Brokers Ireland Submission to the Interdepartmental Pensions Reform and Taxation Group

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Introduction

The Interdepartmental Pensions Reform and Taxation Group (IDPRTG) published a Report in November 2020 which contained various conclusions and proposals on private pension reform and simplification including:

- replacement of ARF with a whole of life PRSA
- introduction of Group ARF structures
- introduction of option for DC schemes to provide in scheme drawdown, as an alternative to an individual ARF/PRSA
- change to the taxation of ARF inheritances by children of the deceased ARF holder – Sounds very unfair.
- replacement of the Personal Retirement Bond (PRB) with a PRSA

Brokers Ireland suggest :

- **the proposals above in some cases are grounded on an inaccurate or incomplete technical analysis of the problem(s) the above proposals claim to address;**
- **in some cases concerns raised by the Report can be addressed in other simpler ways; and**
- **the Report failed to take account of knock on effects, giving rise to unintended consequences which could impact negatively on consumers.**

This Submission address our perceived shortcomings in the Report and puts forward alternative positive proposals.

A lack of consideration seems to have been given within the report to the value of financial advice. Research carried out in 2016, showed that those that have used a Financial Broker are more than twice (71%) as likely to have a pension compared to people that have not used a Financial Broker (33%). Those people are also likely to have more in their pension pot with the average being €132,650 compared with €111,190 for those who don't consult an adviser.

The Report's view of the ARF

The Report identified a number of perceived shortcomings in the current ARF product and advisory process, which the Group felt justified removing the individual ARF product from the landscape at a date in the future, and replacing it with a 'whole of life' PRSA and group ARF structures.

The Report's conclusions and rational for replacing the ARF with the PRSA included alleged:

- lack of regulatory protection;
  - the ARF is not regulated by the Pensions Authority
  - lack of regulation of the ARF advisory process as the ARF is not an Investment Intermediaries Act or MIFID investment instrument, as compared with the PRSA which is an investment instrument under the Investment Intermediaries Act
  - the ARF itself is not a regulated product and is not specifically referenced in the Central Bank's Consumer Protection Code.
  - A consumer is not required to obtain advice before investing in an ARF.
  - An ARF is not a defined investment instrument within the scope of the Investor Compensation Scheme.
- No 'support' to retiring members of DC schemes who transition from the scheme to an ARF at retirement;
- lack of transparency of charges;
- higher charges than group schemes;
- lack of independent oversight and support;
- lack of default investment strategies and investment options; and
- no approval process for QFMs and ARF products

The current ARF product regulatory position

There is a technical error in the Report in suggesting that the PRSA advisory process is regulated because a PRSA is included as an investment instrument in the Investment Intermediaries Act 1995 (IIA), and the ARF and related advisory process is therefore not regulated because an ARF is not an IIA investment instrument.

In fact the position is:

- Advice on PRSAs and ARFs issued as insurance policies is regulated in both cases by the Insurance Distribution Regulations (IDR) and Consumer Protection Code.
- Only the provision of advice on a MIFID firm PRSA is covered by the IIA, as life companies providing PRSAs are no longer[1] an investment business firm for the purposes of the IIA.
- The only regulatory gap is the provision of advice on MIFID firm ARFs.

This gap can be easily rectified by including an ARF hosted by a MIFID firm as an investment instrument under the IIA (as for MIFID firm PRSAs), so that the regulation of advice on ARFs and PRSAs would then be identical, be they insurance policies or MIFID firm products.

Adding an ARF hosted by a MIFID firm to the IIA list of investment instruments, would also bring it within the scope of the Investor Compensation Scheme (ICS); ARFs issued as insurance policies are already within the scope of the ICS as insurance policies.

