

***Infoline conference: simplified products
Dianne Hayter, the consumer perspective
1st July, 2004***

The Consumer Panel's first response to Sandler – and one which has remained with us throughout – is that the regulatory regime must ensure that people are sold products that are suitable for them.

That is all we ask.

Yet there has been a certain deafness – in Horse Guards Road – as the Chancellor and friends have not readily acknowledged the consumer protection hazards of selling products without adequate advice.

And the industry has not always helped, labeling “salespeople” as “advisors” when their motivation is to sell rather than to advise.

Meanwhile, Government, the FSA and industry – whilst all wringing hands over the “savings gap” – have so far failed to address the need to fund and provide unbiased, cheap or free, accessible generic financial advice for those entering this complicated, risky market.

John Tiner has acknowledged that “free or low cost generic financial advice .. would help consumers make better decisions and ... constitute an additional safeguard”¹. And a Working Group has been established as part of the Financial Capability Strategy. But that's all that has happened so far. The Panel is, by contrast, delighted that the current Sandler stakeholder proposals recognise the need for some suitability – and affordability – tests for Sandler products.

These should identify those potential consumers who may already have appropriate products or eligibility, such as an occupational pension scheme.

They should also deal with alerting consumers to the need to keep up payments.

And they should deal with consumers who may have more pressing financial needs – such as paying off troublesome debts, or providing protection for their family should they be unable to work.

However, whilst saying that, the FSA's research on filtered questions showed very low recall of the warnings and prompts about dealing with more pressing financial needs.

Only 1 in 5 of those warned to sort out their existing borrowing spontaneously recalled this warning.

¹ John Tiner letter to Colin Brown, 4 September 2003.

Only 1 in 10 spontaneously recalled being warned to arrange protection cover for their family.

Furthermore, the “understandability” factor remains of concern.

Consumers may not understand the equity element of the product nor the risk they are taking.

And they may not understand the long-term nature of the product.

The Financial Services Consumer Panel commissioned research into consumers’ understanding of their financial needs.

These findings should not make us complacent.

Many consumers do not understand the risks attached to equity products, or even which products are equity based. Let me give you a couple of quotes from our research²:

“Equity ISA – does that mean the stocks and shares ISA, or the cash ISA? Well, I suppose they are both in the same [risk bracket]”³.

“I’ve heard the terms ... wouldn’t know the difference between a cash ISA and an equity ISA ... Equity is probably in your house?”⁴

These people are as bright as any of us in this room – it’s simply that their specialism lies elsewhere. They may be doctors, nurses, chefs or engineers – people on whose skills we rely in our other walks of life, and of whose expertise we may understand nothing.

Sir Richard Sykes, late of Glaxo-Wellcome, now Imperial College, also likens the investment and savings business to medicine, where you entrust a professional to make a decision. But by the time you can tell whether the doctor was right, Sykes points out, it may be too late. He draws from this that this industry needs a similar code to the Hippocratic Oath.

I ask only that the industry takes account of the inequality of understanding and knowledge between buyer and seller. All of us happen to be steeped in one part of consumers’ lives which is vital to their future but about which they rarely think. They will have different levels of debt, some will have a heavy mortgage, some almost none and some keen to acquire one. Many have no dependent’s protection. Many – more than when I started in my working life – will have uneven, perhaps freelance, earnings. Fewer will have occupational pensions to rely on.

² *Financial Services Consumer Panel Annual Report, 2004, p.10*

³ (pre-school children, low-debt, middle income)

⁴ (at school dependents, high debt, middle income)

Is it not then quite possible for some of these to get it wrong with Sandler? Yet it will matter if they squirrel away their only reserves in an equity-based product which they then can't fruitfully release should circumstances require it.

What the results of the Panel's research also showed was that consumers do not think about their financial needs in the way that advisers, the FSA or the Government do. For example, consumers who were saving were likely to think of their savings as developing a pot of accessible money which is multi-functional. This suggests that the products intended to meet medium-term financial needs (the medium-term investment product and smoothed investment fund) are at risk of being mis-understood by the consumer.

This raises concerns about consumers buying (or being sold) unsuitable products because they don't understand the risks of equities, or the nature and implications of medium- and long-term products.

To quote John Tiner again (well, don't we all?!):

"The risk profile of the product is only one of the factors to be considered in devising a regulatory regime ... Consumers need a level of assistance or competitively priced advice to help them choose suitable products and .. they need information to understand the products, taking account of product complexity and their own understanding of, and attitude to, risk".

I wonder if any of the people these products are designed to serve really want to risk their – perhaps only – savings possibly losing their value at the very point they need them for a child's wedding or to cope with unforeseen illness.

Will the Filter Questions really warn about this? The jury is still out, but John Tiner has reassured us that the questions must be *"effective in warning off consumers whose circumstances suggest a particular product would be a poor choice. This is one of the key outcomes we will be looking to test in our research"*. The first round of research showed that the script was not effective enough at matching people to products that would be appropriate for them

We were therefore glad that the FSA decided to revise the script and test again. The second set of research which has just been published also shows unsatisfactory results for the revised script.

