

Financial Services Consumer
Panel submission to the Treasury
Committee's inquiry into
'Restoring confidence in long-
term savings'

January 2004

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Key messages

- i. It is in firms' long-term interests to develop strategies for treating their customers fairly. They must put in place mechanisms for ensuring such strategies agreed in the Boardroom are transferred to sales staff. Firms must show more willingness to address mis-selling problems and put them right, quickly.
- ii. There are still too many firms who persistently behave poorly, which suggests the FSA must be sceptical about firms' willingness to treat their customers fairly. The FSA's monitoring and enforcement of standards in the industry are crucial in providing the right incentives for firms.
- iii. Some firms will only respond to radical action on the part of the regulator. This could include, for example, a league table of bad behaviour. Firms who treat their customers fairly have much to gain from such an initiative as it would help them differentiate themselves from poor behaving firms.
- iv. The FSA should be unapologetic about requiring firms to explain important information to consumers in ways that are meaningful to them. The FSA's monitoring and enforcement of firms' financial promotions are crucial in reducing misleading information.
- v. The Government should be as concerned about consumer protection as it is about the savings gap. Ignoring consumer protection needs will reduce confidence and cause further problems for the savings gap in future.
- vi. The Government and the FSA need to progress proposals to provide consumers with the generic advice they need.
- vii. We are concerned about proposals to add an appeals procedure to the Financial Ombudsman Service (FOS). We hope that the Government and the FSA act to retain the virtue of a speedy and simple ombudsman by rejecting these proposals. Giving firms a further opportunity to drag their feet in paying consumers compensation will diminish confidence in the sector.
- viii. The Government and the FSA must influence the EU early on in discussion about future directives so that they improve on, rather than undermine consumer protection in the UK.
- ix. The Office of Fair Trading's (OFT) review of the effects of the Financial Services and Markets Act (FSMA) on competition should investigate the extent to which the market is anti-competitive because a lack of information diminishes consumers' ability to exercise their power and influence the market. Current regulations have proved too weak in allowing firms' to act anti-competitively by providing consumers with complex and even misleading information.

Introduction

1. Consumers' confidence in the financial services industry and long-term savings has been damaged because too often, the outcomes in this market do not meet consumers' needs. One indication of this is when consumers stop paying into long-term products within the first few years, lapsing. According to the FSA "lapse rates have increased on almost all products in recent years"¹.
2. Behaviour by too many firms has led to a gap between what consumers want and what they get.
 - In the market for financial products, the way in which some firms compete on product variations and the way they are marketed make it difficult for consumers to identify whether a product meets their needs. (A market made confusing for consumers, paragraphs 8-10.)
 - In terms of advice, there has been persistent failure to identify consumers' needs, and widespread sales of unsuitable products. (Poor advice, paragraphs 11-13.)
 - The reluctance of some firms to treat their customers fairly is at the heart of the problem. (Firms' culture, paragraphs 14-15.)
3. It is accepted that the asymmetry of information between the consumer and the firm is far greater in the financial services industry than in other industries, and this is the primary reason for regulation in this sector. However, some firms have taken advantage of this unequal relationship to further complicate products and their marketing and to offer poor advice. This has resulted in a marketplace that is characterised by, according to the Chancellor, Gordon Brown MP, "a vast range of subtly differentiated products" where "advice itself is often compromised by the incentive effects of commission paid by products providers"². The FSA has not been effective enough at creating a more equal relationship between firms and consumers.
4. In addition to the way firms treat their consumers, recent poor investment returns have knocked consumer confidence. (Market performance, paragraphs 16-17.)
5. Furthermore, the market does not deliver good quality advice to the mass market about the whole of their financial planning needs. Whilst the Government and the FSA acknowledge the need for such advice, little progress has been made on finding a solution. (The advice gap, paragraphs 18-19.)
6. We set out the changes needed in order to address these problems, paragraphs 20-29, and future threats to confidence in long-term savings in paragraphs 30-37.
7. Finally, we note that not everyone with a 'savings gap' should be prioritising saving over other financial needs. The lack of confidence in long-term savings is not the only factor influencing the level of saving. Not only is market volume a poor indicator of confidence in long-term savings, but attempts to drive consumers into products that may not be right for them would severely damage confidence in the long-run. (The savings gap and confidence in long-term savings, paragraphs 38-43.)

¹ FSA Occasional paper 21 – 'Stopping short: why do so many consumers stop contributing to long-term savings policies?', January 2004.

² Foreword to 'Medium and long-term retail savings in the UK', a review by Ron Sandler for HM Treasury, July 2002.

