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Treasury Committee

Restoring confidence in long–term savings

Eighth Report of Session 2003–04

Volume I

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The Treasury Committee

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Summary

Confidence in long-term savings

The long-term savings market is worth £1,900 billion-plus and its efficient working is vital for the prosperity of both savers and the wider economy. It is widely accepted that there is now a damaging lack of consumer confidence in long-term savings.

Improving product information

Providing savers with clear, succinct information would reduce the risk of mis-selling. We challenge the industry and regulators to develop a brief, standardised Summary Box showing the basic characteristics of a product. There is an urgent need to develop a simple summary risk indicator for products, suitable for inclusion in the Summary Box.

Aligning savers' and industry interests

A closer linkage between the investment returns for customers and executive remuneration may be beneficial. The dominance of selling activity rewarded on a commission basis may also leave savers suspicious that they are being sold a product for the wrong reasons. A fee structure containing a stronger linkage to investment performance would align the interests of savers and the industry more closely.

Improving distribution

Full and easily understood disclosure of fees and commissions to savers is vital for an efficient market. Clients should be given an explicit comparison of the total cash cost of buying a product on a fee or commission basis over the likely life of the product. For IFAs to receive trail commission whether or not they are providing any real on-going advice to the client is unacceptable. All the major trade bodies in the long-term savings industry should have clear codes of practice and we call on the AIFA to establish such a code.

With-profits products

While investors are unable to see the performance of the underlying investment fund and are subject to exit penalties without clear explanation, they may remain reluctant to re-enter the with-profits market. Closed funds now total £160 billion and offer policyholders lower prospects of growth. A consolidation process among closed funds is now underway and it important that the FSA ensures that policyholders are treated satisfactorily through this process. Reform of the actuarial profession is overdue.

Sandler products

The basic advice process proposed for Sandler products will help meet fears that a

simplified selling process would see large scale mis-selling with little prospect of consumer redress. We are disappointed, however, that part of the charge for Sandler products is not more clearly linked to investment performance. It would be unfair for product providers to levy the new, higher charge on existing stakeholder pension contracts. Regulated prices in the financial services industry should be set by an independent body after clear and transparent analysis.

The role of the FSA

The current low level of consumer confidence in long-term savings largely reflects the weak regulatory framework and industry practices prior to the arrival of the FSA. Apart from in the area of money laundering, where most agree the regulations require simplification, we received no specific complaints of excessively burdensome regulation. The length of time contested enforcement cases take is of concern. The FOS commands wide support and calls for a general appeals process against its decisions should be resisted. Greater public knowledge of the FSA's role in protecting their interests would help restore confidence. The FSA should launch a publicity campaign for its role in regulating financial services.

Tax & benefits

Recent moves to simplify aspects of the tax regime for pensions are welcome but there is substantial scope for improving the coherence of the present complex tax regime in promoting savings. The feasibility of granting more flexible access to pension savings during periods of unemployment or illness should be examined. The working of the new benefits system needs to be monitored closely.

Financial Capability

FSA's efforts to improve financial literacy are widely supported with an acceptance that the industry should meet much of the cost. It is deplorable that complex rules have hampered the provision of financial advice through the work place and via voluntary agencies such as Citizens Advice. The whole financial services sector should be encouraged to support Citizens Advice's work in this area.

Conclusions

The industry needs to take responsibility for tackling the problems confronting it. One of the main priorities is ensuring competitive returns to the saver. The industry itself needs to be more proactive in identifying activities that threaten to tarnish its image. A broad ranging forum should be established with the aim of giving early warning of problems. There is no scope for complacency when it comes to public trust in the solidity and solvency of savings institutions. An important test for all retail products should be: "is the average person likely to be able to understand this unassisted?"

1 Introduction

The issue

1. Long-term savings—in the form of pensions or other savings—are a fundamental part of the financial security of the population. It is important both for savers as individuals and for the economy as a whole that the level of savings—and the industry that manages them—should be in a healthy state. Yet a number of recent events have shown that all is not well and confidence in savings and the savings industry is at a low ebb. In our earlier report, in March, on endowment mortgages we concluded "There is an overriding need to rebuild public trust and confidence in many of the companies that currently dominate the long-term savings industry."[1]

2. The contributory factors include some developments into which this Committee has already conducted inquiries, such as the problems at Equitable Life[2] and the issues that have arisen in the split capital investment trust sector.[3] But we decided in the course of 2003 that a wider examination was called for. Accordingly in November 2003 we announced this inquiry, under the title *Restoring confidence in long-term savings*, indicating that we would particularly welcome evidence on the 'savings gap', marketing practices and costs in the industry, the means of provision of unbiased financial advice, asset allocation policies in the life insurance industry, problems relating to specific products (such as endowment mortgages and precipice bonds[4]), and the role of the regulatory authorities.[5]

Conduct of this inquiry

3. We have held in all 13 oral evidence sessions, with 17 different groups of witnesses. These have included individual experts, consumer groups and representative bodies from across the industry, but also the chief executives of five major life assurance companies, the Chairman and Chief Executive of the Financial Services Authority, and the Financial Secretary to the Treasury (Ruth Kelly MP).[6] The Committee has also received over 300 written submissions or letters from representative organisations, official bodies and individuals.[7] We are most grateful to all those who have assisted the Committee during this inquiry.

4. At an early stage in the inquiry, we decided that it would be useful to produce a separate report, in advance of the wider report, into the situation relating to endowment mortgages.

1 Fifth Report of Session 2003–04, *Restoring confidence in long-term savings: Endowment mortgages*, HC 394

2 See Tenth Report of Session 2000–01, *Equitable Life and the Life Assurance Industry*, HC 272, and further oral evidence taken on 30 October and 13 November 2001 (HC, 2001–02, 317–i and –ii)

3 See Third Report of Session 2002–03, *Split Capital Investment Trusts*, HC 418

4 For an explanation of the characteristics of a precipice bond see FSA Guidance Note 7 issued on 19 February 2003

5 Treasury Committee Press Notice 51 of Session 2002–03, 14 November 2002

6 The full list of witnesses is at pp. 74 & 75; the oral evidence is published in Volume II of this Report, HC (2003–04) 71–II

7 The principal memoranda received in the early part of the inquiry (covering the period up to January 2004) were published in a separate volume HC (2003–04) 275; the principal memoranda received subsequently are published in Volume II to this Report HC (2003–04) 71–II. A number of other submissions, not involving personal or other confidential information, have been put in the public domain by being reported to the House and placed in the Library of the House and in the parliamentary Record Office: these are listed at p. 78

This was both because the situation facing many hundreds of thousands of holders of endowment mortgages was particularly pressing and because it seemed to us that a number of the issues raised provided useful pointers to those we wished to discuss further in this wider report. We published the report on Endowment Mortgages on 11 March,[8] and the Government and FSA responses to the Report were published on 17 June.[9]

5. The Report by Lord Penrose into the events at Equitable Life[10] was published in March. The evidence we took on that report, from Lord Penrose and from the Financial Secretary, forms part of the oral evidence for this inquiry.[11] This evidence contributed to the ongoing debate about a resolution of the problems relating to Equitable and also to the discussion in this report (particularly in relation to with-profits funds). The Parliamentary Ombudsman, Ms Ann Abraham, has now indicated she will be conducting further investigations into the regulation of Equitable Life.[12]

8 Fifth Report of Session 2003–04, HC 394

9 Fifth Special Report of Session 2003–04, HC 655

10 HC (2003–04) 290

11 Evidence session on 16 March, published earlier as HC (2003–04) 71–iv, and included in Volume II to this report, HC (2003–04) 71–II

12 Third Report of the Parliamentary Commissioner for Administration, Session 2003-04, HC 910

2 Confidence in long-term savings

The long-term savings market

6. Household savings have two key roles in the economy. They offer potentially valuable benefits to savers, benefits that were summarised by HM Treasury in its submission to our inquiry as; "security if things go wrong…, comfort in old age; and independence and opportunity throughout [savers'] lives."[13] In addition, households' savings are an important source of capital to fund investment and growth in the economy. Anything that hampers the smooth working of the savings market will have implications for the cost of capital to UK industry and commerce.

7. The savings market can be split into two broad segments. Short-term savings are intended to provide the saver with a readily accessible reserve of funds to cope with any household emergency. The need for short-term savings to be easy to access means they are typically held in assets such as cash, deposit accounts and cash ISAs. Short-term savings are an important part of the savings framework, but the saver's capital is not usually at risk and there is little to suggest any widespread lack of confidence in this area of the market. Short-term savings are thus not a focus of this inquiry.

8. Long-term savings, in contrast, are often invested in assets that are both relatively illiquid and relatively risky in that the saver may not get back the full value of whatever was invested. The level of risk across the spectrum of long-term savings products nevertheless varies enormously and we heard evidence in the course of this inquiry from a wide variety of witnesses suggesting that the way the savings industry presents, and the saver understands, the level of risk implicit in various savings products is a key issue.[14] Repeated mistakes, misunderstandings and misrepresentations in recent years about the risk attached to various savings products have severely damaged consumer confidence in the long-term savings industry.[15]

9. The initial objective of long-term savings is usually to enable the saver to accumulate a capital sum. The ultimate aim may be to use this capital sum to fund specific spending, such as paying off a mortgage for a house. Alternatively, savers may be intending to boost their living standards by using the capital sum to provide an income, often by saving within a pension plan. Pension savings, either via a personal pension or via an occupational pension, are thus an important part of the long-term savings market. Pensions savings, however, are an area distinguished by a variety of special tax rules and other regulations. Many occupational pension schemes have also seen changes recently, with a widespread switch from defined benefits schemes to defined contributions arrangements. Pension-specific tax and benefits legislation, and the issues particularly affecting occupational pensions, are not the focus of this inquiry[16] but the evidence we have heard suggests that

13 HC 275, Ev 127 para 4

14 See paragraph 25 below

15 See paragraph 15 below

16 They have of course been the subject of other reports, including the Government's December 2002 Green Paper *Simplicity, security and choice: Working and saving for retirement* Cm 5677, and the Third Report of the Work and Pensions Committee, *The Future of UK Pensions,* HC (2002–03) 92 in April 2003, and legislative proposals.

many of the factors that are eroding public trust in long-term savings generally are also undermining confidence in pension savings. Equally, we have heard evidence suggesting that tax and benefit regulations aimed specifically at the pension market are having an impact on consumer attitudes towards the wider long-term savings market. Thus, while pensions legislation has not been our primary focus, many issues relevant to pensions have emerged as important issues within this inquiry. We therefore feel that many of our conclusions have relevance to pensions saving.

Table: UK savings market (as at end 2002)

Type of saving	£ billion	%
Occupational pensions: insurance schemes	196	7%
Occupational pensions: in-house schemes	588	22%
Personal pensions	333	13%
Medium and long-term savings: insurance company products (e.g. bonds)	226	8%
Medium and long-term savings: other products (e.g. unit trusts)[17]	576	22%
Deposits and cash	743	28%
Total	**2,662**	**100%**

Source: ABI. Figures include National Savings

10. The above Table presents data provided to the Committee by the Association of British Insurers (ABI).[18] It suggests that at the end of 2002 UK savings were worth in total £2,662 billion, with 28% in short-term savings instruments such as deposits and cash. Non-pension long-term savings, worth £802 billion, accounted for just over 30% of the total and the remaining 42% of the market was made up of pensions savings of one form or another, including £333 billion of savings held in personal pensions.

11. There are concerns that as a nation we are saving too little. The savings ratio, defined as household saving as a percentage of gross household disposable income,[19] has been recovering in recent quarters from a low of 4.8% in Q4 2002. The savings ratio of 6.1% estimated for Q1 2004 nevertheless remains some way below the 8.9% average over the past 10 years and there are particular concerns about the flow of saving into pension funds. The ABI told us that a 2001 study they had commissioned had concluded "the UK faces a savings gap of some £27 billion a year"[20], defined as the difference between "the amount currently being saved and the amount that needs to be saved in order to secure an acceptable retirement income."[21] Other witnesses, however, felt that this figure might be an exaggeration. The Building Societies Association told us of work done by the IFS highlighting "that 25% of the savings gap was accounted for by people aged 25 or under,

17 Includes direct holdings of equities

18 HC 275, Ev 12 Table 2.1

19 Plus an adjustment for the change in the net equity of households in pension funds

20 HC 275, Ev 11 para 2.3

21 HC 275, Ev 12 para 2.7

and those with a household income of less than £9,500" and noting "for such groups, savings may not be their best option."[22] Ruth Kelly MP, Financial Secretary to the Treasury, told us that the Government regards the £27 billion figure with "some scepticism",[23] although there is official concern about low levels of saving. The Department of Work and Pensions has concluded that "3 million people are seriously under-saving for their retirement… In addition, a further group of between 5 and 10 million people may want to consider saving more, working longer, or a combination of both, depending on their expectations for retirement."[24]

12. Experts warned us that it was difficult to put any exact figure on the extent to which, if at all, the UK as a nation is saving too little. One important factor here is the recent strong rise in house prices and its impact on savings behaviour. Long-term trends do show a correlation between house price movements and the savings ratio. At previous times of high house price inflation, the savings ratio has dipped considerably, only to recover again as house price inflation slows. Professor Davis of Brunel University told us that a significant influence on aggregate measures of net saving in recent years had been "a huge growth in the flow of liabilities into mortgage debt" which had "reduced the saving ratio"[25]. He also suggested that consumers might have been "lulled into thinking they do not need to save because of the value of their houses".[26] Aviva plc wrote to us "many consumers would appear to be placing reliance on the gains they currently have from owned property"[27] as a substitute for traditional long-term savings industry products. An ABI sponsored study confirms this point, finding that "32% [of the population] plan to use money from property to fund their retirement, with 13% expecting it to be their main source of income."[28] Mr O'Brien of Nottingham University warned us that other factors could create the scope for statistical confusion in this area, noting that there are several "different measures for savings ratios and some are more helpful than others. For example, if you have people in retirement who are not earning but they are running down their assets, then that is dis-saving. There is nothing wrong with that, that is fine, that is what we would expect, but of course that is a negative effect on the saving ratio."[29] The Treasury shared this view, telling us: "People choose to save in different ways and at different times in their lives. Rather than tell people how much they should save, the Government instead believes it should enable people to make informed choices about retirement income, so individuals can plan to save in accordance with their preferences and circumstances."[30] The Treasury has thus "set no explicit target for the savings ratio".[31] In the course of this inquiry, the Committee has adopted a similar approach.

22 HC 71–II, Ev 305 para 12

23 Q 2080

24 *Simplicity, security and choice: working and saving for retirement*, Cm. 5677, Department for Work and Pensions, December 2002, page 3, para 20

25 Q 15

26 Q 20

27 HC 275, Ev 63 para 1.3

28 *The state of the nation's saving*, Association of British Insurers, October 2003, page 1

29 Q 17

30 HC 275, Ev 128 para 10

31 HC 275, Ev 127 para 3

13. **Long-term savings represent a £1,900 billion-plus market and are vital for the future prosperity of both savers and the wider economy. The government and the industry have a strong interest in encouraging saving. We note that the current savings ratio remains below the average over the past ten years. This Committee believes that individual savers ought to be best placed to decide how much and in what form they should be saving. To ensure that they are in a position to make such decisions, it is essential that savers can be confident both that they will be treated fairly by the long-term savings industry and that they will be given clear, readily accessible and factual information on savings-related issues.**

Confidence in long-term savings

14. All sides who gave evidence to us—consumer groups, regulators, the industry and the Government—united in agreeing that consumer confidence in the long-term savings industry was problematic. The National Consumer Council (NCC), for example, told us that a survey they conducted in March 2003 "found that 52 per cent of people agree with the statement 'I do not trust the pensions industry'."[32] The NCC also highlighted that lack of confidence was a particular problem among younger consumers, with focus groups and in-depth interviews with young people on low and modest incomes aged 21–34 showing that such "consumers lack confidence in the financial services industry, and are generally unconfident decision-makers about saving."[33] The Financial Services Authority agreed that there was a problem. They suggested to us that confidence in the savings industry had been hit by a wide range of factors and that the "task of rebuilding [it] requires effort by a wide range of parties."[34] The ABI meanwhile told us that while an "effective financial system must be built on confidence… In recent years confidence in the long-term savings industry has fallen short" of what was desired.[35] The Financial Secretary to the Treasury thus summarised the situation as being one in which "a lot of consumers are put off the whole process of saving at the moment partly because of a deep-seated distrust of the financial services industry."[36]

15. There was less unanimity on the main factors hitting consumer confidence in the industry. Industry witnesses tended to lay considerable emphasis on the depressed state of equity markets in recent years. Aviva, for example, suggested that the lack of consumer confidence was caused "primarily by negative investment market performance since the beginning of 2000."[37] Other witnesses suggested that while weak equity markets had not helped, they had often simply exposed and exacerbated issues that had their origins elsewhere. Mr McAteer of the Consumers' Association, told us that "I think it is fair to say that the bear market has contributed to the collapse in confidence but I would argue very strongly that what we have seen is a perfect storm of events which has undermined confidence in the long term savings and pensions industry and that the bear market has

32 HC 275, Ev 160 para 14

33 HC 275, Ev 160 para 8

34 HC 275, Ev 99 para 5

35 HC 275, Ev 10 paras 1.6–1.7

36 Q 2098

37 HC 275, Ev 63 para 1.2

simply been the most recent of those events."[38] The FSA also noted that while "consumer attitudes towards saving have undoubtedly been adversely affected by the bear market….there have been too many instances where the industry did not live up to its responsibilities to explain investment risk clearly to its customers at the outset", as well as "well-publicised failures by some firms to treat their customers properly when selling them particular products."[39] A similar view was expressed by the Investment Management Association, who wrote that a "major factor has been financial products that have failed to meet the expectations of those who bought them. In some cases, there has been a mismatch between the promise offered to consumers and the nature of the underlying investment… [The] fall in the markets has exposed some of [these] fundamental mismatches… Problems that might have remained theoretical had the market continued to rise were exposed in the downturn."[40]

16. Most witnesses suggested that a range of issues that extended well beyond the bear market was depressing consumer confidence in the industry. Many mentioned Government policies on savings, tax and benefits, which were often viewed as confusing and potentially discouraging for savers. The Investment Management Association, for example, told us "the present system of means-tested benefits for pensioners is a real discouragement to long term saving, since it imposes a penal rate of tax on saving by people on low incomes."[41] Generally, however, the picture to emerge was that, while a range of factors was serving to undermine confidence in long-term savings, the fundamental issue was that the industry had a poor record for treating its customers fairly. Ms Foster of the Financial Services Consumer Panel, for example, identified a series of matters that she felt stood in the way of consumers feeling confident in their dealings with the industry. These included: "still very, very complex products, extremely difficult for consumers to understand", "far too limited access to generic financial advice", high charges that are resulting in a growing awareness of "what poor value for money some of these [savings] products are". She nevertheless signalled that in her view "the reluctance of some firms to treat their customers fairly is at the heart of the problem." [42] Many other witnesses expressed similar views. Ms Farnish of the National Association of Pension Funds (NAPF), for example, told us that "if the industry is going to get consumer confidence restored" it needed "to treat people decently", adding that "it is in the industry's interest, actually."[43] Several witnesses also highlighted the sector's bad track record for mis-selling. Mr McAteer told us "I am not surprised that consumers have lost confidence in the industry given the litany of mis-selling scandals that we have seen like pension mis-selling, mortgage endowment mis-selling, precipice bonds."[44] The Financial Services Consumer Panel similarly told us in their submission: "large scale and widespread mis-selling by financial services firms has been a feature of the retail financial market throughout the lifetime of the majority of today's consumers. Our research… shows that consumers lack confidence that

38 Q 1432

39 HC 71–II, Ev 355 para 4

40 HC 275, Ev 140 paras 2.2 and 2.3

41 HC 275, Ev 143 para 11.2

42 Q 1432

43 Q 1129

44 Q 1432

firms will sell them products that are right for them."[45] The events relating to Equitable Life were also cited by some witnesses as a factor affecting consumer confidence.

17. Most of the witnesses in our inquiry thus suggested that the financial services industry has a poor reputation in the eyes of consumers. Mr Sandler, author of a major review of the long-term savings market for HM Treasury[46] stated that "a far higher degree of trust is attached to the brands of the large supermarkets than attaches to the large life insurers"[47] and many in the industry acknowledge the problem. Prudential, for example, agreed that "the damaged reputation of the savings industry"[48] was among the reasons for declining consumer confidence in long-terms savings, although equally some in the financial services industry felt that that the external view of the industry is unjust. Aviva, for example, told us that the company felt it was operating "in an environment where it is popular to criticise the long-term savings industry". The company believed that such criticism often flowed from "confusion between the issue of disappointing investment returns (which are not surprising given the market falls over the last three years), and the issue of how the long-term savings industry operates."[49] The Committee noted, nevertheless, the evidence of several witnesses with experience of dealing with a range of industries on consumer related issues, all of whom told us that the financial services industry had a particularly poor record. Ms Johnstone of the NCC described the industry as "significantly below average"[50] in terms of its attitude towards, and treatment of, customers. Mr McAteer of the Consumers' Association told us that his organisation had identified the life insurance industry as the "single biggest source of consumer detriment"[51] across the spectrum of consumer-related industries that his organisation monitors.

