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Our ref: Simple products

Dear Ms Bibby-Scullion

Consultation: Simple Financial Products

This is the Financial Services Consumer Panel's response to HM Treasury's consultation paper on simple financial products.

Overview

We welcome the opening up of the debate on simple financial products and we are pleased to be able to contribute to the development of a regime that should meet the requirements of large numbers of consumers who do not, at present, buy some of the financial products that they need. Estimates of the so-called protection and savings gaps vary, but there seems to be little doubt that the gaps exist.

It is clear from both the consultation paper and our detailed response below that there are a number of considerations and challenges to be overcome if the new regime is to deliver against the Government's three objectives and also to help consumers by providing access to the basic financial products they need.

Previous initiatives in this area have not led to the desired results and it is clear to us that a significant intervention will be needed for the Government to make it happen now. This is likely to involve the development of new distribution channels and new models for simplified advice; incentives in the form of tax breaks or other financial benefits for consumers who are prepared to buy products from the suite and through new distribution models; regulatory involvement in the form of policing and possibly monitoring compliance with product criteria and performance; and a new 'badge' or brand that carries significant weight, as is the case with for example National Savings & Investments. Key to the success of the initiative will be a strong role for Government in endorsing the regime, carrying the initiative forward in the context of a clear timetable and in branding and promotion.

In addition we believe that the Government will have to think more widely and creatively about the kind of products that would be included within the new regime and the way in which they are paid for and delivered. To inform the debate we are proposing to commission research into what the profile of suitable products might be

like. Consideration should be given first to the objective of the product, which could fall into three broad categories:

- “safe” products guaranteed against capital loss, such as National Savings & Investments products and deposits falling within Financial Services Compensation Scheme limits;
- “simple” products on the lines of those envisaged within this consultation paper, being those which can be relatively easily understood and compared and again are without capital risk; and
- “straightforward outcome” products, where the *outcome* can be relatively easily understood and compared. These may involve some risk to capital – such as index trackers – but, again, the risk can be understood and compared.

We would expect the criteria that these products would have to meet would include ‘no regrets or surprises’ – they deliver what they promise; value for money; and ease of exit.

Currently our view is that the appropriate focus should be on products that deliver a straightforward outcome, which could in fact be fairly complex products in terms of structure and cost, rather than “simple products” per se. These straightforward outcome products would not necessarily be the kind of ‘budget’ product that the paper seems to envisage, although clearly the range would have to include products for individuals on low incomes.

The financial services regulator would have a significant role to play in the new regime. There are a number of reasons for this, including the need for regulatory expertise in approving delivery mechanisms and policing of compliance with the product criteria and distribution regime. The proposed Financial Conduct Authority (FCA) is the appropriate body to undertake this work. Without this involvement the regime and products could lack credibility and lead to low levels of consumer confidence – and the Government’s objectives would not be met.

We think there is a need for straightforward outcome products to have a widely recognised brand or badge involving some form of guarantee that would be recognised by consumers. Again we would like this to be policed by the FCA, although an argument could be made for a specialised panel or other body to be drawn up to undertake this role, but the panel would need policing powers in order to do its job.

As regards the distribution of straightforward outcome products, we would like to see them being made available to all. This would involve inclusion within the range of products offered by regulated financial advisers as well as through developing channels such as simplified advice. We see these products potentially performing an RU64-type role as benchmark products against which consumers can measure other products performing similar functions. For the financially excluded we would like to see more creative means of payment being available, such as in the form of modest supplements to payments of rent. The question of compensation and

redress through the Financial Services Compensation Scheme/Financial Ombudsman Service, would have to be addressed.

Our response to the specific questions within the paper is set out below.

Detailed questions

Q1: The Government would welcome general comments on the vision and objectives for a new regime of simple products.

We support the Government's simplified products initiative, although we would like to see the focus widened to straightforward outcome products. By this we mean that we would like HMT to consider the outcomes that various products deliver, rather than product structure. While a straightforward product such as a savings product with some form of guarantee, or tied to movements in an underlying index such as the Bank Base Rate, might be designed to deliver a simple and specific outcome that could meet many consumers' savings needs, the structure and pricing of the product might in fact be quite complex. We envisage straightforward products becoming 'no regrets'-type products – they might not be the best available, or the cheapest, but they deliver what they promise. We believe that the existence of straightforward outcome products would go some way towards ensuring that more individuals would be encouraged to buy financial products that would meet the requirements they have for savings and protection and, over time, perhaps pensions and other investments.