The lack of confidence in long-term savings

A market made confusing for consumers

8. Many firms in the financial services market compete for market share in ways that are often not in consumers' best interests. In his report, 'Medium and Long-term retail savings in the UK', Ron Sandler identifies some of the offending features of this market:

"opaque and inconsistent terminology; lack of clarity and consistency in the reporting of product charges; proliferation of products; and product differentiation that does not reflect true differences in what is being offered".³

9. By taking advantage of consumers' lack of understanding in this way, consumer confusion is further compounded. Faced with a lack of trusted independent guidance about their whole financial situation, a problem particularly acute for the less well off, many consumers switch off.

"Consumers were more or less aware of the need to make longer term provision via life assurance, pensions and investment products etc., but many were frustrated by the inability to understand the ins and outs of these products. Some actually turned away from these choices because they did not feel able to understand or assess what was on offer."⁴

10. Even when consumers have identified a financial need, they may not be able to identify how to meet it.

"Many consumers have good intentions regarding the improvement of their financial situation, and would like to think that when (or if) they have some extra money they will:

- plan to save more in the short-term; or
- plan to start a pension/take out life assurance to cover themselves for the longer-term.

However, there does not appear to be any real understanding of the most beneficial route for any such funds or income."⁵

Poor advice

11. Large scale and widespread mis-selling by financial services firms has been a feature of the retail financial market throughout the lifetime of the majority of today's consumers. Our research, below, shows that consumers lack confidence that firms will sell them products that are right for them.

"There was a widespread sense that some financial organisations were not very straightforward with their customers and did not always give them the full picture. There was a strong feeling that sales staff would present the plus points of a product without necessarily spelling out the downside very clearly. This failure to disclose significant terms clearly was seen as, at best, underhand."⁶

"Many financial organisations are seen to be purely sales orientated, and recommend solutions not based on what is best for the consumers, but on which they will receive the most commission."⁷

³ Page 47, 'Medium and long-term retail savings in the UK: a review', July 2002.

⁴ Page 26, 'Consumer concerns in Great Britain', research report for the FS Consumer Panel, by Andrew Irving Associates, Spring 2003.

⁵ Page 6, 'Understanding financial needs', research report for the FS Consumer Panel, by ORC International, Spring 2003.

⁶ Page 22, 'Consumer concerns in Great Britain', research report for the FS Consumer Panel, by Andrew Irving Associates, Spring 2003.

⁷ Page 5, 'Consumer concerns in Northern Ireland', research report for the FS Consumer Panel, by MORI MRC, Spring 2003.

12. It appears that commission can still be a more powerful driver than the desire to sell the most suitable product. The review, below, in the trade magazine for financial advisers, Money Management, demonstrates the risk to consumers when advisers are commission driven. This review, of a product with the potential for 100% capital loss, begins with the commission payable to advisers.

“Norwich Union has launched the fourth tranche of its Fixed Income Plan, paying 0.25 of a percentage point more than the 3% standard commission. The five year product offers annual income of 5.65% or monthly income of 0.44%. Capital return is linked to the performance of the FTSE 1000. If it falls by more than 30% during the term, capital will be eroded by 1% for each 1% that it finishes down. Close date: 6 February 2004”⁸

13. Furthermore, the burden of the pension review has not discouraged some from further mis-selling. Mechanisms that may encourage mis-selling persist, such as remuneration packages to sales staff that incentivise sales with no balancing incentive not to mis-sell.

Firms' culture

14. The complicated retail market and persistent record of mis-selling are two manifestations of the deep-rooted culture problem in firms. This has damaged confidence in long-term savings. Whilst the Association of British Insurers (ABI) has launched an initiative called 'Raising Standards' for the industry there is little evidence of firms putting into place the mechanisms required to ensure better treatment of customers.
15. An example of the problem is illustrated by some firms' reluctance to put things right when poor treatment of customers comes to light. In December 2003, we raised with the Treasury Committee our concerns that firms were reluctant to put right endowment mortgage mis-selling by swiftly compensating those consumers due compensation⁹. The FSA announced on 17th December that it was fining Friends Provident for mis-handling of mortgage endowment complaints and forcing the firm to review complaints received between January 2000 and 10 February 2003.¹⁰ The FSA's action shows that even after being warned by the FSA (John Tiner's letter of April 2002) about firms' handling of mortgage endowment complaints, this firm failed to treat its customers fairly. The FSA has to do more than send messages to the industry to get them to raise standards. Sometimes only enforcement will achieve the desired result.

