Is There An Advice Gap? – Westminster and City – 27 June 2012

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I have been asked to start this conference by talking in general terms about whether there is an advice gap and, if there is, what should be done about it.

I am going to look at three issues:

1. Is there an advice gap?
2. Is it about to get worse?
3. What can be done about it?

One of the problems that dogs the financial sector is that the word advice has a specific regulatory meaning which is very much more specific than the use of the word in normal conversation. When most people are asked how they get financial advice they talk about family, friends, newspapers and magazines as well as financial advisers. And when talking about financial advisers most people don't understand the difference between an adviser and a sales person who may be giving them information.

So, when I talk about an advice I mean information and guidance delivered by someone who understands the topic they are talking about and which is relevant for the person receiving it. In my mind this is a broader definition than regulated advice, because it could include financial education delivered by a teacher or general guidance from someone who is explaining the role of different types of financial products helping to improve the recipient's financial capability. I will be clear when I am talking about regulated advice by always using the word regulated.

I think it would have been helpful for longer term consumer trust in the industry if the FSA, when it was developing the RDR, could have persuaded the industry to accept the Panel's proposal that any adviser that is tied to a limited number of providers or provides advice in relation to a restricted range of products should be described as a salesman. But that is history.

Everyone needs financial advice at some point in their lives and the industry and government provide lots of advice to meet that need, whether it is on benefits, protection, savings, pensions or investment. Some of this advice is regulated, some is delivered at the individual level, the rest of it comes from the media, advertising, through social conversation, and increasingly through the internet. So the question about an advice gap is really about whether the advice that is available meets people's needs.

The world is changing fast. If we look first at long term savings:

The Pensions Commission estimated in 2009 that of the 19 million people employed in the private sector 6.6 million - about a third (35%) – had some kind of pension provision beyond the state minimum. This was down from almost half (45%) only ten years before and is probably considerably lower now. In comparison, pension take up in the state sector over the same period has remained constant at about four in five (80%) of employees with pension provision beyond the minimum.

Between 2006 and 2009 the number of open Defined Benefit schemes halved from 64% to 38%[1] And a survey by KPMG[2] last year found that over 90,000 DB scheme members have been offered "Enhanced Transfer Values" ("ETVs") to leave their DB schemes in past three years, with a further 70,000 expected this year.

We all know that most people do not realise how much they will need to save to have a comfortable retirement. If we take current median earnings, which were a little over £26,000 in 2011, and assume two thirds of that would be reasonable retirement income, we will need £17,300. We can deduct the £5587 provided by the state basic pension and are left with roughly £11,700 which needs to be funded by the individual. Looking at joint life annuity rates inflated at 3% for a person aged 65 this person will need £325K to get that income and will still need £270K if they retire at 70[3].

At the moment two people both earning the median income living in the South East will struggle to save any money. If they are working in the private sector most of these people will not be saving enough for retirement and increasingly the same pattern will begin to emerge in the public sector. Of course we are looking at the median and, by definition half the working population will be earning more. Also, many people have more equity in their house than they do in their pension but with the age of the average first time buyer now exceeding 40 and, in some areas of the UK, housing prices representing 10 times average income, property ownership is indirectly increasing the pensions gap by siphoning funds. So, even making more cautious assumptions than these, people need to save a lot more. The Chartered Insurance Institute recently estimated that the pension gap over the next 40 years is between £4.4 and £9.0 trillion depending on assumptions about the level of income post retirement and cost of healthcare.

If you still are in any doubt that there is a savings gap, the Money Advice Service estimates that 70% of people do no regular saving and a recent survey by YouGov for Scottish Widows[4] found that half the people surveyed had less than £2500 in savings.

If we look at protection, a similar picture emerges in the Scottish Widows survey this year. It showed only 38% of people possess life assurance, down from 45% in 2009 and just 11% with critical illness cover. Slightly over half the sample had less than £2500 in savings. The report concluded that:

> *"Tangibles such as broadband, mobile phones and cars are considered more essential than insurance policies that could help protect households in the event of illness or death. Protection of income is seen as less essential than it was last year."*

People simply don't understand the risks they are taking by economising on basic protection.