As drafted the first objective – to ensure that people understand the products they need – is a little ambiguous however. It is an advice or guidance service that is likely to help people understand the product they need, with straightforward outcome products hopefully enabling them to be confident that the particular product will meet that identified need. Clear explanations of what the product will deliver, rather than of the product itself, will be needed. Nevertheless given the wealth of evidence available of low levels of financial understanding/capability¹, it will always be the case that there are some groups of consumers who will need assistance in identifying the right product and mapping the product features to what they want the product to achieve. For some, therefore, advice or guidance of some form or another will always be required. This is an area where organisations such as CFEB and Citizens Advice might have a role. We also see possible links with the simplified advice process that - provided feasible and profitable business models can be found – seems likely to meet the needs of many consumers for whom a more holistic advice service is neither appropriate nor affordable.

Although we believe that straightforward outcome products should be suitable for all, we would encourage the Government to think more widely about the products and the regime through which they might be sold. For example, the paper does not explicitly address issues of financial inclusion. There is a need to look more creatively at how the cost of straightforward outcome products could be met by those on low incomes, or how those who have never before been in a position to buy financial products would have access to the market for straightforward outcome products. Work is being undertaken by a number of organisations in this area already – such as the help provided by “My Home Finance” in opening bank and

¹ Reports published by CFEB at www.cfebuk.org.uk

savings accounts tailored to the needs of their clients. Clearly, the Government's current initiative cannot be taken forward in isolation and needs to be co-ordinated and managed from the outset.

We do not think that straightforward outcome products will have to be designed from scratch. Rather, they could be any product that met a set of criteria designed to ensure the clarity of the purpose of the product; the range of outcomes that might be delivered; and the cost. The development of the product criteria, checking the products meet these criteria and the regime through which they were sold would be the responsibility of the FCA.

Q2: Should this work be led by industry and consumer groups and not Government?

The Panel will be pleased to take an active role in the debate on the development of straightforward outcome products, particularly given our unique role as adviser to the financial services regulator. We do not think however that industry and consumer groups alone will be able to achieve the Government's objectives in this area and, as we have said, there will also need to be co-ordination with other initiatives. It seems unlikely that either industry or consumer groups would be able to take on this role.

Any developments relating to financial services require, in our view, the involvement to some degree of financial regulators and in this case, the Government. Both industry and consumer representatives will need informed input on issues such as the impact of regulation on advice or guidance processes, and access to the Financial Ombudsman Service and compensation. There could be complex EU regulatory issues to consider and there is also, of course, the question of cost. The development of straightforward outcome financial products will have to be funded and given the financial constraints that exist for both consumer representatives and industry, we are doubtful that a straightforward outcome products regime would get off the ground without support from Government. The development of models for simplified advice is an example of how ideas for financial services that could benefit both consumers and industry can seemingly run into the ground and we do not wish to see this happen with straightforward outcome products.

While we agree that it is not for Government to design straightforward outcome products, we see three key roles that would fall to Government to fulfil if the desired outcomes are to be achieved. These are:

- Endorsement of the products;
- Setting a clear timetable and driving the initiative forward; and
- Branding and promotion.

It would be neither appropriate nor feasible for industry, consumer representatives or the regulator to undertake these roles, although there would be clear benefits to a collaborative approach.

Q3: How can industry and Government ensure a voluntary set of standards offers sufficient protection for consumers?

The question of the appropriate level of consumer protection will have to be resolved if consumers are to be encouraged to engage with the industry and have trust and confidence in straightforward outcome products. We do not think that consumers who buy straightforward outcome products – say a life policy - should enjoy any lower levels of protection than those buying one of the many other life policies available. This would mean the same access to the Financial Ombudsman Service and to the Financial Services Compensation Scheme – all of which comes with a cost to the industry that would inevitably be passed on to the consumer. The only other option would be the existence of some kind of alternative guarantee of the products, or of the advice/guidance process through which they were sold. For example, if the advice process was to be ring-fenced, approved and could not be subject to interpretation or adviser/sales discretion, it could be considered as delivering a suitable outcome, even if it was not the *most* suitable. As Lord Turner said in his foreword to the FSA Discussion Paper on product intervention² “..there are important tradeoffs to be struck – between consumer protection and consumer choice, between effective regulation to prevent customer detriment and the costs that will inevitably impose.”

We favour an independently regulated regime, rather than a set of voluntary standards. We are doubtful that consumers, particularly those who had not bought financial products before, would feel sufficiently comfortable with what could appear to be self regulation to engage with an industry that unfortunately has often been tainted by large scale mis-selling.

Whatever the basis and detail of the eventual regime, we think the FCA should have responsibility for policing it. This is the only practical means of ensuring that consumers have confidence in both the products and the sales regime.