Market performance

16. Poor investment returns in recent times have dented consumer confidence.
- “Some respondents had been sold endowments mortgages which had subsequently performed well below the expectations generated at the time of sale. Others had found the performance of their pension funds had been disappointing. The uncertainty of returns from life assurance and pension companies, linked to the fall in the value of stocks and shares left many feeling less confident about the sector as a whole.”¹¹
17. Of course, those consumers that understood the performance risk of their investment should accept the implications of recent performance. However, mis-selling has exacerbated the effect on confidence of poor market performance. Consumers who were not aware of the risks when they took out their product will particularly blame the industry for their financial loss.

⁸ Page 18, Money Management (January 2004), review of Norwich Union's high income bond.

⁹ Paragraphs 35-38, FS Consumer Panel submission to Treasury Committee on 'Restoring confidence in long-term savings – endowment mortgages'.

¹⁰ FSA press release 'Friends Provident fined £675,000 for mis-handling of mortgage endowment complaints, 17 December 2003.

¹¹ Page 14, 'Consumer concerns in Great Britain', research report for the FS Consumer Panel, by Andrew Irving Associates, Spring 2003.

The advice gap

18. Consumers want and need advice in managing their money. According to the FSA, “two-thirds of consumers think that financial matters are ‘too complicated for them’ and that they do not know enough to choose suitable financial products”¹². The industry does not currently deliver the general financial planning advice to the mass market needed to address this problem. Finding money matters difficult can prevent consumers from engaging with their financial needs.

“It is clear that few consumers are identifying or prioritising specific financial goals as part of an overall financial planning process. There is little formal process consumers go through to identify what their individual financial goals should be, how to prioritise these goals, and how they could be achieved....

...Some continue to be unclear as to the type of financial products they actually have and there is also confusion and misunderstanding as to what financial products are suitable and whether consumers have chosen the ‘best’ products for their situation.”¹³

19. This lack of engagement with their financial needs will also deter engagement with the financial services market. Research for the Consumers’ Association showed that: 13% of respondents don’t know whether they are saving enough; 52% don’t think they are saving enough and when asked why, 47% of these say it is too expensive to pay for advice about saving.¹⁴

Changes needed

Promoting competition

20. One way to increase competition to consumers’ benefit is to introduce measures that truly reduce information asymmetry and empower consumers to shop around on price and quality. The FSA recognise the importance of increasing consumer understanding and are developing a national strategy for raising consumers’ financial capability¹⁵ which we welcome. However, an important element of consumer understanding is determined by the information they receive from firms and it is not realistic to expect consumers to be experts in financial matters so that they can spot misleading statements or understand much of the jargon used by the industry. There are a number of FSA requirements on firms to help consumers understand and compare price and quality but they do not go far enough in helping consumers to understand the information and why it is important.

- Misleading promotions were responsible for a large proportion of the consumer losses associated with ‘precipice bonds’ and split capital investment trusts (split caps). We have criticised the FSA’s approach to policing financial promotions¹⁶ and have welcomed the FSA’s subsequent commitment to devote more resources to this activity and to developing a strategy for this work. However, despite the FSA’s own research¹⁷ indicating that including monetary values to illustrate past performance in advertisements has the potential to mislead consumers, the FSA has pulled back from banning their use.
- To help consumers understand the service they would receive from firms after ‘de-polarisation’, the FSA will require firms to give an ‘Initial Disclosure Document’. The

¹² Page 6, ‘Towards a national strategy for financial capability’, FSA, November 2003.

¹³ Page 5, ‘Understanding financial needs’ research report by ORC, for the FS Consumer Panel, Spring 2003.

¹⁴ Advice for life campaign briefing, Consumers’ Association, May 2002.

¹⁵ ‘Towards a national strategy for financial capability’, FSA, November 2003.

¹⁶ Page 21, FS Consumer Panel Annual Report 2002/03.

¹⁷ FSA Consumer Research Paper 21 – “Standardisation of past performance”, May 2003.

range of services offered by firms following depolarisation will be confusing and we have asked the FSA to explain it to consumers in terms of the consequences for them. For example, instead of the FSA's proposal that consumers are told 'We [can] only [select] [deal with] products from a **limited number** of companies.', we proposed 'We can select/deal with products from only a limited number of companies. What we recommend will be the best for you from this range, but not necessarily the best in the market'.¹⁸

- The disclosure documents that consumers are given to help them decide whether a product is right for them could go further in helping consumers understand the risks by explaining how it relates to them. E.g. – 'not for you if you can't afford to lose capital' or 'not for you if you may need the money within 10 years'.

The FSA should be bolder in empowering consumers in this way and unapologetic about requiring the industry to explain things to consumers in clear and meaningful ways. Consumers need to understand the consequences of the information so that they can engage with it.

