

The Financial Services Consumer Panel is an independent body, set up by the Financial Services Authority to advise the FSA on its policies and practices from the consumer's point of view. There are more details of the Panel's membership and work on our website – www.fs-cp.org.uk – and in the full version of our Annual Report 2003/04, which is available from our offices, as set out below.

Financial Services Consumer Panel

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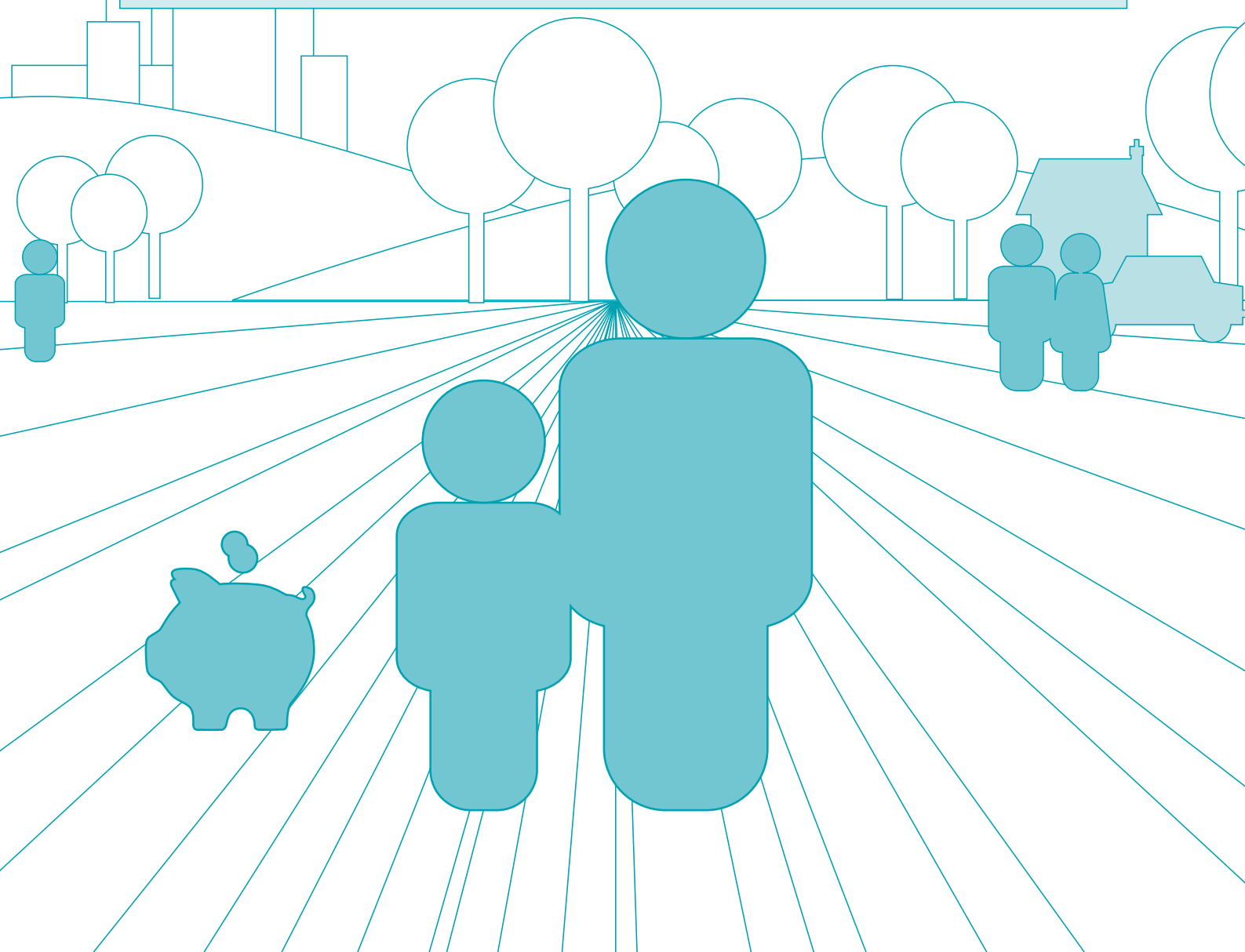
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ISBN: 1-84518-186-7



