

**Financial Services Consumer Panel  
Response to DP11/1:  
Product Intervention**

## Introduction

We are pleased to respond to this important Discussion Paper which in many ways will help to determine the regulatory approach of the future. We have taken the opportunity to set out some of the wider issues that we would like the FSA and, subsequently, the Financial Conduct Authority (FCA) to consider as they develop their strategic and operational approach.

Discussion Paper DP11/1: product intervention sets out a helpful outline of the possibilities for 'nipping in the bud' consumer detriment at an earlier stage than the FSA has attempted so far. We are pleased to see such a comprehensive acknowledgement of the diverse skills, experience and needs of consumers and the clear commitment of the regulator to being far more proactive in its approach. It is important that the FCA has the necessary powers to fulfil this commitment and to ensure better consumer protection in the years ahead. The current period of regulatory change presents a unique opportunity to ensure that the FCA is properly equipped for the future and the options set out in DP11/1 provide a robust framework on which to build.

Adam Phillips  
Chair  
Financial Services Consumer Panel

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## Product intervention – the wider perspective

### Responding to consumer needs

The FSA accepts in the discussion paper that its current regulatory approach, which places greater direct emphasis on the sales process rather than the product being sold, has not delivered the results it had hoped. While we welcome this important shift towards considering the entire product value chain, it will sadly always be the case that that mis-selling will be one of the main root causes of much consumer detriment.

Demographic changes such as the ageing population, with more people dependent on their savings and investments for income; pressure on individuals to work longer before retirement; and the near disappearance of final salary pension schemes in the private sector all mean that there will be an increasing need for an innovative and responsive financial services market to meet consumers' and society's changing needs.

It is suggested in DP11/1 that general product pre-approval would, amongst other things, be likely to inhibit access to more innovative, complex or risky products. We can see that consumers who for example have an extensive balanced portfolio in which they would like to include more risky products should be entitled to do so. But complex, risky products would be for the minority and it is vital that the FCA does not 'take its eye off the ball' in terms of anticipating/mitigating the risk of mis-selling of such products while at the same time addressing the needs of the majority.

### Simplified advice

The Panel has been actively engaged in the debate arising mainly from the Retail Distribution Review on the development of models for delivering simplified advice, which we believe will play a key role in providing access to financial advice for those consumers for whom a full independent advice service is either unnecessary or prohibitively expensive. We were pleased to see reference in Hector Sants' speech at the BBA on 3 March 2011 to forthcoming FSA guidance on simplified advice<sup>1</sup>. We believe that debate around this question, along with "straightforward outcome products", which we have discussed below, is closely linked to many of the issues raised in DP11/1 and forms part of the wider perspective that needs to be taken into account.

### "Straightforward outcome" products

HM Treasury has for some time been discussing ideas for fairly standardised "simple" financial products to encourage consumers to engage in the financial services market, culminating in the recent HMT consultation paper<sup>2</sup>. As we explain in our response to that paper<sup>3</sup>, there are a number of challenges to be

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<sup>1</sup> At [www.fsa.gov.uk](http://www.fsa.gov.uk)

<sup>2</sup> HM Treasury consultation paper "Simple financial products" at [www.hm-treasury.gov.uk](http://www.hm-treasury.gov.uk)

<sup>3</sup> At [www.fs-cp.org.uk](http://www.fs-cp.org.uk)

overcome if this kind of initiative is to succeed and we have called for creative thinking around the kind of products that would be included in such a regime and the way in which they are paid for and delivered. For example, in our response we suggested that the cost of buying some key products such as life or household insurance could be spread over a number of weeks or months by adding a small amount to payments of rent.

To inform our own thinking in this area we have commissioned research into what the profile of products suitable for sale as simple or straightforward products might be like. Consideration would have to 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;
- “simple” products on the lines of those envisaged within the Treasury’s consultation paper; 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.

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

Currently our view is that the appropriate focus should be products that deliver a straightforward outcome, which would not necessarily exclude fairly complex products in terms of structure and cost, rather than “simple products” per se. These straightforward outcome products would not necessarily be limited to a ‘budget’ type brand, although clearly the range would have to include products for individuals on low incomes. We see these products also performing an RU64<sup>4</sup>-type role as benchmark products against which consumers can measure other products performing similar functions.

