

Financial Services Consumer
Panel response to:

- HM Treasury and the Department for Work and Pensions' Consultation on 'Proposed product specifications for Sandler "stakeholder" products'; and
- FSA's Discussion Paper 19: Options for regulating the sale of "simplified investment products".

April 2003

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- (ii) **FSA's Discussion Paper 19 Options for regulating the sale of "simplified investment products".**

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Summary

1. The Financial Services Consumer Panel reiterates its warning that the Sandler Review's proposals to simplify the sale of investment products run the risk of promoting equity-based investments at the expense of consumer protection.
2. The Panel criticises the proposed product specifications for Sandler 'stakeholder' products, saying that the proposed range of products fails to meet the needs of those currently not saving and seems to assume that all low to middle income consumers should have exposure to the equity market. The Panel recommends that a deposit product and an investment product with a capital guarantee should be added to the 'stakeholder' range.
3. The Panel reminds the FSA and the Treasury about the proposals it put forward in June 2002 for the establishment of a new service to offer generic financial planning advice to the majority of consumers, including those on middle to low incomes. It suggests that a properly defined Financial Healthcheck (leading to a portable fact-find or 'prescription' of individuals' financial needs) would be one way of bridging the gap between the Government's wish to establish a simplified regulatory regime for 'stakeholder' products and the FSA's responsibility to ensure that consumer protection safeguards are not compromised.
4. In the absence of a portable fact-find or 'prescription', we cannot see any justification for relaxing the regulatory regime in respect of the unitised and with-profits products in the proposed 'stakeholder' suite.

Panel response to HM Treasury and the Department for Work and Pensions' Consultation Document on Proposed product specifications for Sandler "stakeholder" products

Introduction

This paper is the response of the Financial Services Consumer Panel ('the Panel') to HM Treasury and the Department for Work and Pensions' Consultation Document on "Proposed product specifications for Sandler 'stakeholder' products".

The Government's Vision for Retail Financial Services

The Panel supports the Government's wish to see a competitive and innovative market for retail financial services in which consumers can easily identify the products and the help they require to meet their financial needs and can have confidence in the people who provide and advise on products. We agree that there needs to be better access to financial services for those on low to medium incomes. The Panel recognises the deep-seated continuing problems identified by the Government, notably the information imbalance that has been at the root of recent misselling scandals.

We note the various measures taken by the Government since 1997 to address these problems. While we have views on the extent to which these measures have been successful, this is not the paper in which to express them.

The Sandler Review

In the Panel's response to the Sandler Review Team's 2001 consultation, we expressed our reservations about the remit of the review that Ron Sandler had been asked to carry out. In particular, we said that efficient competition

was not enough to make the market meet consumers' needs and that a purely economic analysis could not take account of the potential risks to consumers arising from an inherently complicated marketplace. If consumers were to be required to take on much of the risk that was once shouldered by the State and employers, we maintained that improvements in competition had to go hand-in-hand with effective consumer protection.

Having said that, we very much agree with the Sandler Review's analysis of the overarching problems in relation to Medium and Long Term Retail Savings in the UK. Complexity and opacity of products, problems of access and the relatively weak position of consumers are very much at the heart of the issue. In the remainder of this paper, we will assess the extent to which the Review's proposals for "stakeholder" products (and the specifications for such products put forward in the HMT/DWP Consultation Document) address these problems. We will also consider the effect that any simplification of regulatory requirements in respect of the "stakeholder" products (as discussed in the FSA's DP19) will have on levels of consumer protection.

Target Market

We note that the suite of regulated products has been designed with a view to offering low-to-middle income groups attractive, easy to access and easy to understand products, which producers and providers will want to sell. We agree that, in order to have broad appeal to people on low to medium incomes, the stakeholder products need to be simple to understand and low-risk in their nature. We agree that charging structures should be explicit and clearly understandable by consumers.

Recent research carried out by the Panel (which will be published in the near future) indicates that low to medium income consumers have very little appetite for products where there are risks to capital.

On the 'branding' of any 'stakeholder' range of products, the Panel feels that great care needs to be exercised. Again, our recent research into consumers'

financial needs indicates misunderstanding among low to middle income consumers about the different forms of branding that have been introduced in recent years. In general, it seems that many people on low to middle incomes do not know what is meant by 'CAT marked' products; nor do they know what a 'stakeholder' pension is. There is also evidence of confusion about ISAs, with some people apparently not appreciating that an 'equity ISA' is linked to the stock market and others thinking that ISAs in general carry some form of Government 'guarantee'.