Annual Report highlights 2003/04

“The financial services sector is complex and confusing for all but the most sophisticated of consumers. There may be plenty of choice in this market but it will be a very long time until consumers can exercise their market power effectively. We look forward to the day when consumers have the information and the knowledge to demand high-quality products and services, to ask searching questions, to compare products, and to identify and resist pressurised selling and misleading advertising. But that day is a long way off and we remain disappointed that far too much of the industry is still characterised by mis-selling, misleading advertising and a failure to treat customers fairly. We implore the industry to examine itself closely and take urgent and effective steps to bring everyone up to the standards of the best. We should all share a common goal of restoring confidence in this important market so that consumers can shoulder their financial responsibilities secure in the knowledge that they are buying suitable products from reliable firms who will deal with them fairly.”

From the Chairman’s Foreword to the 2003/04 Annual Report



The Panel's main work is monitoring and advising on the FSA's policies and activities to ensure they work to promote consumers' interests. Below we outline our views on some of the major consumer issues for the FSA during the past year.

Ensuring the FSA acts to protect consumers

The FSA has made a welcome improvement in its work on consumer protection over the past year. We particularly welcomed the following initiatives:

- The '**Treating Customers Fairly**' team is now working to press firms on the FSA's requirement that a firm must "pay due regard to the interests of its consumers and treat them fairly".
- The review of **data needs** means the FSA will now collect information about which products firms are selling and to whom, while the new '**Product Risk Framework**' is a tool the FSA will use to assess the risks of particular products. So these initiatives should help FSA supervisors to identify, investigate and act on risks to consumers, based on firms' products and the way they are being sold.
- The '**Consumer Risk Group**' is bringing together people from across the FSA to identify quickly the latest risks to consumers as they emerge and the best response from the FSA to them.

We hope these initiatives will enable the FSA to meet our request to act faster in response to market developments.

We welcomed the higher profile of the FSA's **enforcement activity** in recent months. The publicity for a series of fines and consumer compensation agreements sends crucial messages to other firms to treat their customers fairly. However, this still may not be enough. It seems that some firms only respond to more radical action such as a league table of offending firms and wider publicity for the fining of firms. We will be continuing discussions with the FSA on this.

In contrast, the FSA's lack of use of **mystery shopping** has disappointed us. Mystery shopping could be a powerful tool for investigating particular concerns; evaluating changes to the regulatory regime; and providing early warning of abuses in the market place. The FSA must understand that the industry's tolerance of inadequate standards will only change if there is a credible threat of detection.

Encouraging the FSA to make sure firms treat consumers better

Many firms appear to continue to act poorly without intervention, or a credible threat of intervention, from the FSA. Yet there have been times when the FSA has **accepted industry assurances too easily**.

We are not alone in thinking this. The Treasury Select Committee called on the FSA to approach its dealings with firms with a healthy dose of scepticism, and to be much more rigorous in ensuring that the industry implements FSA policies effectively. Lord Penrose's report on Equitable Life similarly contained criticism of the FSA. The FSA itself has acknowledged that more needs to be done to ensure supervisors challenge firms effectively.

For instance, the FSA reviewed **self-certified and fast-track mortgage** applications – where applicants certify their own level of income, usually because they are self-employed, or the lender fast-tracks applications by simply reserving the right to verify income rather than checking every application. Our concern is that consumers are being encouraged to overstate their income, so they take out mortgages they may not be able to afford. The FSA seemed to accept too readily industry assurances that adequate systems are in place. Instead, the FSA should have done some mystery shopping to find out what actually happens when potential borrowers contact firms about mortgages. This will be important when the FSA takes over the full regulation of mortgage business from October 2004.

We also have concerns over the way the FSA warned consumers about the risks of **'precipice bonds'**, known as guaranteed income bonds or **SCARPs** (structured capital-at-risk products). Many firms misled consumers when promoting these products, prompting the FSA to revise its rules and guidance on their promotion. However, we said the FSA should also require firms to give consumers the clearly written FSA factsheet on capital-at-risk products, rather than letting companies use their own versions.

The FSA's new rules on firms' use of **past performance figures** in advertising and marketing material raise similar concerns. The FSA's consumer research clearly showed that using monetary values to illustrate past performance can mislead consumers. Nevertheless, although the new rules require past performance data to be presented in a standard percentage form, they do not stop the use of monetary values as well.