Q4: Are there any reasons that simple products should have price caps or other standardised pricing features?

We are not persuaded that price capping or standardised pricing features would necessarily benefit consumers, provided that the true cost of the product was absolutely clear. The concept of simple products as outlined in the paper implies a ‘budget’ or ‘value’ type brand that has to be cheaper than other products of the same type. For straightforward outcome products however we think it important that there should be a value for money assessment as part of the ‘brand’ criteria. We will be interested to hear the views of industry on this question.

Q5: How could simple products be used as a benchmark or a comparator? Is there a case to support this with regulation, as with the RU64 rule?

The Panel has always been a strong supporter of the retention of the RU64 rule, which seems to have delivered results for consumers in the form of lower charges, and we see parallels with the use of straightforward outcome products as a benchmark. We would expect this to be regulated and policed by the FCA.

² DP11/1 Product intervention, July 2011, at www.fsa.gov.uk

Q6: Are there any groups in particular that simple products should be targeting? If so what implications would this have for the development and promotion of simple products?

If straightforward outcome products are to be used as a benchmark, information about them should be available to all consumers. As regards targeting, as the Paper identifies there are a number of consumers who have need of particular products such as, for example, life cover or household insurance but who for various reasons would not actually buy one, who could benefit most from having access to straightforward outcome products. Consumer research, perhaps with input from CFEB, would help to identify these groups and the channel through which they would be most likely to buy them, with targeting then linked to specific lifestyle stages.

Q7: Is it practical or desirable to have a range of completely standardised products? Is standardisation more practical for some products than others?

Standardisation would be an aid to shopping around and assessing value for money, although in practice consumer needs are so diverse it is unclear how far standardisation could be achieved. We would expect there to be some scope around standardisation of terms and the purpose of the products, rather than necessarily all product features. This might include for example a travel insurance policy or third party motor insurance policy, both of which currently serve a relatively well-understood, specific purpose. Overall however feasibility and desirability should be considered on a product-set basis.

Q8: Beyond standardisation what other measures could be used to help improve consumer understanding of product features?

We do not think that pre-sale product disclosure in itself constitutes adequate consumer protection because of the dangers of 'information overload' and lack of consumer understanding. But it will be an important aid to product comparison if the format and content of disclosure documentation is at least consistent across the market and drafted in straightforward terms. The development of the Key Investor Information Document may be useful and there is further EU work underway on Packaged Retail Investment Products which may also be helpful. Consideration could be given to highlighting the interaction between different products as an aid to prioritisation and linking to lifestyle. In addition the way in which many comparison websites present information could be a useful guide to how the disclosure of product features could be approached.

Q9: Should someone police the standardisation of products?

Yes, probably the FCA with the use of enforcement powers where necessary. Without appropriate policing there is a risk that consumers would lose confidence in the products.

Q10: How could the simple products brand be developed?

The paper cites the ISA 'brand' as being a trusted brand. We do not doubt this, but are not convinced that all consumers also understand that, for example, with very few exceptions their ISA carries a counterparty risk or, in the case of a stocks and

shares ISA, a capital risk. We would like to see a recognised and trusted brand developed for straightforward outcome products but one which would help most consumers also understand that they are not necessarily risk-free. The key to success will rest with the marketing programme that is devised as well as the development of a generic 'stamp of approval' or name. Again, extensive consumer research and use of commercial marketing expertise will be the best sources of information as this work moves forward.

Q11: How can consumers be reassured that these products meet the required standards?

We think that the brand or recognised mark will have to enjoy some kind of guarantee – possibly Government backed – that can be understood and trusted by consumers. National Savings & Investment is one such 'badge'. Of course there are a number of financial and other issues to be considered in such a move, but if consumers are to be persuaded that it is in their own interests to buy these products they will need a high level of reassurance that they will deliver at an affordable and competitive price. As we have indicated, there will also have to be a meaningful mechanism for policing the market to ensure that the products have 'earned' the straightforward outcome products brand. A great deal of useful information is also available in the Commission's report on EU consumer decision making in retail investment services: a behavioural economics perspective³.

Q12: Do you agree that deposit savings products and protection products should be the initial areas of focus? Are there significant features or product characteristics in these categories that would lend themselves to standardisation?

Given that these are two areas which are important to consumers and which involve relatively straightforward outcomes, this could be an appropriate place to start. 'Quick wins' in these areas could have the benefit of carrying the initiative forward fairly soon and bringing the new straightforward outcomes brand to the public's attention, but we think there is more to be gained by tackling products such as tracker funds where complexity is more of an issue for consumers and, therefore, where there will be greater impact. Consideration should also be given to including within the initiative transactional and current accounts of differing types, where a straightforward outcome comparator would be helpful.