The 'Stakeholder' Range of Products

We agree that simplicity, risk-control and charge controls should be key features of any 'stakeholder' product. However, most important of all is a product's attraction to its target market and in this respect we are disappointed with the specifications for the range of 'Sandler' products put forward in the HMT/DWP Consultation Document. As the Consultation Document itself acknowledges, the Pension Product is really little more than a variation on the existing stakeholder pension which, in spite of its incentives for the low-income consumer, has hardly been a success story in terms of take-up. For their part, as the Consultation Document admits, unitised products are in themselves quite straightforward and there can be no denying that the investment restrictions it is proposed to place on the 'stakeholder' unitised product will act as a risk control. However, we do not think that the low to middle income consumers at whom the 'stakeholder' products are aimed will be enticed into the medium to long-term savings market by the lower level of equity risk that will be present in the 'stakeholder' unitised product. The same can be said of the with-profits product, particularly given its more complicated structure and the well-publicised concerns about the transparency of with-profits products.

There seems to be an assumption running through the proposals that low to middle income consumers should have exposure to the stock market. However, the Panel's recent research into the financial needs of such consumers indicates that the majority of them are particularly risk averse.

They do not have money to lose and they are not therefore likely to be attracted to the unitised or with-profits products even if absolute levels of stock market exposure and the types of asset allocation within them are to be controlled. The servicing of high levels of debt is the main preoccupation of low to middle income households and it would seem unlikely that people in that position will be able and willing to make a regular investment in a unitised or with-profits product. On the other hand, if the 'stakeholder' range were to include a deposit or capital guaranteed product, those that are able to do so may be attracted to accumulate some savings (see our comments on 'other products' below).

We note that it is proposed to limit the risk in these products by setting appropriate diversification restrictions for asset allocation and by restricting the maximum level of exposure to equities at the 'cautious fund' level of 60%. Part of the rationale for this is that, in the last five years, only two cautious managed funds are said to have lost money. However, over a shorter timeframe (eg the last year), as far as we can tell all such funds will have lost money as stock markets have continued to fall. Past movements in equity prices over the longer term might well indicate that 'cautious managed' funds will yield a respectable return over the medium to long term, but the recent downward spiral in equity prices is indicative of the risks to which participants in the stock market expose themselves. If a unitised product from the 'stakeholder' suite had been available a year ago, many purchasers would in all probability be nursing significant losses.

We also question the explicit assumption that most 'stakeholder' investors will be investing in the medium to long term and will not be enforced sellers. This may be true of those purchasing a stakeholder pension where the product can be instantly associated with savings for later life and consumers can readily understand the purpose of any investment they make and their inability to access it until they retire. However, the same cannot be said of the unitised and with-profits products. In any event, the Panel's recent research indicates that consumers have little or no appetite to save in the medium term. They

can appreciate the desirability of saving for retirement (although for many low-income consumers this is an aspiration rather than a practicality), but there is scant evidence of any motivation for other medium or long-term savings. The needs of most low to middle income consumers are, it would seem, better served by a combination of short-term saving for a specific goal and short or medium term debt. Against this background, there would seem to be a very real risk that, in the absence of advice as to suitability, consumers will not appreciate the medium to long term nature of the 'stakeholder' range and will want to access their savings in shorter timeframes. In so doing, they would of course expose themselves to the volatility associated with the unitised product and to the application of market value adjusters in the case of the with-profits product. All this points to a continuing need for a check on suitability.

Other Products

Like the Government, the Panel sees advantages in including other products within the 'stakeholder' range. We agree that a wider range could provide an opportunity to set a benchmark for consumers, which would simplify choices between products. In particular, we would like to see the inclusion of products which do not require consumers to assume exposure to equity markets.

As the Consultation Document says, a cash savings vehicle is generally regarded as a sensible component of personal financial planning and a first step on the savings ladder. We feel that the 'stakeholder' suite would be incomplete without one. However, we also take the view that it would be confusing for consumers if a 'stakeholder' deposit product were created to run alongside cash ISAs. We agree that there would be advantages in rebranding the latter in a consistent way with the products of the 'stakeholder' suite. However, we also believe that there needs to be some form of incentive for consumers to save in this way. We are attracted by the ideas aired in the paper about the Child Trust Fund and would like to see a similar scheme with appropriate Government incentives to save (eg matched contributions or tax incentives) established for adults within the 'stakeholder' suite.