Pressing the FSA to make sure firms put things right when they go wrong

We have been pressing the FSA to undertake a **review of the different redress** procedures. There are several ways of assessing whether consumers are entitled to redress: asking the Treasury to require an industry-wide review of past business to identify cases where people would be due compensation (as in the Pensions Review); the FSA requiring individual firms to provide restitution to consumers; and leaving individual consumers to make complaints to firms with access to the Financial Ombudsman Service (FOS) if they are not happy with the outcome of their complaint (as with endowment mortgage mis-selling cases).

As all these options have now been used, the FSA is in a good position to consider which is the best and most efficient way to put things right in different circumstances. Appropriate redress is a key part of consumer protection. The FSA has said it will review this, and we look forward to discussing this further.

It has been good to see the FSA taking enforcement action against a number of firms over **mortgage endowment complaints**. Some firms have been particularly poor in handling complaints. We also plan to discuss with the FSA its strategy for helping consumers whose complaints were dealt with inadequately.

Advising the FSA on developing regulation in the interest of consumers

New ideas continue to emerge in regulation – from **simplified savings products** (as recommended in a report to the Treasury by Professor Ron Sandler) and **de-polarisation** (the removal of rules that obliged sellers of packaged investments – such as personal pensions and unit trusts – to offer products from the whole of the market or from only a single provider); to **FSA regulation of mortgages and general insurance** from October 2004 and January 2005 respectively.

The Government's wish to **close the savings gap** could lead to problems if 'safe' financial products are sold with less advice – particularly without any checking that a product is suitable for that person (the suitability requirement). The FSA and Government should not assume that saving for retirement is right for everyone – many may be better off repaying their debts or arranging insurance cover in case they are suddenly unable to work; others may simply not be able to afford to save. Even simple savings products are unsound if they are wrong for the individual consumer.

We have been following closely the results of the FSA's consumer testing on whether the **Sandler simplified products** (as recommended in the Sandler report) could be sold safely using filtered questions – the questions for sales people to ask consumers and, on the basis of the answers, either to recommend a product or to screen out those for whom the product would be unsuitable. We urged the FSA to incorporate incentivised **pressure selling** into its consumer research, since commission and sales pressure has played a key role in past poor treatment of consumers, and poses a continuing risk. We were disappointed that the FSA did not find it possible to do this.

The FSA carried out a second round of testing of the filtered questions as the initial system did not provide enough consumer protection. There are serious risks to future consumer confidence if too little consumer protection is provided for the sale of Sandler products – especially as they might be perceived as endorsed by the Government.

The FSA was set up as a **single regulator** to bring consistency and coherence to financial regulation. So we were particularly disappointed that the FSA has agreed proposals which mean that consumers who buy both investment and general insurance will be expected to understand that an independent financial adviser offers an entirely different service compared with an independent insurance broker, even if they are the same firm or person. This is not realistic. The FSA's decision to allow two very different meanings of the term '**independent**' contradicts its stated approach that the regulatory regime should reflect consumers' needs.

In contrast, we are pleased that the FSA has reflected consumers' needs in its regulation of **long-term care insurance**. We think that using the same system as for selling investment products is appropriate as the products are sold alongside each other, sometimes to meet the same financial need.

The full effect of the FSA's retail reforms on consumers remains to be seen. The FSA should **review the effects of all its new regulation**, and assess whether the planned benefits have really been delivered and consumers offered adequate protection.

Helping the FSA to communicate better with consumers

The FSA's initiative to develop a **national strategy to improve financial capability** among consumers is to be welcomed. However, the objectives must be specific, realistic and achievable, and consumer education must not be a substitute for consumer protection. Indeed, the FSA must be realistic about consumers' ability to understand both complex financial products and the complicated regulatory regime. In particular, the FSA should not reduce consumer protection in anticipation of raising consumers' financial capability.

We have long argued that consumers would be helped by the setting up of a general **financial advice service** separate from any selling process. A wide range of consumer bodies agree on this, and it is disappointing that the Government and FSA have not undertaken a feasibility study into different ways of providing such a service. We look forward to seeing the results of the FSA's commitment to do more on this next year.

