
3. Project Approach And Reporting

This section of the report sets out the approach to meeting the objectives set down in the brief, the methodologies applied, the defined stages of the project, the structure of this report and some of the key project limitations.

3.1 Initial Hypothesis

From the outset of the project, our hypothesis for the way in which the market could operate has been that:

'demand' for Stakeholder products will be driven largely by the distribution channels that can be supported at different charging levels and by the nature of those channels – the more 'persuasive' the channel and the wider the market reach, the greater the influence on savings behaviour⁶

Implicit in this is the assumption that the construction of simple, value for money savings products will not transform the market overnight and create a demand led market where consumers seek out and buy the best product for their needs and save more than they already do. Rather, that in the early years at least, these products will continue to need to be sold and that critical to the success of the market will be the creation of income flows and cost structures that, as well as delivering value for money to the consumer, can deliver reasonable profits to the industry and continue to support competition.

This has shaped the way in which the market has been analysed. For example, it was not considered appropriate or practical in the timescale to conduct any original consumer research to examine consumer attitudes to products and pricing, although we recognise the validity in such research being undertaken by individual companies as part of the product development process. Neither have we sought to examine consumer attitudes to a simplified sales regime. We understand that the FSA, as part of their future work program, will be researching how consumers could be expected to engage with such a process.

3.2 Methodology

The approach taken by the project team was to undertake as detailed an assessment as possible of the costs of distribution and manufacture of the proposed suite of products against a number of different price cap options in order to understand:

- The implications for consumers in terms of value for money;
- The potential market size;
- The implications for different distribution channels;
- The impact on efficient providers and distributors in terms of return on investment and timeframe for achieving that return.

⁶ As expressed in the Deloitte & Touche proposal for this project March 2003.

In assessing the last of these we have calculated financial results for a hypothetical company using an aggregate approach, ie the financial analysis was based on a "project" methodology rather than considering the profitability of individual cases. Many submissions to the Treasury in response to the Consultation Document have taken an alternative approach, and investigated how the minimum case size which it is profitable for a company to sell can vary under alternative charging structures. This case size can then be taken as indicative of the ability of the companies to market the products to alternative segments of customers. We have not repeated the analysis set out in those submissions, since not only do we understand that most of them will be in the public domain, but also because a "project" methodology was regarded as a better approach for the specific Terms of Reference of this work.

The key stages to the project were:

- An initial, intensive round of meetings with key industry figures including a variety of providers, distributors and other Stakeholders. Details of the meetings held are outlined in Appendix One of this report. The objectives of these meetings were to explore industry enthusiasm for the proposals and to facilitate industry input to the modelling and analysis. We are grateful to the many companies that participated in this phase of the project and who provided valuable insights and, in many cases, data and models of their own to inform our own model building;
- An analysis of possible demand and estimated market size drawn largely from our own study of savings behaviour and wealth⁷;
- The central modelling phase that focused on understanding the fixed and variable costs of manufacture and distribution and describes the rate of return and payback period for various volumes of business, distribution channels and price cap structures and levels;
- Possible structures and costs for smoothing and guarantees were modelled separately using a stochastic approach;
- The final phase of the project took the outputs from all previous stages to describe the possible market outcomes of different charging structures and levels.

The analysis assesses the overall impact on the industry as well as exploring possible differences across alternative potential distribution channels.

3.3 Report Structure

This report is structured in the following way:

Section 4 describes the policy and regulatory context for this project, examining in particular some of the uncertain elements that will affect the way in which the market emerges;

Section 5 explores consumer savings behaviour, provides a view on the possible size and value of the market and examines the market reach of different distribution channels;

Section 6 summarises current provider and distributor views on the market and their views on opportunities and constraints;

Section 7 contains the results of the central analysis of costs and profitability for providers and distributors;

⁷ Wealth & Portfolio Choice 2002/3. For further details, see Appendix Two.

Section 8 describes the results of modelling the cost of smoothing for the potential replacement for with profits as well as guarantees;

Section 9 assesses the potential market impacts of the results for the consumer, distribution, providers and the government objectives.

3.4 Project Limitations

As ever, time constraints have led to a significant number of assumptions being made that with more time could have been modelled in more detail. We have relied heavily upon input from providers who at this stage are also grappling with a largely unknown regulatory future. In particular this applies to the cost of distribution outlined in section 7 of this report where many of the contributory factors are as yet unknown. We have relied heavily upon input from providers who are also grappling with a largely unknown regulatory future.

In addition, it is worth noting that the Deloitte project team did not specifically assess the following issues:

- The implications for cash ISAs or the Child Trust Fund of price cap structures;
- Aspects of product design beyond the price cap;
- The definition of the target market for Stakeholder products. However, in seeking to understand the possible size and shape of the market, we have analysed consumers in some detail, as described in section 5 of this report;
- Whether current market players would enter the market at different pricing levels, but rather assessed the point at which efficient manufacturers and distributors would be able to compete. No attempt has been made to identify the individual financial or other organisations that may or may not wish to operate in the potential market.