

## 4. Policy And Regulatory Context

The Treasury Consultation Document stems directly from the proposals put forward by Ron Sandler to the Government in July 2002 and from DWP reforms of the pensions market. This section of the report examines:

- The policy background (the Sandler Review and the DWP/Inland Revenue (IR) Pension Reform proposals), and
- The associated changes proposed by the Financial Services Authority (FSA) Discussion Paper 19 (“DP19”).

### 4.1 Sandler Review

In June 2001, the Government commissioned Ron Sandler to “identify the competitive forces that drive the retail financial services industry, in particular in relation to their approaches to investment, and where necessary to suggest policy responses to ensure that consumers are well served”. The Sandler review was commissioned by the Government in response to a recommendation of the earlier Myners review of institutional investment and against a backdrop of industry and consumer body concerns about the savings gap in the UK.

Ron Sandler’s review was published in July 2002<sup>8</sup> and concluded that:

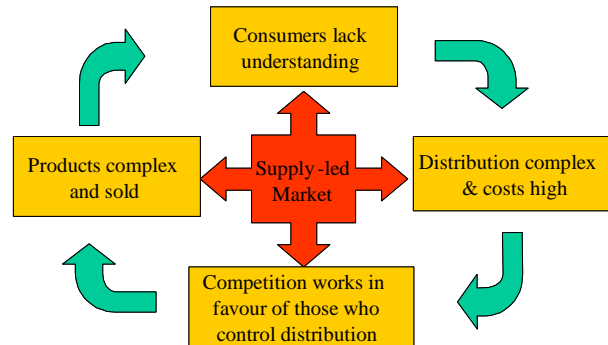
- In the relationships between producer, distributor and consumer, the consumer is often powerless;
- This lack of power is created in part by asymmetry of information due to the lack of transparency and simplicity in product design (With Profits is particularly singled out for review);
- As a result, the consumer is largely unable to drive the decision making and purchasing processes and becomes reliant on advisors and those on lower incomes suffer from lack of access to financial advice;
- The advice process itself is not transparent, in particular the method of remuneration for advice;
- There is insufficient focus on investment advice and asset allocation and a poorly informed advisor sector;
- Different methods of taxation across the sector create distortions.

The left-hand Chart below represents the current state of the market as described by the Sandler Review. The Sandler Review recommended a number of measures designed to help reverse the current market forces which lead to a lack of consumer power and influence in the market. Foremost among these are the stakeholder products. Stakeholder products alone are not expected to instantly lead to a demand led market but it is hoped that, in conjunction with the FSA simplified sales process, they will act as a proxy for the empowered consumer that will lead in time to a reversal of market forces and a move towards the vision shown in the right hand Chart.

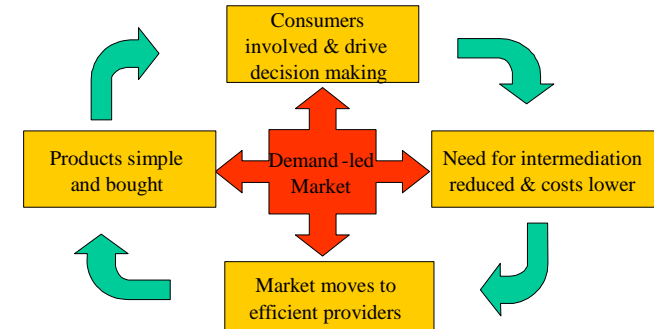
<sup>8</sup> [http://www.hm-treasury.gov.uk/Documents/Financial\\_Services/Savings/fin\\_sav\\_sand.cfm](http://www.hm-treasury.gov.uk/Documents/Financial_Services/Savings/fin_sav_sand.cfm)

Chart 4.1– Market Forces

## Current market forces- lack of consumer influence



## Future market forces- reversing the market



In proposing the range of stakeholder products, Sandler’s objectives were:

- To remove some of the barriers of complexity and lack of transparency that he believed prevent consumers engaging fully in the market and making informed decisions, and
- To enable the regulation of the sales process for straightforward products to be relaxed in order to reduce cost and complexity.

Sandler’s observation that few consumers are self-directed in this market and that consumer influence is weak is a feature of the market that the introduction of Stakeholder products will not remove instantly. In the early days, at least, consumers will continue to need help, information and persuasion to save through these products. For the market to emerge therefore it is necessary to consider the price cap structure and level in the context of those distribution channels that have the ability to engage with lower and middle income consumers.

The review proposed a 1% flat rate annual charge as a “starting-point” for the products. In addition it proposed that there be (1) no initial charges; (2) strictly limited and ideally non-existent surrender charges; (3) an extra smoothing charge for with-profits products.

## 4.2 Government Proposals for Stakeholder Products

On 5<sup>th</sup> February 2003, the Government launched its consultation document “Proposed product specifications for Sandler “stakeholder” products”<sup>9</sup>. This sets out in detail the Government’s proposals for these products, and contains an analysis of whether other products might be included in the suite. It states that whilst attracted to a 1% flat-rate annual charge, the Government would be commissioning independent research into the issue, in order to ensure the price controls meet the needs of both industry and consumers.

With all of the initial pieces of the jigsaw in place, a more detailed analysis was required to ensure that the price cap is set at a level that will best facilitate the meeting of the Government objectives of creating a vibrant and efficient market.