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[1] Pensions Commission Interim Report 2010

[2] In 2011 KPMG surveyed ten firms of Independent Financial Advisers (IFAs) engaged in ETV exercises to review the level of activity to date.

[3] Figures based on annuity rates from the Money Advice Service 24 June 2012, assuming non-smoker, no guarantee, a spouse pension of 59% and payments rising at 3% p.a.

[4] Scottish Widows Protection Report 2012 - YouGov online survey sample size 5000 households,

Swiss Re's recent research[5] has found that the Life Assurance Protection Gap for the UK has increased by 20% from £2.0 trillion to £2.4 trillion over the past ten years. On average, this gap amounts to around £100,000 per person, with the amount of under-insurance greatest among single parents, couples with children and those aged 35 and under.

There is a host of other reports and estimates that are all subject to debate and interpretation, but the fact is that nobody knows with any certainty what the various gaps (savings, pensions and protection) might be. However, we can be confident that **there are increasing gaps in both savings and protection and the shortfall is HUGE**.

People have only three alternatives for tackling these gaps.

1. Purchase their own protection, savings and pension (or have it fully or partly funded by others – such as employer benefits or under auto enrolment)
2. Retire at the State pension age, live on a pension below what they would wish for themselves and die leaving their dependants in potential poverty.
3. Rely on the state (with a significant cost to the exchequer and thus other tax payers)

The second and third options are not politically acceptable options and therefore ways of supporting the first must be found. Auto-enrolment into an employer based pension scheme is one example of a positive attempt to create a culture of savings (in this case for retirement). But auto enrolment is not the same as compulsion. Individuals will be able to opt out and auto enrolment does not include all of the working population, most notably the self-employed.

At a time when there has never been a greater need for savings and protection products, the industry - and by industry I am taking the widest possible definition - has not helped the situation by sometimes offering poor value or inappropriate products and services. While these may only represent a tiny proportion of the overall market they have led to increased mistrust and an unjustified view that the whole industry is inherently bad and expensive.

Against this background the FSA's Retail Distribution Review is likely to reduce the availability of professional face to face advice and thus further decrease the number of investors and savers. This is of course, unless either individuals take personal responsibility for their own provision and physically shop and select their protection and savings products unassisted or the industry is able to find a 'third way' to engage with them.

So people are facing significant challenges. But many of them don't realise it. This is what I see as the advice gap. It's not something that has been created by the Retail Distribution Review, but by focusing on creating more professional regulated advice at the top end of the market it will do nothing to help the mass of the people in the middle who have more need for advice now than in

[5]Swiss Re's *Term and Health Watch 2012* has found that the Life Assurance Protection Gap for the UK has increased by 20% from £2.0 trillion to £2.4 trillion over the past ten years. On average, this gap amounts to around £100,000 per person, with the amount of under-insurance greatest among single parents, couples with children and those aged 35 and under

the past. And, in the short term, the RDR may make matters worse. **So in answer to the second question the advice gap is getting worse.**

The third question was **what can be done about it?** I am hoping that the speakers who follow me will come up with the answers, but here are some thoughts about what needs to be done.

First we need some idea of the size of the potential market: the top end of the population, let us say the top 1% who earned more than £150K in 2007 and accounted for 15% of national income will be able to pay for professional independent advice. The bottom end of the income distribution, those with below median income will struggle to pay for protection and save more than they are able to put into a NEST pension. Between these two there is half (49%) of the working population, or around 19 million adults. A more cautious figure might be people earning more than the top end of the NEST target group which is £35K. This represents around 10 million people. If we want a cautious estimate and leave out the 3-4 million people working in the public sector which is probably an over estimate of the number who need to save more for retirement, given the changes coming in the future, 7.5 million is still a lot of savings and protection money.