18. **It is widely accepted that a lack of consumer confidence in parts of the financial services industry is now deterring many households from saving as much as they might otherwise choose to. This is likely to have significant adverse long-term consequences, not just for savers and the financial services industry, but also for the wider economy. The overwhelming weight of the evidence presented to us also suggests that a range of issues extending well beyond the recent fall in equity values has damaged consumer confidence in the industry. In consequence, it would be foolhardy for the industry or others to assume that a simple recovery in equity market conditions will be enough to restore the industry's reputation in the eyes of consumers.**

45 HC 275, Ev 120 para 11

46 *Medium and Long-Term Retail Saving in the UK, A Review*, HM Treasury, July 2002

47 Q 315

48 HC 275, Ev 164 para 2

49 HC 275, Ev 66 para 5.2

50 Q 1436

51 *ibid*.

3 Improving product information

19. One problem identified by the FSA as contributing to the lack of confidence in the long-term savings industry discussed in the preceding section was poor information flows within the long-term savings market. The regulator told us "retail financial services markets are characterised by severe 'asymmetries of information' between consumers and producers/advisers—more acute than in other retail markets. In other words, suppliers know and understand much more than consumers reasonably can about their products and services; there is a significant imbalance. Some firms have exploited this imbalance to their own advantage, because they perceive the short-term benefits to outweigh the risks of brand damage."[52] Other witnesses confirmed this analysis. **It became clear during the course of our inquiry that the current information on savings products provided to savers is sometimes not effective in allowing them to make an informed judgement as to the suitability of a product. There is a need for urgent action to re-balance the "asymmetries of information" in the financial services industry by improving the information available to consumers.**

Summary Boxes

20. The current strategy for providing information on long-term savings products appears to rest heavily on the assumption that the saver will have an adviser who can be trusted to advise them dispassionately on a product's suitability given their circumstances. This assumption is usually warranted, but too often savers have been mis-advised or misled as to a product's suitability. **One of the best ways of minimising the risk of mis-selling is to provide savers with clear, accessible and succinct information on the product so that they can judge its suitability for themselves. In addition, some savers may, for a variety of reasons, not want to use a financial adviser and we think it is important to respect the rights of individuals to make that choice in designing the regulatory framework. In the case of the less affluent, it may be unrealistic to expect them to pay for the cost of "one-on-one" financial advice. In these cases clear, accessible and succinct information on the product becomes essential.**

21. In theory, savers can do a reality check on the suitability of a savings product by consulting the "Key Features" document the FSA requires product providers to give to the client. This is designed to tell the saver "the aims of the product, the risks involved, the charges and the commitment that the consumer will be making."[53] Most witnesses in our inquiry felt that the current key features document is not achieving its aims, although Mr Prosser, Chief Executive of Legal & General, pointed out that the document would usually be used in conjunction with an adviser.[54] Mr Bloomer, the Chief Executive of Prudential, however, told us the key features document "is not the most helpful document for most customers in its current form… It is too long: normally people just do not read things that are that long and complex. We have to get to something more straightforward and

52 HC 71-II, Ev 355 para 6

53 HC 71-II, Ev 356 para 13

54 Qq 1627–1628

simpler."[55] Moreover the FSA's own website warns savers that "the Key Features Document is not always easy to find amongst all the information you'll be sent."[56] The FSA also told us "some progress has been made in improving the quality of information given to consumers about financial products and services which they are considering buying or have bought. But the situation is still far from satisfactory."[57] In consequence, the regulator has been working on a shorter "Key Facts" document, which will "include a 'Quick Guide' (of no more than two pages)."[58] The draft Key Facts document provided to the Committee nevertheless remains a substantial document with, in addition to the two page Quick Guide, three pages of "frequently asked questions" and a three page "personalised example" to illustrate costs and charges. Even so, it was criticised by some witnesses for not being comprehensive enough. Mr Crombie, the Chief Executive of Standard Life, for example, observed "the trouble is… if you remove some of the features and relegate them to another document, the consumer may miss things that are important to him."[59] Equally, however, the Committee notes that the proposed Key Facts document is too long to be incorporated prominently on the face of marketing material to enable savers to see at a glance the most important features of a savings product.

22. In our report on the credit card industry, we concluded "the industry and regulatory frameworks need to provide consumers with clear and understandable information. This is clearly not happening currently. Important information is buried in small print of often miniscule proportions, written in technical jargon."[60] We have reached similar conclusions in respect of the long-term savings market. In the credit card market, we suggested "providing customers with clear and transparent information about what are necessarily complex products [should] now become a priority."[61] We thus "challenged the industry to bring to the Committee an agreed set of proposals"[62] for a Summary Box, giving a clear presentation of the key elements of the credit card in tabular format that "must be fully standard and consistent, and the placement clear and prominent."[63] We are pleased to note that the credit card industry and regulators accepted our challenge and Summary Boxes are starting to appear on credit card marketing material.

23. A similar Summary Box, encapsulating the crucial features of often complex savings products in a simple, standardised tabular form of the sort that could be included prominently on the face of marketing material, would be valuable in helping to provide better information to consumers in the long term savings industry. Consumer groups we asked reacted positively to the idea of a Summary Box. Mr McAteer, of the Consumers' Association, for example, told us: "obviously anything that simplifies the way information is presented has to be good", although he went on to warn that a Summary Box should be "no substitute or replacement for a duty of care on the advisers in the industry to give good

55 Q 1601

56 http://www.fsa.gov.uk/consumer/search/index.html

57 HC 71–II, Ev 356 para 12

58 HC 71–II, Ev 356 para 13

59 Q 1607

60 First Report, Session 2003–04, *The Transparency of Credit Card Charges*, HC 125 paragraph 19

61 *ibid*.

62 *ibid.*, page 3

63 *ibid.,* paragraph 35

advice".[64] Similarly, Mr Harvey, Chief Executive of Aviva, felt that developing a suitable Summary Box for long-term savings products was a "perfectly fair challenge"[65] for the industry and all the Chief Executives of the major insurers that we asked to commit to working to develop a Summary Box over the coming months agreed to do so.[66] The FSA also welcomed the idea, with Mr McCarthy, Chairman of the FSA, assuring us that "one of the things we would like to see, if it is practical to achieve, is a very short Summary Box."[67]

24. **We challenge the industry and regulators to develop over the next six months a simple standardised Summary Box, brief enough to be displayed prominently in most marketing material. We would like all parties to report to us on progress here by the end of the year. The Summary Box might show: whether the client is guaranteed to get his money back, any other guarantees attached to the product, the risk rating of the product, what the investment is linked to, what the charges are and if there are any penalties for early withdrawal. Such a Summary Box could make a significant contribution to the understanding of long-term savings products and considerably reduce the scope for mis-selling and mis-advice.**

Risk ratings

25. The long-term savings industry has been beset by a series of problems where the risk of a savings product has been widely misunderstood by consumers. The FSA told us: "we expect consumers to consider carefully the risk disclosures given in financial promotions where these are clearly presented and to heed warnings given by the FSA about the risks in particular products."[68] Unfortunately, as Mr Tomlinson, Chairman of the Investment Management Association, told us, "a lot of the [savings] products which have been designed have just been too complicated for people to understand the risk within them or even for the providers to understand fully the risks that are implicit within them."[69] This suggests that both the industry and the regulator need to devote much more effort to assessing accurately the risk inherent in savings products and ensuring that this risk assessment is communicated to consumers in a way that is both understandable and prominent.

26. The need for the industry to pay greater attention to assessing and clearly communicating the risk inherent in any saving product has been demonstrated by the problems encountered in a string of products in recent years. Many of these products were sold to large numbers of savers but the risks inherent in them appear to have been clearly appreciated neither by the buyers, nor, in some instances, the sellers. Our inquiry into split capital investment trusts, for example, concluded that "many zeros launched in the late 1990s (and subsequently) were structured in such a way that, in adverse market conditions, [they] were not low risk products. Even their designers appear not to have *fully* understood

64 Q 1434

65 Q 1636

66 Qq 1635, 1637

67 Q 1984

68 HC 71–II, Ev 350, para 12

69 Q 1019

how they would react to falling markets.”[70] Endowment mortgages similarly suffered from what Professor Davis described as “a fundamental problem, in that you have a nominal liability which is the bank loan which is mortgaged out there but you are investing it in assets [equities] which in a sense give a nice real return, but if you get disinflation, as we did of course, the return on them is going to go down.”[71] It seems likely that many homeowners never appreciated the risk inherent in this mismatch between the assets and liabilities in the endowment mortgage product, not least because neither the product providers nor the product distributors ever highlighted it to them.

27. The FSA’s current procedures for warning savers about the risk inherent in particular products appear to be largely ineffective. In the case of precipice bonds, for example, warnings from the regulator about the risks inherent in these products went unheeded or un-noticed by the market. The FSA told us: “in December 1999 we issued a warning 'High income products: Make sure you understand the risks' and placed a warning on our website drawing specific attention to our concern that consumers needed to understand that their capital may be at risk. This was backed up with a press release aimed at encouraging the personal finance press to raise concerns about the products.”[72] But “the majority of sales [of precipice bonds] took place from 1999 to 2002”,[73] suggesting that many consumers either ignored, or never knew of, the FSA’s warning on these products.

28. There appears to be a wide recognition from all parties that the assessment and communication of risk levels in savings products is a problem that the industry and regulators need to tackle. In its submission to our inquiry, the FSA wrote “there have been too many instances where the industry did not live up to its responsibilities to explain investment risk clearly to its customers at the outset.”[74] The major product providers also appear to accept the need for action. The Chief Executive of Aviva told us that “understanding exactly what the risk profile of a product is, making sure it is sold to a consumer who can afford that kind of risk profile—and that they also realise that that is a risk they are taking—is a really important means of diffusing later recriminations by both parties.”[75]

29. We suggested to various witnesses that it would be both possible and extremely useful to develop a single summary risk measure to be included in the proposed Summary Box. This would both inform the consumer and ensure that the product provider thought seriously about the risk inherent in the product. Mr Prosser of Legal & General did not think this would be useful “for the average consumer.”[76] Others were more positive. Mr Bloomer of Prudential told us it could work, and agreed that such an approach could have avoided many of the problems encountered, for example, in precipice bonds,[77] but suggested that a standardised risk measure would only work if it were confined to a

70 Third Report, Session 2002–03, *Split capital investment trusts*, HC 418 paragraph 29

71 Q 109

72 HC 71–II, Ev 350 para 15

73 HC 71–II, Ev 349 para 4

74 HC 275, Ev 98 para 5

75 Q 1581

76 Q 1616

77 Qq 1624–1625

"relatively small number" of "relatively broad categories".[78] Mr Crombie of Standard Life also felt a summary risk rating would be useful, suggesting "it would undoubtedly be helpful to consumers if we could standardise the way that risk was described."[79] We asked Mr Tiner of the FSA if he felt it might be possible to develop a simple risk indicator to be shown prominently on the face of marketing material for a product, perhaps modelled on a traffic lights system. He told us that while a "very simple traffic light system could be quite difficult in practice" [80]… "if it is possible to reach a simplified scoring system or something like that of relative risk weightings, then that would be a great outcome" and he was "absolutely committing the FSA to working with the industry on it."[81] The Committee notes that towards the end of our inquiry the FSA confirmed that it is now conducting work "on whether there is a practical and consumer-friendly form of standardised risk indicator which can be adopted."[82] The Financial Secretary, however, warned of some potential practical difficulties. She told the Committee that assigning a summary risk rating to a financial product "is an interesting idea but not without its difficulties", adding that "the reason I think it is difficult is partly because the risk profile of a particular product may change over time."[83]

30. **The recent fall in equity markets has exposed the fact that some of those manufacturing or selling long-term savings products often have a poor understanding of the underlying risks inherent in them. Too often, therefore, savers have bought long-term savings products without any satisfactory explanation of the inherent risks. This is a problem increasingly widely acknowledged by the long-term savings industry itself. There is a need for urgent action to correct this situation. The Committee believes that a vital step in restoring confidence can be taken by developing a simple system of signalling the inherent risk level of a savings product. This should be suitable for inclusion in the "Summary Box" we have proposed for all savings products and it ought to be displayed prominently on the face of all marketing material. While we acknowledge that there are practical issues to be overcome in designing a summary risk measure and how it can be simply presented to the client, we were encouraged by the statements of the leading industry representatives who gave evidence to us. We welcome the commitment of both the industry and the regulator to work together to overcome these issues and we note the FSA's recent announcement that it has now commissioned work on this project. We would ask the regulator and the industry to report to us on progress here by the end of the year. In products where the risk characteristics may change over time, it is particularly important to give the client a clear indication of this, perhaps via regular updates. We recommend that the risk rating attached by the product provider to the product should be regarded as an important part of the sales advice given to the client. The industry should appreciate that, if such an indicator is implemented, it would provide an important safeguard against mis-selling.**

78 Q 1619

79 Q 1626

80 Q 1972

81 Q 1981

82 FSA press release, 5 July 2004

83 Q 2103

4 Aligning savers' and industry interests

31. The FSA's analysis that some firms have exploited consumers "because they perceive the short-term benefits to outweigh the risks of brand damage"[84] suggests that as well as better information, consideration needs to be given to how to ensure the industry behaves in the long-term best interests of both the consumer and itself. The FSA described one option as being for the regulator "to ratchet up the intrusiveness of our regulation—detailed prescription of standards and behaviour in more areas; more intensive supervision; more enforcement actions."[85] The FSA told us that it "was strongly opposed to this course"[86] due to its likely cost burden on both the industry and savers. One possible less costly approach that better serves the interests of customers may well be to look at means of ensuring that pay and rewards at all levels in the long-term savings industry are tied to those issues that really matter for savers. **That some companies are judged by authoritative outside observers to be exploiting consumers for perceived short-term gains while damaging the long-term reputation of the industry suggests that fundamental changes are needed to provide better alignment between the interests of the industry, at all levels, and consumers.**

Senior management remuneration

32. Several witnesses[87] told us an essential part of aligning the interests of senior management and staff with those of savers is to ensure that their remuneration, from top to bottom in financial institutions, is related to the sorts of issues that matter to savers. The Consumers' Association observed a need to ensure "that consumer interest is 'institutionalised' from the boardroom to the point of sale"[88] and the National Consumer Council agreed that current corporate governance arrangements did not do enough to align the interests of senior management with those of consumers.[89] The Committee notes that in recent years savers have too often read of top management in financial institutions reaping large rewards and bonuses at the same time as a mixture of a bear market in equities and poor asset allocation has savaged the value of savers' funds.

33. We asked a variety of major insurance companies to provide us with details of senior executive remuneration and how it was determined. Some of the results were striking. For example at Standard Life, most of the Executive Directors for whom we had information and who had not been promoted or retired through the period saw their basic pay and performance related bonuses rise by over 30% between 1999 and 2001, in spite of this being described by the company as a "period of turbulence".[90] The Committee further notes that the same directors also enjoyed substantial additional benefits from the Society's "long-

84 HC 71–II, Ev 355 para 6

85 HC 71–II, Ev 355 para 7

86 *ibid*.

87 This issue was mentioned also by many individuals who wrote to the Committee during the course of the inquiry.

88 HC 71–II, Ev 313 para 37

89 Q 1446

90 See list of Memoranda placed in the Library of the House and in the parliamentary Record Office p. 78 (Memorandum from Standard Life)

term incentive plan". Other major insurance companies also gave us details of their senior managements' remuneration. In the case of Legal & General, for example, the Chief Executive's salary and cash bonus, excluding deferred bonuses and long-term incentive payments, rose from £795,000 in 2000 to £1,005,000 in 2003, a rise of over 26%.[91] Aviva provided us with information on the range of bonus payments made to executive directors: taking the mid-point of this range each year as a guide, bonus payments rose by 37.5% between 2000 and 2003.[92] Standing out against this general trend was the position at Prudential, where the Chairman of the Remuneration Committee told us the remuneration of the current Chief Executive in 2003, at £1,131,000, was 9% lower than his remuneration in 1999 when he was Finance Director.[93]

34. We also asked for details of how the remuneration of senior management was decided. Most companies replied in similar terms to Standard Life, who told us that basic pay was determined with reference to "the level of salaries paid to senior executives performing similar roles in the financial services industry and more broadly where appropriate."[94] Generally, however, there was relatively little direct linkage between the returns to savers and the total remuneration of senior management. Standard Life, for example, told us that "the relationship between policyholder returns and executive directors' remuneration is a complex one"[95] and Legal & General told us they did "not see a strong linkage with nominal investment returns as the best reward mechanism"[96] given the danger of extreme short-term fluctuations. It was clear that, for most of the companies we asked, it was issues of primary interest to shareholders that dominated the assessment of senior management remuneration. Prudential, for example, told us "we seek in the incentive element of remuneration to align the interests of shareholders and senior executives"[97] but pointed out that as a long-term business it was in the interests of shareholders to provide customers with superior service and investment returns.

35. **The Committee recognises that ultimately the level of remuneration of senior management in the financial services industry is a matter for shareholders and, in the case of mutual societies, members. The recent trend in institutional shareholders becoming more active in challenging remuneration reports is welcome, and greater shareholder activism should be encouraged. Shareholders and the membership of mutually owned organisations can nevertheless only benefit from anything which helps restore consumer confidence in the industry; and we suggest that greater transparency in the determination of senior executive remuneration and a more direct linkage between remuneration and the performance of those institutions relative to market conditions and accepted benchmarks would be useful in this respect.**

91 *ibid.* (Memorandum from Legal & General)

92 *ibid.* (Memorandum from Aviva)

93 *ibid.* (Memorandum from Prudential)

94 *ibid.* (Memorandum from Standard Life)

95 *ibid.*

96 *ibid.* (Memorandum from Legal & General)

97 *ibid.* (Memorandum from Prudential)

The role of commission

36. Away from the top tier of management, it is clear that unlike most major consumer industries, most of the people actually responsible for the day-to-day marketing of long-term savings products in the UK are paid in terms of commission on sales. Several witnesses indicated that they believed this to be one of the principal reasons why the industry is dogged by accusations of short-term behaviour. The Actuarial Profession, for example, wrote in their submission "salesmen incentivised by commission are motivated to maximise their commission. Such market activity is detrimental to consumers."[98] Similarly Mr Sandler told us that "a commission-based system where the front line is effectively rewarded on the basis of how much product it delivers to the market—and that is true irrespective of whether we are talking about a tied sales force or an independent financial adviser—such a system is always going to be prone to the more enthusiastic or perhaps the less ethical choosing to circumvent the process and deliver a product which may, with the fullness of time, not be suitable for the recipient."[99] **In the Committee's view it seems likely that as long as most of the selling activity in the long-term savings industry is rewarded on a commission basis, many savers may remain suspicious that they are being sold a product for the wrong reasons. Shifting away from the current commission-based sales system common in much of the industry is likely to be a key component of any strategy to rebuild consumer confidence in the industry after the long catalogue of mis-selling scandals in recent years.**

Regulatory costs & commission

37. The focus on commission within the financial services industry creates obvious dangers that some within the industry will be tempted to make mis-sales to boost short-term gains. Not only does this create loss for those who have been mis-sold, but the need to impose stringent regulations in an attempt to control the conflicts of interest created by the commission system has also added considerably to the cost burdens confronting the industry and, ultimately, the saver. As Mr Myners, author of a major report on institutional investment for HM Treasury,[100] told us, "commission based advice, where the advice is paid for by the product provider, is beset with hazard. It does not mean the hazard cannot be appropriately ameliorated, but it does require a robust regulatory regime."[101] Several witnesses told us that the "robust regulatory regime" needed to guard against the potentially deleterious effect of a commission dominated sales process is producing a sales process that is too expensive to be viable for savers on lower incomes and a sales process that is so lengthy and cumbersome that, in reality, it deters many savers. Aviva, for example, wrote to us in their submission that "the key cost components of advice are the initial and ongoing training and competency costs of the adviser and the necessary supporting compliance and regulatory reporting infrastructure surrounding sales" and that the "typical time to complete a fully advised purchase was seven hours, rising to 12 hours when account is taken of the time spent on unsuccessful leads."[102] Mr Sandler said that in

98 HC 71–II, Ev 370 para 9

99 Q 278

100 *Institutional Investment in the UK*, HM Treasury, March 2001

101 Q 275

102 HC 275, Ev 63 para 2.2.2

his view "the more that the sales process has become the subject of stringent regulation, the more expensive it has become—the more cost has been added to the process—which has contributed to the effect of pricing out of the market of the small saver."[103] The Financial Secretary agreed, telling us that "people have been put off by the complexity of the process, the time taken and also because it is unprofitable for sales to target [the less affluent saver]."[104]