Standardisation falls into two distinct areas: standardisation of the features of the product and standardised disclosure of those features. On the deposit account side, standardised requirements already exist for disclosing information such as the interest rate payable on deposit accounts and cash ISAs; and factual matters such as when interest is payable and notice periods would seem to be suitable for a standardised approach. As regards protection products, the breakdown of and disclosure of cost and basic terms (including the dates when premiums are payable) and the length of cover (for term life assurance) would again seem to lend themselves to standardisation. As we have already indicated, work already underway on Packaged Retail Investment Products and Key Investor Information Documents in particular, might be of assistance.

³ At http://ec.europa.eu/consumers/strategy/docs/final_report_en.pdf

It would be helpful too to have more information about where the largest 'gaps' in consumer financial product needs actually lie, so that the initiative can be targeted accordingly.

Q13: Do you have views on how simple financial products could be developed to benefit particular age-groups or sections of the market?

We believe that in the first instance straightforward outcome financial products should be developed to meet consumer needs as identified by extensive research, with the focus on those who are assessed as being most in need of protection and/or savings products, rather than targeted at particular age groups or sections of the market. Products should then be linked to lifestyle events.

Q14: The Government would welcome any evidence about costs and benefits of developing a new regime of simple products, preferably drawing on experience of implementing previous simple products initiatives or introducing new products lines.

The Panel is not in a position to respond to this question.

Q15: What would be the benefits and disadvantages of linking simple products to CFEB's national financial advice service, including within the financial health check?

In principle this would have the benefit of keeping up the momentum of the individual's interest in his/her financial position and would seem likely to lead to the individual being helped to act on the advice received. The process might, in contrast, deter those who would benefit more from buying products falling outside the range of straightforward outcome products from looking more widely or seeking regulated financial advice. We will be interested to see CFEB's views on this point.

Q16: Should the new regime of simple products be linked to regulated advice? If so, how might this work?

We see no reason why straightforward outcome products would not be amongst the range of products available through regulated advice, in much the same way as we expect advisers to include National Savings & Investment products within their range at the moment. As we have said in our response to question 5, we would also expect straightforward outcome products to be used as a 'benchmark' in much the same way as RU64 requires those providing regulated advice to refer clients to stakeholder pensions. As we have indicated, it might be possible to sell straightforward outcome products through a (regulated) simplified advice regime, or possibly through a decision-tree type aid.

Q17: The Government would welcome evidence on the role of savings stakeholder products in the market and the effects of removing or keeping them.

HM Treasury has published a helpful report by Professor James F Devlin to accompany the consultation paper on simple products and we have nothing further in the way of specific research to add to the report.

It is clear that there were a number of factors that led to the failure of the stakeholder initiative to deliver on the scale that had been hoped for. There are some key challenges that the straightforward outcome products regime will have to overcome if it is to be successful, perhaps the most significant being the need for producers (and advisers) to be able to make a profit from these products; and the assumption that consumers will be able to afford to buy them. On the first point, the absence of a price cap and options for 'cheaper' regulated sales regimes such as simplified advice might be of some help, but on the second point it would seem - at first – there is nothing to be done. We do think that there is merit in considering incentives such as tax breaks or a subsidy for consumers who are prepared to commit scarce funds to protection and savings products. The benefits of such a move would lie in a reduction in later reliance on benefits financed from the public purse. Whether the stakeholder regime should be abandoned or retained is a moot point. In our view the approach should be, do such products meet the criteria for the new regime?

Q18: The Government would welcome evidence on how the basic advice regime is working, if it is understood by consumers and profitable for providers.

The Panel is not in a position to respond to this question.

Q19: The Government would welcome views on any other wider issues that need to be considered alongside simple products, including the impact on the wider market.

The Paper sets out some of the initiatives already underway, such as the FSA's Retail Distribution Review (and in particular simplified advice) and the Packaged Retail Products work emerging from within the EU, but the development of straightforward outcome products should also be considered in the context of other developments in the retail financial services market. For example, the previous Government began work on developing the range of financial products and services available through Post Offices that would seem to fit naturally into the question of distribution channels. There is a further EU initiative on the mandatory availability of payment accounts that might also be included in the wider picture of encouraging consumer engagement with financial services in the broadest sense. We believe it is important to co-ordinate so far as possible all these developments in order to reduce costs to industry (and ultimately to consumers) of perpetual change, which could in itself be a barrier to the development of straightforward outcome products. Co-ordination, perhaps in terms of branding or labelling, would also present a greater opportunity for promoting these products to consumers more effectively than in a piecemeal approach.

Yours sincerely

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