Helping these people to take more responsibility for their protection and long term financial health is a major challenge. People need different approaches at different times of their lives. This problem is not new and various research initiatives have attempted to find a solution. One customer centric piece of work was completed a few years ago by AEGON[6]. This asked consumers to describe what they wanted. It identified five engagement concepts.

1. ***The Financial Guru***
The guru is an independent expert giving high-quality, holistic, ongoing and personalised financial advice. He or she is separate from product selling, and someone with whom the consumer can build a long-term, trusted relationship. The guru is proactive but never pushy; the consumer is in charge.

2. The Financial Coach
The coach gets people motivated to undertake personal financial planning and keeps them committed. It is comparable to having a fitness trainer or attending a financial 'Weight Watchers.' The coach also educates the consumer and focuses on their behaviour and habits. Ideally, the coach would have solid credentials but would not necessarily be an expert in every field, although independent advisory and life-coaching skills would be ideal.

3. The Drop-in Centre
This would be an initial problem-solving service for people with specific financial problems or needs. It would be convenient and easily accessible, be it an actual physical place or delivered through telephony or web-based services. It would be impartial and run by Government. Advisers would need to be well-trained despite only providing basic information and advice—the goal is to point the consumer in the right direction by being easy to understand and informal.

[6] AEGON UK Distribution & Financial Advice Consumer Research – Opinion leader - August 2008

4. The Personal Shopper
This person works for the consumer, helping to simplify all the available choices and provide products that are flexible and tailored to the customer's needs. They are independent, knowledgeable and up-to-date on, ideally, all products and brands. The shopper is professional and non-judgmental, with no 'hard sell' or pressure tactics.

5. The Financial Superstore
This service would make buying easier for people with straightforward needs or those who have a good idea of what they want. It could be delivered either through a website or a physical store, and would be available for late-night and weekend consultations. This service would be for people who have the knowledge and confidence to know what they may need. The assistants in the store would be trained to offer clear, simple information that enables easy comparisons.

Looking at the market today, we are still some way from covering all of these concepts and while the Retail Distribution Review (RDR) is a positive development that will lead to a better qualified and more professional advisory sector, it is also likely to reduce the access to advisers and inadvertently increase the savings gap. However we also expect the RDR to stimulate alternative delivery mechanisms. These will largely be technology driven – with or without the added input of a human 'facilitator' and we are likely to see 'Social networking' play an increasingly important role.

Arguably concept 1 - the Guru - and 4 - the Personal Shopper - are provided by existing advisers and this will continue to be the case post RDR. The introduction of Adviser Charging will assist the development of these concepts but only where the consumer thinks there is a value. It should also be recognised that these concepts are not restricted to 'face to face' advice, with a number of firms now experimenting with offering remote access to advice by telephone or using online systems offering modular advice.

Concept 3 - the Drop in Centre - is akin to the Money Advice Service. Whilst MAS is suffering some teething troubles the Panel is convinced of the need and importance of the service and we hope some commercial firms will also move into this space by providing generic financial planning without any subsequent product sale, the most visible of these at present being Money Vista.

Concept 5 could neatly follow up on the needs identified by MAS (Concept 3) and many financial service firms are known to be developing such facilities. I believe that it is only a matter of time before this will be developed for delivery via conventional retail brands, but only if and when the economics work and the regulatory environment is favourable.

I have no suggestions about concept 2.

All of the above concepts (and others frequently discussed in the market) are supply driven and this is a major concern. There needs to be more demand. We need to change the way people think about spending their money. The recent crisis will have helped, but only if we take advantage of the crisis and plant ideas about better behaviour before everyone forgets. In my view this will include:

- Regulating access to credit more effectively, so that people are not encouraged to take on more debt than they can afford. Part of the change in attitude can be created by education and by advertising and publicity, part can be supported by good generic advice.

