

Financial Services Authority

Feedback Statement on DP19 -

Options for regulating the
sale of “simplified investment
products”

July 2003



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Annex 1: List of non-confidential responses

This Feedback Statement reports on the main issues arising from Discussion Paper 19: Options for regulating the sale of “simplified investment products”.

Comments or enquiries can be addressed to:

Steve Barclay
Conduct of Business Standards Division
The Financial Services Authority
25 The North Colonnade
Canary Wharf
London E14 5HS

Fax: 020 7066 9719

E-mail: dp19@fsa.gov.uk

It is the FSA’s policy to make all responses to formal consultation available for public inspection unless the respondent requests otherwise.

1 Executive summary

- 1.1 In January 2002 we published CP121 "*Reforming Polarisation: Making the market work for consumers*". Among the proposals contained in that CP was one that a differentiated sales regime might be developed for those investment products where the relative risk of consumer detriment was lower because of the features of the products. Subsequently, in July 2002, Mr Ron Sandler's Review was published in which he recommended the introduction of a suite of simplified investment products. Substance was given to those recommendations through a joint HM Treasury and Department for Work and Pensions consultation document "*Proposed product specifications for Sandler stakeholder products*", published in February 2003.
- 1.2 In parallel with that document, the FSA published its DP19, which took the ideas in CP121 and applied them in the specific context of simplified products. This Feedback Statement summarises the comments we received on Discussion Paper 19: *Options for regulating the sale of "simplified investment products*, published in January 2003, and our responses to those comments.
- 1.3 We publish this Feedback Statement alongside the policy response from the government to their Consultation Document: *Proposed product specifications for Sandler "stakeholder" products*, published in February 2003. The two papers form a stage in the process of drawing together work on key recommendations to the government and the FSA made by Mr Ron Sandler in his review.
- 1.4 The responses to DP19 broadly reflected two distinct themes. Those commenting from a consumer perspective were, properly, concerned about the risk that any reduction in the know-your-customer/suitability obligations currently governing all face-to-face selling of investment products, could result in extensive mis-selling or mis-buying. Most industry interests, however, saw the option of helping consumers make product choices through a sales process incorporating filtered questions as potentially promising. At the same time, in their responses to us and to government, most firms emphasised a reluctance

their responses to us and to government, most firms emphasised a reluctance to offer the suite of stakeholder products unless they could earn a reasonable return on capital and without the fear of a retrospective mis-selling review.

- 1.5 In the light of the feedback we have received, and our discussions with the various stakeholders in the sales process for simplified products, we continue to view a filtered questions approach to guided self-help for consumers as promising. Before we can formulate proposals as a basis for consultation, and make a balanced cost-benefit assessment, consumer research on the effectiveness of a filtered question approach is essential. We are commissioning such research, on the basis of the decisions the government has now made about the stakeholder product specifications.
- 1.6 This Feedback Statement gives updates on relevant thinking of the Financial Ombudsman Service and on actual and potential constraints arising from European directives. It also explains next steps, including a planned consultation by year-end, taking account of the consumer research results.

CONSUMERS

This paper will be of interest to consumers. The issues it discusses link mainly with our statutory objectives of securing appropriate consumer protection, promoting public understanding of the financial system, and maintaining confidence in that system.

2 Introduction

Background

- 2.1 In July 2002 HM Treasury published Mr Ron Sandler's report on the retail savings market¹. He recommended that government and the FSA should consider developing a suite of straightforward 'stakeholder' investment products carrying reduced market risk because of controls on their structure. The aim was to counteract what he saw as a market failure. In particular his concern centred on the availability of a wide range of complex products, which required relatively costly regulatory requirements over the sales process. This, he believed, acted as a barrier to the purchase of products by consumers who could benefit from straightforward, lower risk products. The FSA welcomed the Sandler Report and indicated that it looked forward to supporting government work on the design of a suite of stakeholder products.
- 2.2 In January 2003 we published Discussion Paper 19: *Options for regulating the sale of "simplified investment products"* (DP19). This set out our thinking about three broad options for regulating the sales process for stakeholder products²:
- self-help and warnings (Option 1)
 - guided self-help and warnings (Option 2)
 - focussed advice (Option 3)
- 2.3 The streamlining of regulatory requirements bearing on face-to-face selling of a suite of stakeholder products was one recommendation from Mr Ron Sandler's review of the retail savings industry.