Clearly the FCA would have a significant role to play in the new regime, which in our view would be entirely consistent with the overall approach to product intervention set out in DP11/1. This role would include providing regulatory expertise in designing delivery mechanisms and policing of compliance with the product criteria and distribution regime.

### Treating Customers Fairly (“TCF”)

In the Panel’s own discussions of the issues raised in DP11/1 we have formed the view that in most, if not all cases where it seems likely that the FCA would actively intervene it could have done so by ensuring that the principle of TCF was firmly embedded within firms’ culture. Principles alone will not achieve regulatory compliance, but we would like the FCA to consider enforcing TCF

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<sup>4</sup> The commonly used name for COB5.3.16R(3) which requires advisers to compare their recommended pension product against a stakeholder pension. At [www.fsa.gov.uk](http://www.fsa.gov.uk)

more widely, for example as a means of ensuring that products continued to meet requirements and deliver the right results over time, not just at the outset. Regulation should address the entire “journey” of the product. Effective enforcement of TCF would also cut across any debate about whether a ‘new’ product was in fact a new design, a hybrid or further development of an existing product and enable the FCA to protect consumers more easily on a continuing basis.

### **Consumer outcomes**

Finally, we thought it would be helpful to set out the consumer outcomes we would like to see from a system of regulatory product intervention, taking account of the wider issues we have set out in this response.

1. Consumers should be able to buy straightforward outcome products that deliver what they promise including value for money, through all distribution channels including execution only.
2. Those unable or unwilling to pay for a full independent advice service should have access to a process for delivering simplified advice with appropriate levels of consumer protection.
3. Consumers should have access to a wide range of financial products that meet a diverse set of needs and aspirations, that have been subject to appropriate internal and regulatory scrutiny both at the design stage and during subsequent product development, such that regrets and complaints to FOS are minimal.
4. Consumers should have access to fair redress and compensation if things go wrong.

## Overview of responses to questions in DP11/1

The Panel welcomes the publication of this Discussion Paper and overall we agree with the market failure analysis that it contains.

We support the inclusion of the widest possible range of regulatory options for product intervention by the regulator even though the most intrusive regulatory tools, such as product pre-approval and product banning, would not be used routinely. We favour the development of a regulatory benefit in the form of a process of 'self-certification' for firms that had demonstrated high levels of compliance in product design and development, with the FCA having the option of mandatory pre-approval for 'persistent offenders'. For this to succeed the FCA would need access to a significant amount of detailed intelligence, firm-specific information and analytical reports and would have to have sufficient resources in place to use this data effectively.

We have included in our response a number of additional indicators of potential problems with products, such as excessive profit lines and rapidly increasing market share; and we have drawn on the high level organisational requirements in the Markets in Financial Instruments Directive, such as running compatibility assessments and stress testing, as an appropriate basis for new rules for firms when designing and managing products.

Finally, while we support the use of prescriptive rules where necessary, we would like to see greater emphasis placed on the need for firms to treat their customers fairly as an integral part of the new product intervention regime.

## Equality and diversity

### ***Q1: What issues should we consider in relation to how our product intervention approach affects equality and diversity?***

The FSA acknowledges in DP11/1 that where it is considering action to stop a product being sold, the relevant cost benefit analysis should factor in the interests of those groups of individuals covered by the Equality Act 2010 (the Act). Similarly, we would expect the FSA to carry out an impact assessment that included an appropriate and relevant sample of groups identified in the Act.

### ***Q2: How could we use our focus on products to promote equality and diversity?***

We envisage that provided the cost benefit analysis and impact assessment were completed on the basis we have indicated in our response to question 1, well targeted product intervention would increase the confidence of all classes of existing and prospective consumers in the products purchased, thereby fostering market growth for firms and better outcomes for all consumers. Future post implementation reviews could adopt the same approach as for the CBA and impact analysis, using a set of objective criteria against which to measure the effectiveness of the FSA's action from the perspective of this same sample. In addition it would be important to monitor the achievements of the new approach by customer facing research on uptake and satisfaction, as well as by tracking complaints. Equality and diversity would be promoted by simplified advice as a means of distributing appropriately designed products that meet the needs of the widest range of consumers.