38. The proposed Sandler suite of stakeholder products is aimed at simplifying the selling process for a limited group of standardised products. More generally, however, the basic conflicts of interests created by the industry's traditional commission-led business model remain, as does the need for a stringent regulatory regime to control those conflicts of interests. It would clearly be desirable to adapt the industry's current business model to create a closer alignment between the interests of all those involved in the sale and purchase of long-term savings products, including senior management, their staff and savers. We would point out that this is an area where the industry can make substantial improvements on its own initiative. During the course of our inquiry the ABI announced that it was commissioning research to look "at the way in which long-term savings are sold, and particularly the role of commission. The aim is an objective and fact-based analysis of how the present system performs, how it might develop in the light of regulatory and commercial changes, and its alternatives."[105] **The Committee welcomes the commitment from the ABI to assess the role of commission payments in the long-term savings industry and examine possible alternatives. We would emphasise the negative image created in the eyes of some potential savers by the current commission-driven distribution model. Account should also be taken of the extent to which the heavy cost burden of the current exhaustive regulatory regime reflects a need to offset the conflicts of interest created by payment by commission.**

Rewarding superior investment returns

39. A greater emphasis on aligning the interest of those in the industry with savers might also improve the investment performance of the long-term savings industry. We were struck in the course of our inquiry how seldom poor returns to investors were mentioned as a factor hitting consumer confidence in the industry. When it was mentioned, it was usually in the context of the impact of the bear market in equities, a factor that many companies and those advising the industry seemed to view as an unavoidable problem for investors. Thus, Aviva, for example, told us in their written submission that the lack of consumer confidence in the industry had been caused primarily by the poor performance of capital markets since early 2000.[106] This seems to ignore the point that more astute asset allocation policies in many funds might well have significantly mitigated the impact of the fall in share prices and provided investors with greater exposure to the strong rally in bond markets. Leading academics suggest that while UK equities fell by 22.0% between the start of 2000 and the start of 2004, bonds rose by 21.8% over the same period and short-term

103 Q 277

104 Q 2106

105 ABI press release, 25 May 2004

106 HC 275, Ev 63 para 1.2

Treasury Bills rose by 20.1%.[107] The weak returns provided to many investors in recent years in spite of the strong performance in bond markets seems to confirm the evidence we heard from Mr Myners, who told us: "the long-term record of the industry in asset allocation is not terribly good."[108] This is particularly regrettable since, as Mr Sandler told us, "there is no question that the ultimate outcome for consumers in their savings process is governed in the overwhelming majority by the asset allocation decision. Some analysts would attribute 90% of the outcome to asset allocation and the balance to security selection and stock selection thereafter"; he added that, looking at the retail market, "there is almost universally no attention given to asset allocation by advisers in this country. Their focus is on product purchase."[109] Apparently confirming this view, Mr Goford, President of the Institute of Actuaries, told us that he felt that "asset allocation has little to do with restoring confidence in long-term savings"[110] and "the best you can say of the market at any time is that the market can go up and the market can go down."[111] The Committee finds these opinions surprising given the overwhelming evidence that asset allocation is a key driver of investment returns.

40. The weight of the evidence presented to our inquiry suggests strongly that more is required to encourage the industry to focus on asset allocation and investment performance issues. We suggested to various witnesses that it might be useful to provide a stronger linkage between the charges the saver pays and the performance of the underlying investment. Company chief executives pointed out that the trail commission[112] and annual charges that are levied on many savings products are levied on the value of the fund, not the initial investment, and are thus tied to the performance of the savings product, but they agreed with the Committee that there is no arrangement giving any emphasis—or gearing—to this linkage.[113] Many of the outside experts agreed that a more powerful, emphasised linkage between charges and performance might well have a beneficial impact. Mr Sandler told us that "anything that has a performance-related dimension is further to be welcomed because it aligns the adviser more closely to the consumer";[114] likewise Professor Davis argued that a clearer linkage between performance and charges was likely to produce "much more care in terms of sales."[115] **The evidence presented to our inquiry suggests that the retail long-term savings industry gives insufficient weight to the issue of asset allocation and the investment returns it delivers to savers. The fee structure that currently dominates the industry primarily rewards the initial sale. A fee structure containing a stronger linkage to subsequent investment performance would help align more closely the long-term interests of the saver and the industry**.

107 *Global Investment Returns Yearbook 2004*, Elroy Dimson, Paul Marsh and Mike Staunton, London Business School, page 26, Table 3b

108 Q 317

109 Q 317

110 HC 71–II, Ev 371 para 10; in subsequent evidence, Mr Goford clarified that this phrase referred to asset allocation in with-profits funds having little to do with restoring confidence in with-profits products

111 Q 862

112 Commission on some products which is paid annually to advisers for as long as the product remains in force

113 Qq 1663–1666

114 Q 326

115 Q 104

5 Improving distribution

Independent Financial Advisers

41. The Committee's conclusion that it would be desirable for the industry to move away from its current reliance on a commission-driven sales model was shared by some senior figures in the industry. The Chief Executive of Prudential, for example, told us he "would much rather see advisers remunerated on a fee basis"[116] but he also highlighted several practical difficulties the industry faced in making the switch. Most of these difficulties centre on the position of independent financial advisers (IFAs). IFAs are currently the dominant distribution channel in the long-term savings market. The Chief Executive of Aviva told us "IFAs probably represent about 65% of the total industry business"[117] although the Committee heard that in the case of Standard Life, for example, over 90% of the company's business is sold through IFAs.[118]

42. It is widely acknowledged that IFAs have established a relatively good record for servicing their client base. Mr Smee, Director General of the Association of Independent Financial Advisers (AIFA), told us "persistency generally has been better in the IFA channel than in other channels."[119] Mr McAteer of the Consumers' Association told us his organisation had "found that IFAs generally have given the better quality advice and they have been more economic in terms of distribution when compared to the big banks or the insurance companies."[120] The Financial Secretary told us "IFAs have a valuable role to play"[121] in the distribution of financial products. There is also a widespread recognition, however, that IFAs effectively service only one part of the potential market for long-term savings products, creating an "advice gap" in the savings market. The Investment Management Association, for example, told us "independent financial advisers and other intermediaries like stockbrokers cater to those of some means, with sufficient sums to invest that will generate enough fees and commissions to be viable. At the other end of the scale Citizens Advice Bureaux do a very effective job in counselling people on low and modest incomes about debt. But there is no source of independent advice for those in between."[122] Mr Sanders, Deputy Director General of the AIFA, confirmed to us that it would currently be "very difficult" for any IFA to offer an economically viable service based on someone, for example, saving £20 a month into a product.[123] Consumers lacking effective access to financial advice are clearly at a significant disadvantage in a long-term savings market generally agreed to be characterised by severe inequalities in the information available to consumers and producers/advisers.

116 Q 1572

117 Q 1668

118 *ibid*.

119 Q 1233

120 Q 1467

121 Q 2116

122 HC 275, Ev 142 para 8.1

123 Q 1325

43. The heavy reliance of the major product producers on IFAs for the distribution of their products has also led to a market that the Financial Secretary described to us as "highly intermediated"[124] with little direct relationship between the product producers (such as the large insurance companies) and the end client. The product producers' attitude on this was summarised by the Chief Executive of Legal & General who told us "there is the difficulty that they [IFAs] are independent; therefore we cannot get too close to these people because otherwise we undermine their independence."[125] and that "the adviser is his [the end client's] independent adviser; they are not acting for us."[126]

44. **The gap that is apparent between the major companies and their ultimate clients is unhelpful when it comes to rebuilding consumer confidence in the industry, given that better communication with savers is likely to be an important part of the rebuilding process. IFAs now dominate the distribution of long-term savings products in the United Kingdom and the Committee recognises the positive role that many IFAs perform. The current reliance on IFAs as a means of selling financial services and advising potential savers nevertheless risks leaving a large segment of the population without effective access either to financial advice or to long-term savings products. This reflects the general focus of IFAs, for sound commercial reasons, on the more affluent members of the community. The fact that many potential savers have little or no regular access to advice needs to be recognised by regulators and the industry when communicating with the public. Planned reforms of the distribution of financial services should attach a higher priority to widening access to the financial services industry beyond the relatively affluent that are currently the main focus of IFAs.**

The menu of fees and commissions

45. Commission arrangements vary from product to product and with the scale of the investment an individual is making, but IFAs currently have three main sources of commission income. One is "initial commission", which the Investment Management Association told us had settled at an "industry *de facto* standard"[127] of 3%. The second element is "renewal commission", which is a commission paid on regular premiums; the AIFA told us this was typically in the range of 1.5% to 2.5%.[128] The third element is "trail commission", which is paid on the total fund value and, the AIFA told us, was typically in the range of 0.5% to 1.5% per year.[129] Over time these charges can amount to a considerable percentage of the saver's original capital investment. Recent press articles[130] have highlighted that the mixture of initial commission and trail or renewal commission can result in clients paying many of thousands of pounds in commission over the life time of a long-term savings product, payments which can represent as much as 18% of the client's total contributions over 20 years. The chief executives of the major companies were unable

124 Q 2130

125 Q 1587

126 Q 1695

127 Q 1053

128 HC 71–II, Ev 294

129 HC 71–II, Ev 294

130 *Financial Times*, 7 February 2004, page 28 ; *Sunday Telegraph* 7 March 2004, page 19

to confirm these figures for us when we asked them[131] although the Investment Management Association did confirm that over 10 years a client could see at least 8% of contributions accounted for by commission payments on some products.[132] Mr Cazalet of Cazalet Consulting told us that the result is that the total cost to the industry each year of "procuring new business, commission and other expenses, was about £7 billion, which is roughly about £330 per household."[133]

46. In view of the potential scale of the commission charges, it is important that clients are made fully aware of them and any alternatives. The main alternative is the payment of a direct fee by the saver to the IFA for the advice received. Several industry witnesses, like Mr Bloomer of Prudential, pointed out that survey evidence suggested that consumers had "a concern about paying fees"[134] and therefore if presented with an option would typically prefer to pay commission. To make an informed choice, however, consumers must have a clear idea of how much they might pay in fees relative to how much they might pay on the same product in commission. The FSA already has major reforms in train here as part of its reforms aimed at depolarising the investment advice market. The introduction of regulation in 1988 saw a 'polar' regime initiated for financial advisers. They had to be either independent and without contractual tie to any provider; or tied and advising solely on the products of one provider. The FSA, in response to an OFT finding that this was anti-competitive, is now abandoning polarisation and as part of the proposed depolarisation reforms[135] IFAs will be required to make much fuller disclosure of their commissions, via a so-called "menu", and give the client the option of paying a fee. The Chief Executive of the FSA told us "The whole idea of our new menu system is to make it much clearer to the customer the options they have and how they pay for the service they are acquiring."[136]

47. The Committee heard evidence, nevertheless, of continuing doubts about how effective the menu approach will be in making savers fully aware of the full costs in terms of initial and trail commission that they may end up paying for a long-term savings product. Mr Prosser of Legal & General thought the menu looked "quite a complicated document" and the draft menu document provided by the ABI and examined by the Committee used industry jargon in identifying various products (such as "whole of life assurance" and "income drawdown plan"). Ms Farnish, Chief Executive of the National Association of Pension Funds pointed out "even the talk of 'units' is mystifying to many consumers."[137] The FSA appear to accept that the menu document is not necessarily readily understandable to the average saver. Mr Tiner told us "the menu goes with advice, so the adviser will need to talk to that customer about what 'whole of life insurance' means."[138] This seems to fall some way short of the goal of allowing fully informed consumers to choose for themselves between paying fees and commission. In addition, the Committee notes that the FSA's own research into the proposed menu noted various factors in the

131 Qq 1677 and 1678

132 Q 1072

133 Q 62

134 Q 1572

135 Published by the FSA in CP 04/3, *Reforming Polarisation: A Menu For Being Open with Consumers*, 26 February 2004.

136 Q 2001

137 Q 1138

138 Q 2019

presentation of the various options that "combined to make the fee option less attractive when the document was read without the support of an adviser."[139] In spite of this, Mr Tiner told us he thought "over time the menu may act as an encouragement to more people to pay a fee for truly independent advice."[140]

48. The Association of Private Client Investment Managers and Stockbrokers (APCIMS) wrote in their submission to our inquiry that "hiding the cost of advice in commission distorts the market and leads to commercial drivers and business structures that have led to some adverse consequences for savers. Our preference is for advice to be charged openly."[141] We note that the current FSA proposals on depolarisation and the menu of commissions and charges represent what the AIFA described on their website as a "U-turn"[142] relative to the FSA's original proposal which would have constituted much more radical reform. **Full and open disclosure of fees and commissions in a manner that is readily comprehensible to savers and gives them a balanced view of the various options is a vital part of delivering an efficient market in financial advice and long-term savings products. The current proposals from the FSA fall short of this goal in several key respects. There should be no suspicion that an adviser might be able to steer a client towards paying commission that might add substantially to the client's advice bill, to the detriment not only of the client but also the more efficient and fairer operators in the advice market. It should be a basic requirement that each client should be given an explicit comparison of the total cost, in cash terms, of buying a product on a fee basis and the total cost on a commission basis over the likely life of the product.**

49. The Committee asked the FSA what would happen to the trail commission payable on many products if the client opted to pay a fee under the new menu proposals. We were told that this was subject to negotiation between the IFA and the client[143], but that the trail commission was intended to pay for on-going advice to the client regarding the product. In the course of our inquiry into endowment mortgages, however, it became clear that there are many savers who over time sever their relationship with an IFA and there are equally many IFAs that go out of business over time. It would clearly be inequitable for the client to continue to have to bear the cost of trail commission in such circumstances. The Financial Secretary told us that she could not "justify that for a minute"[144] and the FSA agreed that savers would find it "a little strange"[145] that they were still being charged trail commission if they no longer had any relationship with the IFA receiving the commission.

50. **For IFAs to receive trail commission whether or not they are providing any real on-going advice to the client is unacceptable. The persistence of this practice is a clear sign that the market for financial advice is not working in the best interests of consumers. The Committee urges the major product providers, IFAs and the regulator to limit urgently the basis on which trail commissions are paid in the financial services industry**

139 *Polarisation—menu testing research*, FSA Consumer Research Paper 24, February 2004, page 12, para 1.22

140 Q 2016

141 HC 71–II, Ev 297 para 3

142 www.aifa.net/about/default.htm

143 Q 2023

144 Q 2123

145 Q 2027

and to ensure that such payments only occur when the client is actually receiving the annual advice that such commissions are supposed to fund. Clients opting to pay for financial advice via fees should be given the explicit option of paying an annual fee for any on-going advice they receive rather than having trail commission paid from their investment.

51. Several witnesses told us that the role of IFAs and their commitment to providing dispassionate advice to the client, the saver, would become more transparent if they were paid on a fee basis rather than by commission paid, in the first instance, by the product providers. Mr Sandler told us that he had recommended that "the use of the terms 'independent' and 'adviser' be limited to those who established with the consumer at the outset that the consumer would be paying fees."[146] The Chief Executive of Prudential told us that while he would rather see advisers paid on a fee basis, any major shift in this direction "would leave a big cash-flow problem for [IFAs]".[147] The product providers have already taken some action to offset the cash-flow impact on IFAs of reforms in the commission system. The Chief Executive of Aviva told us that the product providers were increasingly offering level charge products, which charged the customer no initial commission. Instead this was paid to the IFA by the product provider who then recovered the cost by charging the saver slightly more over a period of years. He pointed out that this gave product providers "a very strong and obvious and direct interest in the quality and the persistency" of any new business.[148] Even so, Mr McCarthy, Chairman of the FSA, indicated that reforming the current IFA-led, commission-dominated distribution system within the long-term savings industry was an area in which the FSA found it "difficult to make changes very quickly."[149] The Financial Secretary similarly commented that a "big bang" approach to reform was unlikely because "IFAs have low capitalisations generally, [meaning] it is difficult for the IFA market to adjust quickly to change."[150] The AIFA's submission acknowledged that the "most frequently heard criticism about commission is that it is an opaque means of remuneration", before going on to argue that the proposed menu "removes that opacity."[151]

52. **The Committee acknowledges the need for a measured approach towards reform of the financial advice market. Even so, given the potential failings we have identified in the proposed menu approach to reform, we ask the FSA and the industry to collect and publish regular data on the relative cost of buying major products on a fee and commission basis and the percentage of savers opting to pay via fees or commission.**

Self-regulation of IFAs and others in the industry

53. We noted earlier that consumer groups had given us reassuring evidence about the quality of the service generally provided by IFAs and that this was underpinned by statistical evidence suggesting that IFAs have a better than average persistency rate for the

146 Q 288

147 Q 1572

148 Q 1575

149 Q 2000

150 Q 2116

151 HC 275, Ev 51

products they sell. Even so, given the generally poor level of consumer trust there is little room for complacency and a minority of IFAs has engaged in practices which risk tarnishing the public reputation of the majority. We were surprised to hear that the AIFA, an organisation that represents 70% of IFAs,[152] currently has no code of ethics for its members,[153] an omission which surprised the chief executives of several of the major product providers too.[154] The AIFA told us this reflected the fact that "we are in a regulated market where, in effect, the FSA imposes various standards."[155] Subsequent to our evidence session, the AIFA wrote to the Committee informing us that the Association's Council had considered the question of whether the AIFA should have a code of ethics but still believed "that it would not be appropriate for the Association to introduce any formal code as part of its membership requirements."[156] We asked the major product producers the extent to which they enforced standards within the IFAs selling their products. Mr Harvey of Aviva told us "80% of that job is done through the [regulatory] process" and the FSA.[157]

54. The British Bankers' Association (BBA) have a voluntary code, the Banking Code, which they described to the Committee as their "flagship product".[158] It is reviewed every two years by an independent reviewer after consultation with consumer groups, government and the industry and the BBA told us the it allowed the industry to react "quickly and flexibly to difficulties in a way that Government regulation rarely can."[159] They us told us that in a Treasury sponsored review of the code its chairman, Ms DeAnne Julius (at that time a member of the Monetary Policy Committee), had described this as "an exemplar of self regulation".[160] The ABI has more recently also introduced a voluntary code entitled "Raising Standards" and they told us "among the key benefits of voluntary regulation are the ability to enhance value for money for the customer and a proven ability to adapt quickly and flexibly to potential problems. This in turn leads to better relationships with customers, through enhanced consumer protection, accessible providers and clear information."[161]

55. **The Committee deplores the fact that a major trade body such as the AIFA has no code of ethics, particularly given the key role IFAs play in terms of the experience most consumers have of the long-term savings industry. Across the industry there is a danger that companies and trade bodies are abrogating their responsibilities in relying so heavily on the FSA to police and deliver good standards of behaviour. External regulation by a body such as the FSA should not be seen as a substitute for effective self-regulation within the industry via codes which react quickly and flexibly to problems as they arise. All the major trade bodies in the long-term savings industry should have**

152 www.aifa.net/about/default.htm

153 Q 1274

154 Q 1651

155 Q 1275

156 HC 71–II, Ev 399

157 Q 1585

158 See list of Memoranda placed in the Library of the House and in the parliamentary Record Office p. 78 (Memorandum by British Bankers' Association)

159 *ibid*.

160 *ibid*.

161 HC 275, Ev 25 para 4.1

clear codes of practice which take the standards of behaviour laid down by the FSA as a minimum but aim to improve on the FSA's requirements in those areas where the industry feels that better standards will do most to help its customer base. We call on the Association of Independent Financial Advisers to establish a code of ethics for its members, to monitor compliance with it and to establish a means of enforcement for members who do not comply .