1 Medium and Long-Term Retail Savings in the UK – A Review, July 2002.

2 H M Treasury issued a consultation document in February 2003 setting out proposed products to be included in the stakeholder suite. In this document we use the words "stakeholder product" synonymously with the term "simplified investment product" used in DP19.

- 2.4 DP19 developed a debate opened in our *Reforming Polarisation : Making the market work for consumers Consultation Paper* (CP121), of January 2002, about ways of differentiating regulatory requirements to reflect the lower risk profile of certain investment products. We also sought to build on the decision trees that we introduced in 2001 to help consumers decide whether a stakeholder pension would be the right choice for them without needing to take or pay for advice.
- 2.5 We also discussed in DP19 considerations bearing on consumer redress through the courts and the Financial Ombudsman Service (the FOS), and the potential future constraints that could be imposed by EU Directives³.
- 2.6 Since January 2003, we have held seminars in London, Edinburgh and Birmingham, in conjunction with the Treasury and in which the FOS participated. We have had further discussions with consumer and industry representatives including the Financial Services Consumer Panel, the Consumers' Association, the Association of British Insurers, and a wide range of individual firms.

Purpose and structure of the Feedback Statement

- 2.7 The primary purpose of this Feedback Statement is to summarise the comments received on DP19, and we are grateful to all who responded. Chapter 3 summarises the responses received to each of the questions in DP19, and Annex 1 lists non-confidential respondents.
- 2.8 The FSA has taken no decisions on the differentiated regulatory regime to govern the face-to-face selling of lower risk investment products, or what types of product could be sold through it. Safeguards in product design can bring lower risks and reduced complexity, which it is appropriate for the regulator to take into account in setting requirements for the selling process. Introducing streamlined regulation of the sales process for simplified lower risk products could be of particular help in reducing barriers to access to competitively-priced products for consumers with modest savings capacity. But there is the possibility of significant consumer detriment if in practice the streamlined approach leads to mis-selling or mis-buying of products that are a poor fit with consumers' needs. Avoiding this situation will depend on establishing an appropriate sales process for products that carry lower risk for consumers.
- 2.9 In parallel with the FSA consultation on DP19, the government has consulted about the kinds of investments that might be included in its suite of stakeholder products. Its Consultation on Sandler: '*Stakeholder*' *Product Specifications – Government Response*, published alongside this FSA

3 Several Directives bear on the Sandler proposals, in particular the Investment Services Directive, on which the European Parliament is due to vote in September 2003, the Insurance Mediation Directive and the Distance Marketing Directive.

Feedback Statement, now provides a clear reference case, in terms of product type and specification, enabling further work by the FSA. In doing that further work, including consumer research as mentioned in 'Next Steps' below, we shall take account of all the responses to DP19.

2.10 The government has set 1 April 2005 as the target date for the availability of the new suite of stakeholder products. The products for which it plans to set 'stakeholder' specifications are :

- a unitised medium-term product, with a maximum 60% equity content and structured as a unit trust/OEIC or a life insurance product;
- a stakeholder pension; and
- (a new proposal) a cash deposit product.

In September 2003 it plans a further announcement about linking the Child Trust Fund to the stakeholder concept.

2.11 The government's firmed-up specifications for products to be included in its stakeholder suite are subject to final adjustment depending on results from FSA's work on a differentiated regulatory regime for the sales process. Although straightforward products are already available on the market, it is crucial that only carefully-defined lower-risk products would benefit from the streamlined face-to-face sales process. Other, higher risk, products - for example those having the potential for exceptionally volatile returns through stepped links to stock market or commodity indices - would be excluded. Also, the addition now of a cash deposit product to the government's proposed stakeholder suite of products could facilitate take-up by consumers looking to save more, but who are unable to bear equity risk on those savings.

Next steps

2.12 Against this background, the FSA is able to plan its next steps. In the next stage of our work we shall also need to take account of announcements we expect shortly from the Inland Revenue and the Department of Work and Pensions. These will set the framework for consumers' decisions on whether to make long-term investments through a pension contract.

2.13 In DP20⁴ we reviewed Mr Ron Sandler's recommendations on how with-profits business should be structured and operated in the future. We intend to provide feedback on DP20 in the autumn of 2003, and will continue to discuss the role of a stakeholder with-profits product with the Treasury as part of this response.

