

FSA ANNUAL OPEN MEETING – 19 JULY 2007**SPEECH BY JOHN HOWARD, CHAIRMAN OF THE CONSUMER PANEL**

For the Consumer Panel, the most important piece of work undertaken by the FSA in the last twelve months has been the **Retail Distribution Review**.

Last year the Panel said that if there was one change in financial services that could make a real difference to consumers, it would be to change the system of paying financial advisers by commission. We believe commission has the effect of encouraging advisers to sell products to consumers that may not be the best or most suitable for them, but which boosts the income of the advisor. A view backed up by research by no less a body than the ABI which showed that Firms can achieve a 70% increase in sales for a 10% increase in commission.

In our view the cause of many of the misselling scandals of the past can be traced back to commission bias. We set ourselves the target of encouraging debate about a new system of paying for advice that cannot bias the recommendation a consumer receives. I am very pleased to say that in the last year this has really moved forward with all credit to the FSA.

The speech on the subject by the Chairman Sir Callum McCarthy at last year's Gleneagles conference - and the Retail Distribution Review - have paved the way for major changes. The FSA must be congratulated for this. Not only for doing it, but also for involving the industry so effectively.

The Review has recognised that change is necessary and made a number of proposals about increasing the professional standards and the knowledge of advisors but we see the most important aspect of the Review as being the possibility of moving away from commission payments to a new customer agreed remuneration system.

Far from being a threat we see CAR as having the potential to save independent financial advice. It's a neat solution to the inadequacies of

commission. Our view is that it need not change the income of advisors but it will change their relationship with the consumer, making them the agent of the consumer and acting solely in their interests.

The heart of customer agreed remuneration is to agree the cost of the advice with the customer at the outset. The advisor then chooses a product from the market place without the risk of commission bias. It's clear that many consumers don't want to pay for advice up front, so the cost they've agreed is added to the selected product. The advisor is paid straight away by the chosen product provider and the consumer pays off the cost over the lifetime of the product, in the same way they pay for commission at present.

But how do we reach this goal? The review, whilst leaving open the possibility of ending commission, seems to prefer a carrot and stick approach, encouraging advisors in this direction. It carves up the advice industry in a new and even more complicated way with independent financial planners, not paid by commission, and general financial advisors who can still be paid by commission but who will be encouraged to migrate up the scale to become financial planners. I think that runs the risk of creating a two tier system where wealthy clients get truly independent financial advice, while everybody else is still left with the inadequacies of commission payments. I think the FSA may have to take more of a lead here.

The Review is a golden opportunity to change the face of retail financial services and avoid future misselling scandals. It requires that everybody moves away from commission. The challenge has been ducked in the past; will the industry and the regulator really confront it this time? I believe that establishing a new system of paying for advice could be the most important development in financial services since the FSA was created. The reasons are quite simple.

For some time consumers have been told that they are not saving enough when the prospect of poverty in old age is confronting them. The Consumer Panel's own research revealed, once again, that some consumers don't take

out investments because they have concerns about obtaining good quality impartial advice. Misselling scandals like endowments and pensions have made consumers wary. The financial products they are persuaded to purchase are often badly sold and of poor value. This all points to a crisis in consumer confidence. If we could revolutionise the advice process, put an end to commission and make advisors the agents of their clients, misselling would be much less likely and consumer confidence could be restored. And this is the real prize for ending commission. With an advice sector which truly represents the interests of clients and acts entirely on their behalf, confidence in financial services could be rebuilt and many more people encouraged to save and to purchase financial products.

For the second year we have rated the FSA's performance in a number of important areas; and we rated their work on the RDR highly. We also rated as Very Strong the FSA's major work-stream on **Financial Capability**. The regulator has committed a significant amount of money to this area, although the Panel was concerned that there was insufficient focus on older people, a point now addressed.

We also rated the FSA's **Communications** as very strong. Its consumer website and publications on the 'money made clear themes' have been very valuable tools for consumers.

We were pleased with the FSA's decision to retain the rule known as **RU 64**. We thought this showed that the FSA recognises some key rules need to be retained to ensure standards in a principles-based world.

We felt the FSA was to be congratulated over its work on **Mortgage Exit Administration Fees, Interest Only Mortgages and Lifetime Mortgages**.

We were less pleased though with **Financial Promotions** work. Our own research showed the FSA was only concentrating on major breaches of rules, and later FSA research also suggested this. Our view was that ignoring numerous minor breaches of the rules puts the regulatory framework at risk

and could lead to consumers comparing products on an unequal basis. We felt there was a need for greater clarity in the market place. That the FSA needed to make public what it didn't like about particular ads, to help firms in drawing up their own promotions and to alert consumers. We have proposed a new tier of monitoring for promotions which will allow the FSA to act quickly to get adverts changed and to make public the changes they have required.

On **Industry Guidance and Codes**, we were concerned that FSA rules were going to be replaced with industry guidance which had not been subject to consultation with consumers. We have now held discussions with the FSA to ensure that there is an effective process of consultation for industry guidance.

Looking to the future, one particular area has caused us to raise some very fundamental questions with the FSA - **Retail Banking**. The Panel is of the view that change is necessary in this sector. Public confidence in the banks is at a low point, with the unseemly spectacle of thousands of banking complaints being settled at the door of the courts or before a decision can be made by the Financial Ombudsman, when intervention by the regulator ought to be able to bring order back to the marketplace. We have advised the FSA that in our view it is time to look again at the arrangements for retail banking to improve consumer protection arrangements and restore confidence; and this we feel involves taking more direct control of retail banking.

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