- Encouraging more saving. The government probably has a role to play in supporting behavioural change. Auto-enrolment and NEST is an encouraging start, some tax breaks would also help, although this is not a good time to be asking for them. I like the behavioural approach of "save more tomorrow"

- The regulator has an important role in encouraging better behaviour by those sectors of the industry that have not learned from the crisis

- However, the most important task is to simplify the market for people with limited spare cash. And to change the way they think about saving and protection.

Standard Life, in its report 'Keep on nudging' advised that scaring people into saving is not an effective approach and that messages of poverty in retirement are the least effective and seem to make people stick their head in the sand even more. It said more positive illustrations should be used to complement more effective, fact-based, statements of encouragement. In this respect I think the financial industry still needs to come up with some equivalent to the food industry's *"eat five portions of fruit and vegetables every day message"*. The messages need to cover short and long term saving, protection and managing credit, by giving some very simple, memorable rules of thumb. They should be repeated by everyone to every customer.

The existence of regulated advice and the UK tax system has encouraged a complicated market where regulated advice has now become essential. One of the important changes introduced by the RDR is the idea that regulated advice needs to be related to the benefit for the consumer. To quote FSA Policy Statement 10/6:

> *"....firms should consider whether the advice is likely to be of value to the client when the total charges the client is likely to be required to pay are taken into account. For example,* ***we would not expect a firm to provide advice to a customer for whom the cost of that advice is such that it is not in their best interests to receive advice at all****."*

The industry needs to stop focusing quite so hard on making money by selling products and start thinking about how to make money providing advice and meeting customers' needs. To make money providing advice we need to be able to provide advice at lower cost for people who have limited amounts to save. Some of them will eventually become rich and provide income for IFA's who expect clients to have several £100K of investable assets to justify the cost of a tailor made personal service.

A focus on the mass market means providing straightforward outcome products which are good value and are designed to meet common needs. The products should be appropriate for non-advised sales and good starter products for the financially inexperienced. The Panel published research last year which proposed criteria for testing whether financial products were straightforward and likely to meet expectations. It demonstrated that many existing products already pass this test, but many more do not. Unfortunately it is not easy for the consumer, or sometimes an adviser, to tell the difference.

A mass market focus also means that we need to find a way to reduce the cost of advice, as pointed out by the FSA in their policy statement. There are various models for doing this and we hope that

the FSA's unwillingness to relax the regulatory boundaries, which is partly but not wholly driven by EU regulation, will stimulate creative thinking on both sides. The Consumer Panel is concerned that, at a time when the need for advice for people in the middle market has never been greater, the industry and the regulator seem to have become so risk averse. Demand needs to be created and this will require commitment and creativity from everyone – the industry, the regulator, the Bank of England and the Government.

So to sum up:

There is a rapidly growing savings and protection gap. This creates a huge need for advice and therefore an advice gap covering both regulated and unregulated advice. This gap has not been created by the RDR but the RDR could make it worse.

1. Solving the problem will be difficult because the level of demand for advice is low for three reasons,
    i. people have forgotten about the importance of long term saving and protection.
    ii. there has been a loss of trust in the industry as a result of the crisis
    iii. the industry is focusing too much on selling products rather than meeting people's needs.
2. We need a simple repetitive message about saving, protection and house purchase. A financial equivalent of the "five portions of fruit and vegetables a day" advice from the other FSA
3. There is a need for lower cost advice systems based on computer supported systems and advisers working on salary rather than commission. Developing these will require creative and constructive thinking from both the industry and the regulator
4. We need to promote straightforward outcome products which are good value and which are likely to meet the expectations they create. This does not need to lead to generic products or brands.

As I am sure you will agree, this is a hugely challenging list. Yet the consequences of not meeting the widening advice gap and of not convincing people of the need both to protect themselves against future key risks and to save, particularly to give themselves the prospect of a reasonably comfortable retirement, will be dire. But given that I am an optimist, I am already looking forward to hearing how my fellow speakers hope this huge challenge can – and will – be addressed.

Thank you