6 With-profits products

56. The ABI told us that "with-profits business makes up a substantial proportion of in-force policies. It has traditionally offered more cautious savers a way of investing in assets other than cash, without being exposed to the extremes of stock market volatility. Benefits are smoothed down in good years in order to boost returns in bad years."[162] With-profits products have nevertheless proved particularly problematic for investors in recent years. The major problems at Equitable Life, for example, focused on its with-profits fund. It is clear from the evidence we have heard in the course of this inquiry that consumer faith in with-profits products has been severely dented. The major insurance companies told us that the market share of with-profits products has fallen sharply.[163] The ABI told us with-profits funds had once been "the insurance industry's staple product"[164], but the companies giving us evidence told us with-profits now accounts for around 10%–15% of new business.[165] Not only have investment returns often been disappointing, many funds have closed to new business. The press has reported that £161 billion of savings is now in closed funds.[166] The ABI told us that there was currently a total of £365 billion[167] of with-profits policies in force, in a mixture of closed and open funds and the Chief Executive of the FSA confirmed to us that roughly half of all with-profits funds were now closed to new business.[168] Mr Tiner told us that when a fund closes to new business "it does not necessarily follow that policyholders are worse off but many of them are."[169]

Reform of with-profits funds & smoothed investment products

57. In recognition of the problems besetting the with-profits sector, the FSA has published proposed reforms for with-profits products in a consultation paper CP 207, commonly referred to as "Principles and Practices of Financial Management". In the course of our inquiry a variety of expert witnesses told us that these reforms were unlikely to be effective in providing reassurance to doubtful investors. Mr O'Brien of Nottingham University told us that CP 207 would help, but he felt that for most investors "with-profits will still be an act of faith and… you are not going to be able to understand exactly what has gone on."[170] The Committee also notes that Lord Penrose, in his report on Equitable Life, commented that "The proposals [CP207] lack definition and as currently framed appear to leave unanswered many of the issues that would inevitably have arisen in the [Equitable Life's] case… the present proposals do not equip the regulator to take effective action."[171] Lord Penrose also discussed the doubt that with-profits policies could exist without some degree

162 HC 275, Ev 25 para 4.1

163 Q 1705

164 HC 275, Ev 10 para 1.10

165 Qq 1702 and 1703

166 *Financial Times* 26 May 2004, page 24

167 HC 275, Ev 25 para 4.1

168 Q 2062

169 Q 2052

170 Q 27

171 Report of the Equitable Life Inquiry, led by the Rt Hon Lord Penrose (Penrose Report), HC (2003–04) 290, page 732, para 18

of mystery, noting that "There is a view that with-profits cannot survive without mystery. But that cannot continue to provide an excuse for delay in the open provision of financial information."[172] Equally, however, several of the major product providers told us that fuller disclosure would make it difficult to operate a with-profits fund. Prudential told us "we strongly oppose proposals for disclosure of asset shares at an individual policyholder level, as this would allow informed policyholders to deal against the fund and thereby profit at the expense of other policyholders. We are also concerned that similar arbitrage opportunities would occur if pay-out values were applicable for a whole year."[173] Standard Life expressed similar concerns "that excessive limitation of companies' discretion may impair the performance of with-profits products, and that excessive disclosure may make the smoothing of returns to reduce volatility more difficult to achieve."[174]

58. Most of the major industry operators feel that the with-profits concept of a smoothed investment fund still has a valuable role to play. Aviva, for example, told us that the company saw "an important role for 'smoothed' investment type products going forward"[175] and Prudential[176] and Standard Life[177] expressed similar views. Equally, however, it is plain that a rapid return of public confidence in the with-profits model is unlikely without much greater transparency about the operation of smoothed investment products. The Government has thus announced that a "smoothed investment fund" option will be available within the Sandler suite of stakeholder products, with the "with-profits" nomenclature dropped as a potentially confusing piece of jargon.[178] The smoothed product will be distinguished by a separate smoothing account and improved transparency, but the fund will still be able, in "exceptional" circumstances, to introduce market value adjustment exit penalties,[179] a source of considerable policyholder dissatisfaction in with-profits funds in recent years. In addition savers will only see the difference between the smoothed value of their individual savings and its unsmoothed value on surrender, in order "to prevent selection against the fund."[180] **It is evident that in many instances savers are no longer content to allow the managers of with-profits funds wide discretion or to accept limited disclosure of the performance of the funds on which their savings depend. Many investors also do not understand the reasons for apparently large market value adjustment (MVA) exit penalties and consider they are unfair. It is not clear from the evidence presented to our inquiry that either the FSA's proposed reforms for existing with-profits funds—CP207—or the proposed disclosure requirements in the new smoothed investment Sandler products go far enough in terms of disclosure to satisfy consumer concerns in this area. As long as investors cannot regularly see the performance of the underlying investment fund and can be subject to MVA exit penalties without clear explanation there may be consumer reluctance to re-enter this**

172 *ibid.*, page 737, para 41

173 HC 275, Ev 173 para 51

174 HC 275, Ev 186 para 30

175 HC 275, Ev 64 para 2.3.2

176 HC 275, Ev 165 para 6

177 HC 275, Ev 186 para 29

178 *Government response to the consultation on Sandler 'stakeholder' product specifications*, HM Treasury and Department for Work and Pensions, July 2003

179 *ibid.,* page 25 para 92

180 *ibid.*, page 26 para 97.

area of the long-term savings industry. Firms should be required to give a much clearer explanation of the scale of, and reasons for, any MVA exit penalty imposed.

Closed funds

59. In our report on endowment mortgages we concluded that the treatment of investors in closed funds was "unfair",[181] not least because on closure the investment characteristics of a fund often changed dramatically from those that pertained in the fund the saver originally bought. We urged the FSA to examine the case for allowing savers to transfer out of closed funds without attracting penalties. In its reply, the FSA told us that while it still saw difficulties in allowing individual transfers from closed funds without penalties, there was "scope for market-based solutions to address concerns about closed funds…. Chief amongst these is the sale of closed funds, effectively transferring a whole fund to another firm through a sale rather than on a policy by policy basis."[182] This would allow economies of scale[183] and Mr Tiner told us that he was hopeful that if the new managers of such funds "can inject new equity, it can provide the opportunity for the managers to have a balance of the portfolio which is relevant to the maturity of the fund."[184] Nevertheless there remains concerns, both because, as Mr Tiner confirmed, "we are going to see more funds closing probably over the next several years"[185] and because consumer understanding of the exit penalties applied to policyholders, particularly as funds close or change hands, remain poor. Mr Tiner agreed that the issue of fair exit terms was an area of concern and promised that the FSA would pay close attention to "the level of policing"[186] in this area. The FSA also stressed that there would be a "regulatory imperative for companies to treat their customers fairly"[187] in transactions involving the purchase of closed funds.

60. **£160 billion is now invested in closed funds. This is an issue in that policyholders can often feel their savings are now trapped in policies offering lower prospects of growth. All the signs are that this problem will grow further in the future. The Committee recognises that a consolidation process among the many with-profits funds that have now closed to new business is both desirable and inevitable. It places the highest priority on the FSA ensuring that policyholders are treated satisfactorily through this process. They should not be confronted by punitive exit penalties and should receive a fair share of the efficiency benefits that will hopefully result from such transactions.**

The role of actuaries

61. In the wake of Lord Penrose's report on events at Equitable Life the Treasury have asked Sir Derek Morris to conduct "a wide-ranging review of the actuarial profession."[188]

181 Fifth Report of Session 2003–04, *Restoring confidence in long-term savings: Endowment mortgages*, HC 394, paragraph 51

182 Fifth Special Report of Session 2003–04, *Responses to the Committee's Fifth Report,* HC 655, Appendix 2 para 15

183 *ibid.*, para 16

184 Q 2055

185 Q 2067

186 Q 2067

187 Fifth Special Report of Session 2003–04, *Responses to the Committee's Fifth Report,* HC 655, Appendix 2 para 15

188 HM Treasury press release, 8 March 2004

At the same time the FSA has proposed sweeping changes to the role of actuaries within the regulatory regime. The regulator told us "from the end of 2004 the role of appointed actuary is to be replaced by two new advisory functions: the actuarial function (applicable to all life insurers); and the with-profits actuary function (only for firms carrying on with-profits business). Both will be controlled functions, whose holders will require prior approval from the FSA."[189] Given the current changes that are sweeping the with-profits sector, the precise role of the with-profits actuary is clearly of particular importance. The FSA told us: "The holder of the with-profits actuarial function will be responsible for advising the governing body on its use of discretion within its with-profits fund(s) as this relates to the fair treatment of policyholders. This is an area where there may be particular tensions between policyholder interests and those of management and any shareholders."[190] In our report on endowment mortgages, we agreed that there was an "urgent need for change" in the conduct of the actuarial profession and its role in the long-term savings industry; we added that we considered "it important that the FSA's proposed reforms of the actuarial process within insurance companies are effective in providing warnings and more proactive and independently minded actuarial advice"[191] than had been evident as the endowment mortgage problem unfolded through the 1980s and 1990s.

62. The Morris Review will hopefully ultimately deliver an actuarial profession "fit for purpose" in terms of giving the public the protection and reassurance it has a right to expect from the profession. The Review's consultation document observes: "The problems that arose with both endowment mortgages and pensions mis-selling highlight the issues around potential conflicts of interest and whether actuaries are primarily accountable to their client or employer or to policyholders, consumers, pension scheme members and the broader public interest. Other commentators have pointed to actuaries' role in designing unit-linked insurance policies as further evidence that actuaries' primary responsibility appears to have been towards maximising sales for their clients or employers rather than in delivering policies that are likely to meet policyholders' expectations."[192] Given the role actuaries have in ensuring the fair treatment of policyholders within with-profits funds, we are concerned that there is little evidence to date of the actuarial profession fully recognising wider responsibilities in this area. In evidence to us Mr Goford, the President of the Institute of Actuaries, reassured us that that "actuaries understand the mechanics of the insurance business. We know what is going on."[193] The profession's view of its role nevertheless still appears to be a relatively limited one. Mr Goford also told us "actuaries are advisers and it is the managers of insurance companies which do the execution."[194] **It is still far from clear to the Committee that the actuarial profession can be relied on actively to alert the public in cases where policyholders' interests are being sacrificed in favour of the interests of management or shareholders. We welcome the Morris review of the actuarial profession and consider reform here to be overdue. Nevertheless, any recommendations made by Sir Derek are necessarily going to take some time to**

189 HC 71–II, Ev 347 para 10

190 HC 71–II, Ev 347 para 10

191 Fifth Report of Session 2003-04, *Restoring confidence in long-term savings: Endowment mortgages*, HC 394, paragraph 18

192 Morris Review of the Actuarial Profession: A Consultation Document, HM Treasury, June 2004, page 6, para 1.17

193 Q 742

194 Q 743

implement. In the meanwhile, a period of rapid change is taking place in the with-profits industry and many of the changes could lead to particular tensions between the interests of policyholders and the interests of managers and shareholders of with-profits funds. In the face of continuing doubts about the readiness of the actuarial profession to safeguard policyholders' interests through this period of change we consider it particularly important that the FSA scrutinises closely changes and transactions in the with-profits area and demonstrates to investors that their interests are being preserved.

7 Sandler Products

63. The Sandler Review recommended that a suite of simple, standardised products should be introduced into the UK long-term savings market. Mr Sandler argued that "at present, competitive forces in the long-term savings industry actually drive towards greater complexity, not simplicity, of products. This leads to distribution economics which make it difficult for low/middle income consumers to access products. The heart of the solution lies in product regulation… Product regulation provides an embedded means of protection that does not rely on advice and so minimises the fixed cost element of interacting with the consumer. The Review therefore recommends the introduction of a suite of simple and comprehensible products, the features of which would be sufficiently tightly regulated to ensure that, with certain additional safeguards, these could be purchased without regulated advice."[195] Mr Sandler also recommended "there should be no initial charge, and annual charges for 'stakeholder' products should be regulated… The Review recommends that… a 1% ceiling would be a suitable starting point."[196]

The selling process

64. Many witnesses to our inquiry, from both the industry and consumer groups, expressed concern about the proposal that Sandler products might be sold without regulated advice. Mr Harvey of Aviva argued that it had to be accepted as part of the Sandler process that the risk of mis-selling was being transferred to the purchaser as a risk of mis-buying.[197] The Investment Management Association told us this implied that the Sandler product suite could "be dangerous if not introduced with the greatest care because of the risk of encouraging mis-buying."[198] The Financial Services Consumer Panel noted that "we are very concerned that Sandler products could be the next case of widespread sales of unsuitable products because consumers may not understand the risks of some of the products, which are equity-based, and may even have felt that the Government somehow guaranteed the products."[199] Mr McAteer of the Consumer Association also told us "anything that actually reduces the duty of care on these companies and restricts access to the ombudsman, I think it is going to undermine confidence even further."[200] Legal & General, however, emphasised that "to be low cost, the simple Stakeholder products must also have a simple selling process, as originally envisaged by Ron Sandler."[201]

65. Towards the end of our inquiry the Financial Secretary announced to the House that the Government was to move ahead with Mr Sandler's proposal, using a "new basic advice regime for stakeholder products. This would reduce the time taken for a typical pension sale from several hours to approximately 30–40 minutes. In the future, employees would be

195 *Medium and Long-Term Retail Savings in the UK, A Review*, HM Treasury July 2002, page 23

196 *ibid.*, page 24

197 Q 1762

198 HC 275, Ev 146 para17.1

199 HC 275, Ev 123 para 32

200 Q1452

201 HC 275, Ev 153 para 5.6

able to buy a pension or other stakeholder product in their lunch hour."[202] The FSA wrote to the Committee to inform us that within the basic advice process that would apply to Sandler products "certain key protections will remain: firms will have to gather information from consumers with the aim of trying to ensure that products they recommend are suitable for those consumers; and consumers will be able to take any complaints which they have been unable to resolve with the firm to the Financial Ombudsman Service."[203]

66. **The Committee hopes that the basic advice process now proposed for Sandler products will go some way towards meeting the fears of consumer groups and others that the new simplified selling process would see large scale mis-selling with little prospect of consumer redress. We note that firms will still be expected to establish the basic suitability of a product for the client and that the client will have the right of appeal in any dispute to the Financial Ombudsman Service. The reduction in the consumer time taken for the sales process from several hours to a projected 40 minutes ought also to play a key role in widening access to the savings market.**

Price caps

67. The price cap of 1% on Sandler products originally proposed was fiercely criticised by some witnesses before our inquiry. Ms Francis, Director General of the ABI, told us that "At 1 per cent the UK would be unique in the world in the low level of fees that were charged. Every other country that you compare with, including countries such as Australia, have a higher charge… you do need some additional charging up-front to enable you sensibly to cover the cost of advice, information and so forth." [204] Others within the industry were more positive and Invesco noted that "products priced at less than 1% already exist and have enjoyed growing market share throughout the 1990s."[205]

68. Many of those opposed to the 1% price cap pointed to what they viewed as the disappointing experience of stakeholder pensions. Prudential told us "we believe that the aim of promoting and selling Sandler stakeholder products would not be achieved in a 1 per cent regime… We urge the Treasury to relax the 1 per cent charge cap to allow the industry to promote and distribute Stakeholder pensions effectively."[206] Others, however, took a dramatically different view of the success of stakeholder pensions. The National Consumer Council, for example, observed that "over 1.5 million consumers (on a variety of incomes) of stakeholder pensions are now building up savings in a low-cost, flexible product. In addition, millions of consumers who continue to save in personal pensions have benefited from the general reduction in charges that followed the introduction of stakeholder pensions. Similar downward pressures on charges across the market might follow the introduction of the other stakeholder products."[207] The evidence we heard from the Building and Civil Engineering Benefits Schemes (B&CE) illustrated the success of

202 HC Debates, 17 June 2004, col 53WS

203 HC 71–II, Ev 357 para 16

204 Q 66

205 HC 275, Ev 135 para 4.5

206 HC 275, Ev 165 paras 5 and 9(g)

207 HC 275, Ev 161 para 25

some organisations in selling stakeholder pensions with a 1% price cap. They told us "We will be able to live within the 1% cap… This partnership between employers and individuals in the construction industry has given B&CE an advantage. But we believe that innovative commercial providers should have, from the outset, been looking to work with employers and unions in the manual industries to build a joint approach to pension provision."[208] The B&CE went on to suggest "the financial services industry as a whole has failed to rise to the challenge of the 1% world."[209]

69. Alongside the new basic advice regime the Treasury announced that it was setting the price cap for Sandler products at 1.5% for the first ten years, reducing to 1% thereafter. This announcement has been welcomed by many in the industry. HBOS plc, for example, wrote to us that they believed "that a 1.5% annual charge is realistic" and that the decision "will increase access to advice and products… [which can]…only be good for consumers."[210]

70. The Treasury also announced that the 1% price cap for stakeholder pensions would be raised to 1.5%. The Financial Secretary told us that the extra 50 basis points on the price cap above Mr Sandler's proposals was a "charge explicitly for advice but only for the first ten years" and that "returns, over a period of 25 years say, are virtually identical to [those] if you charged one per cent the whole way through."[211] The Financial Secretary went on to tell us that for those with stakeholder pensions already "We very much expect that the industry will retain their current charging structures. We will be negotiating this closely."[212] We also asked the Financial Secretary if she had considered linking charges more explicitly to performance and she told us that the fact that there was no up-front fee or exit penalty was a good incentive for the industry to deliver good returns in order to encourage client retention.[213]

71. **The Committee notes the 1.5% price cap set on the first ten years of non-cash Sandler products and notes also that the advice component of the new products is higher than that proposed by Mr Sandler when he recommended a 1% price cap. We are disappointed, however, that part of the charge is not more clearly linked to the investment performance of the products. Given that the higher charges for stakeholder pensions are explicitly for additional advice in the selling process, it would clearly be unfair for product providers to levy the higher charge on existing stakeholder pension contracts. We expect the Government to monitor charges on existing contracts very closely as the new stakeholder charges are introduced.**

The price cap setting process

72. As well as ensuring reasonable charges to the consumer, price caps on regulated products can help improve the efficiency of the industry by encouraging low cost

208 HC 275, Ev 71 para 19 & 21

209 HC 275, Ev 71 para 18

210 See list of Memoranda placed in the Library of the House and in the parliamentary Record Office p. 78 (Memorandum by HBOS)

211 Q 2131

212 Q 2137

213 Q 2193

producers and placing additional pressure on others to lower their costs. Mr Sandler indicated that "improving the efficiency of the industry presents a considerable challenge. Consumer weakness and the absence of meaningful incentives from within the industry to address inefficiencies mean that, without some form of external intervention, persistence of the status quo is inevitable. Such intervention is unlikely from the FSA, whose remit as regards consumer protection does not, in practice, extend to a concern about industry efficiency considerations and levels of charges."[214] The current system of setting price caps by Ministerial announcement has been criticised, however, for its lack of openness and vulnerability to lobbying. Ms Johnstone, Director of Policy at the National Consumer Council (NCC), told us "a price cap is a kind of economic regulation and you have to set it properly with proper economic analysis on a basis of fact. At the moment it is just who can shout the loudest; it appears to be just about lobbying and that is a hopeless way".[215] The NCC pointed out: "A rigorous, analytical framework is needed to make decisions of this nature. Ministers and government departments are not responsible for setting price-caps in other sectors, such as telecoms or energy. Decisions in these sectors are now made by independent regulators based on extensive research, open consultation and clear time-frames."[216]

73. **Regulated price caps for regulated products in the financial services industry serve the dual role of guaranteeing the client the price he will pay and putting additional pressure to improve efficiency on an industry where consumer weakness has reduced the normal competitive pressures to drive down costs. But caps set too low can reduce product range and stifle new product development, thus limiting real choice for consumers. Where such caps are to be set, it would be preferable if they were set by an independent body after clear and transparent analysis. The price cap should be consistent with fair returns to both savers and the most efficient producers in the industry but should maintain downward pressures on the cost base of less efficient producers.**

214 HC 275, Ev 179 para 5

215 Q 1518

216 HC 275, Ev 161 para 27

8 The role of the FSA

The performance of the FSA

74. The evidence we have heard about the lack of consumer confidence in the financial services industry raises questions about the FSA's fulfilment of the statutory objectives laid down for it in the Financial Services and Markets Act 2000 (FSMA), under which it was established. The Treasury noted that there were four such objectives:

i. Maintain market confidence in the UK financial system;

ii. Promote public understanding of the financial system;

iii. Secure the right degree of protection for consumers; and

iv. Contribute to reducing financial crime. [217]

75. While there is no clear definition of the "right degree" of consumer protection, a regulatory framework that leaves consumers distrustful of the industry might well be considered to be failing to meet its core objectives. Some witnesses were indeed critical of the FSA. Only one, however, the President of the Institute of Actuaries, suggested that the FSA was doing a worse job than the regulatory arrangements it replaced. Mr Goford contended that the Personal Investment Authority, the FSA's predecessor organisation, had been successful in putting "supervisors on the ground to ensure that the benefits of a recommended product met identified, prioritised needs."[218] Mr Goford continued: "This activity does not seem to be followed up with as much vigour as in the early 1990s. That activity increased confidence in sales that were made and helped reduce inappropriate sales. Subsequent activities of the FSA have concentrated on structural issues that have had little immediate effect on confidence."[219] The Actuarial Profession's submission also suggested that part of the problem now was a "culture of mistrust of financial institutions … partly exaggerated by the activities of the FSA and the media."[220] Others within the financial services industry clearly share this view with, for example, one independent financial adviser observing to us that "FSA's mission seems to be to maximise bad press" for the industry.[221]

76. These views were not shared by any of the witnesses from outside the industry who gave us evidence. The Treasury's assessment is that "doubts had been raised about the effectiveness of the previous system of self-regulation, principally as a consequence of the high levels of mis-selling of personal pensions during the existence of the SROs [Self Regulatory Organisations]."[222] The view of most witnesses was that the FSA had inherited a regulatory approach that was outmoded and that it was now delivering a steady

217 HC 275, Ev 129 para 18

218 HC 71–II, Ev 372 para 12.1

219 *ibid*.