## 4.3 DWP Green Paper / IR Reforms of Pension Taxation

In December 2002, DWP published its proposals for simplification of the pensions market “Simplicity, Security and Choice: Working and Saving for Retirement”<sup>10</sup>. Alongside this proposals for radical reforms of pension taxation were published by the Inland Revenue.

In its proposals, the DWP introduces a number of outline proposals for reform of the pensions market, acknowledges the work being undertaken by the Government in response to the Sandler review and the plans to integrate stakeholder pensions into the new range of products. The objectives of the proposed reform package as described in the foreword to the Green Paper are:

*“This Green Paper sets out a new more flexible approach making it easier for people to save and easier for employers to contribute. We propose radical simplification of tax rules, better information about pension choices and a range of options to strengthen protection for employees. We want people to be able to choose between simple, quality products, assisted by trustworthy information tailored to their own circumstances.”<sup>11</sup>*

The extent to which the pensions market can be simplified will have a significant impact on the application of the DP19 sales process as described below and ultimately on the success of Stakeholder pensions in this new environment.

## 4.4 FSA Developments

Central to the case for provider and distributor engagement in this new market will be the degree and manner in which sales regulation is adapted by the FSA. The detail of the regulation will impact on the profitability of sales under different price caps as well as the size of the market that can ‘safely’ be targeted without fear of future claims of misselling.

<sup>9</sup> [http://www.hm-treasury.gov.uk/consultations\\_and\\_legislation/consult\\_sandler\\_products/consult\\_sandlers\\_index.cfm](http://www.hm-treasury.gov.uk/consultations_and_legislation/consult_sandler_products/consult_sandlers_index.cfm)

<sup>10</sup> <http://www.dwp.gov.uk/consultations/consult/2002/pensions/gp.pdf>

<sup>11</sup> Rt Hon Andrew Smith MP, Secretary of State for Work and Pensions, December 2002

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A core aspect of the original proposals in the Sandler Review was the concept of reducing in some manner the full array of Conduct of Business Standards (COBS) for Stakeholder products whilst continuing to protect the consumer through product regulation. In essence, although the product may not be the absolute best available solution for an individual's particular circumstance, the nature of the product should be such that it would generally be suitable, and there would be limited downside if the individual bought a Sandler product rather than another financial services offering (or taking another course of action). The FSA issued Discussion Paper 19 ("DP19") in January 2003 to set out some options to achieve this reduction in COB requirements. Three options were described in the DP as follows:

*"The three options identified for regulating the sale of simplified products to reflect the mitigation of risk through the standards applying to the product can be summarised as follows. In each case, existing financial promotion rules would apply to the simplified products, and the salesperson would be required to give appropriate product risk warnings at the point of sale.*

### **Self help and plain English warnings (Option 1)**

*The main features would be:*

- *consumer reliance on the integrity of information and warnings given by the provider and regulation of the product;*
- *self-certification by the consumer that he or she had received and understood the information given;*
- *the salesperson need not be FPC-qualified but would be required to be trained and competent to do the job;*
- *no "suitability" or "know your customer" obligations would apply; and*
- *there would be provision for face-to-face meetings and telephone discussion for clarification of information, risk warnings and encouragement to buy.*

### **Guided self-help (Option 2):**

- *all the features of Option 1 would apply, including self-certification; additionally*
- *"front end" filter questions would be put by the salesperson to identify those for whom a simplified product looked likely to be a poor choice or who would not be eligible to buy the product; and*
- *the salesperson would keep a record of the customer's responses to the filter questions.*

### **Focused advice (Option 3):**

- *limited "suitability" and "know your customer" requirements would apply;*
- *advisers would have to hold FPC1 as a minimum qualification (subject to the FSA consultations on the general insurance and mortgage regime they might also be able to sell non-investments as well);*
- *the adviser might use filter questions, but there would be no requirement to do so; and*
- *self-certification that the consumer understood the limited scope of the advice".*

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The consultation period on DP19 ended on 15 April 2003. At the time of preparing this report the FSA was still deliberating how to move the debate forward, a project made harder with the numerous other initiatives on distribution that are ongoing. Industry preference appears to centre around Option 2 and it is this approach that we have adopted in sections 7 and 8 of this report. Consumer bodies by contrast are concerned about the relaxation in consumer protection that they feel is implied by all of the options. Many points of both principle and detail remain to be resolved by the FSA, and financial institutions' enthusiasm towards the Stakeholder project varies with the institution's confidence in the FSA's ability to satisfactorily resolve these issues.

Some of the key issues that may remain to be tackled include:

- A full cost benefit analysis;
- The scope and nature of the filter questions set out. At present questions on debt, protection and the existence of an emergency fund are being considered;
- How any filtering questions or decision trees would operate in practice. This will need to include the level of prescription in how the information is gathered (including what data if any is needed to verify the answers given), and what actions are allowable if a consumer does not pass through the filters but wishes to purchase a Sandler product;
- Whether a full-advice channel can exclude Stakeholder products from the range of offerings on which advice is given ('RU64');
- The feasibility of an institution operating a two-tier distribution channel, with one specialising in selling Stakeholder products and hence not subject to full COBS, and one providing full advice.