## The rationale for product intervention

### ***Q3: Do you have any comments on our market failure analysis?***

Overall we agree with the key points set out in the market failure analysis, including the ways in which consumers are obstructed from making judgements about the price and quality of products and the lack of relevant, straightforward information. Many consumers will buy financial products only rarely and are not in a position to build financial services expertise. The Paper (at paragraph 3.7) states that “consumers often cannot learn from their mistakes in ways that allow them to put pressure on providers to offer good quality and good value products.” While up to a point this is true, consumers in fact learn only too well from the detriment they suffer as a result of mis-selling of products such as endowment policies and payment protection insurance, and that they learn about through the media, and are understandably reluctant to engage with the industry. There has been a misconception too that disclosure alone is an effective means of consumer protection and overall this has not helped consumers struggling to make balanced decisions about their money.



We continue to be strong supporters of the Retail Distribution Review and we welcome these steps to rectify issues such as the conflict between sales incentives and the provision of investment advice that is truly in the consumer's interests. The development of models for simplified advice and more straightforward outcome products, where much of the impetus has arisen from the RDR debate, is also welcome and could ultimately remove some of the confusing complexity and cost from the financial services market<sup>5</sup>.

***Q4: What do you think are the criteria by which we should judge when to intervene further?***

The over-riding principle of Treating Customers Fairly should be applied and enforced. For example, the indicators of problematic product features listed at figure 3 in DP11/1 include "use of product names that imply greater levels of safety/return than are actually possible". It seems patently clear to us that the design and sale of such a product would not constitute treating customers fairly and without doubt the regulator should intervene. For example, recently published research<sup>6</sup> by the Association of British Insurers into new sector names identified that respondents wanted to be able to draw a conclusion about a fund's level of risk from its name and were inclined to make assumptions or inferences if the name did not give clear information. This is clear evidence of the importance of product naming and, again as supported by the ABI research, there is a real and entirely appropriate preference for everyday terminology to be used.

We also think that the FCA should look critically at cross-subsidy. We acknowledge that cross-subsidy can be a feature of many retail markets and that in financial services the practice can serve consumers well in ensuring that products are available to all. But in many cases we think it likely that cross-subsidy between products will be more in the interests of the firm than the customer, for instance by discouraging new entrants to the market, and that the case-by-case approach referred to in the Paper is the right one. It will, however, require a detailed and comprehensive review of individual firms' operating models and business plans and it will be important to ensure that the FCA has access to the appropriate level of economic and analytical resources.

We are pleased to see that the FSA recognises poor value for money would be grounds for intervention, including whether the product costs are compatible with the objectives of the product.

***Q5: Are there any other relevant indicators that would help us identify potential problems?***

We suggest the inclusion of:

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<sup>5</sup> Chapter 2 of the HM Treasury Consultation Paper on simple financial products sets out the rationale for designing a simple products regime

<sup>6</sup> ABI Research paper no 27, 2011 New names for the mixed-asset sectors, at [abi.org.uk](http://abi.org.uk)

- High commission or other remuneration incentives;
- Opaque charging structures;
- Insurance products where the percentage of successful claims is below the industry norm;
- Rapidly increasing market share;
- Excessive profit lines; and
- Targeting higher risk firms already identified as a result of the FSA's work on conduct risk.

We also think it will be important for the regulator to consider the context of a product and not just the product itself. For example, where the product is one of a large number of similar products, eg ISAs, offered by a provider, is there sufficient clarity around the features of each product to prevent confusion between them?

## The emerging supervisory approach

***Q6: Do you have any comments on the supervisory approach we have adopted, or suggestions to help develop it?***

We are supportive of the aims of the supervisory approach that is being developed and of the strategic objectives that are driving it. The examples contained within Chapter 4 of the Paper are helpful in demonstrating some of the achievements of this new approach so far. We would like some reassurance however that the information gleaned from these specific cases is then used to review particular sectors, or sectors of all firms' business, where the intelligence might also be relevant.