220 HC 71–II, Ev 369 para 4.4.

221 See List of Memoranda placed in the Library of the House and in the parliamentary Record Office p. 78 (Memorandum by Paul B Bennett & Co)

222 HC 275, Ev 128 para 14

programme of improvements. The ABI told us that "the regulation of the industry needed to be fundamentally reviewed to ensure it remained fit for purpose" and that the industry therefore "welcomed the fundamental review of all aspects of regulation begun by the Financial Services Authority in November 2001 (the Tiner Review)."[223]

77. Consumer groups also agreed that the regulatory environment had improved in recent years. Ms Foster of the Financial Services Consumer Panel told us that the "regulator cannot, unfortunately, stop mis-selling, but they can take steps to do something about it. I do think the FSA has improved greatly in the area of enforcement action."[224] The Treasury noted that "the Government believes the regulatory framework established by FSMA has been a success, so the two-year review [established to review the workings of the Act] is not intended to bring about radical alterations." The Treasury went on to suggest, however, that "nonetheless, it is appropriate to consider the regulatory framework and how it can be improved".[225] While generally confident that the FSA had already delivered a significant improvement in the regulatory framework supporting consumer confidence in the financial services industry, many of those giving evidence in our inquiry similarly went on to suggest specific areas where the current regulatory approach could be improved. **The Committee agrees with the view of the overwhelming majority of witnesses that the current low level of confidence in the financial services industry is in large part a reflection of the weak regulatory framework and inappropriate industry practices that existed before the arrival of the FSA.**

Appropriate regulatory burden

78. The Association of Independent Financial Advisers (AIFA) wrote to us "that small firms in particular have been confronted by a never-ending succession of changes driven by regulation. Not only does this deflect businesses from their main function of giving advice to consumers; it also adds to the impression that this is a sector in which confidence is lacking."[226] We therefore asked their representatives which regulations they found most burdensome. Mr Sanders, Deputy Chairman of the AIFA, told us "If one looked at a checklist of things you would want to modify, as opposed to scrap, certainly you would start with money-laundering… That has become now one of the most time-consuming and onerous aspects of day-to-day relationships with clients and new clients, in a way that possibly was unforeseen when the regime came in."[227] Mr Sanders also told us "I think it is fair to say that the present handbook from the FSA is in need of being shortened, and indeed the work has started to do just that."[228] But he added that there were no regulations that were so burdensome or of such trivial effect that he would recommend scrapping them.[229] Similarly, when we took evidence from the chief executives of the major

223 HC 275, Ev 35 para 5.16

224 Q 1448

225 HC 275, Ev 30 para 29

226 HC 275, Ev 52

227 Q 1307

228 Q 1310

229 Q 1312

companies we asked if there were any rules that they felt that could be scrapped without weakening consumer protection and no suggestions were forthcoming.[230]

79. The burdens imposed by money laundering regulations were also mentioned by the Building and Civil Engineering Benefits Schemes. They wrote "individuals typically saving between £5 and £10 a week in a Stakeholder Pension are not using them as a tax shelter or to launder ill-gotten gains. 'Know your customer' identity checks act as a disincentive to many potential members who often struggle to provide the relevant documentation and are an additional administrative cost to providers."[231] In addition, their submission suggested that the amount of documentation and forms that need to be filled in for stakeholder pensions is "hardly practical when our members frequently move from employer to employer, including periods of unemployment and self-employment. Our members are put off by the size of the pack and are not the kind to find filling in forms an enjoyable or productive activity."[232] The Treasury also told us that firms have "raised compliance issues regarding the complexity of the FSA's Handbook of Rules and Guidance and the difficulty of obtaining individual guidance from the FSA"[233] as part of its N+2 Review of the FSMA.

80. The FSA has long recognised that many people find the money-laundering regulations burdensome. Last autumn Mr Tiner told us "We think that there should be a kind of proportionate and risk-based approach to identification checking, so that it does not completely close down access to those whom we are trying to encourage to come into the financial system. There is an important point of balance here. I am not sure that point of balance has been satisfactorily reached yet."[234] On the particular issue of the bureaucratic burden attached to stakeholder pensions, however, the FSA told us that this was a matter for the Occupational Pensions Regulator.[235]

81. **The evidence we have heard in the course of this inquiry tends to confirm that FSMA is currently working well. Apart from in the limited area of money-laundering regulations, we received no specific complaints of excessively burdensome regulation from the major companies in the industry, while consumer groups generally acknowledged a significant improvement in the protection afforded to the consumer. We note, however, that both the industry and the regulator agree that the current money laundering regulations require simplification.**

Speed of enforcement

82. The Treasury told us that "the ability of consumers to obtain speedy redress when things go wrong" was an essential requirement "for building trust and confidence in the UK financial services market."[236] As well as speedy redress, the public is entitled to expect

230 Q 1593

231 HC 275, Ev 72 para 33

232 HC 275, Ev 72 para 32

233 HC 275, Ev 130 para 30

234 Evidence to the Committee 21 October 2003, Q 64 (HC, 2002–03, 1211)

235 Q 2037

236 Fifth Special Report of Session 2003–04, *Responses to the Committee's Fifth Report*, HC 655, Appendix 1 para 49

rapid enforcement action against wrongdoers to ensure that, in the worst cases, unsuitable individuals are removed from the long-term savings industry as quickly as possible. It has become clear, however, that in contested cases, bringing enforcement actions to conclusion can take a very long time indeed. The FSA is currently investigating events in the split capital investment trust sector. The Chairman of the FSA told us he regarded this investigation as "very serious" because the regulator believes that what happened "represents collusion on a very substantial scale between a number of practitioners in the market, collusion which brings the market into disrepute and collusion which has had harmful effects for very large numbers of consumers of split products."[237] The FSA agreed with our suggestion that rapid settlement of this case was highly desirable. Mr McCarthy told us "I think there are overwhelming reasons for drawing a line under this affair… The three reasons are, firstly, there has clearly been collateral damage to the investment trust sector as a result of this. Just look at the levels of sales of investment trusts. Secondly, for what was quite a specialised corner of the market, the damage to the reputation of financial services generally has been quite great and quite disproportionate to the size of that particular corner of the business. As you are conducting your inquiry in trying to restore trust and confidence in the sector, I think drawing a line under this is a key part of that. The third and perhaps the most important issue of all is that we believe there are thousands of investors who have been harmed by these collusive activities. It is only right to see that investors are put right as soon as possible."[238] The FSA is thus pursuing "a twin track approach—enforcement action in case there is no prospect of a negotiated settlement and negotiations to see if we can obtain faster compensation for those who have suffered,"[239] although Mr Tiner told us so far only three firms of the 21 under investigation had agreed to mediation.[240] Investigations began two years ago and the Committee notes that the press has reported that contested cases could take another three to five years to resolve.[241]

83. While an enforcement action is proceeding, the FSA cannot inform the public of the identity of those under investigation. The position was laid out in an FSA press release. "The FSA has not made public the names of the 21 firms with which it has held discussions. In accordance with the requirements of the Financial Services and Markets Act 2000, it will continue to keep the details of its cases confidential until either the relevant mediation or enforcement processes are concluded."[242] Such confidentiality arrangements raise the obvious danger that the public could entrust their savings to an unscrupulous individual unaware that the FSA was engaged in a protracted enforcement action against that individual.

84. **Those accused of wrongdoing by the FSA clearly have a right to defend themselves at fair hearings. However, the length of time contested cases are taking to bring to a conclusion denies the public the speedy redress they have the right to expect in cases of wrongdoing. The fact that those under investigation have a right to anonymity reinforces the need to speed up enforcement actions. How this should be achieved**

237 Q 1880

238 Q 1885

239 Q 1880

240 As at 23 June 2004 Q 1897

241 *Financial Times*, 29 May 2004, page 3

242 FSA press release, 26 May 2004

should be addressed in the current review by the Government of the Financial Services and Markets Act 2000.

The Financial Ombudsman Service

85. The Treasury explained to us that "the Financial Ombudsman Service (FOS) was set up in recognition that consumers want a speedy, fair and inexpensive method of resolving disputes. There can be little doubt that the FOS has and continues to meet this aim—over 61,000 complaints of all types were considered by the FOS last year."[243] Consumer groups we asked were generally very positive about the FOS.[244] The Treasury, however, wrote to us "some in the industry have raised concerns about the decision-making process of the FOS. On 4 November, the Government announced, as part of the two-year review of the Financial Services and Markets Act 2000, that the FOS and the FSA will jointly review when regulatory action by the FSA should replace decisions on individual cases by the FOS and on the possibility of appeals of FOS decisions."[245] Consumer groups we asked were all opposed to any general right of appeal against FOS decisions. The Financial Services Consumer Panel wrote to us that an appeal mechanism would "diminish the current advantage of the FOS as a speedy and simple adjudicator and would lead to firms further dragging their feet in paying compensation to consumers."[246] Mr McAteer of the Consumers' Association told us "this industry has powerful lawyers and deep pockets, it has powerful trade associations. If they get a right of appeal against the Ombudsman's decisions they will just tie the Ombudsman up in knots for years and it will cause a reduction in the Ombudsman's efficiency and that will have a knock-on effect on consumer confidence."[247] Mr Merricks, Chief Ombudsman at the Financial Ombudsman Service, told us that the appeal route "has substantial disadvantages"[248] and that so far the consensus view appeared to be that "the answer lies in clarifying the way that cases which have wider implications which reach us are dealt with rather than [going] through appeals."[249] We note that the leading insurance companies from whom we took evidence indicated that they were not seeking a general right of appeal to be introduced. Mr Bloomer, Chief Executive of Prudential stated: "I do not think the industry is lobbying for a major change in the way the Ombudsman Service works"[250] and the industry was not certainly lobbying for an appeal process.[251] Major companies would like to see "a relationship between the FOS and the FSA that will deal with [cases with wider implications] properly"[252] but this applied to "a very narrow group" of cases.[253]

243 Fifth Special Report of Session 2003–04, *Responses to the Committee's Fifth Report,* HC 655, Appendix 1 para 45

244 Q156

245 Fifth Special Report of Session 2003–04, *Responses to the Committee's Fifth Report,* HC 655, Appendix 1 para 46

246 HC 275, Ev 124 para 35

247 Q 1539

248 Q 1802

249 Q 1800

250 Q 1790

251 Q 1791

252 Q 1792

253 Q 1793

86. The Financial Secretary told us that while a review was in hand, there was "absolutely no presumption that we will necessarily change the way [the FOS] operates at the moment."[254] **The Financial Ombudsman Service currently commands wide support among the industry and consumers as an inexpensive and speedy way of resolving disputes and achieving redress where redress is due. Introducing a general right of appeal into the Ombudsman process risks undermining confidence in a system which is currently working well. The Committee notes that the Chief Ombudsman sees substantial disadvantages in introducing any general right of appeal and that the major insurers are not pressing for such a right. While there may be scope to improve co-ordination between the FSA and FOS in certain cases with wide implications, the Committee believes that calls for a general appeals process should be resisted.**

Establishing an identity with the consumer

87. The Complaints Commissioner, Ms Radcliffe, who is responsible for investigating complaints against the FSA, told us last summer that there was a need to address "the extent to which the FSA focuses adequately on consumer as well as industry issues."[255] She went on to argue that, while there had been some improvements, "the way in which they have organised themselves to relate to consumers is something which they still need to do a lot of work on."[256] The representative of the Financial Services Consumer Panel similarly felt that "the FSA could do better to be aware of the consumer interest right across the organisation. There are some parts which are very much alive to the consumer interest and build it into their thinking and policy making. However, there are still some gaps,"[257] with those areas of the FSA dealing with wholesale markets doing little to consider if their actions may also have an impact on retail consumers.

88. Both consumer groups and industry representatives felt that it would also be useful for the FSA to improve its communication with, and raise its profile among, consumers. Help the Aged wrote to us suggesting that currently regulatory bodies in financial services "communicate poorly with the general public about what they are doing and why they are doing it".[258] The fact that Mr McCarthy, Chairman of the FSA, told the Committee last autumn that he was "not sure how many financial services consumers know about the FSA"[259] seems to confirm that communicating with the public has been a relatively low priority at the FSA. Ms Foster of the Financial Services Consumer Panel suggested "the FSA actually has to question more whether its profile amongst consumers should be much higher."[260] Similar views were expressed by leading figures within the industry. We asked Mr Bloomer, Chief Executive of Prudential, if greater public awareness of the FSA and its role in consumer protection would bolster consumer confidence. He replied that "it may well do… there is a role because I think the FSA does take a strong line and we do have in the FSA one of the best regulatory systems, as I look at different countries, around the

254 Q 2096

255 Letter to the Committee from the FSA Complaints Commissioner, 13 June 2003

256 Evidence to the Committee, 21 October 2003, Q 176 (HC, 2002–03, 1211)

257 Q 1438

258 HC 275, Ev 127 para 4.1

259 Evidence to the Committee, 21 October 2003, Q3 (HC, 2002–03, 1211)

260 Q 1438

world. We could make more of it and if that helped bolster confidence it would be a good thing."[261] The Financial Secretary also told us that she felt that "there is an awful lot that the Financial Services Authority could do"[262] in this area.

89. The Committee notes that towards the end of our Inquiry the FSA announced that it was setting up "a Hotline for the public and firms to report misleading advertisements for financial products."[263] The FSA's press release stated that "the Hotline is part of the FSA's commitment to put significantly more resources into the regulation of financial advertising, including setting up a new department which will lead the efforts to stamp out misleading advertising… To help us put an end to misleading ads we need the eyes and ears of the public." [264]

90. **Greater public knowledge of the FSA's role and activities in protecting their interests can only do good in terms of restoring consumers' confidence in the financial services industry after a chequered history of weak regulation and successive mis-selling scandals. We recommend that the FSA should now engage in a publicity campaign. The aim should be to ensure that potential savers are fully aware that underpinning the financial services industry there is an effective regulatory body ensuring that the industry treats its customers fairly. We welcome the recent launch by the FSA of a hotline for firms and the public to report misleading advertisements, but would observe that this is only likely to be effective if the public are regularly reminded by advertising of the hotline number and the FSA's role in regulating the financial sector.**

261 Q 1577

262 Q 2083

263 FSA press release 6 July 2004

264 *ibid*.

9 Tax & benefits

Tax

91. Several witnesses told us that the current tax incentives to save were excessively complex, blunting their impact on savers, and ineffectively targeted. Ms Farnish, Chief Executive of the National Association of Pension Funds, for example, told us that "the Government claims it is currently providing about £11 billion worth of incentives overall to encourage people to save in pensions… but those incentives tend to be complicated and confusing, particularly for individuals."[265] Mr Bloomer, Chief Executive of Prudential, agreed. He told us "general customers do not understand all the tax benefits available to them. The system is complex, it varies from product to product, and I suspect a lot of customers just do not take advantage of all the tax issues."[266] Mr Bloomer added that "if [the tax incentives] are there, as I presume they are, to encourage saving, I am not sure that they do that job as effectively as they might."[267] The Investment Management Association (IMA) suggested that "there is a lack of coherence to Government policy on savings. A number of separate initiatives are being pursued, none of which may have a major impact on its own, and which do not appear to flow from any coherent strategy towards saving, investment and financial services in the round."[268] As part of its proposed reforms it urges "simplification of the taxation of savings".[269]

92. The IMA also made a plea for "rational tax incentives"[270] and pointed out that it was perverse that the main beneficiaries of some current tax incentives were higher rate rather than standard rate tax payers.[271] Similarly Mr Bloomer told us "a review of the overall taxation system of savings would be worthwhile, because I am not sure the tax credits that are available always go the most effective way."[272] The Financial Secretary acknowledged that the tax system had played a part in adding to the "asymmetry of information between the consumer and the provider."[273] She also told us in the past "it has been almost impossible for the consumer to compare products because of different tax treatments,"[274] although she went on to note that she hoped the new Sandler suite of simplified products would make comparison easier for the saver. In addition, she told us that the UK now had "the most simple tax regime in the world applying to pensions."[275] **The Committee welcomes recent moves to simplify some aspects of the tax regime for pensions and long-term savings. It is important, given the sums of money involved from the Exchequer, that the tax reliefs and incentives granted to long-term savings are as**

265 Q 1170

266 Q 1711

267 Q 1712

268 HC 275, Ev 143 para 11.3

269 HC 275, Ev 144 para 13.1

270 *ibid*.

271 HC 275, Ev 142 para 5.2

272 Q 1712

273 Q 2081

274 Q 2102

275 Q 2169

effective as possible in achieving their stated objectives. The evidence we have received in the course of this inquiry suggests that there is substantial scope for improving the coherence of the present complex tax regime in promoting savings.

Pensions

93. As with tax, several witnesses criticised the UK's current pension arrangements for their complexity. Many also criticised their inflexibility. Ms Farnish told us that the UK has "probably the most complicated state pension system in the world. We are not satisfied with having one state pension; we have two. The whole area of contracting in or contracting out of the second state pension is a complete maze, and it is one of the reasons why it is hard… to sell a simple pension product without advice, because that decision is a very important one and it is difficult to know what is the right thing to do, even for financial advisers these days."[276] The Treasury told us it was introducing a range of measures to encourage pension savings and help the consumer make better choices in this area. These measures included "improving information through pension forecasts, a pension information pack for employers, and piloting different forms of employer information and advice ("Informed Choice"); encouraging simple and flexible savings products, broadening access to the financial services industry; simplifying the taxation of pensions; and introducing measures to extend working lives."[277] In addition, the Financial Secretary told us that the Government had "introduced a pension simplification which makes the whole tax scene in relation to pensions a huge amount simpler and alongside that flexible retirement, so that people can make different choices about the combination of work and saving. I think it will become a lot more attractive to people to think about their savings choices and to act on them in the future." [278]

94. Prudential, however, while acknowledging "the current Inland Revenue proposals for simplifying pensions taxation will produce far greater simplicity prior to retirement" told us they were "concerned that the current post-retirement proposals will make the choices that consumers have to take when they retire more complex. The focus to date appears to have been on high net worth individuals rather than the mass market."[279] Other witnesses also suggested that, away from high net worth individuals, the lack of flexibility in the current pension arrangements remained a key problem. The Building and Civil Engineering Benefits Scheme told us: "We believe greater flexibility is particularly important for younger people and low to moderate earners. In our experience, many 25 year-olds on lower incomes, with limited means to save, are concerned about accessing the money they save for unforeseen circumstances. We believe controlled access for events such as unemployment or sickness, would overcome a major barrier to saving for those on lower incomes."[280] The lack of flexibility in the current pension arrangements was also criticised by the NAPF, who wrote to us "many consumers are no longer convinced that they should save in a pension—which requires locking their money away, often for decades, and then being forced to convert their saving into an income stream on

276 Q 1131

277 HC 275, Ev 131 para 41

278 Q 2098

279 HC 275, Ev 169 para 21

280 HC 275, Ev 73, para 39

retirement."[281] The Financial Secretary, however, suggested that the new pension arrangements did offer considerable flexibility because "it will be possible, again for the first time, to save money in a liquid form before moving it over and transferring to a pension without loss of tax relief because there will be no annual limits on pension contributions under £215,000 in any year compared with the current very restrictive limits. It will be just subject to one lifetime limit starting at £1.5 million. This will make pension saving far more flexible and easy for 15 million people."[282]

95. The Committee has recently met with US pension fund managers who described to us the 401(k)[283] pension system in the US, which allows savers to borrow against their pension savings or make a withdrawal in case of an emergency, such as job loss, albeit with penalties. The Financial Secretary, however, indicated that she was not in favour of such flexibility in the UK and told us "the evidence suggests that, when you allow free draw-down from a pension product, as happens up to a point in the United States, then people spend that money before they reach retirement and eventually they fall back onto means-tested benefits. The fundamental purpose of tax relief is to enable people to build up a pot of money which is then available to provide a secure income in retirement."[284]

96. **The Committee welcomes the recent simplifications of the tax system surrounding pension savings and the additional flexibility this has introduced into the pensions market. The freedom to make annual pension contributions up to £215,000 a year is unlikely, even so, to have a significant impact on the attitude of younger workers and those on modest incomes towards pension savings. While the Committee accepts that savers should be discouraged from withdrawing cash from their pension schemes, except in times of emergency, granting more flexible access to pension savings during periods of unemployment or illness has proved effective overseas in improving the attractiveness of saving via a pension scheme. We recommend that the Government should examine the feasibility of such an option in the UK.**

Benefits

97. The Treasury wrote to us that the "introduction of a Pension Credit in 2003 will reward pensioners for having built up savings during their working lives."[285] The Financial Secretary added "the pension credit, when it was introduced, did two things: it tackled pensioner poverty but it also, for the very first time, said to people, 'If you have small private savings, you will be rewarded for that small private saving or occupational pension.' It is the first time that we can unambiguously say to people that savings count."[286] Several industry witnesses nevertheless told us that the new framework of means-tested benefits was having a significant negative impact on the savings market.