4 DP20 Issues for with-profits business arising from the Sandler review, published in February 2003

- 2.14 In the light of the comments received, we are not discussing either Option 1 (self-help and warnings) or Option 3 (focussed advice) in more detail in this document. Option 1 does however look increasingly problematic as European debate progresses on relevant provisions of the Investment Services Directive. Option 3 has the potential to be used as the sole approach or as a complement to Option 1 or 2.
- 2.15 The key requirement now is work on how effective, in practice, an Option 2 approach could be in controlling the risks of significant mis-buying or mis-selling of equity-linked products in the stakeholder suite. Though - for the medium-term unitised product - performance risk will be reduced by capping exposure to the equity market at 60%, unsuitability risk will remain. As we pointed out in DP19 and as many respondents to the consultation have emphasised, significant numbers of consumers particularly in lower and middle income groups, should not be led into taking equity risk with what they can afford to lose. Hard information, based on detailed consumer testing, of how effective an Option 2 approach can be in limiting mis-buying/mis-selling risks for such consumers, is essential. With that, we will have a basis for FSA decisions on appropriate regulation of the sales process and for government decisions to confirm final product specifications and set the level and shape of a charge cap. We shall stay in close touch with government thinking on the charge cap as decisions on its level and form could affect product risk to some degree.
- 2.16 Filter questions are designed to identify those for whom a particular simplified product is likely to be an inappropriate choice. As a prior step, there should also be mechanisms to prompt consideration of debt management requirements and protection needs (such as life insurance for consumers with dependants).
- 2.17 Accordingly, we have commissioned consumer testing of a series of filter questions, reflecting Option 2 of DP19, examining the type and number of questions that consumers should be asked and whether different questions and processes are needed for different simplified products. We will publish the results of this consumer testing which we aim to complete in the autumn of 2003. Our aim is to publish a Consultation Paper, with draft rules and full cost-benefit analysis as required under the Financial Services and Markets Act 2000 (FSMA), by the end of this year.

3 Comments and responses

3.1 We received fifty-seven responses, of which five were confidential.

This chapter summarises the comments made and our responses to them.

Risk assessment

3.2 In DP19 we set out our assessment of the risks associated with the kinds of simplified products the government had said it wanted to introduce. In particular, we highlighted the prudential, bad faith, complexity/ unsuitability and performance risks that could still arise even from the sale of products whose specifications incorporated risk safeguards.

Q1: Do you agree with our assessment of the risks involved in selling the kind of simplified products recommended in the Sandler report? If not, what do you consider are the key risks to our objectives?

3.3 Most respondents agreed with our assessment. Several noted that government decisions on the specifications of products to be included in the suite, and on the level and application of capped management charges, would shape the level of risk. It was therefore too early to decide on the risks that would remain to be addressed in the marketing and sales process. Any ‘one size fits all’ approach to the regulation of simplified products was seen by one respondent as a risk in itself.

Prudential risk

3.4 A number of respondents commented on the potential prudential risk to firms from a cap imposed on the annual management charge that did not reflect the economics of finding consumers interested in buying and then seeing to them. They emphasised it would be financially irresponsible for firms to market products on which a reasonable return on capital could not be obtained over

a viable period of time. The possibility of few products being sold would have to be allowed for in assessing the cost of introducing the suite of products. The potential for consumers migrating from existing products to a new suite with lower margins would also have to be taken into account.

Bad faith risk

- 3.5 In respect of Option 1, several respondents expressed concern that, however much risk warnings were expressed in plain English, this still did not mean that consumers would read and take them fully into account in coming to their decisions. Others warned that self-certification by consumers that the warnings had been understood would provide little comfort to firms against claims of mis-selling. This is because it would be simply one of a number of documents signed at the point of sale and consumers might still have grounds to challenge the basis on which they had been invited to sign.

Complexity / unsuitability risk

- 3.6 A number of respondents suggested the key driver to risk mitigation is through improved and accessible consumer information. This was essential to achieving a better balance between the ‘power’ of the consumer compared to the provider. One respondent expressed concern that a ‘tick box’ approach to testing for unsuitability might not engage the consumer sufficiently in the buying process, and lead to disputes before the Ombudsman. There was general concern, heightened by the FSA research results on stakeholder pension sales, that many consumers would fail to understand, under an Option 2 or even an Option 1 approach, that they had received information and not advice.
- 3.7 A number of respondents were concerned about the interaction between stakeholder products and means-tested benefits. This interaction meant, for example, that they could become ineligible for means-tested benefits as a result of investing in a simplified pension product. Potential for shifts in policy under future governments was a further risk.