We would also like to see a Guaranteed Product added to the suite. As the Consultation Document acknowledges, capital protection and guarantees are what consumers say they want and the Panel's recent research into low to middle income consumers' understanding of their financial needs confirms this. We appreciate that guarantees have to be paid for, but our perception is that there is a willingness among consumers in general to forgo some of the potential gains in return for capital certainty. 'Precipice bonds' did not do this. On the contrary, they provided high levels of income in return for potential loss of capital and the problems they are causing are attributable to the fact that many consumers do not appear to have realised this when they first purchased the product. However, bonds with a guarantee backed by HM Treasury to return the original investment in full have been issued by National Savings and Investments and we believe that some regulated firms have already structured and marketed products that provide capital guarantees of this nature. Equally, however, some providers have marketed products under a variety of different 'banners' where only part of the capital outlay is actually guaranteed. 'Guaranteed income bonds', 'guaranteed growth bonds' and 'capital protected funds' are examples of the confusing terminology used in this area. This has muddied the waters for consumers and we see benefits for the 'guaranteed' market in general in the formulation of agreed minimum standards to enable a product that provides a 100% capital guarantee to be included in the 'stakeholder' suite. The complicated way in which the provider uses derivatives in order to be able to offer the guarantee is not something that need concern the consumer; the very existence of a clear capital guarantee - and an indication of the price they are being charged for it - is all that he or she needs to know.

We agree that there is no strong case for including a protection product such as term assurance in the suite of 'stakeholder' products. We also agree that a simple benchmark approach would not be appropriate for annuities. In our April 2002 response to the DWP/Inland Revenue Consultation on 'Modernising Annuities', we advocated that all pension savers should receive free independent financial advice before they make any decisions about

turning their pension savings into pension income. The purchase of an annuity to meet one's own financial needs is something which, we would say, requires individually-tailored financial advice.

As mentioned above, the Panel likes the main features of the Child Trust Fund and, subject to our comments on the options for regulating the sale of 'stakeholder' products, we agree that there would be benefits in allowing both 'stakeholder' and 'non-stakeholder' Child Trust Funds with the former having appropriate investment restrictions.

Panel response to FSA DP19: Options for regulating the sale of “simplified investment products”

On 9 July 2002, the day on which the Sandler Review was published, the Panel issued a Press Release warning of the risk that the Review's recommendations for simplification of the sales process for savings products posed for consumer protection. The publication of the proposed product specifications for Sandler “stakeholder” products has done nothing to dispel our concerns in this regard.

The suite of “stakeholder” products described in the HMT/DWP Consultation Document does not, in the Panel's view, represent a range of 'safe' products wherein low to middle income consumers can identify their own personal needs in a 'light touch' regulatory environment. On the contrary, under the proposals both the unitised and with profits products could contain up to 60% equity exposure. Set against the background of the significant fall in equity prices that has occurred in recent years, it is clear that there is potential for unsuspecting consumers to suffer considerable detriment if product sellers are permitted to disclaim all responsibility for suitability. In the current state of the market, we suggest that the idea of selling equity-based products to consumers without a suitability test is perverse.

Risks

We note the FSA's assessment of the risks to its objectives involved in selling the kind of simplified 'stakeholder' products outlined in the HMT/DWP Consultation Document. In particular, we concur with the assessment that a 'simplified' product whose design meets specified minimum standards may for some consumers still be an inappropriate choice. We agree that, even for simple products, there is a strong case for some form of filter to screen out consumers for whom the products look likely to prove unsuitable. We note that the FSA sees the provision of clear warning signs to consumers whose circumstances are likely to make purchase of a particular product inappropriate as key to developing a sales regime that does not include a suitability obligation on the firm looking to make a sale. We agree that the FSA's selling regime for the 'stakeholder' products needs to ensure that consumers have information on performance risk at the point of sale in a way they will understand and that they are warned about any false perceptions they may have about capital guarantees.