The regulatory position after adding an ARF hosted by a MIFID firm as an investment instrument under the IIA (shown in red below) would be:

	Insurance policies	MIFID firms
PRSA	• Insurance Mediation Regulations • Consumer Protection Code • Investor Compensation Scheme	• Consumer Protection Code • Investor Compensation Scheme
ARFs	• Insurance Mediation Regulations • Consumer Protection Code • Investor Compensation Scheme	• Consumer Protection Code • Investor Compensation Scheme

The absence of any specific provisions in the Consumer Protection Code dealing with advice on ARFs is an issue for the Central Bank to address; it already has the capacity to add specific conduct of business requirements to the CPC in relation to providing advice on ARFs issued as insurance policies, and after adding an ARF hosted by a MIFID firm as an investment instrument under the IIA, the Central Bank could also prescribe similar requirements for advice provided on MIFID firm ARFs.

Retiring members of DC schemes who transition from the scheme to an ARF at retirement

The Report suggested that retiring members of DC schemes receive no 'support' when transitioning from the scheme to an ARF at retirement. This itself is an indictment of the structure of group schemes where no advice is provided to the member at a crucial time, i.e., when the member has to make

[1] See Regulation 55(b)(ii), Insurance Distribution Regulations 2018 (SI 229 of 2018) which removed from the IIA life companies providing PRSAs and tracker bonds, as these products now fall under the Insurance Mediation Regulations.

irrevocable decisions on how to take their retirement benefits; this confirms a major weakness of group schemes, the lack of advice provided to members.

In fact retiring members of DC scheme can and do receive advice from independent financial advisors when making a decision on how to take their retirement benefits. It is therefore completely incorrect to suggest there such members do not or can not receive independent advice at such time.

In fact, it is concerning that any group DC scheme member may be allowed to take their retirement benefits without seeking independent financial advice on their options.

It is a feature of group trust based schemes and arrangements that the trustees or administrator do NOT provide advice to members. For example where a deferred member of a DB scheme receives an enhanced transfer value offer from the trustees of a DB scheme, a frequent condition of the offer is that he or she obtain *independent financial advice* before making a decision to take a transfer value.

It is therefore not the fault of the current ARF product, that group DC scheme members receive no advice from the scheme on taking their retirement benefit. The lack of 'support' for retiring DC scheme members transitioning to ARFs is the fault of the DC scheme trustees, administrator and employer who are usually not willing to provide advice to members. Independent financial advisers can, do and will continue to fill this advice gap.

Where some group schemes refer members for advice, it is usually to a 'tied' advisor linked to the administrator of the scheme; it is not independent advice.

In our view, therefore, the majority of group DC schemes will not offer 'in scheme drawdown' to retiring members as an alternative to moving to an ARF, as the trustees and employer of such schemes will not see it as their function or role or wish to provide independent advice to scheme members.

ARF charges

It is incorrect to state, as the Report did, that there is no or limited disclosure of charges on ARFs products currently:

- There is complete transparency of charges on ARFs issued as insurance policies under the Life Assurance Disclosure Regulations, Insurance Distribution Regulations, and Consumer Protection Code.
- MIFID firms hosting ARFs are subject to full disclosure of charges and fees under the MIFID Regulations.

- Consumer Protection Code disclosure requirements would also extend to MIFID firm ARFs if our proposal above to include such ARFs as an IIA investment instrument is implemented.

The suggestion that individual ARF product charges are higher than could be obtained under group arrangements is also incorrect because it does not compare like with like:

	Group ARF structure/DC scheme	Individual ARF
Ongoing individual advice provided	No	Yes
Cost of advice included in charges	No	Yes
Investment choices	Very limited. Extensive use of 'one size fits all' default investment strategies.	Wide. Can personalise investment options to each individual's risk appetite and circumstances
Someone to talk to	No/limited. Extensive use of portals, AI, etc.	Yes, where the client uses a personal financial adviser

It is therefore a misleading comparison to compare the headline charges under a group/trust arrangement with those on an individual ARF, as the group structure provides a more limited service and crucially does not provide INDIVIDUAL independent advice to members.

Approval process for QFMs and ARF products

The Report suggested that there was no approval process for QFMs and ARF products.

