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Dear John

## **Stakeholder products and the sales regime**

I am writing to make some points about the Sandler 'Stakeholder' products and the options for regulating their sale. The Panel and the FSA have an ongoing discussion on this important subject, but at this stage I thought it would be helpful to put several specific points on paper.

First I should repeat the Panel's view about the medium-term product in the Sandler suite. Even with the proposed 60 per cent limit on equities, the product will be a hazardous savings vehicle for people who have no previous investment experience. If it is used by savers who mistakenly intend to use it for short-term savings or, perhaps more importantly, savers who might find that at a later date they have a pressing need to cash in the product, then they could well lose money if they have to sell when the market is low. We therefore do not accept that investment risk has been reduced sufficiently to sell it through a streamlined regime such as the FSA's Option 2. As I mentioned during the FSA Annual Meeting, FSMA makes it clear that the risk profile of the product is not the only factor to be considered: the experience and understanding of the target market are also important, and the Stakeholder initiative is purposely aimed at people who have low to middle incomes and who have little or no experience of saving or investment.

There is, of course, no guarantee that equity prices will rise even over the medium term. They may well fall. People may be better off investing in index-linked National Savings products or property. Why push them into equities through a government-approved stakeholder plan? This risk should at least be explained to them.

Clearly the FSA's research on Option 2 will be provide key information and the Panel will seek to discuss the project with FSA staff over the coming weeks. Our initial reaction is that it will be as important to research the way in which firms would sell the products as it will be to research consumer handling of guided self-help scripts and forms. One of the essential elements of the Sandler approach is to give sales

staff greater freedom to sell. To assess consumer reactions to the sales process the FSA will need to get an idea of how those sales staff will behave under the streamlined regime – otherwise regulatory decisions will be made knowing only one half of the story. We are concerned that with a simplified regime, unsophisticated consumers may be actively pursued and sales forces given sales targets which will encourage poor selling practices. The targeting of low income consumers for the sale of sub prime mortgages is an example of how badly things can go wrong.

Meanwhile we note that the FSA has not made a final decision on the sales process, but we also note that the Stakeholder project as a whole has a considerable momentum. We hope that while fundamental issues are still under examination (such as the risks of the streamlined sales process and the level of the charge cap), the currently proposed model does not harden into a new orthodoxy. It would be a pity if the policy development process –regarding either the Treasury’s product range or the FSA’s selling regime – reached a point of no return before the basic elements of the policy were known to be viable. We too recognise the problem of the savings gap and the need to help people arrange their financial lives better than many do today. There are alternative ways of approaching those problems, even within the general framework of a ‘Stakeholder’ group of products, and to illustrate that I think it is worthwhile outlining three of them here.

Alternative 1: A financial health-check as an entry point. The Panel has suggested this before. One way of securing suitability would be to have a generic advice ‘front end’ on the Stakeholder transaction. If free or low-cost generic financial advice were much more widely available through a variety of outlets, as proposed by consumer groups (the Consumer Panel, the Consumers’ Association and the National Consumer Council), then it would be possible for Stakeholder sales to be made on the basis of a prescription from such an advice session. It could centralise the costs of providing advice. Furthermore, it might be possible to utilise the FSA’s own Healthcheck tool if it were further developed for this purpose. Not only would this reduce the risk of the medium-term product being mis-sold or ‘mis-bought’, but it would also secure a much needed general financial review for consumers – most of whom have needs that will not be satisfied simply by an opportunity to get a small stake in the equities market.

Alternative 2: Omit the medium-term investment product. The Panel did not oppose the existing streamlined sales process introduced for Stakeholder Pensions (Mark I), namely the decision tree approach. The original Stakeholder, when compared with most other personal pension products on the market at the time of its launch, was a consumer-friendly product. Moreover, in any pension the long-term nature of the investment is built in, and that is understood by most consumers: a pension is something that pays out in retirement. It is very unlikely to be misunderstood to be a short-term savings vehicle, or to be misrepresented as such. For those reasons, and because the FSA research showed that the decision trees worked, the Panel supported the simplified regime. Following the same logic, we do not regard the Stakeholder (Mark II) pension product in the same light as the medium-term product. Although we do think that there could be a problem of opportunity cost (we have said before that many younger people ought to sort out their debt problems and protection needs before putting their available money into a pension) we do not see the same consumer risks of unexpected losses as with the medium-term product. A

Stakeholder package comprising the pension and the cash product would be a reasonable candidate for a modified sales regime, subject to consumer research.

Alternative 3. Make the FSA the gatekeeper. The FSA operates a risk-based regime and would be the logical body to assess the risk involved in a transaction. It is currently developing its methodology for product risk assessment. One model for approaching a simplified regime for lower-risk products would be to give the FSA the responsibility of assessing product designs submitted by the industry and allowing them into a simplified regime if they qualify. The FSA is no stranger to product regulation: it already scrutinises investment scheme offerings and makes rules about asset allocation, and about particular sales channels for particular products. The regime would not necessarily correspond with any of the three Options. Just as the products should not be set in stone, the approach to a modified selling regime should not necessarily be the same for all 'low risk' products. This model would be more flexible over time than the prevailing Stakeholder model whereby HMT designs a product and the FSA then tries to fit a regime to it. The criteria to be used when assessing products would be subject to the normal FSA public consultation.

I have described these alternatives because we think it is important that the debate does not narrow down at this point. There are probably other alternatives too. You know that from the consumer side – and not only from the Consumer Panel - we see real dangers in the Stakeholder project as it is shaped now. We think it is still possible, however, that a version could be developed that delivered a number of important benefits both to the consumer and to the industry. But that will need the debate to stay open, and for other options to be taken seriously.

Yours sincerely



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