Performance risk

- 3.8 Standardised product specifications were seen by some respondents as making it easier for sales staff to explain the investment risk posed by the products, and therefore less confusing for consumers. Respondents also suggested that the Key Facts documentation should be reduced to no more than two pages to reflect the reduced risk and lighter regulation.
- 3.9 Other respondents expressed concern that product descriptors such as ‘simple’ and ‘transparent’, and the fact that the product standards will be set and imposed by government, may cause consumers to mistakenly see them as risk-

free. The risk of a perception amongst consumers that stakeholder products were 'government backed' was highlighted by results from FSA consumer research into the use of decision trees in the sale of stakeholder pensions, published in April 2003⁵.

Additional risk

- 3.10 Other risks identified included: a consumer not purchasing a product, so failing to address his or her needs and 'overbuying' simplified products when a more diversified portfolio would be more appropriate.
- 3.11 **Our response:** Our assessment as set out in DP19 appears to have recognised most risks to which respondents have referred. Clearly the risks associated with Option 1 are greater than those of Options 2 or 3. Most industry respondents supported the view that filter questions could significantly reduce the risks to consumers whilst offering cost savings compared with an Option 3 approach.
- 3.12 Respondents confirmed our view that a combination of consumer information, generic advice, and product disclosure are key drivers to mitigating risk. This is potentially important in helping consumers appreciate the risk/ reward trade-off associated with equity products.
- 3.13 As part of our follow-up to our consultation on improved point of sale product disclosure, undertaken through CP170⁶, we will continue to look at how Key Facts will be applied in relation to simplified products.

Options for change

- 3.14 In DP19 we outlined the main options for a differentiated sales regime, and discussed the scope for consumer redress from the Financial Ombudsman Service together with the potential constraints posed by European Directives.
- Q2: Do you agree that these are the main options open to us for devising an appropriate sales regime for the kind of simplified products recommended in the Sandler report? If not, what other option should we consider?
- 3.15 Most respondents agreed that the three options described in DP19 reflected the issues and how they might be addressed through regulation. Some respondents supported a combination of features in each of the options, in particular a combination of Options 2 and 3. Two industry respondents expressed the wish to be free to choose which option they applied, depending

5 Two fifths of investors (41%) felt there were no risks inherent in buying a stakeholder pension. This was mainly because they were wrongly seen to be "backed by the Government" (25%), which in turn was felt to provide guarantees over the safety of money invested (10%) and returns (5%).

6 CP170 *Informing consumers : Product Disclosure at the point of sale*, published in February 2003.

on the product and distribution channel. Some respondents suggested a fourth option, which would be to apply the current regulatory regime in full to the selling of simplified products.

- 3.16 A number of respondents, particularly those commenting explicitly from a consumers' point of view, saw none of the three options as suitable. The Financial Services Consumer Panel expressed the view that any relaxation of the current regulatory regime would result in a real risk of mis-selling. The prospect of even limited mis-selling was seen by several respondents as likely to be of significant concern to professional indemnity insurers.

Distribution channels

- 3.17 A few respondents, whilst agreeing with the description of the options, emphasised the importance of the workplace as a means of distributing stakeholder products. This particularly applied to encouraging employees to join a pension scheme to which the employer was contributing.
- 3.18 The importance of the sales regime facilitating a range of distribution channels was emphasised by a number of respondents, in particular the use of telesales but also the Internet, supermarkets, and Post Offices. One respondent suggested that there should be no distinction in FSMA regulations between real time and non-real time financial promotion for the new suite of products. Another was concerned that firms would restrict distribution through appointed representatives, who will be required to have just the one principal for investment business.

Other options

- 3.19 Alternative solutions for providing generic advice were proposed. One of them was the establishment of a National Financial Network, with regulation recognising that different advice should reflect different product complexity. Another respondent, drawing a parallel with other industries, suggested that suppliers should bid for an exclusive national franchise to sell products in the stakeholder suite via a non-advised sales process.
- 3.20 Some respondents suggested that those selling products in the stakeholder suite should also be able to sell products with similar low risk characteristics but which were not included in the suite, such as protection products and general insurance.
- 3.21 **Our response:** We are satisfied that the three options described in DP19 represent the potentially appropriate ways forward within the scope of the FSMA.