281 HC 71–II, Ev 365 para 10

282 Q 2170

283 401(k) s are so-called after the provision in the US internal revenue code under which they are established

284 Q 2172

285 HC 275, Ev 127 para 3.c

286 Q 2185

98. The Building and Civil Engineering Benefits Schemes (B&CE) told us the introduction of the Pension Credit in October 2003 had indeed addressed the issue of those with relatively modest savings being left no better off than those who had made no savings, a problem with the previous Minimum Income Guarantee scheme. Even so, the Pension Credit "will still reduce by 40% any pension income up to the level of the guaranteed credit (currently £102 per week). This acts as an effective higher rate of income tax on what are very modest pension incomes. Indeed, it will turn some of our members from lower paid workers to higher rate pensioners."[287] B&CE went on "It is currently estimated that a pension fund of between £60,000–£90,000 may be needed to catapult oneself clear of the Pension Credit. In our experience very few construction operatives manage to attain such a fund, and therefore could find themselves penalised by the Pension Credit. This is likely to be true for many lower to middle income earners across the economy."[288] The NAPF also wrote to us, stating that, as a result of the Pension Credit, "not only are financial advisers wary of advising anyone earning less than around £20k to save in a pension. A number of NAPF Members have reported that they no longer offer membership of their pension scheme to those on low incomes because they judge that such employees would be better off relying on means-tested Pension Credit."[289] Mr Ross, President of the Faculty of Actuaries warned that, looking out, the impact of the Pension Credit had "the potential of extending a long way up the income distribution to well over half of working people."[290] Mr Harvey of Aviva made a similar point, telling us that not only did means-testing now apply quite a long way up the income scale, but the saver was "in danger, to put it crudely, of saving 22% tax on the way in but [paying] 40% on the way out because of the way the means-testing process may work"[291]

99. The Financial Secretary told us "I do not accept the figures that you have put forward"[292] from witnesses in this area, although she undertook to submit a further note to the Committee[293] and reassured us that the Treasury "are prepared constantly to keep this under review and, if we feel there is a need to act further, then of course we would."[294] In our report in the 2004 Budget we concluded "the treatment of capital in assessing retirement benefits is an issue which needs to be kept under review."[295] **The evidence we have heard on the workings of the Pension Credit highlights the need for the working of the new means-tested benefits system to be monitored closely. There still seems to be considerable uncertainty as to how many households could see deductions under the means-testing arrangements and the size of pension fund that is likely to attract benefits deductions. We recommend a detailed study of how the new system is working, which would considerably clarify the debate on how effective the new Pension Credit is**

287 HC 275, Ev 72 paras 26-27

288 *ibid.*, para 27

289 HC 71–II, Ev 364 paras 7-8

290 Q 946

291 Q 1715

292 Q 2188

293 Not yet received

294 Q 2179

295 Sixth Report of Session 2003–04, *The 2004 Budget,* HC 479 paragraph 66

at delivering benefits to those who need help while not penalising those who have attempted to make provision for their own future.

10 Financial capability

Consumer education

100. The FSA told us that "it is widely accepted that in the UK overall consumer understanding of financial matters is at a worryingly low level. It is also agreed that, without this understanding, consumers are not well placed to discharge their responsibility for their own financial decisions. It is our aim, in collaboration with other bodies, to help educate and inform consumers about the different needs for financial services which they may have, and about the way in which the different categories of products that are available might help them to meet those needs." The FSA added "it is clear that it will take at least a generation to make a significant impact on overall levels of financial awareness in the UK."[296] There is wide support for the FSA's work in this area. The Financial Secretary, for example, told us that this work "is core to restoring trust in the industry and providing access to low to moderate income earners."[297] The ABI felt that "work to improve consumer education or financial capability is essential."[298] The National Consumer Council (NCC) meanwhile told us "The NCC is enthusiastic about the FSA's proposal to develop a national strategy for financial capability… We are particularly pleased that, as part of the strategy, the FSA has recognised the requirement to tackle the consumer need for basic financial advice."[299] The only dissenting voice came from the Actuarial Profession, who warned that the current plans "would result in wasted money. Expenditure on education aimed at helping the customer make a good financial decision is likely to be ineffective… a 'good presentation' will override good education every time."[300] Others, however, did warn that better financial education was unlikely to be a panacea. The Financial Services Consumer Panel wrote to us "for large groups of consumers no amount of simplification, education and information will obviate the need for accessible, independent and good quality help, generic advice, in understanding their financial needs and how to meet them. Furthermore, no amount of generic advice will overcome the lack of confidence consumers have in the market unless errant firms change their culture and develop strategies to treat customers fairly that are not only talked about in head office, but implemented in the market."[301] In addition many warned, like Mr Bloomer, Chief Executive of Prudential, that any benefits from financial education "will be some way off".[302] Standard Life also suggested that it was important to avoid "adding more strands to an already very fragmented approach to the financial education of consumers. It is essential that greater synergy and benefits are obtained from existing literacy activities."[303] Mr Prosser, Chief Executive of Legal & General, expressed similar views, telling us he agreed that it would be

296 HC 275, Ev 99 paras 10–11

297 Q 2182

298 HC 275, Ev 11 para 1.18

299 HC 275, Ev 163 paras 46 & 47

300 HC 71–II, Ev 369 paras 6.1 & 6.2

301 HC 275, Ev 123 para 29

302 Q 1766

303 HC 71–II, Ev 399

useful to rationalise the current proliferation of financial literacy schemes and focus resources on the most promising prospects.[304]

101. Some witnesses expressed frustration that more has not yet been done to identify how work on improved financial capability might be funded. The NCC, for example, wrote to us: “disappointingly, the FSA’s initial capability strategy document touches only very briefly on the critical question of funding. It is still very unclear as to how the implementation of the strategy is to be funded.”[305] The FSA has stated that there is currently “around £35–40 million which is spent on financial capability work, funded by a combination of Government money, industry contributions, charitable trusts and the FSA.”[306] It is currently awaiting fully costed proposals which would make it “possible to estimate whether additional resources may be needed and if so, how much and who is best placed to provide the funding.”[307] None of our witnesses was prepared to pre-empt the FSA’s work and estimate the likely cost of an effective financial capability programme. Mr Bloomer, for example, told us “I am not going to take a stab at a number before that work is done.”[308] There appeared, even so, to be a general expectation that a significant increase in spending from current levels would be required. When we asked the Investment Management Association, for example, about the likely scale of any network to provide effective advice and education, Mr Ellis, Chairman of their Investment Funds Committee, replied that it would need to be “vast”.[309] There also appeared to be a broad consensus that the FSA could not fund any significant programme from within its own resources. Mr McCarthy, Chairman of the FSA, pointed out that “the question of financial capability is basically a question about education. The expenditure on primary and secondary education and some pre-school education runs at around £22 billion a year. Our budget is £200 million a year. So there are things that we can do, there are things we can encourage other people to do, and we are working very hard to make sure that they take their responsibilities seriously, as we take ours seriously, but I think it is important that we are realistic.”[310] Rather than attempting to raise new money, Ms Farnish, Director General of the NAPF, suggested a lot could be done by making “better use of the £1.4 billion—that was the figure I recall when I was at the FSA—that [the industry] currently spends on marketing and promoting financial services products. It is a huge figure compared with the resources that are ever going to be available for consumer education and advice.”[311] Ultimately, however, there was a general expectation that the industry would provide additional funding for a financial capability programme. Mr Bloomer, for example, told us the various bodies were “trying to decide… how much it is sensible to put in and how to raise the finance to do that. They are bound to come back to the industry to do it.”[312] The view that the industry was likely to prove the best source of funding was shared by the

304 Q 1786

305 HC 275, Ev 163 para 48

306 FSA press release, 27 May 2004

307 *ibid*.

308 Q 1781

309 Q 1002

310 Q 1964

311 Q 1138

312 Q 1781

Financial Secretary, who told us she had a "very strong expectation that the industry will come back and volunteer lots of money for this work to be taken forward."[313]

102. **The Committee found wide support from the industry and consumer bodies for the FSA's efforts to coordinate a programme aimed at improving financial literacy among consumers, alongside a general recognition that such work needs to be viewed as very long term and is unlikely to bear fruit for a generation. In this context it is particularly important to see work on improved consumer understanding of financial issues as an addition to, rather than a replacement of, efforts to make the information available to consumers on financial products clearer and more accessible. We also support the proposition—which we found to have wide general acceptance—that the financial services industry should make a substantial contribution towards the cost of any expanded programme aimed at improving financial capability.**

Workplace based advice

103. There was a broad agreement among a variety of witnesses that the workplace had strong advantages as a venue for delivering advice and information to savers. Mr Harvey, Chief Executive of Aviva, told us "obviously the workplace is a particularly important place for that because of its close relationship to pension savings."[314] The NAPF concurred, noting "the workplace has obvious advantages as a forum for giving information and helpful advice to working adults, highlighting the need for retirement planning and long-term savings, and helping them through the decisions they need to make."[315] Abbey National Plc told us that delivering financial services via the workplace enabled access for many who had difficulty accessing services via other means. In their experience, "many are on lower incomes. A minority would fall into the category of the financially excluded." [316]

104. Prudential agreed that the workplace-based provision of financial services and advice was desirable, arguing that use of the workplace produced economies of scale "enabling employees to obtain a better deal collectively than they could individually."[317] The NAPF also pointed to evidence from the experience with 401(k) pension schemes in the US that suggested "face to face group advice sessions in the workplace are more powerful than the size of the employer's contributions in getting people to save."[318]

105. There was also a widespread view that the current regulations on giving financial advice hampered efforts to use the workplace as a delivery platform. Legal & General, for example, told us that "employers who have been required to designate a Stakeholder scheme are also required to draw it to the attention of employees, but are not permitted to promote the scheme or encourage employees to join—not even if they make a contribution to the scheme. No such restriction exists where occupational scheme rules apply, even though the latter may operate on a very similar defined contribution basis. The

313 Q 2181

314 Q 1669

315 HC 71–II, Ev 365 para 4

316 HC 71–II, Ev 287

317 HC 71–II, Ev 391 para 8

318 HC 71–II, Ev 365 para 14

inconsistency here is indefensible. We have held discussions on this with the Financial Services Authority but their hands are tied by the legislation that they are required to enforce."[319] The NAPF also told us that the current regulatory framework is "unhelpful in that the extent to which employers and trustees can give advice to individuals is unclear."[320] Mr Tiner, Chief Executive of the FSA agreed that this was an area that "badly-needed liberalisation".[321] He told us "people who are in the workplace need more advice on how to take care of their financial interests in the future. I hope as a consequence of the Treasury's N2 + 2 review and our own work on generic advice, we will see some liberalisation there. I would support that very much."[322] The Financial Secretary told us "If I look five or ten years ahead, I think the workplace will be a major distribution channel. I would like to see it as a distribution channel not just for pensions but for all sorts of financial products… I cannot justify the old regime. I think it needed to be changed. We are in the process of doing that. I hope very much that the workplace will really take off in the future as a delivery channel."[323]

106. **The workplace has strong advantages in delivering financial advice and services to savers, particularly those who are less affluent. It is deplorable that complex and poorly understood rules have until now hampered efforts to provide financial advice through the work place. We welcome the commitment given to us by the Minister to push ahead with reform here. We hope that in the future the workplace will develop as a popular delivery channel for a wide range of financial services.**

The role of Citizens Advice Bureaux

107. While the workplace offers strong advantages for the delivery of financial advice to those with jobs, those without jobs, who are often those members of society who most need dispassionate advice on financial problems, will often turn to voluntary agencies such as Citizens Advice Bureaux (CAB) for help. CAB have been constrained, however, by the regulations on the advice they could give on financial matters. This issue is currently under review and the FSA informed us the Government is consulting "on whether more can be done to reduce the impact of regulation on sources of non-regulated advice such as employers, Citizens Advice Bureaux, and other advice centres, in order to widen access to such advice and improve awareness of financial products."[324] As well as regulatory hurdles, however, there are funding issues if CAB are to play a major role in the provision of financial advice. Mr Lord, Head of Money Advice Strategy for the National Association of Citizens Advice Bureaux (Citizens Advice), told us that CAB "see about 350,000 consumers a year who have debt problems" but that if people with other problems were included there were probably "800,000 people a year who go into a Citizens Advice Bureau" [325] who could benefit from financial advice. In the course of our inquiry Citizens Advice announced "a radical new pilot project to provide generic financial advice to consumers. The project—

319 HC 275, Ev 153 paras 4.7 & 4.8

320 HC 71–II, Ev 365 para 4

321 Q 2034

322 *ibid*.

323 Q 2108

324 HC 275, Ev 100 para 14

325 Q 1495

which will see nine Citizens Advice Bureaux working in collaboration with independent financial advisers—is aimed at providing Citizens Advice Bureaux clients with access to free, independent and impartial financial advice… The £90,000 scheme has been funded by Barclays Bank, the Society of Financial Advisers and the Tudor Trust charitable trust."[326] Mr Lord told us the scheme "will be running for six months from late summer [and] we estimate [it] will see about 400 clients" and that after evaluation expenses "the ball park cost figure is going to be about £150 for each client who is seen."[327] Scaled up across the whole CAB network this would clearly imply a need for a very large budget for financial advice.

108. We asked the Chief Executives of the major insurers if they would support the CAB scheme financially if the pilot proved successful. Mr Prosser of Legal & General told us "if it is successful, I am sure we will look at it… The difficulty I think with CAB is that their current customer base is actually seeking advice on debt. They are not seeking advice on how to make savings."[328] Mr Harvey of Aviva told us that CAB "provide very good support to people, but most of that advice is about debt and loan structures, which is not the immediate area in which we are involved but is absolutely crucial to a range of people who go to that organisation for support in difficult times… I think there is a big issue to be tackled here and it is broader than just the savings and life industry you have represented here."[329]

109. **We welcome moves to review the regulations surrounding the provision of generic financial advice by voluntary agencies such as Citizens Advice Bureaux, but the issue of funding also needs to be addressed. If the current pilot scheme on the provision of financial advice via CAB offices proves successful, the whole of the financial services sector, including banks, credit card companies and the long-term savings industry, should support Citizens Advice's work in this area.**

326 Citizens Advice press release, 12 May 2004

327 Q 1495

328 Q 1787

329 Q 1784

11 Conclusions

110. The bear market has exposed a catalogue of problems and scandals that has left a large body of savers feeling disillusioned with the long-term savings industry. These problems include:

- about half of all with-profits policyholders, with savings worth around £160 billion, now find themselves in closed funds offering very limited long-term growth prospects;[330]
- endowment mortgage policyholders are suffering a collective shortfall of approaching £40 billion;[331]
- a £3 billion shortfall emerged at Equitable Life;[332]
- savers with precipice bonds have suffered capital losses estimated at £2.2 billion;[333]
- the FSA is pressing for £350 million to compensate investors for losses on split capital investment trusts.[334]

111. The Investment Management Association deduced from this background that "the lessons of the last few years for the industry are that products whose risks are not clear, or which raise unrealistic expectations in the minds of consumers, bring problems in their wake. The financial services industry therefore needs to set itself high standards in respect of product transparency, clarity of information and good client service. Investment products need to make clear to the investor how his or her money is invested, and what costs the investor is bearing… In addition, the industry needs to take care about the way in which it promotes products."[335] Carrying on with traditional industry practices is simply not an option in the view of many witnesses. The Association of Private Client Investment Management and Stockbrokers (APCIMS) told us that recent trends have resulted in the "purchaser being disillusioned with the product and with savings in general."[336] APCIMS went on to warn that it is "much easier for consumers to lose confidence than it is for that confidence to be regained."[337] **The sheer scale, diversity and nature of the problems encountered by customers of the long-term savings industry in recent years show that the industry needs a thorough re-think of the nature of the products it sells, how it sells them and the "after-sales" service it provides to its customers. Regulators, the Government and other interested bodies can assist the industry through this process of reform, but our inquiry has made it clear that fundamentally what is needed is for the**

330 Q 2062

331 Fifth Report of Session 2003-04, *Restoring confidence in long-term savings: Endowment mortgages*, HC 394, page 3

332 Q 583

333 HC 71–II, Ev 349 para 6

334 Q 1881

335 HC 275, Ev 142 para 7.1 & 7.2

336 HC 71–II, Ev 296

337 *ibid.*

industry to recognise the problems confronting it and take responsibility for tackling them.

112. Apart from the damage caused by the bear market, the collapse in expected future investment returns as inflation has fallen is another issue that poses significant challenges for the long-term savings industry. Several witnesses pointed out that, with many products expected to deliver returns of 6% or so before costs on current FSA projections,[338] by the time costs are deducted savers will often get little more than they can expect in a good deposit account, with little reward for the risks inherent in tying up their cash in a long-term savings product.[339] Standard Life summarised the situation as being one in which the industry has "allowed a situation to develop where the Government's success in managing the shift from a high inflation, high interest rate economy to a low inflation, low interest one has created problems for customers, and in turn for the industry that serves them."[340] **Presently, many areas of the long-term savings industry are struggling to offer returns that can realistically be expected to be much better than those available from a good deposit account, especially when allowance is made for the risks involved in most forms of long-term savings. This suggests that one of the main priorities for the long-term savings industry is to work out how it can deliver competitive returns to the saver. This is likely to require both the development of lower cost distribution mechanisms and a much greater emphasis on investment performance and asset allocation.**

113. Some in the industry are still reluctant to accept that the industry has acquired a poor reputation among its customers, or believe that any problems are purely cyclical and will disappear as the equity market recovers.[341] Mr Sandler, however, told us that while "there is still a long way to go", he did detect "some glimmers of hope that the industry is beginning to acknowledge that it has a reputational problem and is now taking steps to rectify that."[342] We note that the Association of British Insurers, for example, has launched the "Raising Standards" initiative. This is overseen by the Pensions Protection and Investments Accreditation Board, who told us: "the scheme is a voluntary initiative by the industry. Its purpose is to improve performance in the conduct of business, and to build consumer confidence in the long-term pensions, protection and investments industry. It aims to ensure: clear information in a consistent format, written in plain language, high standards of customer service, including complaints handling, and fair treatment of customers."[343]

114. The Committee welcomes voluntary initiatives such as "Raising Standards" from the long-term savings industry. They can have an important role in tackling the issues undermining consumer confidence. We also note that the ABI has commissioned a study of the "scope for a new generation of initiatives on customer service… looking particularly at best practice in other sectors."[344] There is always a risk, however, that in an industry as diverse and fragmented as the long-term savings industry improvements taking place in

338 FSA press release, 23 June 2003

339 See for example HC 71–II, Ev 310 para 6 and Q 302

340 HC 71–II, Ev 399

341 See for example HC 275, Ev 63 para 1.2 and Q337

342 Q 325

343 HC 71–II, Ev 382 para 3

344 ABI press release, 25 May 2004

one section will be undermined by a reluctance to change, or by difficulties arising, in another part. The FSA, for example, signalled to us that "for what was quite a specialised corner of the market, the damage to the reputation of financial services [from the problems arising in split capital investment trusts] generally has been quite great and quite disproportionate to the size of that particular corner of the business."[345] **Parts of the long-term saving industry are undertaking a range of voluntary initiatives, such as the ABI's "Raising Standards" scheme, to improve the quality of the service they offer their customers. The Committee welcomes such initiatives. Some other parts of the industry, however, still appear to be wedded to behaviour that does little to persuade the public that things have really changed. The risk of reputational contagion in an industry so reliant on consumer trust underlines not only the role for firm and effective regulatory enforcement but also suggests that the industry itself needs to be more proactive in identifying and tackling activities that damage its image.**

115. A range of witnesses highlighted the current lack of communication between the various parties involved in the long-term savings industry. The ABI told us that, in the area of pensions, it felt that there was a clear need for a "partnership embracing Government, consumers and their representatives, employers, trade unions, the financial services industry and its regulators, particularly the FSA."[346] More broadly, Prudential took the view that "it is essential that Government, the FSA, the financial services industry, employers, consumer bodies and commentators work together" with the aim, among other things, of creating "a stable long-term savings infrastructure that has cross-party support and ensures people feel it is worthwhile saving."[347] Similarly, the Association of Friendly Societies suggested to us that "the Government, regulators and industry must work closer together and that as an initial step a forum should be set up,"[348] in particular to look at the issues of improving access to long-term savings for the less affluent. **We are surprised that the industry currently fails to engage in serious dialogue on a regular basis with consumer bodies and other interested parties on issues such as pension reform, access for the less affluent or, indeed, general consumer confidence. This may well partly explain why the industry in recent years has seemed to limp from crisis to crisis. There is a need for the industry, the regulator and consumers to establish a collective, forward-looking joint agenda. This should particularly focus on how the industry can better serve its customers. We recommend the establishment of a broad ranging forum, including representatives from all parts of the industry, consumer groups, the FSA and Government. This should meet regularly with the aim of agreeing priorities, monitoring progress, giving early warning of problems that might be arising and putting pressure on laggards in the industry to catch up with best practice.**

116. Doubts about the solvency of any institutions in the long-term savings industry are extremely damaging to consumer confidence. The Treasury, for example, told us that confidence in pension saving "has been undermined by firms becoming insolvent with under-funded defined benefit pension schemes."[349] In response to this, the Government

345 Q 1885

346 HC 275, Ev 12 para 2.4

347 HC 275, Ev 165 para 9

348 HC 275, Ev 52 para 1.5

349 HC 275, Ev 131 para 45

has announced the introduction of the Pension Protection Fund. The Committee also notes the wide-ranging damage to confidence created by events at Equitable Life. The Financial Secretary told us of her confidence that the FSA's new proposal on realistic reporting "will make sure that the industry is on a sound capital base looking to the future."[350] The ABI told us that, while the details still needed to be clarified, "the broad thrust of the FSA's proposals has the support of the industry".[351] The ABI added that the FSA's proposals "ought to provide a secure basis on which the industry can conduct its business in the 21st century."[352] We note, however, Lord Penrose's conclusion that "constant review will be required to ensure that reporting requirements continue to focus on areas of current relevance to the exercise of regulatory powers."[353] **One of the key roles of regulators in the field of long-term savings is to ensure that savers can have reasonable confidence in the solvency of the institutions to which they entrust their money. We welcome recent improvements here such as the FSA's proposals on realistic reporting. Lord Penrose's warning that "constant review" is needed to ensure that the regulations are still relevant is nevertheless an important one. There is no scope for complacency when it comes to public trust in the solidity of savings institutions**.