In fact an entity must be a regulated financial services provider to be a QFM[2], e.g. a life assurance company or a MIFID firm, and hence such entities are subject to authorisation and prudential regulation by a competent authority, the Central Bank of Ireland for firms established in the State. **Therefore it is not correct to state that there is no regulatory approval process for QFMs; a QFM must be and remain a regulated financial services provider to provide and operate an ARF.**

In relation to approval process of ARF products:

- ARFs issued as insurance policies are subject to the Product Oversight & Governance requirements made under the Insurance Distribution Directive[3], in relation to:
    - Product approval process

[2] See definition of QFM in s784A(1)(a) Taxes Consolidation Act 1997
[3] See Commission Delegated Regulation 2017/2358

- Target market
- Product testing
- Product monitoring and review
- Distribution channels

- For a MIFID firm, an ARF is not a 'product' but a collection of assets to which it provides one or more investment services. Where such services relate to MIFID financial instruments, the service and advice is subject to the MIFID Regulations.

  A MIFID firm setting up an ARF for a new client has to fully comply with all MIFID requirements in relation to assessing suitability, disclosure of fees, etc.

Therefore:

- **A QFM is subject to regulation as a financial services provider; and**
- **ARFs issued by life assurance companies are subject to Product Oversight & Governance requirements made under the Insurance Distribution Directive**
- **the operation of ARF portfolios hosted by MIFID firms is subject to the full rigours of the MIFID Regulations.**

Default investment strategies and options

ARFs currently offer a very wide range of investment options, including collective investment fund, and self directed fund and discretionary portfolio (for MIFID firm ARFs) options.

For collective funds, e.g. life company unit linked funds, providers typically band them by risk category which are then matched to the consumer's established risk profile, following an assessment by a financial adviser.

It is incorrect to suggest, as the Report did, that group ARF structures would offer better or wider investment choices than current individual ARFs.

Indeed the opposite is more likely to be the case, i.e. group ARF structures are more likely to offer limited investment options and to mechanically direct members into potentially unsuitable default investment strategies without the consumer receiving independent financial advice or a proper full risk assessment.

Default investment strategies are currently often used as a 'cop out' by the trustees and employer of group DC schemes to absolve themselves of any legal responsibility to members for investment performance. One of the requirements to benefit from the statutory exemption for liability for investment performance provided by s59(2) Pensions Act 1990 is that the scheme trustees provide a default investment strategy.

It is therefore highly likely that the trustees/providers of group ARF structures will also seek similar statutory exemption for investment performance by offering default investment strategies and not provide investment advice.

Proposal to replace individual ARF with a 'whole of life' PRSA

We feel the proposal in the Report to replace, from a certain date in the future, the individual ARF with a whole of life PRSA product is flawed for the following reasons:

- We have already outlined above that ARF products, and the provision of advice on ARFs, are regulated and any perceived current regulatory gap can be easily filled by:
  - Adding a MIFID firm ARF to the Investment Intermediaries Act list of investment instruments, to mirror the approach taken with PRSAs; and
  - Inserting any additional conduct of business rules required in the Consumer Protection Code.

  Therefore replacing the ARF with a PRSA is not going to add any increased regulatory protection to consumers.

- The PRSA product would need to be substantially changed from its current design to facilitate advised drawdown in retirement:
  - The capped charges of the Standard PRSA reduce or eliminate the scope to pay for independent financial advice.

    The reduction/elimination of the scope to fund advice would be detrimental as:

    - Upon retirement; an individual will have to make decisions around the retirement lump sum, other available 'cash/savings' along with the remaining taxable portion and the order of timing as to when to draw upon each one. Without adequate advice they may follow the incorrect order of liquidation, draw on the ARF too early and see the ARF bomb out much sooner than it otherwise would have, had they been suitably advised as to their options at retirement.
    - In addition, there are tax implications to be considered for both the lump sum itself and also the order of drawing down the ARF. In the absence of financial advice; an individual will likely pay a higher level of taxation if they fail to follow an effective drawdown strategy. Similarly; an individual needs to understand the

tax implications around investing their retirement lump sum such as DIRT, Exit Tax etc.