21. We further note the role that financial journalists play in explaining the market and products to consumers. Journalists should empower consumers to play a more effective role in the market, but have at times written misleading articles that may have contributed to 'mis-buying'.
22. Ron Sandler's solution to asymmetric information is to offer simplified products in a simplified selling regime. We explain in paragraphs 31-34 why we think his proposals pose a further threat to consumer confidence.

Encouraging and enforcing higher industry standards

23. It is in firms' long-term interests to better meet consumers' needs. Whilst firms talk about raising standards and the FSA tells them to do so, there appears to be little change in the way that some firms treat their customers. If senior managers of firms are serious about competing on the basis of price and quality, rather than obscuring them, they must introduce systems to effect change throughout their organisations. For example, they could introduce smarter remuneration packages that discourage mis-sales.
24. The FSA must remain critically objective about the industry and back up its calls for higher standards by thorough monitoring and enforcement action where necessary. Mechanisms to change the culture in firms could include more fines on individuals to incentivise compliance and more transparency about poor performing firms, this could even include a league table of bad behaviour. Good firms would benefit from such transparency as they would be able to differentiate themselves from poor behaving firms.
25. The FSA must make use of mystery shopping to find out what is really going on in firms at the level of customer contact. There may also be scope for developing 'consumer audits' of firms to evaluate a firms' customer strategy, and its implementation.

Closing the advice gap

26. Consumers need help, in the form of generic advice, to engage with financial matters and the financial services market. The industry would benefit from increased sales but this should not be the overriding aim of a such a service, and indeed there may be other financial needs that are met first. The Association of British Insurers in their publication 'Closing the Savings Gap' refer to research by Oliver Wyman & Co which they say proves that the savings gap is linked to the advice gap. They go onto say "for some, the right answer is not to buy a savings product, and the urgent financial problem is debt management. For others the right financial answer does not lie with the savings industry, and the urgent financial problem is with a bank account or credit card company. For still

¹⁸ FS Consumer Panel response to the FSA's consultation paper 166, May 2003.

others, the service they want is information, generic explanation and re-assurance, not a sale.”¹⁹

27. The Government would also benefit from the provision of generic advice as it would help address concerns of over-indebtedness as well as other financial needs on the Government’s agenda. Successive governments have sought to encourage saving by offering tax incentivised products. Too often this has further complicated the retail market without raising the level of savings.²⁰ We think a more effective use of taxpayers money may be to fund a service for consumers to help them manage their money.
28. In July 2002, we called for the Government and the FSA to conduct a feasibility study into providing a generic advice service.²¹ Whilst this feasibility study has not been undertaken, the FSA has made some progress. In March 2003, the FSA produced a prototype of a ‘financial healthcheck’, a computer based programme to help consumers identify their needs. In November 2003, the FSA announced
- “The FSA will explore the scope for developing interactive generic advice service(s) (using people or technology or both). The aim is to help consumers identify their needs and to provide them with generic solutions: it is not about providing product-specific recommendations. It may be possible to build on advisory services and other facilities which are already available.”²²
29. They now need to make rapid progress on these proposals.

For large groups of consumers no amount of simplification, education and information will obviate the need for accessible, independent and good quality help, generic advice, in understanding their financial needs and how to meet them. Furthermore, no amount of generic advice will overcome the lack of confidence consumers have in the market unless errant firms change their culture and develop strategies to treat customers fairly that are not only talked about in head office, but implemented in the market.

Future threats to confidence in long-term savings

30. There are a number of decisions to be taken by the FSA, Government and others over the next few years that will influence future consumer protection and therefore future confidence.
31. The Government is to launch a suite of ‘simplified products’, Sandler products, to be sold through a simplified selling regime. Under this regime consumers will not be given advice as to what is suitable for them and as a consequence will have less protection if the product does not turn out to be right for them. The FSA’s research into the first draft of the filtered questions for the proposed regime demonstrated considerable risk of consumers not understanding the protection afforded them.

“37% [of respondents] felt that the firm who gave them the recommendation would be responsible and therefore they would be able to complain.”²³

¹⁹ Closing the savings gap: why the savings industry wants to change, ABI July 2002

²⁰ Page 147, Medium and long-term retail savings in the UK, a review by Ron Sandler for HM Treasury, July 2002.

²¹ Financial planning advice, briefing by the FS Consumer Panel, July 2002.

²² Page 12, ‘Towards a national strategy for financial capability’, FSA, November 2003.

²³ Page 24, Consumer Research 23: Consumer testing of a filtered questions approach to selling stakeholder products.

