

Simple financial products:  
a consultation

## APATHY AND ANALYSIS PARALYSIS - IS THIS THE ANSWER?

### Introduction

The Government – the ‘new’ one – has published a **Treasury Consultation Paper regarding ‘Simple Financial Products’**. It says that for many people, **financial services are confusing** but that this is not surprising when there are over 2,000 savings products on the market from 150 providers.

**They believe that a vast array of choice is not always a good thing** saying that complexity can cause confusion and inaction.

Along with the new **Consumer Protection and Markets Authority (CPMA)** to act as a consumer champion, they have asked the **Consumer Financial Education Body (CFEB)** to deliver a **National financial advice service**. Included in the approach will be a **new financial healthcheck that they say will help people to take a holistic view of their finances and advise people how to manage their money better**, as well as looking at the types of products they will need and where to get further advice.

While **the healthcheck may advise someone to save**, and show them how they can do it within their budget, they **do not believe it will not solve the issues of complexity and too much choice**.

The Government believes that there is a **compelling need for the financial services industry to offer a range of simple products**, both to help consumers understand the choices they face, and to provide a benchmark against which all consumers can compare the many thousands of other products in the market as **RU64 has caused in the use of ‘Stakeholder’ as a benchmark for comparisons**.

### Past Experience and Research findings

**The Government says that it has learned the lessons from previous simplified financial products**, particularly that **it does not want to design these products**, nor cap the charges that product providers can charge. **Competition between providers should ensure that there is healthy competition on price, service, and customer experience** and they feel that **further development of simple products should be led by the industry and consumer groups**.

Although effective competition should lead to better products and services for consumers, there is a concern that **a lack of effective information and explanation can lead to consumers buying products that are not right for them** or that they are so uncertain of what to do that they simply withdraw from making a decision.

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**Marginally different features between products can hinder effective direct comparison** and the FSA found in a 2007 survey that **over two thirds of people hate shopping for insurance** (as a broad category). They discovered that more **than half found it too complicated to compare insurance products** with almost half claiming that they didn't know if they were getting a good deal.

GfK NOP research also found that consumers feel a lack of interest and engagement with financial matters and that **they do not feel fairly treated by the industry**. Consumers fear not making effective decisions or not having found the hidden 'catches' when purchasing products and that in the end **people have a bias towards sticking with the status quo when they are uncertain of what action to take**.

Some consumers have raised **issues regarding trust with comparison websites**, for example whether commission is a factor in the product ranking that is displayed. However, the GfK research also found that consumers generally found such website to be a reasonable trade-off between time and cost. Indeed, some **37% of consumers say they are likely to use a comparison site in the future** and that still leaves room for growth.

There is an acknowledgment that **some people rely on friends and family for advice**. According to the ABI over a quarter of consumers (26%) say they would go to their friends and family for advice on buying a financial product. However, whilst they can be a useful source of information, they are **unlikely to offer the best advice in most situations**.

There are some **noticeable gaps in product holdings, particularly savings and protection**.

Around a quarter of households in the UK have no savings provision. In 2006, Scottish Widows noted **that almost half of households in the UK (48%) had the equivalent of less than one month's salary in savings, with 27% of households apparently having no savings at all**.

**The life assurance 'Protection gap'** - defined as the difference between what they should ideally have in place to cover their protection needs and what they do have - has been estimated by Swiss Re to be in the order of £2,400 billion (by sums assured). While some have rejected holding insurance and others are unable to afford it, the fact remains that many people remain unprotected or under-protected.

**Some of the main findings from the review of previous simple product initiatives were:**

- **Previous initiatives did not have a significant impact on their original objectives of increasing take up** of products amongst people on low to medium incomes, and amongst those with limited experience of financial services.
- Price caps, when combined with free transfers in and out and low levels of funds invested, meant that **the products were less attractive for providers**. As providers were free to offer non-capped products, they often made the decision not to offer CAT standard or stakeholder products.
- **Consumers have benefited from lower prices due to the charge cap**, particularly for pensions, in part due to the **'RU64' rule that required advisers to compare their recommended pension product against a stakeholder version**.
- The **basic advice regime created by the FSA for selling stakeholder products was too expensive** to make the products profitable for providers. Firms were also concerned that, in the event of a

**mis-selling claim**, they **would be judged under the principles of full advice rather than basic advice**. Consumers also had low awareness of what basic advice provided.

- Among consumers there was **not enough demand to make products a success**. This was in part because the initiatives did not catch consumers' attention and partly because firms had no incentive to market or sell products to consumers. For example, many consumers had not heard of CAT standards and did not know if the product they had bought met these standards or not.
- However **consumers like the broad concept of simple products** and there does seem to be a place for simple products in the market.

## Objectives

The Government believes that **simple products should be designed to be as straightforward as possible** in order to aid consumer understanding of the different features of each product. They should also help consumers to compare simple products from different providers. It is not the Government's intention that **simple products should restrict consumer choice - it believes that they should sit alongside existing products** similar, for example, to supermarket ranges which carry labels like 'essential' or 'basic'.