We note however that in many cases there seems to have been no publicity or valuable dissemination of information for consumers resulting from these particular interventions. There seems to be a general acceptance that the FCA will in future adopt a more transparent approach<sup>7</sup> than the FSA has been able or willing to do so far, so we would like to see a greater commitment to use publicity as a consumer and firm education tool built in to the new supervisory strategy.

It will be important that procedures are put in place to ensure a level of cohesion between the FCA, Prudential Regulatory Authority and Financial Policy Committee. Clearly this is vital to the success of regulation overall, but it is particularly important that the FCA has access to the widest range of intelligence and analytical sources available to ensure that conduct risks, and prudential risks with implications for conduct risk, are all taken

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<sup>7</sup> "Openness and transparency will be at the heart of the FCA's work. We expect the FCA to have a regulatory culture based on a presumption of transparency." Speech by Mark Hoban MP, Financial Secretary to the Treasury, to the BBA Conference on 2 March 2011 at [www.hm-treasury.gov.uk](http://www.hm-treasury.gov.uk)

into consideration. If the FCA is able to intervene to nip in the bud new problematic products, then any risks to stability arising from substantial redress to consumers associated with crystallised risks would be minimised.

## Possible development of the regulatory framework

### ***Q7: Should we give further consideration to new rules to prescribe conduct by firms when designing and managing products?***

We have supported the FSA's approach to more principles-based regulation and have agreed that more prescriptive rules should be applied where the non-prescriptive approach has failed to deliver the right outcomes. But principles do have their place in regulation and, from the consumer perspective, the most significant is the Principle of Treating Customers Fairly. A great deal could be achieved by ensuring that TCF has been embedded within firms' culture and that compliance with the principle is enforced.

### ***Q8: If so, what should be covered?***

The European Commission's recent public consultation<sup>8</sup> on the Review of the Markets in Financial Instruments Directive (MiFID) set out proposals – which the Panel has supported<sup>9</sup> – for specifying the current high level organisational requirements on firms for the launch of products, operations and services. In brief, these are:

1. running an assessment of the compatibility of a product (or service or operation) with the characteristics and needs of the target clients;
2. strengthening the duty of the compliance function in ensuring that procedures are in place to ensure the product complies with all the applicable rules;
3. ensuring the risks to the firm of new products are adequately managed;
4. stress testing new products;
5. periodic reviews of distribution and performance;
6. employment of staff with the necessary expertise and training to understand the characteristics and risks of new products; and
7. ensuring that the board has effective control of these requirements.

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<sup>8</sup> Public consultation: Review of the Markets in Financial Instruments Directive at [www.ec.europa.eu/internal\\_market/consultations](http://www.ec.europa.eu/internal_market/consultations)

<sup>9</sup> The Consumer Panel's response to the MiFID review at [www.fs-cp.org.uk](http://www.fs-cp.org.uk)

The Commission envisages, amongst other measures, the routine inclusion of information about the firm's products in compliance reports to senior management and on request, to regulators.

We believe that these proposals would provide a sensible and proportionate basis on which the regulator could prescribe new rules for firms when designing and managing products.

**Q9: *What would be the impact on the market?***

We expect to see a positive impact on the market with consumers better placed to make choices, and firms benefitting from less (and hopefully no) financial and reputational damage as a result of scandals such as the high level of investor losses linked to precipice bonds. Ultimately we believe that this new approach could also help to stimulate effective competition, to the benefit of both firms and consumers.

**Q10: *What would the implications be if we consider similar interventions for services as those discussed in this Paper for products?***

It would not be appropriate to exclude services – platforms are probably the most topical example – from the new regulatory approach, so we are supportive of extending the product intervention regime to services.

## **Additional product intervention options**

**Q11: *Do you have any comments on any of the possible additional interventions?***

We support the range of additional interventions set out in the Paper. Our impression from Chapter 6 of DP11/1 however is that the FSA has already shied away from the more radical options, such as product pre-approval. We do not agree with this premise and favour a more flexible approach which gives the regulator access to the widest possible range of intervention powers. This would provide scope for the FSA/FCA to employ different intervention strategies in different markets and for different firms, as the particular circumstances warrant, for example products that have already caused detriment should be subject to particular scrutiny. So while we would not necessarily expect or want to see the FSA/FCA pre-approving all new products, we would like the regulator to have these powers available.