3.22 We acknowledge the concerns expressed by consumer groups and independent financial advisers that only full advice can completely address the issue of suitability. As an important element of its work on consumer understanding and information, the FSA is carrying forward development of the 'generic financial healthcheck' software designed to help consumers analyse their own needs on an assisted basis. However, to insist that all face-to-face selling of even straightforward products be undertaken with full advice, has a downside. Specifically, limiting the ability of firms to reach consumers having only modest amounts to invest serves as a barrier to some consumers buying products from which they would benefit. The case for carefully-designed regulatory requirements governing a new process for controlled-risk straightforward products merits further work. This must be rooted in careful testing of how effective such a process could be in preventing unsuitable sales and in providing a route for additional sales meeting consumer needs.

Scope for consumer redress:

3.23 In DP19 (paragraphs 4.28 to 4.33) we discussed the way in which the nature of consumers' recourse to the FOS might be affected by the introduction of simplified regulatory requirements to be met by firms in selling simplified, lower-risk products. A number of respondents, including all the principal consumer groups, made clear their view that consumers should continue to have full access to the FOS. By contrast, some industry respondents were concerned at the possibility that rulings by the FOS could in practical terms become a way of re-introducing suitability requirements even under an Option 1 or Option 2 approach. The result could then be an unwillingness to market simplified products other than with full, and relatively expensive, advice based on detailed inquiry into each consumer's financial circumstances and future needs. Against this, however, the ABI expressed confidence that the FOS would judge sales of Sandler products against the appropriate standards rather than against the standards expected for current advised sales of investment products.

3.24 **Our response:** No overriding case has been made for making complaints about the selling of simplified products ineligible for consideration by the FOS. The FOS has pointed out that it has extensive experience of dealing with complaints about other financial products sold without advice or suitability requirements. In practice, the FOS's chief concern would be restricted to circumstances where the consumer had been actively misled, always provided that relevant risk warnings and filter questions had been properly applied in the sales process. The restricted scope of the legal duties of firms would be reflected in the FOS's approach.

EU Directives

- 3.25 We highlighted in DP19 the fact that a number of EU Directives affect the concept of simplified products sold through a streamlined process, in particular the Investment Services Directive (ISD), the Insurance Mediation Directive (IMD), and the Distance Marketing of Consumer Financial Services Directive (DMD). These Directives impose requirements on interaction with the customer during the sales process, and the scope to de-regulate that process is constrained accordingly. We expect to publish a Consultation Paper on the IMD in September 2003 and a Consultation Paper on the DMD in July 2003.
- 3.26 A number of respondents expressed concern that European legislation, the ISD in particular, would restrict any reduction in the regulation applied to the simplified sales regime.
- 3.27 **Our response:** The European Parliament is due to vote on the ISD in September 2003. The ISD is set to impose know-your-customer and suitability obligations on firms when providing investment services, but these obligations will depend on the type of service being offered, the retail or professional nature of the customer and the complexity of the product. It will apply to stocks and shares, money market instruments, collective investment schemes and most derivatives. The scope of the ISD remains to be finalised but is expected to cover activities in relation to units or shares in a collective investment scheme but not life policies. The Directive will be unlikely to apply to collective investment schemes which market their own shares directly to consumers (whether on an advisory or execution-only basis. The Directive should therefore deliver a calibrated conduct of business regime that distinguishes between non-advisory, advisory and portfolio management services.
- 3.28 A sales process involving filter questions might also be accompanied by advice on the merits of a consumer buying a particular product. A sales person as well as taking a customer through the filter questions may also seek to persuade a customer to buy a product. Article 18 of the ISD has yet to be finalised, but we consider that a properly designed filter question approach could be a way of meeting the ISD requirement for a limited suitability assessment before the sale of an investment product. This is less likely to be met under an option 1 approach which would also involve seeking to persuade a customer to buy a product.
- 3.29 Alongside any differentiated regime for the face-to-face selling of stakeholder products, sales will also be possible by execution-only, direct offer financial promotion, or with full advice. Execution-only simplified products would not be covered by the ISD's requirement for a form of suitability assessment as this will not involve seeking to persuade a customer to buy a product. The UK's policy intention is that the Directive will not be worded so as to prevent or restrict the sale of simplified investment products by execution-only or direct offer financial promotion.