We hope the FSA will **make more use of its factsheets** in helping consumers understand important messages. Its own research has shown that "the FSA branding of the factsheet adds weight to the communication and therefore had a positive impact on readership levels and behaviour". We have suggested that firms should have to include an FSA factsheet on complaining about mortgage endowments with the reprojected letters (which say whether the product is likely to repay the debt at the end of the mortgage term), and that the FSA factsheet on the risks of SCARPs should be included with promotions for those products.

We remain concerned about the FSA's strategy in **communicating key messages to consumers** through its website and the media. For instance, the FSA could have been quicker in putting information for consumers on its website about Standard Life's financial position after media speculation. The effectiveness of the FSA's website warnings to consumers through Consumer Alerts needs to be evaluated. The FSA website should be easier for consumers to navigate, so that they can find specific information more quickly. The regulator has an important role in giving consumers clear and objective information, particularly in times of crisis and uncertainty. We will be discussing this further with the FSA.

Encouraging the FSA to ensure consumers get better information from firms

Last year, we welcomed the FSA's development of **Key facts** as a document which firms would have to give consumers before they bought packaged investment products such as pensions and unit trusts, and which would set out the costs and charges in a simple and understandable format. We are therefore disappointed that these documents are being delayed pending a review of projection rates (the rates of potential return on investments). This means Key facts may not be introduced for some time.

The selling of **new and complex products** should also require the provision of Key facts documents. Recent problems relating to complex products, such as split caps and precipice bonds, have shown that firms have targeted them at unsophisticated consumers. Extending the Key facts disclosure would help close the consumer protection gap and support the FSA's objective that regulation should reflect consumers' needs.

The FSA had planned to **review the effectiveness** of the information consumers get after buying a product. It is disappointing that the FSA delayed doing this, and we hope there will be progress next year. Meeting consumers' needs for ongoing information is an important part of treating them fairly.

Misleading marketing and financial promotions increase consumers' difficulties in understanding financial products. We called for more effort in this area, and we welcome the FSA's commitment of more resources to this for the second consecutive year. The FSA has also adopted our suggestion to monitor television advertising and to think more strategically about how to alert consumers to misleading statements by firms.

The **depolarisation** proposals should lead to consumers being better informed about the costs of advice. The proposals will require firms to give consumers a 'menu' explaining their options for paying for advice. However, the menu will not tell consumers why this is important, and without this they are unlikely to concentrate on the information. Consumers should be told that paying by fee avoids the possibility of the adviser being influenced by commission.

Making sure the FSA takes consumer research into account

The FSA should take account of consumer research in developing its policy. Its own research showed that consumers were confused by the use of monetary values in advertisements to illustrate past performance, yet the FSA did not prohibit this practice. On other occasions, the FSA should have done research, for example to help assess the risks to consumers from the handling of general insurance claims.

Future priorities for the FSA and the Consumer Panel

We have identified the following key areas for FSA action for consumers over the next year.

Firms' culture from top to bottom – We will be pressing the FSA to look further at ways of changing the industry's culture including the role of commission, penalties for mis-selling, fining individual staff or consultants who misbehave, and ways of increasing publicity about poorly behaving firms.

Generic advice – Making help on financial planning available to all consumers is essential to enable them to get the most from their money. We will be pressing the FSA to make this happen.

The information consumers receive from firms – We will seek to influence FSA work on the disclosure regime and 'Key facts'; projection regulations; the menu of financial advice and its associated costs; and financial promotions.

The information consumers need from the FSA – We will be looking for improvements in the FSA's key services for consumers including its website, consumer alerts and the Consumer Contact Centre.

Reform of the retail market – We will continue to advise the FSA on the new mortgage and general insurance regulatory regimes, the final de-polarisation rules, and the regulatory regime for simplified products.

Current consumer protection – We will look at the FSA's use of its powers under the unfair contract terms regulations and its work on mortgage endowments, precipice bonds and split caps.

Future consumer protection – We will be advising the FSA, and putting our views directly, on European Union proposals to influence UK consumer protection. We are taking part in the review of the Financial Ombudsman Service and hope to influence the FSA's review of how to give consumers redress when things go wrong.

Taking full account of consumer interests – We will continue to monitor the FSA on its use of consumer research in policy making; its inclusion of consumer interests in cost-benefit analyses; and its publication of evaluations of its effectiveness.