One approach to product intervention could involve a presumption that the FSA/FCA would monitor closely firms' compliance with the new requirements relating to product design and development, with product pre-approval being limited to product classes and individual firms already identified as potentially presenting a greater risk to consumers. There would be parallels with the policy adopted by the Advertising Standards Authority whereby 'persistent offenders' may be subject to the most intrusive scrutiny, including pre-approval. In all other cases there would be

a form of 'self certification' where firms that demonstrated high levels of compliance could be free to introduce new or varied products without pre-approval. We would expect these firms to be able to demonstrate, with a clear audit trail, that they had identified, considered and sought to mitigate key causes of potential consumer detriment. There would of course have to be ad hoc compliance checks in these cases but overall it could still represent a regulatory benefit to individual firms.

We would also like the FSA to consider product approval as part of a broader regime. For example, we have set out earlier in this response our views on the development of straightforward outcome financial products, where the regulator would have a role to play in providing regulatory expertise in designing delivery mechanisms and policing of compliance with the product criteria and distribution regime. In addition we have called for straightforward outcome products to have a widely recognised brand or badge involving some form of guarantee that would be recognised by consumers, and this would also be policed by the FCA.

The FSA states in the Paper that product pre-approval would have "massive" resourcing implications, although this is not quantified. While we recognise the challenges inherent in product pre-approval we believe it is a useful part of the regulatory toolkit. It would be a worthwhile investment if it prevented consumer detriment by identifying products that did not represent value for money and/or served firms' interests, rather than met consumer needs. The resource implications could be reduced significantly in the medium and longer terms if the earned autonomy/self certification option outlined above were to be developed, as well as by a reduction in the regulatory resources required to deal with issues arising in the later stages of the product life cycle.

Reference is made in the Paper to the regulator adopting a conservative approach in order to mitigate the moral hazard of having responsibility for signing off products. We were a little surprised by this as we would not regard the FSA as being overly conservative in exercising its other regulatory powers. The regulator does of course have recourse to external advice. Perhaps the relevant team could, for example, make use of strategic and policy advice from the Consumer Panel on the potential for consumer detriment if this was a particular concern, although we do not envisage a role for the Panel in specific product approval. With the right expertise at its disposal from within and outside the FSA/FCA, we think that product approval should not be a major problem for the regulator.

We also support use of the power to ban products where appropriate. Although we agree with the analysis in DP11/1 that there could be significant risks in such an approach, such as consumers assuming that any product that had not been banned must be 'safe', the overall benefits in forestalling widespread consumer detriment outweigh such risks. These risks could also be mitigated by effective communication with consumers through a range of media.

In terms of charging and price-capping, we support the use of an RU64-type approach to benchmarking as a valuable aid to consumers. As we have said, we agree that poor value for money should be a possible reason for intervention and we support too creating or reinstating rules for addressing excessive charges.

***Q12: What activities could we define as non-mainstream advice for the purposes of developing additional qualifications?***

The starting point for deciding on these activities should be the identification of any gaps in the training and competence regime, perhaps as evidenced by past mis-selling. A common sense approach to new products that would have a significant impact on consumer interests, backed by a set of objective criteria, would be an appropriate approach. For example, in our response to the HM Treasury consultation on early access to pensions savings<sup>10</sup> we said that there could be a need for mandatory advice for individuals who wish to access their pension savings early; and that for advisers there should be specific CPD requirements or even a specific tailored qualification put in place. We support the retention of specific qualification requirements for long-term care insurance contracts, pension transfers and equity-release mortgages, as identified in the Discussion Paper.

***Q13: Are there any other interventions we should consider?***

The Panel has no additional suggestions.

***Q14: What would the impact of these specific interventions be on the market?***

As we have said in our response to question 9, we expect to see a positive impact in the form of, ultimately, a more competitive market. We would also expect consumers to become more confident over time and for firms to be able to benefit from increased levels of confidence and trust in the form of better engagement with consumers.

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<sup>10</sup> Call for evidence Early access to pensions savings at [www.hm-treasury.gov.uk](http://www.hm-treasury.gov.uk) and the Panel's response is at [www.fs-cp.org.uk](http://www.fs-cp.org.uk)