- 3.30 The IMD applies to insurance contracts, including life insurance investment contracts. It includes life and pensions products but not unit trusts, and applies only to intermediaries as opposed to the life office itself. Article 12 of the IMD requires a 'demands and needs' statement to be provided to the customer. The scope of this statement remains to be finalised. Depending on the complexity of the contract, this could simply require a record of the path taken through a decision tree, or a more rigorous statement of suitability.
- 3.31 We are required to implement the DMD by October 2004. The DMD relates to financial services generally and applies to 'distance contracts'. These are where there is no 'simultaneous physical presence' of the supply and retail consumer in the offer, negotiation and conclusion of a contract.
- 3.32 Following our Discussion Paper 21 published in March 2003⁷, we intend to issue a Consultation Paper in early 2004 to make rules, giving time for firms to make systems and other changes before October 2004. Under the DMD, we must require firms to provide the 'consumer' (i.e. an individual) with specified, and reasonably comprehensive, information about the supplier and product or service, before a distance contract is concluded. Firms are also required, in most circumstances, to give these consumers the right to cancel a distance contract during a cooling-off period (30 days for life assurance products, 14 days otherwise).

Choice between the options

- 3.33 In publishing DP19 we set out some initial comments on how we saw the choice between the three options described and expressed a view that Option 2 appeared the most promising. We also indicated that our understanding of the stakeholder products to be included in the suite by the government left us unconvinced of the need to adopt the principle of RU64⁸. As carried forward into the FSA's Conduct of Business Sourcebook, the RU64 requirement is that a personal pension is not sold unless the firm is satisfied on reasonable grounds that the pension scheme is likely to be at least as suitable as a stakeholder pension scheme, and must record why it thinks this is justified.

Q3: Do you have comments at this stage on what appears the most appropriate way forward?

- 3.34 Responses on the most appropriate way forward largely fell into two camps. Banks, insurance companies and building societies supported the adoption of Option 2, as offering both the opportunity to reduce the risk of mis-selling whilst also providing the prospect of cost savings by distinguishing the regime for simplified products from the full advice regime as embodied in the current rules.

7 Implementation of the Distance Marketing Directive, published in March 2003.

8 The Personal Investment Authority issued guidance in March 1999 in Regulatory Update 64.

- 3.35 Against this other respondents, in particular consumer representatives and those representing independent financial advisers, felt suitability could only be addressed by a full factfind. Or they felt that Option 3 should be adopted as best matching the consumer expectation that they will receive advice.

Option 1

- 3.36 Few respondents supported Option 1, which generally was considered to offer insufficient protection to consumers. Most respondents felt consumers would need more than simply information and warnings, which could be misunderstood. They also emphasised the scope for salespeople to play down the importance of warnings, and use consumer self-certification mechanisms as a means of protecting the firm at the expense of the interests of the consumer.
- 3.37 Those respondents that did support Option 1, argued that it was the only option consistent with the aspirations behind Mr Ron Sandler's original recommendation. However, a number of firms disputed the suggestion that Option 1 offered significant cost savings compared to Option 2, as they made it clear that they would introduce self-regulation to guard against reputational and legal risk. It was also suggested that Option 1 implied a market of consumers with some degree of financial knowledge and awareness, which might not be reflected in the target market as identified by the Treasury.

Option 2

- 3.38 The majority of industry respondents agreed that Option 2 had potential, and suggested that this would repay more detailed work as to the design and use of filter questions. They emphasised that these questions needed to be short and that it should be possible to complete the sales process in as little as 30 minutes. Most supporters of Option 2 said that the filter questions needed to be prescribed by the regulator, partly to provide greater certainty against the risk of a retrospective mis-selling review.
- 3.39 There was some concern that filter questions about consumers' debt might prevent those with any level of debt from investing in a simplified product. In practice that could well rule out much of the target market. Many consumers were willing to save provided their debt was manageable. Whilst logically the financial priority is likely to be to repay outstanding debt before saving, in practice consumers dissuaded from saving could well spend rather than apply the money to reducing their debts.
- 3.40 A number of respondents emphasised that it should be possible for consumers to be taken through the filter questions on the telephone, or on-line with access to a telephone helpline. They also suggested that different filter questions would be required for different products. Notably, it was suggested that a limited set of questions would be unlikely to cover consumers' circumstances properly.