117. Several witnesses told us there is "no magic bullet for restoring confidence".[354] The process is therefore likely to be incremental. For example, a requirement to provide better, readily accessible information about issues such as the risk of a product should both force product providers and others in the industry to think carefully about the nature of the savings products they offer and enable savers to assess more easily the suitability of any product. Often the suitability assessment by the consumer will be by way of a reality check on the advice they have been offered by a professional adviser.

118. At the heart of the question of advice to the consumer is the present business model of the industry which is heavily focussed on independent financial advisers who gain their rewards either from commission or fees. **We recommend that the industry should explore alternative arrangements for advice based on the industry's duty of care to the consumer.**

119. As well as those who would rather not have to seek advice, there are many who have no realistic access to advice even if they wanted it. Citizens Advice warned us "there are particular difficulties for those on low income in accessing suitable financial advice at a low cost. Distrust of financial advisers, not knowing how to find a suitable adviser and the cost of financial advice are significant factors for many consumers to put off seeking professional independent financial advice."[355] **Too often, the response of the industry, the regulator and the Government to problems in the long-term savings industry is to assume that everyone has access to trusted financial advice. This is unrealistic. The easier provision of financial advice for those who want it is an important goal. The Committee recommends that an important test for all retail product information, tax,**

350 Q 2082

351 HC 275, Ev 36 para 5.26

352 *ibid*., para 5.30

353 Penrose Report, HC (2003–04) 290, page 738, para 44

354 HC 71–II, Ev 296; but see also, for example, HC 272, EV 11, para 1.19 (ABI)

355 HC 275, Ev 76 para 4.2

pension and benefit rules should be: "is the average person likely to be able to understand this unassisted?" Material that fails that test is unlikely to help take the long–term savings industry into the 21st century. Complex and opaque practices and products have been allowed to persist for too long. The average consumer feels excluded because they simply do not understand what the industry has to offer them. There is an urgent need for the industry, regulator, Government and consumer groups to come together to establish a coherent forward-looking programme of reform for the long-terms savings industry, and the consumer has to be its central focus.

Conclusions and recommendations

Confidence in long-term savings

1. Long-term savings represent a £1,900 billion-plus market and are vital for the future prosperity of both savers and the wider economy. The government and the industry have a strong interest in encouraging saving. We note that the current savings ratio remains below the average over the past ten years. This Committee believes that individual savers ought to be best placed to decide how much and in what form they should be saving. To ensure that they are in a position to make such decisions, it is essential that savers can be confident both that they will be treated fairly by the long-term savings industry and that they will be given clear, readily accessible and factual information on savings-related issues. (Paragraph 13)

2. It is widely accepted that a lack of consumer confidence in parts of the financial services industry is now deterring many households from saving as much as they might otherwise choose to. This is likely to have significant adverse long-term consequences, not just for savers and the financial services industry, but also for the wider economy. The overwhelming weight of the evidence presented to us also suggests that a range of issues extending well beyond the recent fall in equity values has damaged consumer confidence in the industry. In consequence, it would be foolhardy for the industry or others to assume that a simple recovery in equity market conditions will be enough to restore the industry's reputation in the eyes of consumers. (Paragraph 18)

Improving product information

3. It became clear during the course of our inquiry that the current information on savings products provided to savers is sometimes not effective in allowing them to make an informed judgement as to the suitability of a product. There is a need for urgent action to re-balance the "asymmetries of information" in the financial services industry by improving the information available to consumers. (Paragraph 19)

4. One of the best ways of minimising the risk of mis-selling is to provide savers with clear, accessible and succinct information on the product so that they can judge its suitability for themselves. In addition, some savers may, for a variety of reasons, not want to use a financial adviser and we think it is important to respect the rights of individuals to make that choice in designing the regulatory framework. In the case of the less affluent, it may be unrealistic to expect them to pay for the cost of "one-on-one" financial advice. In these cases clear, accessible and succinct information on the product becomes essential. (Paragraph 20)

5. We challenge the industry and regulators to develop over the next six months a simple standardised Summary Box, brief enough to be displayed prominently in most marketing material. We would like all parties to report to us on progress here by the end of the year. The Summary Box might show: whether the client is guaranteed to get his money back, any other guarantees attached to the product, the risk rating of the product, what the investment is linked to, what the charges are and

if there are any penalties for early withdrawal. Such a Summary Box could make a significant contribution to the understanding of long-term savings products and considerably reduce the scope for mis-selling and mis-advice. (Paragraph 24)

6. The recent fall in equity markets has exposed the fact that some of those manufacturing or selling long-term savings products often have a poor understanding of the underlying risks inherent in them. Too often, therefore, savers have bought long-term savings products without any satisfactory explanation of the inherent risks. This is a problem increasingly widely acknowledged by the long-term savings industry itself. There is a need for urgent action to correct this situation. The Committee believes that a vital step in restoring confidence can be taken by developing a simple system of signalling the inherent risk level of a savings product. This should be suitable for inclusion in the "Summary Box" we have proposed for all savings products and it ought to be displayed prominently on the face of all marketing material. While we acknowledge that there are practical issues to be overcome in designing a summary risk measure and how it can be simply presented to the client, we were encouraged by the statements of the leading industry representatives who gave evidence to us. We welcome the commitment of both the industry and the regulator to work together to overcome these issues and we note the FSA's recent announcement that it has now commissioned work on this project. We would ask the regulator and the industry to report to us on progress here by the end of the year. In products where the risk characteristics may change over time, it is particularly important to give the client a clear indication of this, perhaps via regular updates. We recommend that the risk rating attached by the product provider to the product should be regarded as an important part of the sales advice given to the client. The industry should appreciate that, if such an indicator is implemented, it would provide an important safeguard against mis-selling. (Paragraph 30)

Aligning savers' and industry needs

7. That some companies are judged by authoritative outside observers to be exploiting consumers for perceived short-term gains while damaging the long-term reputation of the industry suggests that fundamental changes are needed to provide better alignment between the interests of the industry, at all levels, and consumers. (Paragraph 31)

8. The Committee recognises that ultimately the level of remuneration of senior management in the financial services industry is a matter for shareholders and, in the case of mutual societies, members. The recent trend in institutional shareholders becoming more active in challenging remuneration reports is welcome, and greater shareholder activism should be encouraged. Shareholders and the membership of mutually owned organisations can nevertheless only benefit from anything which helps restore consumer confidence in the industry; and we suggest that greater transparency in the determination of senior executive remuneration and a more direct linkage between remuneration and the performance of those institutions relative to market conditions and accepted benchmarks would be useful in this respect. (Paragraph 35)

9. In the Committee's view it seems likely that as long as most of the selling activity in the long-term savings industry is rewarded on a commission basis, many savers may remain suspicious that they are being sold a product for the wrong reasons. Shifting away from the current commission-based sales system common in much of the industry is likely to be a key component of any strategy to rebuild consumer confidence in the industry after the long catalogue of mis-selling scandals in recent years. (Paragraph 36)

10. The Committee welcomes the commitment from the ABI to assess the role of commission payments in the long-term savings industry and examine possible alternatives. We would emphasise the negative image created in the eyes of some potential savers by the current commission-driven distribution model. Account should also be taken of the extent to which the heavy cost burden of the current exhaustive regulatory regime reflects a need to offset the conflicts of interest created by payment by commission. (Paragraph 38)

11. The evidence presented to our inquiry suggests that the retail long-term savings industry gives insufficient weight to the issue of asset allocation and the investment returns it delivers to savers. The fee structure that currently dominates the industry primarily rewards the initial sale. A fee structure containing a stronger linkage to subsequent investment performance would help align more closely the long-term interests of the saver and the industry. (Paragraph 40)

Improving distribution: IFAs, fees and commissions

12. The gap that is apparent between the major companies and their ultimate clients is unhelpful when it comes to rebuilding consumer confidence in the industry, given that better communication with savers is likely to be an important part of the rebuilding process. IFAs now dominate the distribution of long-term savings products in the United Kingdom and the Committee recognises the positive role that many IFAs perform. The current reliance on IFAs as a means of selling financial services and advising potential savers nevertheless risks leaving a large segment of the population without effective access either to financial advice or to long-term savings products. This reflects the general focus of IFAs, for sound commercial reasons, on the more affluent members of the community. The fact that many potential savers have little or no regular access to advice needs to be recognised by regulators and the industry when communicating with the public. Planned reforms of the distribution of financial services should attach a higher priority to widening access to the financial services industry beyond the relatively affluent that are currently the main focus of IFAs. (Paragraph 44)

13. Full and open disclosure of fees and commissions in a manner that is readily comprehensible to savers and gives them a balanced view of the various options is a vital part of delivering an efficient market in financial advice and long-term savings products. The current proposals from the FSA fall short of this goal in several key respects. There should be no suspicion that an adviser might be able to steer a client towards paying commission that might add substantially to the client's advice bill, to the detriment not only of the client but also the more efficient and fairer operators in the advice market. It should be a basic requirement that each client should be given

an explicit comparison of the total cost, in cash terms, of buying a product on a fee basis and the total cost on a commission basis over the likely life of the product. (Paragraph 48)

14. For IFAs to receive trail commission whether or not they are providing any real on-going advice to the client is unacceptable. The persistence of this practice is a clear sign that the market for financial advice is not working in the best interests of consumers. The Committee urges the major product providers, IFAs and the regulator to limit urgently the basis on which trail commissions are paid in the financial services industry and to ensure that such payments only occur when the client is actually receiving the annual advice that such commissions are supposed to fund. Clients opting to pay for financial advice via fees should be given the explicit option of paying an annual fee for any on-going advice they receive rather than having trail commission paid from their investment. (Paragraph 50)

15. The Committee acknowledges the need for a measured approach towards reform of the financial advice market. Even so, given the potential failings we have identified in the proposed menu approach to reform, we ask the FSA and the industry to collect and publish regular data on the relative cost of buying major products on a fee and commission basis and the percentage of savers opting to pay via fees or commission. (Paragraph 52)

Improving distribution: self-regulation of IFAs and others in the industry

16. The Committee deplores the fact that a major trade body such as the AIFA has no code of ethics, particularly given the key role IFAs play in terms of the experience most consumers have of the long-term savings industry. Across the industry there is a danger that companies and trade bodies are abrogating their responsibilities in relying so heavily on the FSA to police and deliver good standards of behaviour. External regulation by a body such as the FSA should not be seen as a substitute for effective self-regulation within the industry via codes which react quickly and flexibly to problems as they arise. All the major trade bodies in the long-term savings industry should have clear codes of practice which take the standards of behaviour laid down by the FSA as a minimum but aim to improve on the FSA's requirements in those areas where the industry feels that better standards will do most to help its customer base. We call on the Association of Independent Financial Advisers to establish a code of ethics for its members, to monitor compliance with it and to establish a means of enforcement for members who do not comply. (Paragraph 55)

With-profits products

17. It is evident that in many instances savers are no longer content to allow the managers of with-profits funds wide discretion or to accept limited disclosure of the performance of the funds on which their savings depend. Many investors also do not understand the reasons for apparently large market value adjustment (MVA) exit penalties and consider they are unfair. It is not clear from the evidence presented to our inquiry that either the FSA's proposed reforms for existing with-profits funds—CP207—or the proposed disclosure requirements in the new smoothed investment Sandler products go far enough in terms of disclosure to satisfy consumer concerns

in this area. As long as investors cannot regularly see the performance of the underlying investment fund and can be subject to MVA exit penalties without clear explanation there may be consumer reluctance to re-enter this area of the long-term savings industry. Firms should be required to give a much clearer explanation of the scale of, and reasons for, any MVA exit penalty imposed. (Paragraph 58)

18. £160 billion is now invested in closed funds. This is an issue in that policyholders can often feel their savings are now trapped in policies offering lower prospects of growth. All the signs are that this problem will grow further in the future. The Committee recognises that a consolidation process among the many with-profits funds that have now closed to new business is both desirable and inevitable. It places the highest priority on the FSA ensuring that policyholders are treated satisfactorily through this process. They should not be confronted by punitive exit penalties and should receive a fair share of the efficiency benefits that will hopefully result from such transactions. (Paragraph 60)

19. It is still far from clear to the Committee that the actuarial profession can be relied on actively to alert the public in cases where policyholders' interests are being sacrificed in favour of the interests of management or shareholders. We welcome the Morris review of the actuarial profession and consider reform here to be overdue. Nevertheless, any recommendations made by Sir Derek are necessarily going to take some time to implement. In the meanwhile, a period of rapid change is taking place in the with-profits industry and many of the changes could lead to particular tensions between the interests of policyholders and the interests of managers and shareholders of with-profits funds. In the face of continuing doubts about the readiness of the actuarial profession to safeguard policyholders' interests through this period of change we consider it particularly important that the FSA scrutinises closely changes and transactions in the with-profits area and demonstrates to investors that their interests are being preserved. (Paragraph 62)

Sandler products

20. The Committee hopes that the basic advice process now proposed for Sandler products will go some way towards meeting the fears of consumer groups and others that the new simplified selling process would see large scale mis-selling with little prospect of consumer redress. We note that firms will still be expected to establish the basic suitability of a product for the client and that the client will have the right of appeal in any dispute to the Financial Ombudsman Service. The reduction in the consumer time taken for the sales process from several hours to a projected 40 minutes ought also to play a key role in widening access to the savings market. (Paragraph 66)

21. The Committee notes the 1.5% price cap set on the first ten years of non-cash Sandler products and notes also that the advice component of the new products is higher than that proposed by Mr Sandler when he recommended a 1% price cap. We are disappointed, however, that part of the charge is not more clearly linked to the investment performance of the products. Given that the higher charges for stakeholder pensions are explicitly for additional advice in the selling process, it would clearly be unfair for product providers to levy the higher charge on existing

stakeholder pension contracts. We expect the Government to monitor charges on existing contracts very closely as the new stakeholder charges are introduced. (Paragraph 71)

22. Regulated price caps for regulated products in the financial services industry serve the dual role of guaranteeing the client the price he will pay and putting additional pressure to improve efficiency on an industry where consumer weakness has reduced the normal competitive pressures to drive down costs. But caps set too low can reduce product range and stifle new product development, thus limiting real choice for consumers. Where such caps are to be set, it would be preferable if they were set by an independent body after clear and transparent analysis. The price cap should be consistent with fair returns to both savers and the most efficient producers in the industry but should maintain downward pressures on the cost base of less efficient producers. (Paragraph 73)

The FSA

23. The Committee agrees with the view of the overwhelming majority of witnesses that the current low level of confidence in the financial services industry is in large part a reflection of the weak regulatory framework and inappropriate industry practices that existed before the arrival of the FSA. (Paragraph 77)

24. The evidence we have heard in the course of this inquiry tends to confirm that FSMA is currently working well. Apart from in the limited area of money-laundering regulations, we received no specific complaints of excessively burdensome regulation from the major companies in the industry, while consumer groups generally acknowledged a significant improvement in the protection afforded to the consumer. We note, however, that both the industry and the regulator agree that the current money laundering regulations require simplification. (Paragraph 81)

25. Those accused of wrongdoing by the FSA clearly have a right to defend themselves at fair hearings. However, the length of time contested cases are taking to bring to a conclusion denies the public the speedy redress they have the right to expect in cases of wrongdoing. The fact that those under investigation have a right to anonymity reinforces the need to speed up enforcement actions. How this should be achieved should be addressed in the current review by the Government of the Financial Services and Markets Act 2000. (Paragraph 84)

The Financial Ombudsman Service

26. The Financial Ombudsman Service currently commands wide support among the industry and consumers as an inexpensive and speedy way of resolving disputes and achieving redress where redress is due. Introducing a general right of appeal into the Ombudsman process risks undermining confidence in a system which is currently working well. The Committee notes that the Chief Ombudsman sees substantial disadvantages in introducing any general right of appeal and that the major insurers are not pressing for such a right. While there may be scope to improve co-ordination between the FSA and FOS in certain cases with wide implications, the Committee believes that calls for a general appeals process should be resisted. (Paragraph 86)

Public knowledge of the FSA's role

27. Greater public knowledge of the FSA's role and activities in protecting their interests can only do good in terms of restoring consumers' confidence in the financial services industry after a chequered history of weak regulation and successive mis-selling scandals. We recommend that the FSA should now engage in a publicity campaign. The aim should be to ensure that potential savers are fully aware that underpinning the financial services industry there is an effective regulatory body ensuring that the industry treats its customers fairly. We welcome the recent launch by the FSA of a hotline for firms and the public to report misleading advertisements, but would observe that this is only likely to be effective if the public are regularly reminded by advertising of the hotline number and the FSA's role in regulating the financial sector. (Paragraph 90)

Tax & benefits

28. The Committee welcomes recent moves to simplify some aspects of the tax regime for pensions and long-term savings. It is important, given the sums of money involved from the Exchequer, that the tax reliefs and incentives granted to long-term savings are as effective as possible in achieving their stated objectives. The evidence we have received in the course of this inquiry suggests that there is substantial scope for improving the coherence of the present complex tax regime in promoting savings. (Paragraph 92)

29. The Committee welcomes the recent simplifications of the tax system surrounding pension savings and the additional flexibility this has introduced into the pensions market. The freedom to make annual pension contributions up to £215,000 a year is unlikely, even so, to have a significant impact on the attitude of younger workers and those on modest incomes towards pension savings. While the Committee accepts that savers should be discouraged from withdrawing cash from their pension schemes, except in times of emergency, granting more flexible access to pension savings during periods of unemployment or illness has proved effective overseas in improving the attractiveness of saving via a pension scheme. We recommend that the Government should examine the feasibility of such an option in the UK. (Paragraph 96)

30. The evidence we have heard on the workings of the Pension Credit highlights the need for the working of the new means-tested benefits system to be monitored closely. There still seems to be considerable uncertainty as to how many households could see deductions under the means-testing arrangements and the size of pension fund that is likely to attract benefits deductions. We recommend a detailed study of how the new system is working, which would considerably clarify the debate on how effective the new Pension Credit is at delivering benefits to those who need help while not penalising those who have attempted to make provision for their own future. (Paragraph 99)

Financial capability: consumer education, workplace advice, Citizens Advice Bureaux

31. The Committee found wide support from the industry and consumer bodies for the FSA's efforts to coordinate a programme aimed at improving financial literacy among consumers, alongside a general recognition that such work needs to be viewed as very long term and is unlikely to bear fruit for a generation. In this context it is particularly important to see work on improved consumer understanding of financial issues as an addition to, rather than a replacement of, efforts to make the information available to consumers on financial products clearer and more accessible. We also support the proposition—which we found to have wide general acceptance—that the financial services industry should make a substantial contribution towards the cost of any expanded programme aimed at improving financial capability. (Paragraph 102)

32. The workplace has strong advantages in delivering financial advice and services to savers, particularly those who are less affluent. It is deplorable that complex and poorly understood rules have until now hampered efforts to provide financial advice through the work place. We welcome the commitment given to us by the Minister to push ahead with reform here. We hope that in the future the workplace will develop as a popular delivery channel for a wide range of financial services. (Paragraph 106)