In the past, AT8 has used the analogy of using a top of the range BMW or a cheap and basic TATA Nano in order to get from A to B. One will get you there in more style and comfort, but both vehicles will get you to your destination and that it is better to have made the journey even in a more basic fashion than not to have made the journey at all. In the same way simple products in Financial Services can have a role to play for some people.

The Government believes that **simple products should be developed so that they deliver against three clear objectives**

- To ensure that people understand the products they need
- To help people make better choices
- To encourage competition in the market

The Government has **no plans to mandate the development of simple products**, or to require that all providers supply a simple product option; indeed, it believes that simple products should be a **wholly voluntary initiative**. It also recognises that the design of financial products varies from product to product and that different approaches to design may be required for different simple products categories.

The Government sees simple products as **being beneficial across the mass market**. While a **simple product may not be the most suitable choice for everyone, it should never be a 'bad' choice** (the principle of the BMW versus the TATA Nano).

The Government would like to see the new **regime of simple products develop clear brand recognition** – something they believe to be an important way of building trust and sustainable demand. For example, **the 'ISA' brand has become embedded in consumers' consciousness** and is a trusted brand, with over 20 million adults in the UK now holding ISAs.

By **allowing industry to take the lead in product design**, providers should recognise the benefits of simple products that they create and market them to consumers (Stakeholder was seen to be an unwelcome imposition by many providers).

Although the Government believes that the principles of simple products are widely applicable, it also believes that, initially, **simple products should focus on products that do not carry risk to capital - not investment products**. They feel that **'investment risk' would add an extra level of complexity to the product design**, as the design would have to weigh up how much risk individuals are willing to tolerate, both in terms of capital risk and risk to potential gains.

## No Advice needed?

The Government believes that **simple products should be straightforward enough to be purchased without regulated advice**. Given that consumers have in recent years developed an increased use of the Internet and comparison sites for product research, the Government believes that **focusing simple products on non-advised channels will help support consumers** in taking responsibility for their decisions. However, **it does not want to preclude or prevent simple products being sold through advised channels**, or being used by advisers as a benchmarking tool where this would benefit customers.

### **Savings & Protection focus**

**The Government believes that savings accounts and protection products should be developed first.**

Currently, deposit **savings** accounts can contain introductory bonuses, penalties for early withdrawals or frequent withdrawals, and stepped interest rates, amongst other features. Comparing across products with different features can be challenging even for sophisticated individual consumers.

The Government is **eager to ensure that complexity is not a barrier to saving**. It therefore believes that simple deposit savings products would be of benefit to the market and would deliver clear benefits to consumers.

**Protection** also has an important role in helping people to build up financial security and many people do not have protection to cover them in the event of a loss of income through redundancy, illness, or loss of life.

**Protection products are often described as being 'sold, not bought'**, and **many consumers may not understand the value or features of these products**. Whilst some people may choose not to purchase such protection, or judge that these products do not offer sufficient value for money, there are likely to be some consumers who find difficulty in choosing between products or in understanding the value of the product.

Previous examples of simple products initiatives have shown **how critical the sales process is both in terms of ensuring sufficient consumer demand and keeping costs low for providers**. For stakeholder products the price cap coupled with a more expensive advice model than originally anticipated, led to the products being expensive to supply. There is now an opportunity to rethink these issues in the context of a new advice landscape.

## Changes in the advice landscape

The Government's **Coalition Agreement** includes a commitment **to implement the UK's first free and impartial national financial advice service**, and the Government has asked the Consumer Financial Education Body (CFEB) to develop this. **It will not give regulated advice**, but it will provide people with information and advice on all major areas of money and personal finance. A key component of the national financial advice service will be **a financial healthcheck that will provide people with a holistic review of their finances**, highlight areas to prioritise, and **give people a personalised action plan to take forward**. The service will **move as close to the regulatory boundary as possible** to ensure that people have a seamless journey between the national financial advice service and regulated advice, should they need it. To this end, **CFEB is exploring the possibility of providing generic product recommendations**, for example 'you should consider purchasing home contents insurance'.

While **simple products should be available to buy direct from the provider**, simple products **may also be sold through, or linked to, advice and information channels**.

The Government believes there is a strong rationale for retaining stakeholder pensions. Pensions are not an early target for development of simple products and while the take up of stakeholder pensions has been limited, **stakeholder pensions do provide an 'off the shelf' option for people who want a private pension**. They are also argued to have had a **beneficial impact on prices** of personal pensions through the RU64 rule. While the pension landscape will be changing significantly with the **introduction of the National Employment Savings Trust (NEST)**, the Government is minded to continue stakeholder pensions.

**Stakeholder products can be sold through basic advice** (created by the FSA to provide a cheaper alternative to full advice for a limited range of stakeholder products), although in practice **most are sold using full advice**. The FSA reviewed basic advice in 2008, when it concluded that the regime should be retained. While considering the evidence on stakeholder savings products, the **Government is once again also seeking views on the basic advice regime**.

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