- Standard PRSAs can only offer pooled funds as investment options.
- The current definition of charges for PRSAs reduces fund and investment choice compared to that offered by ARFs and causes confusion on which fund options can be offered by the PRSA.
- ARFs offer the flexibility for the financial adviser to individually tailor its charge for advice to the circumstances of each investor and investment; PRSAs severely limit the scope to vary charges between different consumers[4] with similar circumstances, so that essentially all similar PRSA consumers must pay the same charges.

The current PRSA product design and structure would need to be substantially changed to function as an ARF, offer consumers the same range of investment options, and the ability to pay for independent financial advice from the fund, as ARFs currently offer.

In effect there will have to be a Generation 2 PRSA product, while allowing existing Generation 1 PRSA products to continue or switch to the new Generation 2 PRSA product. This introduces more complexity into the pensions market, not less.

In that case the question then arises, why devise a new Generation 2 PRSA product to do the job of the current ARF, when the new PRSA will not provide any better regulatory protection for the consumer, but will provide reduced investment choice and scope for consumers to pay for independent financial advice?

The current ARF product should be retained, albeit also allowing PRSAs to offer lifetime drawdown.

Group ARF structures and in scheme drawdown

We believe group ARF structure and in scheme drawdown proposed by the Report will not provide better protection and outcomes for consumers for the following reasons:

- We have already outlined why we feel few if any group DC schemes will offer in scheme drawdown;

[4] See s104(3) Pensions Act 1990

- While some group ARF structures might appear to offer lower charges than the current individual ARF product, and provide independent oversight and governance, group ARF structures will be an inferior product for the consumer than the current ARF, because:
    - Investment options will be very limited compared to the current ARF choice.
    - Complex investment options, e.g. smoothing of returns, often used by group schemes can have the effect of tying in the member to the scheme and disincentivising him or her moving to a different arrangement, e.g. the use of MVAs on transfers to other arrangements
    - No or reduced individual financial advice will be provided to members; instead members will be forced into default investment options, portals and robot advisers. Member queries will be routed to call/service centres where a different person answers each time a member contacts the centre; there is no continuity of service
    - Group structures have the capacity to become monopolies to the detriment of members, e.g. when tied to one employee benefit consultancy provider and/or to one affinity or trade group, leading to poor service, limited or 'own'[5] investment options, limited or non existent advice, and potentially higher charges for the services provided.

      In this regard we would point out that current group structures rebuff the involvement of independent financial advisers where a member wishes to seek advice on their benefits, so that it is very difficult if not impossible to provide independent financial advice to members of group structures.
    - Tied advice: where members of current group structure need advice, they are frequently seamlessly (to the member) transferred to an associate (to the main administrator/provider) providing personal financial advice; the member does not get independent advice.

      E.g. one large employee benefits consultancy firm has an associated personal financial advisory firm to which members of their group scheme are referred when advice is needed, e.g. leaving service, at retirement, etc. However both firms use the exact same trading name, so that it is virtually impossible for the member to know that:
        - They are being referred to a tied adviser; and

[5] E.g. where some or all of the investment options are manged by an associated firm to the employee benefits consultant operating the group structure

- They could alternatively use an independent adviser.

If group ARF structures are to be allowed, significant consumer protection measures need to be part of the structure to protect the consumer, including:

- Right of a consumer at retirement to not join a group ARF structure but use an individual ARF product instead;
- Regular tendering for service providers to the structure;
- Total public transparency on charging and investment options and returns;
- No referring by the group ARF structure of members to a 'tied' advisor connected with any of the existing service providers to the structure;
- right of the member to leave the group ARF structure at any time, without penalty, to move to an individual ARF; and
- right of the member to seek independent financial advice on his or her group ARF structure benefits and to have the cost of such independent financial advice charged to his or her group ARF fund.

Taxation of ARF inheritances by children

The Report's proposal to double tax[6] an inheritance of ARF funds by children of the deceased will lead to an effective tax rate on such inheritances of up to 68%[7], far in excess of the rate of tax relief originally provided to accumulate such funds in the first place, and significantly greater than the current fixed income tax charge of 30%. It is unfair to charge more than the tax relief enjoyed by the contributions which created the ARF.