33. We welcome moves to review the regulations surrounding the provision of generic financial advice by voluntary agencies such as Citizens Advice Bureaux, but the issue of funding also needs to be addressed. If the current pilot scheme on the provision of financial advice via CAB offices proves successful, the whole of the financial services sector, including banks, credit card companies and the long-term savings industry, should support Citizens Advice's work in this area. (Paragraph 109)

Overall conclusions

34. The sheer scale, diversity and nature of the problems encountered by customers of the long-term savings industry in recent years show that the industry needs a thorough re-think of the nature of the products it sells, how it sells them and the "after-sales" service it provides to its customers. Regulators, the Government and other interested bodies can assist the industry through this process of reform, but our inquiry has made it clear that fundamentally what is needed is for the industry to recognise the problems confronting it and take responsibility for tackling them. (Paragraph 111)

35. Presently, many areas of the long-term savings industry are struggling to offer returns that can realistically be expected to be much better than those available from a good deposit account, especially when allowance is made for the risks involved in most forms of long-term savings. This suggests that one of the main priorities for the long-term savings industry is to work out how it can deliver competitive returns to the saver. This is likely to require both the development of lower cost distribution mechanisms and a much greater emphasis on investment performance and asset allocation. (Paragraph 112)

36. Parts of the long-term saving industry are undertaking a range of voluntary initiatives, such as the ABI's "Raising Standards" scheme, to improve the quality of the service they offer their customers. The Committee welcomes such initiatives. Some other parts of the industry, however, still appear to be wedded to behaviour that does little to persuade the public that things have really changed. The risk of reputational contagion in an industry so reliant on consumer trust underlines not only the role for firm and effective regulatory enforcement but also suggests that the industry itself needs to be more proactive in identifying and tackling activities that damage its image. (Paragraph 114)

37. We are surprised that the industry currently fails to engage in serious dialogue on a regular basis with consumer bodies and other interested parties on issues such as pension reform, access for the less affluent or, indeed, general consumer confidence. This may well partly explain why the industry in recent years has seemed to limp from crisis to crisis. There is a need for the industry, the regulator and consumers to establish a collective, forward-looking joint agenda. This should particularly focus on how the industry can better serve its customers. We recommend the establishment of a broad ranging forum, including representatives from all parts of the industry, consumer groups, the FSA and Government. This should meet regularly with the aim of agreeing priorities, monitoring progress, giving early warning of problems that might be arising and putting pressure on laggards in the industry to catch up with best practice. (Paragraph 115)

38. One of the key roles of regulators in the field of long-term savings is to ensure that savers can have reasonable confidence in the solvency of the institutions to which they entrust their money. We welcome recent improvements here such as the FSA's proposals on realistic reporting. Lord Penrose's warning that "constant review" is needed to ensure that the regulations are still relevant is nevertheless an important one. There is no scope for complacency when it comes to public trust in the solidity of savings institutions. (Paragraph 116)

39. We recommend that the industry should explore alternative arrangements based on the industry's duty of care to the consumer. (Paragraph 118)

40. Too often, the response of the industry, the regulator and the Government to problems in the long-term savings industry is to assume that everyone has access to trusted financial advice. This is unrealistic. The easier provision of financial advice for those who want it is an important goal. The Committee recommends that an important test for all retail product information, tax, pension and benefit rules should be: "is the average person likely to be able to understand this unassisted?" Material that fails that test is unlikely to help take the long–term savings industry into the 21st century. Complex and opaque practices and products have been allowed to persist for too long. The average consumer feels excluded because they simply do not understand what the industry has to offer them. There is an urgent need for the industry, regulator, Government and consumer groups to come together to establish a coherent forward-looking programme of reform for the long-terms savings industry, and the consumer has to be its central focus. (Paragraph 119)

Formal minutes

Monday 19 July 2004

Members present:

Mr John McFall, in the Chair

Mr Nigel Beard	Norman Lamb
Mr Jim Cousins	John Mann
Angela Eagle	Mr George Mudie
Mr Michael Fallon	Mr James Plaskitt
Mr David Heathcoat-Amory	Mr Robert Walter

Draft Report (Restoring confidence in long-term savings), proposed by the Chairman, brought up and read.

Ordered, That the Chairman's draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 4 read and agreed to.

Paragraph 5 read, amended and agreed to.

Paragraphs 6 and 7 read and agreed to.

Paragraphs 8 and 9 read, amended and agreed to.

Paragraphs 10 and 11 read and agreed to.

Paragraphs 12 and 13 read, amended and agreed to.

Paragraphs 14 to 17 read and agreed to.

Paragraphs 18 and 19 read, amended and agreed to.

Paragraphs 20 and 21 read and agreed to.

Paragraphs 22 and 23 read, amended and agreed to.

Paragraphs 24 to 29 read and agreed to.

Paragraphs 30 and 31 read, amended and agreed to.

Paragraphs 32 to 34 read and agreed to.

Paragraphs 35 and 36 read, amended and agreed to.

Paragraph 37 read and agreed to.

Paragraphs 38 to 40 read, amended and agreed to.

Paragraphs 41 and 42 read and agreed to.

Paragraphs 43 to 45 read, amended and agreed to.

Paragraphs 46 and 47 read and agreed to.

Paragraph 48 read, amended and agreed to.

Paragraph 49 read and agreed to.

Paragraphs 50 to 52 read, amended and agreed to.

Paragraphs 53 and 54 read and agreed to.

Paragraph 55 read, amended and agreed to.

Paragraph 56 read and agreed to.

Paragraphs 57 and 58 read, amended and agreed to.

Paragraph 59 read and agreed to.

Paragraph 60 read, amended and agreed to.

Paragraph 61 read and agreed to.

Paragraph 62 read, amended and agreed to.

Paragraphs 63 to 72 read and agreed to.

Paragraph 73 read, amended and agreed to.

Paragraphs 74 to 76 read and agreed to.

Paragraph 77 read, amended and agreed to.

Paragraphs 78 to 83 read and agreed to.

Paragraph 84 read, amended and agreed to.

Paragraphs 85 to 91 read and agreed to.

Paragraph 92 read as follows:

"The IMA also made a plea for "rational tax incentives" and pointed out that it was perverse that the main beneficiaries of some current tax incentives were higher rate rather than standard rate tax payers. Similarly Mr Bloomer told us "a review of the overall taxation system of savings would be worthwhile, because I am not sure the tax credits that are available always go the most effective way." The Financial Secretary acknowledged that the tax system had played a part in adding to the "asymmetry of information between the consumer and the provider." She also told us in the past "it has been almost impossible for the consumer to compare products because of different tax treatments," although she went on to note that she hoped the new Sandler suite of simplified products would make comparison easier for the saver. In addition, she told us that the UK now had "the most simple tax regime in the world applying to pensions." **The Committee welcomes recent moves to simplify some aspects of the tax regime for pensions and long-term savings. It is important, given the sums of money involved from the Exchequer, that the tax reliefs and incentives granted to long-term savings are as effective as possible in achieving**

their stated objectives. The evidence we have received in the course of this inquiry suggests that by better targeting and simplification there is substantial scope for improving the effectiveness of the current tax regime in promoting savings."

Amendment proposed, in line 11, after the word "pensions.' ", to insert the words "**The Government's current tax regime for savers is incoherent, complicated and confusing. Policy decisions since 1997 such as the withdrawal of advanced corporation tax relief on pension fund dividends, the scrapping of PEPs and TESSAs, the regulation of the stakeholder pension, and the failure to index-link the state pension to earnings have themselves undermined confidence in pensions and long-term savings.**"—(*Mr Michael Fallon.*)

Question put, that the Amendment be made.

The Committee divided.

Ayes, 3	Noes, 7
Mr Michael Fallon	Mr Nigel Beard
Mr David Heathcoat-Amory	Mr Jim Cousins
Mr Robert Walter	Angela Eagle
	Norman Lamb
	John Mann
	Mr George Mudie
	Mr James Plaskitt

Another Amendment proposed, in line 16, to leave out the words "**by better targeting and simplification there is substantial scope for improving the effectiveness of the current tax regime**" and to insert the words "**there is substantial scope for improving the coherence of the present complex tax regime**".—(*Mr Jim Cousins.*)

The Committee divided.

Ayes, 5	Noes, 4
Mr Nigel Beard	Angela Eagle
Mr Jim Cousins	John Mann
Mr Michael Fallon	Mr George Mudie
Mr David Heathcoat-Amory	Mr James Plaskitt
Norman Lamb	

Paragraph, as amended, agreed to.

Paragraphs 93 to 98 read and agreed to.

Paragraphs 99 to 102 read, amended and agreed to.

Paragraphs 103 to 105 read and agreed to.

Paragraph 106 read, amended and agreed to.

Paragraphs 107 and 108 read and agreed to.

Paragraph 109 read, amended and agreed to.

Paragraph 110 read and agreed to.

Paragraphs 111 and 112 read, amended and agreed to.

Paragraph 113 read and agreed to.

Paragraphs 114 to 117 read, amended and agreed to.

A paragraph—(*Mr Nigel Beard*)—brought up, read the first and second time, and inserted (now paragraph 118).

Paragraph 118 read, amended and agreed to (now paragraph 119).

Summary read, amended and agreed to.

Resolved, That the Report be the Eighth Report of the Committee to the House.

Ordered, That the Chairman do make the Report to the House.

Ordered, That the provisions of Standing Order No. 134 (Select committees (reports)) be applied to the Report.

Several Papers were ordered to be appended to the Minutes of Evidence.

Ordered, That the Appendices to the Minutes of Evidence taken before the Committee be reported to the House.

Several Papers were ordered to be reported to the House.

[Adjourned till Thursday 9 September at 9.15 am.

Witnesses

Tuesday 11 November 2003 [HC (2002–03) 1274–i]

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Mr Ned Cazalet, Cazalet Consulting, **Professor Philip Davis**, Brunel University **Ms Mary Francis**, The Association of British Insurers, and **Mr Christopher O'Brien**, Nottingham University Business School — Ev 1

Tuesday 2 December 2003

Ms Teresa Perchard, Director of Policy, Citizens Advice, **Ms Louise Hanson**, Senior Public Affairs Officer, **Mr Mick McAteer**, Senior Policy Adviser, Consumers' Association, and **Ms Ann Foster**, Chairman, **Mr Dave Watts**, Member, Financial Services Consumer Panel — Ev 26

Mr John Tiner, Chief Executive, Financial Services Authority, and **Mr Walter Merricks**, Financial Ombudsman, Financial Ombudsman Service — Ev 38

Thursday 22 January 2004

Mr Paul Myners, Chairman of the Guardian Media Group, and **Mr Ron Sandler**, Chairman of Computacentre Plc — Ev 48

Tuesday 27 January 2004

Mr Sandy Crombie, Group Chief Executive, Standard Life, **Mr Jonathan Bloomer**, Group Chief Executive, Prudential plc, **Mr David Prosser**, Group Chief Executive, Legal & General, **Mr Richard Harvey**, Group Chief Executive, Aviva plc, and **Mr Andy Haste**, Group Chief Executive, Royal and Sun Alliance Group plc — Ev 65

Tuesday 16 March 2004

Rt Hon Lord Penrose and **Mr Hugh Burns,** Equitable Life Inquiry — Ev 89

Ruth Kelly, a Member of the House, Financial Secretary, **Mr Phil Wynn Owen**, Director, Financial Services, **Mr Paul Kirkman**, Head of Savings and Investment Product Team and **Mr John Breckenridge**, Adviser, Savings and Investment Product Team, HM Treasury — Ev 99

Tuesday 27 April 2004

Mr Tom Ross OBE, President, Faculty of Actuaries **Mr Jeremy Goford**, President, Institute of Actuaries, **Mr David Strachan** Director of Insurance Firms, and **Mr Paul Sharma,** Head of Prudential and Accounting Standards, Financial Services Authority — Ev 116

Thursday 6 May 2004

Mr Richard Saunders, Chief Executive **Mr Lindsay Tomlinson** Chairman, and **Mr Simon Ellis**, Investment Funds Committee, Investment Management Association — Ev 141

Ms Christine Farnish, Chief Executive, National Association of Pension Funds — Ev 156

Tuesday 11 May 2004

Mr Paul Smee, Director General, **Mr Roger Sanders**, Deputy Chairman, Association of Independent Financial Advisers and **Ms Amanda Davidson**, Director, Charcol Holden Meehan — Ev 164

Mr John Jory, Deputy Chief Executive, Building and Civil Engineering Benefit Schemes — Ev 182

Thursday 20 May 2004

Mr Mick McAteer, Principal Policy Adviser, Consumers' Association, **Ms Ann Foster**, Chairman, Financial Services Consumer Panel, **Mr Nick Lord**, Head of Money Advice Strategy, National Association of Citizens Advice Bureaux and **Ms Jill Johnstone**, Director of Policy, National Consumer Council — Ev 188

Tuesday 25 May 2004

Mr Sandy Crombie, Group Chief Executive, Standard Life, **Mr Jonathan Bloomer**, Group Chief Executive, Prudential plc, **Mr David Prosser**, Group Chief Executive, Legal & General and **Mr Richard Harvey**, Group Chief Executive, Aviva plc, — Ev 208

Tuesday 8 June 2004

Mr Walter Merricks, Chief Financial Ombudsman, Financial Ombudsman Service — Ev 232

Wednesday 23 June 2004

Mr Callum McCarthy, Chairman and **Mr John Tiner**, Chief Executive, Financial Services Authority — Ev 243

Monday 28 June 2004

Ruth Kelly, a Member of the House, Financial Secretary, **Mr James Sassoon,** Managing Director, Finance, Regulation & Industry**, Mr Paul Kirkman,** Head, Savings & Investment Products Team**,** and **Mrs Caroline Barr,** Head of Retail & Financial Products and Distribution, HM Treasury — Ev 267

List of written evidence

(a) Written evidence printed in HC 275 (comprising written evidence received up to January 2004, published with the Committee's earlier Report on Endowment Mortgages)

Association of British Insurers (ABI)
- Preliminary memorandum Ev1
- Endowment mortgages Ev 3; 45
- Restoring confidence in long-term savings Ev 9

Association of Friendly Societies Ev 52
Association of Independent Financial Advisers Ev 49
Aviva
- Preliminary memorandum Ev 62
- Further memorandum on endowment mortgages Ev 68

Building and Civil Engineering Benefit Schemes Ev 70
Chartered Insurance Institute Ev 73
Citizens Advice Ev 75
Consumers' Association
- Endowment mortgages Ev 78
- Preliminary memorandum Ev 81
- Further memoranda on endowment mortgages Ev 85; 88

Financial Ombudsman Service Ev 93
Financial Services Authority
- Endowment mortgages Ev 95; 191
- Restoring confidence in long-term savings Ev 98

Financial Services Consumer Panel
- Endowment mortgages Ev 112
- Restoring confidence in long-term savings Ev 118

HBOS Ev 124
Help the Aged Ev 126
HM Treasury Ev 127
INVESCO Ev 132
Investment Management Association Ev 138
Legal and General Group
- Endowment mortgages Ev 156
- Restoring confidence in long-term savings Ev 150

Paul Myners Ev 157
National Consumer Council Ev 159
Prudential Ev 164
Royal and Sun Alliance Insurance Group Ev 175
Ron Sandler Ev 179
Standard Life
- Endowment mortgages Ev 181
- Restoring confidence in long-term savings Ev 191

(b) Written evidence printed in HC 71–II (written evidence received since January 2004)

Abbey National plc		Ev 286
Association of British Insurers (ABI):		
	Depolarisation	Ev 290
	The Menu	Ev 291
	Paying for advice	Ev 292
Association of Independent Financial Advisers		
	Commission charges	Ev 294
	Financial Services Compensation Scheme	Ev 294
	Code of Ethics	Ev 399
Association of Private Client Investment Managers and Stockbrokers		Ev 295
British Bankers' Association		Ev 298
Building and Civil Engineering Benefit Schemes		Ev 303
Building Societies Association		Ev 303
Chartered Insurance Institute		Ev 308
Citizens Advice		Ev 308
Consumers' Association		Ev 309
Equitable Members Action Group		Ev 320
Fidelity Investments		Ev 340
Financial Ombudsman Service		
	The role of the Financial Ombudsman	Ev 341
	Consumers sold endowment policies by IFAs pre 1998	Ev 344
Financial Services Authority:		
	Endowment mortgages secondary markets	Ev 345
	Actuarial issues	Ev 346
	Precipice bonds/ SCARPS	Ev 348
	Supplementary memorandum on actuaries at FSA	Ev 353
	Memorandum in advance of oral evidence on 23 June 2004	Ev 355
Financial Services Consumer Panel		Ev 357
HSBC		Ev 358
Investment Management Association		Ev 361
Lloyds TSB		Ev 377
National Association of Pension Funds (NAPF)		Ev 364
Pensions Protection Investment Accreditation Board		Ev 382
President, Institute of Actuaries		Ev 366
Prudential		Ev 388
Resolution Life Group		Ev 389
Zurich Financial Services		Ev 391

List of unprinted written evidence

Additional papers include the following, which have been reported to the House. To save printing costs they have not been printed and copies have been placed in the House of Commons Library where they may be inspected by Members. Other copies are in the Record Office, House of Lords and are available to the public for inspection. Requests for inspection should be addressed to the Record Office, House of Lords, London SW1 (Tel 020 7219 3074); hours of inspection are from 9:30am to 5:00pm on Mondays to Fridays. (Alternatively, inquiries may be made on 020 7219 1975.)

Justin Aaron

Association of Policy Market Makers

Aviva (21 May 2004 & 22 June 2004)

Paul B Bennett & Co

Berkley Berry Birch

British Bankers' Association (14 June 2004)

Burgess Wreford Limited

CitiSolutions

Endowment Claims (21 January 2004 & 16 March 2004)

John Flowers

Hartley Greatbatch & Co (4 February 2004 & 25 June 2004)

HBOS (17 June 2004)

Heather, Moor and Edgecomb Limited (28 January 2004 & 10 May 2004)

Justice in Financial Services

Legal and General (19 May 2004)

Marlborough Stirling

Prudential (20 May 2004)

Royal and Sun Alliance (20 May 2004)

Adam Samuel

Standard Life (19 May 2004)

Syndaxi Financial Planning

David Williams Training Limited

Stephen Wynn

List of Reports from the Treasury Committee since 2001

Session 2003–04

		Report	*Govt Response**
First Report	The Transparency of Credit Card Charges	HC 125	*HC 431, HC 761*
Second Report	Child Trust Funds	HC 86	*HC 387*
Third Report	The 2003 Pre-Budget Report	HC 136	*HC 478*
Fourth Report	Annual Report for 2003	HC 386	—
Fifth Report	Restoring confidence in long-term savings: Endowment mortgages	HC 394	*HC 655*
Sixth Report	The 2004 Budget	HC 479	*HC 654*
Seventh Report	The Administrative Costs of Tax Compliance	HC 269	*Awaited*
Eighth Report	Restoring confidence in long-term savings	HC 71	*Awaited*

Session 2002–03

First Report	National Statistics: The Classification of Network Rail	HC 154	*HC 550*
Second Report	The 2002 Pre-Budget Report	HC 159	*HC 528*
Third Report	Split Capital Investment Trusts	HC 418	*HC 651*
Fourth Report	The Handling of the Joint Inland Revenue/ Customs and Excise PFI Project	HC 184	*HC 706*
Fifth Report	Annual Report for 2002	HC 491	—
Sixth Report	The UK and the Euro	HC 187	*HC 1004*
Seventh Report	The 2003 Budget	HC 652	*HC 1028*
Eighth Report	Appointment to the Monetary Policy Committee of the Bank of England of Mr Richard Lambert	HC 811	—
Ninth Report	Appointment of Ms Rachel Lomax as a Deputy Governor of the Bank of England and member of the Monetary Policy Committee	HC 1011	—
Tenth Report	Inland Revenue Matters	HC 834	*HC 1181*

Session 2001–02

First Report	The 2001 Census in England and Wales	HC 310	*HC 852*
Second Report	Budget 2002	HC 780	*HC 1075*
Third Report	The Office of Government Commerce	HC 851	*HC 1217*
Fourth Report	Appointment to the Monetary Policy Committee of the Bank of England of Mr Paul Tucker and Ms Marian Bell	HC 880	—
Fifth Report	Banking, the Consumer and Small Businesses	HC 818	*HC 1218*
Sixth Report	The Financial Regulation of Public Limited Companies	HC 758	*HC 1219*
Seventh Report	Parliamentary Accountability of Departments	HC 340	*HC (2002–03) 149*
Eighth Report	Inland Revenue: Self Assessment Systems	HC 681	*HC 1220*
Ninth Report	Appointment of Sir Andrew Large as a Deputy Governor of the Bank of England and member of the Monetary Policy Committee	HC 1189	—

* Government Responses are usually received in the same session as the Report was published. Accordingly, the HC number refers to that session unless otherwise indicated.