32. We are very concerned that Sandler products could be the next case of widespread sales of unsuitable products because consumers may not understand the risks of some of the products, which are equity based, and may even have felt that the Government somehow guaranteed the products. The FSA's research also demonstrated this risk.

"22% agreed that 'the government will guarantee the amount of money you get back from 'Sandler' products."²⁴

33. Many in the target market for these products do not know when a product is equity based and don't think these products are relevant to them, which makes mis-buying more likely.

"There is clearly a general mis-understanding of the so-called more 'sophisticated' financial products. Although many seem able to identify which products could be 'risky', they do not appear to understand why this is the case. In particular, many do not understand which products are linked to the stock market, and what the term 'equity' means. At the most basic level, there is some understanding that capital could be lost, or conversely that money could be made with 'risky' products. Equity-based products are not perceived to be relevant to their financial situation, and most do not plan to look into these products further, classifying themselves as risk-averse".²⁵

34. Any such widespread problems are likely to have a more fundamental effect on confidence than previous 'scandals' as the consumer's rights to redress would be restricted compared with those they have when buying on full advice. Some people have suggested that the previous government's agenda to encourage consumers to make private provision for their retirement helped fuel mis-selling in the past. We warn against prioritising closing the 'savings gap' over consumer protection issues. The resulting consumer detriment is likely to further undermine long-term confidence in the savings industry.

35. As part of the N2+2 review of FSMA, the Government has announced²⁶ a review to consider whether the FOS should be subject to appeals. We believe this diminishes the current advantage of the FOS as a speedy and simple adjudicator and would lead to firms further dragging their feet in paying compensation to consumers. The consequent reduction in confidence would be wider than the consumers affected as the press will feature their cases.

36. European Union (EU) directives impacting on financial services regulation too often threaten to weaken consumer protection in the UK. The Government and the FSA need to be better at promoting understanding of the UK's regime in the EU and influencing policy at an early stage to improve on, rather than weaken the UK's regime.

37. Anti-competitive forces in the financial services market comes from firms diminishing consumers' power in the market, paragraphs 8-10 above, rather than from regulations that try to raise standards in firms. The review of competition by the OFT of the effects of FSMA on the financial services market, announced as part of the N2+2 review²⁷, should consider how the FSA could better prevent firms from this anti-competitive behaviour, rather than looking for ways to allow them more freedom to indulge in it.

²⁴ Page 23, Consumer Research 23: Consumer testing of a filtered questions approach to selling stakeholder products.

²⁵ Page 5, 'Understanding financial needs', research report for the FS Consumer Panel, by ORC International, Spring 2003.

²⁶ Review of the Financial Services and Markets Act 2000, HM-Treasury press notice, 4th November, 2003.

²⁷ Review of the Financial Services and Markets Act 2000, HM-Treasury press notice, 4th November, 2003.

The savings gap and confidence in long-term savings

38. Whilst a lack of confidence in long-term savings may discourage people from entering the market, there are many other reasons why consumers may not be saving. Confidence in this market should not be measured by market volume. Similarly, the Government should not aim to increase saving per se, but to increase the extent to which consumers' needs are met.
39. If the savings gap is defined as additional savings needed in order to have a comfortable retirement, it is not always the case that the best course of action for those affected is to increase their savings.
40. Consumers' may have other financial needs. For example, some may have debts which they are struggling to repay and that attract a higher rate of interest than any saving would. B&W Deloitte's research shows that 38% of people have non-mortgage debts of, on average, £4600 and this figure does not include credit card balances that are paid off each month. Of this non-mortgage debt, which totals £79bn, 21% is from 'rolling debt': credit cards, store cards, catalogue debts and overdrafts. All interest rates on debts, but especially on rolling debt, are likely to be significantly higher than any return on savings. It is important, therefore, that these consumers consider clearing their debts before buying long-term savings products. Other consumers may be better off by ensuring they have adequate protection for them and their dependants if they should be unable to work or in the event of death.
41. Some consumers may prioritise today's spending needs ahead of tomorrow's to the extent to which saving is precluded. The Government and FSA should be concerned with ensuring that this is a decision based on sufficient understanding of the options and consequences. Consumers should understand the extent to which they can rely on help from the state for their retirement. Understanding the risk and consequences of relying on their housing assets to fund their retirement is also important.
42. However, some people don't save because they can't afford to. There are, therefore, policy implications for government that are outside the control of firms and their regulators and will not be resolved by consumer education.
43. Policy to address the savings gap must acknowledge the heterogeneous nature of the consumers who are not saving enough to have a comfortable retirement. Providing generic advice will be key to addressing consumers' different needs.