Options for Change

We have considered the three broad options for change that the FSA says it could adopt in setting regulatory requirements to be applied to the sales process for the suite of simplified 'stakeholder' products. While we acknowledge that, from a provider's point of view, the self help option would be the most cost effective means of selling a 'stakeholder' product with a capped charge, this would require consumers to know as much about financial planning and the appropriateness of the 'stakeholder' products to their own circumstances as the people selling the products. In the Panel's view, the provision of generic information and relevant risk warnings about the products would not be sufficient to mitigate against the risk of mis-selling to low to middle income consumers, even if consumers were required to self-certify to the effect that they had understood what they had been told. Regulatory experience in the past with 'execution only' selling has shown that

consumers can be misled into signing such warnings without understanding the consequences.

The Guided self-help option (option 2 in the FSA's DP) introduces the concept of a series of filter questions seeking to identify and screen out those for whom an investment product would be unsuitable. In this respect, we note that the decision trees used for sales of Stakeholder pensions provide an example of the sort of filter questions that could be used. We could envisage a similar approach being adopted in respect of the sale of the 'stakeholder' pension product, but we do not feel it would be appropriate to adopt a similar approach in respect of the unitised or with-profits products where the risks of mis-selling are that much higher in our view.

The Focussed advice option (option 3 in the DP) provides for a limited assessment of the consumer's suitability and is therefore closer to what we believe is necessary to provide an appropriate level of consumer protection. However, we note the FSA's comments that the variation of needs between different customers makes it difficult to decide what aspects of consumer circumstances can safely be left out of any cut-down fact-find. We would suggest that a fourth option – and one that firms themselves may prefer to option 3 – would be to leave the present regime intact. In the absence of a portable fact-find or 'prescription' (see below), we cannot see any justification for relaxing the regulatory regime in respect of the unitised and with-profits products in the proposed 'stakeholder' suite. We acknowledge the FSA's obligations to establish a regulatory regime that is proportional to the risks posed by the 'stakeholder' products, and it is our view that the proposed products carry largely the same suitability risks as existing collective investment products which are subject to the full regime.

Turning to the FSA's comments on scope for regulatory redress, we think it is particularly important that stakeholder policyholders retain rights of access to the Financial Ombudsman Service and, when necessary, to the Financial Services Compensation Scheme. Ron Sandler concurred with this view, but we note that DP19 mentions the possibility that the Government could

redefine the scope of the activities regulated under the Act. We do not think that such action would be in the interests of consumer protection.

Financial Health Check

In the HMT/DWP Consultation Document, views were invited on whether an advice service could have a place in the 'stakeholder' suite and on the form that it might take. The Panel has long been an advocate of the need to establish a service offering generic financial advice to consumers and we put forward proposals in June 2002 for Government and the FSA to establish a new service to offer financial planning advice to the majority of consumers.

While the Panel is naturally somewhat reticent about the prospect of giving up consumer protection safeguards in return for a simpler sales regime, we could see some justification for the adoption of a combination of options 2 and 3 if accompanied by the introduction of a properly defined Financial Health Check developed in the context of a widely available financial advice service. Our expectation would be that the 'Healthcheck' would produce some form of portable fact-find or 'prescription' that would facilitate some relaxation of the present regulatory regime. We were encouraged by the prototype 'Healthcheck' that was demonstrated at HMT at the beginning of March. Although not a portable fact-find in its present form, it could be expanded to incorporate one and developed in the context of an advice service to support consumers using it. It would be unacceptable to remove consumer protections without this.

About the Financial Services Consumer Panel

The Financial Services Consumer Panel was established by the Financial Services Authority (FSA) in December 1998 to ensure that consumers' interests are represented in the development of the regulation of financial services. The Panel is independent of the FSA so that it can: advise the FSA on policy as it evolves, monitor the FSA's effectiveness in meeting its statutory objectives towards consumers, review developments in financial services where they impact on consumers, and publicly report its findings and recommendations. It can raise its own concerns and has resources to carry out its own research.

Who is on the Panel?

Colin Brown

Colin is a consultant specialising in consumer affairs, working with consumer organisations throughout the EU and in Central and Eastern Europe. Previously Deputy Director of Research at the Consumers' Association and Senior Fellow at the Policy Studies Institute, he has over 25 years' experience of research and development in social and consumer policy. He was appointed to the Panel in December 1998 and appointed Chairman in January 2001.

Ann Foster (Vice-Chairman)

Ann is an independent consumer affairs consultant and a formerly Director of the Scottish Consumer Council. She is a member of Postwatch, the Consumer Council for Postal Services, and a member of the Health Professions Council. She was appointed Vice-Chairman of the Panel in January 2001.