A couple of findings from this second round of research highlight the significant risk of consumer detriment:

Overall, of all the products recommended, less than three quarters were deemed to be 'good outcomes', i.e. – suitable.

For personal pension recommendations, the proportion of good outcomes was only just over a half.

For equity non-ISA recommendations, the proportion of good outcomes fell well below 50%⁵.

(None of you would be satisfied with that – either as providers/sellers of financial products – or if you yourselves were buying a new sofa by this method.)

The outcomes that were deemed not good/suitable, were because the consumer: either did not have an appropriate risk appetite for the product they were recommended, or had a more pressing financial need; or had, or was eligible for, an appropriate product already.

The FSA has therefore yet to prove that this “filtered questions” approach can provide adequate consumer protection.

The Consumer Panel will be looking to the FSA to demonstrate that filter questions can work in providing the right outcomes for the vast majority of consumers.

All of this brings me back to the consumers, their understanding of their own financial needs, of the “products” on sale (which they don’t even consider products, but ways of saving) and of their exposure to risk.

As the FSA constantly remind us, 25% of adults can’t do simple calculations – and 50% of the population doesn’t understand this sentence, because of the percentages involved.

Much of the steam behind Sandler is to try and close the savings gap. Sandler’s original report concluded – hardly to anyone’s surprise – that the savings market was daunting for the consumer, that the industry’s products were complex and opaque, and that there were weak competitive pressures on providers of financial products.

Despite all of those ills, the major progress has been on producing simpler products, with a new basic advice regime.

However, people will not rush to buy just because it has been made easier to sell – or quicker, “over their lunch break” was the phrase used.

People make their own decisions about present and future consumption.

Anyway, moving money from a deposit account to a cash ISA does not increase savings by a penny piece.

I therefore worry that Sandler products are designed to deal with the perceived problem of people not having enough for old age. Whereas confidence in the

⁵ to 43%.

future of one's savings, confidence in the industry, and an acceptance of responsibility for one's own future, are perhaps more important.

"Confidence in the Industry" is a concern shared not just by the Treasury Select Committee, but by your own industry. In his speech introducing a Report by the industry, on the industry, its Chairman, Sir Richard Sykes said last month:

*"this industry, for all its merits, has suffered a near fatal erosion of trust" and called for "a culture change" which is needed if the industry "is really to start putting the customer first"*⁶. The report acknowledges that *"people's understanding of investment risk is woefully poor"* but its diagnosis is not so much "train the customer" as that *"the onus for change lies with the investment and savings industry, not the consumer"*.

The Report itself⁷ concluded that *"there has been a significant and continuing erosion of trust, not just in the financial services industry, but also in big companies as stewards of people's savings and pensions"*, citing *"the methods used by some to achieve sales targets have tarnished the industry's reputation. The approach has been sales-driven, not needs-focused"* – indeed, it warns that people may look elsewhere to provide for their future if this does not change. The Report's authors worry about the *"lack of alignment of the incentives and remuneration of the industry with those of the long-term interests of their customers"*.

The government – even the powerful FSA – cannot tackle such problems alone. Sykes and his Panel identify the requirements for a healthy investment climate as:

- Investment confidence in the market's products and provider
- An industry with a reputation for fair dealing
- And a growing investor understanding of need.

Some of the concerns I've voiced, and some of the Syke's emphasis on the understanding of risk, would be addressed by the provision of a general financial planning service.

This would help consumers identify their financial needs and understand the options for addressing them.

Furthermore, Generic advice which people can trust is more likely to encourage consumers to set aside money safe in the knowledge it's where it should be and growing adequately, and looked after in a way that meets their requirements.

The FSA's Financial Capability strategy must make the provision of generic advice perhaps its highest priority.

⁶ Speech by Sir Richard Sykes, 15 June 2004.

⁷ *Restoring Trust: Investment in the twenty-first century*, published by Tomorrow's company, June 2004.

Without it, the Consumer Panel remains concerned about the Product (or at least the equity elements) being sold inappropriately. Secondly, that it will be sold, not bought, and sold by salespeople effectively on commission, the effect of which was NOT tested in the FSA's research on filtered questions and thirdly that it will be sold to unsophisticated consumers.

(As an aside, even I – now long used to this industry – was surprised by Sykes' tale of a consumer contributing £2,000 a year into a modest personal pension, giving the lifetime cost of the salesman's commission £12,000!)

The Financial Services Consumer Panel warned the Government that attempts to close the savings gap at the expense of consumer protection will only serve to undermine future consumer confidence.

The Consumer Panel has consistently pressed on the government and on the FSA that consumer protection must come first.

In weighing up the costs and benefits, the FSA must not value a net gain made up largely of benefits to the industry more highly than it does meeting its consumer protection objective.

The industry should set out to ensure its systems and incentive structure encourage suitable sales, or face future decline in consumer confidence which will hit their bottom line.

The challenge to the industry, to government and to the FSA is:

Can you ensure that Walter Merricks and his colleagues in the Financial Ombudsmen Services won't be faced with scores of claims in 5, 10 or 15 years' time because of what happens in 2005, 6 or 7?