We feel the current fixed 30% income tax charge on ARF inheritances taken by adult children of the deceased had the following significant advantages:

- simplicity; the same rate is applied to all ARF inheritances by all adult children
- certainty; a fixed taxed rate gave certainty and predictability, both to future beneficiaries and the Exchequer.

The proposed double taxation treatment, on the other hand, leads to an unpredictable tax charge on future ARF inheritance by children as the charge will be dictated by then tax rates, available Income

[6] PAYE first as income of the deceased in the year of death, with the residual net amount then treated as a taxable inheritance

[7] i.e. (1- 40% IT -8% USC- 4% PRSI) x (1 – 33% IHT) = 32.1%

Tax credits, allowances and standard rate bands of the deceased, and available CAT Threshold of the child inheriting the funds and CAT rates at that time.

Currently the tax charge under the proposed new basis could vary between 0% and 68%, depending on personal and fiscal circumstances at the time of death.

We feel the proposal to double tax children inheritances from ARFs will act as a push factor for those with larger funds to transfer overseas, under the Occupational Pensions Schemes and Personal Retirement Savings Accounts (Overseas Transfer Payments) Regulations, 2003, before maturity, to the detriment of the Exchequer. Inheritance of overseas pension funds on death are currently taxed once only as an inheritance at a rate of up to 33%, with the benefit of any unused CAT Threshold.

We therefore feel there is a strong case to retain the simplicity and certainty of the current fixed tax charge on adult children's ARF inheritances, possibly with an increased tax rate of 33% to reflect current capital tax rates.

Such a change would raise additional tax revenues while retaining the advantages to consumers and the Exchequer of the current fixed income tax charge.

Replacement of Personal Retirement Bonds with PRSAs

The Report proposes to replace PRBs with PRSAs as a destination for scheme transfer values at some point in the future. We believe this will have significant knock on effects:

- the PRSA product will need to be significantly adapted, to provide the same options and flexibility as the current PRB offers:
    - the option of salary/service lump sum in addition to the normal 25% of fund
    - significant changes to charges and investment options to allow the same level of flexibility and range of investment options offered by PRBs currently.
    - Changes to offer the flexibility for the financial adviser to individually tailor its charge for advice to the circumstances of each investor and investment.
    - Access to funds from 50 would have to be allowed, without a requirement to terminate the consumer's then employment.
- Transfer funds which are currently not allowed to transfer from a PRB to an overseas arrangement under the Occupational Pensions Schemes and Personal Retirement Savings Accounts (Overseas Transfer Payments) Regulations, 2003, will be able to transfer overseas when in a PRSA. **There will be more overseas transfers, particularly if access to PRB/PRSA funds is to be raised to 55 when earlier access may be allowed in overseas arrangements.**

- The task of developing a new Generation 2 PRSA product to do the job of the current PRB and ARF, while continuing to fulfil the traditional accumulation role of the PRSA, will be very difficult and a complex product will surely be the end result, with the added complexity of two generations of PRSA products in the marketplace, i.e. current PRSA products (generation 1) and the new (generation 2) PRSA products.

Standardised early access to 55

The Report's proposal to standardise early access to retirement benefits to 55 will impact particularly on:

- those currently holding PRBs who expect to be able to access their funds from 50; and
- proprietary directors and the self employed who under current rules can access prior employment scheme and PRB benefits from 50 onwards.

  Proprietary directors and the self employed often access prior employment retirement benefits early as a source of finance for their current business, to repay debts etc.

Access from 50 can also be a lifeline for those who have lost their job in middle age and find it difficult to get another job. Access to benefits can provide start up funds for a new self employed business, for example.

We therefore urge the retention of access from 50 for funds related to a prior employment, even if PRBs are replaced by PRSAs in the future. While consumers are always advised that funds are for retirement, life will always throw up unforeseen events giving rise to a need for early drawdowns on PRB's from 50 onwards.