Jean Gaffin OBE

Jean chaired OFTEL's Advisory Committee on Telecommunications for Disabled and Elderly People until 31 December 1999 and is currently Chair of Brent Primary Care NHS Trust. She has extensive experience of working on behalf of vulnerable customers. Previous positions include: the Executive Director of the National Council for Hospice and Palliative Care Services and Chief Executive of Arthritis Care. She was appointed to the Panel in December 1998 and re-appointed January 2002.

Yvonne Gallacher OBE

Yvonne is Chief Executive of Money Advice Scotland, set up in 1989 by Scottish Consumer Council. She has over thirteen years' experience of consumer credit/money advice issues and of working with vulnerable consumers in a variety of roles, including debt counsellor, trainer and manager. She has also lectured and co-authored a Guide to Money Advice in Scotland. Yvonne is presently a member of the FSA Consumer Education

Forum and Credit Union Consultation Panel. Yvonne is a member of the Scottish Consumer Council. She was appointed to the Panel in December 1998 and re-appointed January 2002.

Harriet Hall

Harriet is a solicitor with considerable experience of consumer policy and retail financial services. She is a former legal officer with the National Consumer Council, where she has worked on the needs of low income consumers, banking, credit, mortgages, regulation of equity release and long-term care insurance, the Financial Services and Markets Bill and the proposed EU directive on distance selling of financial services. She was appointed to the Panel in January 2001.

Dianne Hayter

Dianne is on the Board of both the National Consumer Council and of the newly established National Patient Safety Agency. She was formerly the Chief Executive of the Pelican Centre (a cancer charity). Before that she had periods as the Director of Corporate Affairs of the Wellcome Trust, Chief Executive of the European Parliamentary Labour Party, Director of Alcohol Concern, General Secretary of the Fabian Society, a journalist and trade union research officer. She is a member of the Labour Party and on their National Executive Committee. She is currently also a research student at Queen Mary College, London. She was appointed to the Panel in January 2001.

John Howard

John is a solicitor with extensive experience of consumer issues as a presenter of the daily consumer panel programmes on Radio 4 'You and Yours'. He is currently a freelance broadcaster and his work includes presenting personal finance programmes. He is a member of the Mortgage Code Compliance Board. He was appointed to the Panel in October 2000.

Vinod Kumar

Vinod is a social scientist with market research skills and extensive voluntary and public sector experience of policy analysis and research. Until recently, he was Head of Policy and Research at the Royal National Institute for Deaf People, and he has previously worked for the Commission for Racial Equality. Now retired, Vinod is currently a Non-Executive Director of the Barnet Primary Care Trust, and a member of the Consumer Liaison Group of the Medical Research Council. He was appointed to the Panel in October 2000.

Nick Pearson

Nick is the National Money Advice Co-ordinator for the Federation of Information and Advice Centres. A career spent in advice organisations including the National Association of Citizens' Advice Bureaux where he was manager of the Money Advice Support Unit, he has particular experience of credit, debt and personal finance issues and of working with vulnerable

consumers. He was appointed to the Panel in December 1998 and re-appointed January 2002.

Paul Salvidge

Paul is a former senior civil servant with experience of regulatory work, employment law, competition, consumer protection, telecommunications, financial services and company law. He was previously Competition Policy and Consumer Affairs Director at the Department of Trade and Industry. He was appointed to the Panel in October 2000.

Richard Smethurst

Richard is Provost of Worcester College, Oxford University; previously a non-executive Director of IMRO, he chaired their Training Standards Panel. He has served as an economic adviser in Whitehall, and on the Monopolies and Mergers Commission, where he was Deputy Chairman. He was appointed to the Panel in December 1998 and re-appointed in January 2001.

Dave Watts

Dave is a partner in a media business, which is involved in publishing, editing and journalism - personal finance plays a large part in this. He is a former editor of Which? and Money Which? and former Assistant Director of Consumers' Association. He was also a policyholder representative on the Insurance Brokers Registration Council for nine years. He was appointed to the Panel in December 1998 and re-appointed in January 2001.

Jane Vass

Jane is an independent consumer researcher specialising in financial services. She is a former Head of the Financial and Economic Research Group at Consumers' Association. Her current committee memberships include Council of the Ombudsman for Estate Agents and the FSA Training Advisory Panel. She was appointed to the Panel in December 1998 and re-appointed January 2002.

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