or units in an *exchange traded fund* that does not physically replicate an index by acquiring shares.

…

**PUB REF: 002506**

The Financial Services Authority
25 The North Colonnade Canary Wharf London E14 5HS
Telephone: +44 (0)20 7066 1000 Fax: +44 (0)20 7066 1099
Website: www.fsa.gov.uk

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