- 3.41 Some respondents queried at which point filter questions should be applied in the sales process. Some suggested that there should be a backstop to filter out a particular product from a specific provider, rather than enabling the consumer to choose the type of product they needed. This was seen as linking in with the FSA's Financial Healthcheck, which would help the consumer to identify their saving and investment needs before completing the sales process to decide which specific product to purchase.
- 3.42 Critics of Option 2 were concerned that this could provide least protection to the least affluent consumers. Switching off the know-your-customer/suitability obligations, with a corresponding restriction then on the right to seek redress through the FOS, would, they suggested, create an unacceptable risk to consumers and an incentive for firms to mis-sell. Consumers would not understand the limited scope of Option 2 and would consider they had been given advice. These respondents advocated either Option 3 or the application of the current full advice regime.

Option 3

- 3.43 Option 3 was seen by a significant minority of respondents - including those representing IFA interests - as most closely matching consumers' expectations. It would be more time-consuming to apply in practice, but could be more likely to secure more sales. Respondents argued that a minimum of Option 3 would be necessary to avoid liability of firms for future mis-selling, although some regarded even that option as posing unacceptable risks. In particular, a distinction was drawn between general financial planners providing general financial healthchecks and specialist financial advisers providing detailed advice on complex products.
- 3.44 Opponents of Option 3 however see it as a 'no change' option, given that focussed advice is already permitted in the conduct of business rules. It was fundamentally different from the regulatory regime envisaged by Sandler, and over time would become indistinguishable from current regulatory requirements. Respondents suggested it would not be commercially viable for them to market charge-capped stakeholder products under such a regime.
- 3.45 We said in DP19 that we were unconvinced of the need to adopt the principle of RU64 pending the introduction of the stakeholder products. Most respondents who commented on the issue agreed. However consumer representatives were concerned that firms might continue to recommend more costly products to consumers who took advice.

- 3.46 **Our response:** We continue to regard Option 2 as the most promising for consumers and the industry, and will consider this further in the light of our consumer research and the cost-benefit analysis that it will enable.

- 3.47 Based on the products the government intends to introduce as part of the suite of stakeholder products, we remain unconvinced of the need to apply RU64 principles.

Preliminary cost-benefit analysis

- 3.48 In DP19 we outlined a preliminary, high-level analysis of the benefits and costs of the three broad options for regulating the face-to-face sale of simplified products. We also highlighted the wider regulatory issues bearing on the development of a lightly regulated sales regime, in terms of training and competence requirements, the impact on rules and guidance in the handbook, consumer information and education, supervision, and authorisation.

Q4: Do you have any comments on the costs and benefits and wider regulatory issues identified at appendices A & B?

- 3.49 Of those who responded, a majority felt that it was premature to assess cost structures associated with the sale of simplified products. A few respondents said that whatever costs are imposed on firms, the regulator should have regard to the competitive implications of non-UK firms, or UK firms with a European parent. It was also emphasised that, in considering the impacts of the changes on distribution reach, the costs associated with our regime were only one part of the total costs of the industry. A price cap set by the Government would also have a significant role to play in determining the economics of provision.

- 3.50 **Our response:** At the cost-benefit analysis stage, we will necessarily have to take the introduction of stakeholder products, with relevant standards prescribed by the government, as a given and therefore our cost benefit analysis will not include evaluation of the introduction of stakeholder products itself. Specifically, we will take the current situation – that packaged investment products, including stakeholder products when they become available, can only be sold through direct marketing/execution-only or, face-to-face, with full advice with its associated obligations (e.g. know your customer, suitability) – as the relevant counterfactual. We recognise that the overall economics of stakeholder products will be affected not only by the costs associated with the regulatory regime, but also by other costs of manufacture and distribution (e.g. marketing costs) and also by any price cap set by the Government. But we focus on the impact of changes to the advice regime.

- 3.51 In carrying out our analysis, we have identified the following factors as being crucial to understanding the main costs and benefits of the new regime:

- To what extent existing purchases of packaged saving/investment products (i.e. purchases of packaged products⁹ that would take place even if there were no lighter touch regime) will shift to stakeholder products as a result of there being a simplified advice option.

⁹ But in the absence of the lighter touch regime, consumers are unlikely to be sold or purchase a stakeholder product because of providers' reluctance to supply.

- To what extent there may be increased purchases of packaged saving/investment products due to increasing accessibility of stakeholder products under the proposed lighter touch regulatory regime.
- To what extent there will be cost savings under the proposed lighter touch regime, specifically:
 - what the reduction in selling time will be under the proposed lighter touch regime (compared with the current full conduct of business regulatory regime with its associated 'know your consumers' and 'suitability' requirements)
 - what the saving in salaries and training will be under the proposed lighter touch regime (compared with the current regulatory regime with its FPC3 requirements)
 - to what extent mis-selling and/or mis-buying may occur under the proposed lighter touch regime (compared to the relevant counterfactual), and what the potential consumer detriments will be in the event of any increased mis-selling and/or mis-buying.

3.52 We expect that the stakeholder product market will be larger under a differentiated regime than under a continuation of the current regime. This market will consist of two elements: existing purchases of packaged product and potential new purchases of packaged products. These two elements have somewhat different counterfactuals, e.g., for existing purchases, the comparison is against selling stakeholder products under the full advice regime, while for incremental purchases, the appropriate comparison for CBA purpose is against no sale of packaged products. We will examine the cost-benefit implications for these two elements separately.

Wider regulatory issues

- 3.53 A number of respondents welcomed the opportunity that a simplified sales regime could offer for training advisers as a stepping stone on the career path to becoming a fully qualified adviser. Most respondents called for the *training and competence* regime to be flexible rather than prescriptive with specific examinations. Requiring qualifications would add costs, in particular through higher salaries. One respondent suggested the level that should be required for salespeople in a simplified sales regime is that used for introducers, rather than the level currently applied for stakeholder pensions. Some suggested training standards should also be aligned with general insurance and mortgage proposals, so that salespeople could sell a wider range of products.
- 3.54 Other respondents saw the risk of mis-selling increased by allowing unqualified salespeople to sell simplified products, not least as they would be reluctant to reveal the limited scope of the service they offered and refer consumers elsewhere for more suitable non-stakeholder products.

- 3.55 Respondents generally supported a set of stand-alone *rules* for the sale of simplified products to be separately identified within the FSA Handbook of rules and guidance, to make the regime easier for their sales staff to understand and follow.
- 3.56 Several respondents recognised that it is still an early stage for the regulator to set out how we will support the suite of products through *consumer education*, although one respondent advocated providing a leaflet setting out the positive features and risks of simplified products. Others noted that whilst consumer education would be beneficial, it would take time to become apparent on the level of sales.
- 3.57 A few respondents requested clarity regarding how the FSA's *supervision* and *authorisation* regime would work, in particular whether any distinction would be drawn for telesales compared to face-to-face sales. However most respondents did not comment on these wider regulatory issues.
- 3.58 **Our response:** We will work with the Skills Council in setting the Training and Competence standards to apply to the sale of simplified products.
- 3.59 In its parallel Feedback Statement, the government explains that it is considering the most appropriate means for setting down by regulation the specifications of the suite for stakeholder products. We are liaising with the government and other parties including Occupational Pensions Regulatory Authority (Opra) about supervising firms compliance with the stakeholder standards.

List of non-confidential responses

Association of Independent Financial Advisers
Abbey National
Association of British Insurers
Aegon
Alliance for Finance
AMP
Association of Private Client Investment Managers & Stockbrokers
Association of Friendly Societies
Baigrie Davies
Baxter & Lindley
British Bankers Association
Building Societies Association
Mr Ross Carter
Close Fund Management
Consumers' Association
Co-operative Insurance Society
Egg
Faculty and Institute of Actuaries
Family Assurance Friendly Society
First Direct
Foresight
Friends Provident
Financial Services Consumer Panel
Financial Services Small Business Practitioner Panel

HBOS
HSBC
Investment & Life Assurance Group
Investment Management Association
Insight Investment Management
Investment By Design
Lambeth Building Society
Legal & General
Life Insurance Association
National Consumer Council
Norwich Union
Pep & ISA Managers Association
Prudential
PricewaterhouseCoopers
Mr Brian Rooney
Royal London
Sainsbury's Bank
Mr Adam Samuel
Skandia Life Assurance
The Society of Financial Advisers
Standard Life
Swiss Life
Trinity Financial Management
UK Social Investment Forum
Virgin Money
Mr Stephen Walker
Wesleyan Assurance Society
Zurich

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The Financial Services Authority
25 The North Colonnade Canary Wharf London E14 5HS
Telephone: +44 (0)20 7066 1000 Fax: +44 (0)20 7066 1099
Website: <http://www.fsa.gov.uk>

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