House of Commons

Treasury Committee

Responses to the Committee's Eighth Report: Restoring confidence in long–term savings (HC 71)

Eighth Special Report of Session 2003–04

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The Treasury Committee

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Contacts

All correspondence for the Treasury Committee should be addressed to the Clerk of the Treasury Committee, 7 Millbank, House of Commons, London SW1P 3JA. The telephone number for general enquiries is 020 7219 5769. The Committee's email address is: treascom@parliament.uk.

Eighth Special Report

On 28 July 2004, we published our Eighth Report, *Restoring confidence in long-term savings*, as House of Commons paper No. 71. We have now received responses from the Government (dated 27 September 2004 appended below as Appendix 1) and the Financial Services Authority (dated 21 September 2004, appended below[1] as Appendix 3). We have also received papers from the Government and the Financial Services Authority containing responses to a number of outstanding points raised in the oral evidence taken from the Financial Secretary on 28 June 2004 and the Chairman and Chief Executive of the Financial Services Authority on 23 June 2004; these are at Appendix 2[2] and Appendix 4[3] below respectively.

APPENDIX 1

GOVERNMENT RESPONSE TO THE EIGHTH REPORT OF THE TREASURY COMMITTEE SESSION 2003-04 (HC 71)

This memorandum sets out the Government's response to the Treasury Committee's report on 'Restoring Confidence In Long-Term Savings'.

2. The Government is grateful to the Committee for its work in examining the issue of confidence in long-term savings, and recognises the important contribution that it has made. We share with the Committee the belief that confidence in the long-term savings market is an issue that must be resolved for the benefit of all in society, and will require the concerted effort of all, including the Government, Industry, Regulators, Consumer Bodies and Trade Associations.

Confidence In Long-Term Savings

3. The Government concurs with the Committee that the long-term savings market is essential to the UK, and thank the committee for their valuable assessment. Consumers need to be confident that they will be treated fairly, as well as having the necessary information to make informed decisions about their financial decisions.

4. The Government is already addressing these concerns through a variety of policies. Notably, there is the introduction of the 'stakeholder' suite of simple, low cost, risk controlled savings and investment products from April 2005. In February 2004 the Government also published its proposals to enable people to make real and informed choices on working and saving for retirement in "Simplicity, Security & Choice: Informed Choices For Working & Saving". The Government also welcomes the actions being taken

[1] See page 15

[2] See page 16

[3] See page 24

by the Financial Services Authority (FSA) and the financial services industry to address these issues.

Improving Product Information

5. It is essential that consumers have the necessary product information to ensure that they are able to make an informed decision, with all literature provided in a sensible and comprehensible format. The Government thanks the Committee for examining these issues and the recommendations that it has made.

The Government also recognises the ongoing commitment and efforts of the FSA and the financial services industry to tackle this problem.

Creation of a Standardised Summary Box

6. The Government is keen to see the results of work the industry and regulators have agreed to undertake.

Risk Ratings

7. The Government has previously informed the Committee that we have concerns surrounding the practical difficulties that a summary risk rating could have, especially when one considers that the risk profile of a particular product may change in the future.

8. However, the Government warmly welcomes the commitment of the FSA and the Industry to examine this recommendation, and, along with the Committee, awaits the findings of their research.

Aligning savers' and industry interests

9. The Government agrees with the Committee that the financial services industry should be providing consumers with products and services that meet their needs, and that this should be at the core of their business proposition.

10. The Government agrees with the Committee that remuneration levels in the financial services industry are a matter for shareholders (and members in the case of financial mutuals). The Government has implemented and is implementing measures to strengthen shareholders' ability to hold boards of directors to account (and the issue of mutual directors' accountability is currently being considered by the independent review into the governance of mutual life companies led by Paul Myners).

Industry & Consumer Interests

11. The Government agrees with the Committee that more needs to be done. In a fully functioning market we would expect to see industry choosing their own strategy for enhancing shareholder value through providing services and products that always met their customers needs. At the same time informed consumers would have the opportunity to move their custom from firms where they did not believe they had been treated fairly, to a firm that they believe did meet their specific needs. In such a scenario, the consumer

would be at the centre of the business. Value creation would occur through long-term relationships forming between consumers and firms whereby the needs of the consumer were met, which in turn created consumer brand and product loyalty. Without this, long-term shareholder value would not be created. Ultimately, shareholder value creation would be through the quality of products and services offered to consumers, which would in turn determine the remuneration of senior management.

12. In a market that does not meet customer needs as effectively as possible, it follows that shareholder value will not align perfectly with the value delivered to customers. A number of Government, FSA and Industry initiatives are continuing to examine and remedy this concern.

13. The Government is also of the belief that it is important for consumers to understand when purchasing products through a variety of distribution channels that they understand the value of the advice they receive. The Government welcomes the continued efforts of the FSA and the Industry in implementing the reforms to polarisation.

Improving Distribution: IFAs, fees and commissions

14. The Government agrees with the Committee that access to the financial services industry should be widened to include those on moderate and lower incomes, who have the capacity to save. There are several reforms in train, driven by the Government and the FSA, that are designed to achieve this:

15. Depolarisation: the FSA has decided to remove the polarisation requirement from the market as this restricts the choice of business model available to firms. The removal of this restriction will allow those firms currently tied to market a wider range of products than they could offer from a single provider. This should also enable them to achieve better product pricing for consumers.

16. Menu: the FSA has also been designing the 'menu', an integral part of the depolarisation reforms. The 'menu' is a concise document that firms will be required to provide to private customers when they first seek advice on packaged products. This will give consumers an up-front indication of the cost of advice.

17. Basic Advice: the FSA's basic advice process, which was tested in support of the Government's stakeholder product initiative, will enable advisers to give consumers advice on basic investment and savings products. Where appropriate, the basic advice process will also highlight to consumers the importance of reducing consumer debt and protecting dependents financially. The FSA will require advisers to be competent to perform their role but they will not expect them to obtain formal qualifications, as those who give full advice must do. The advice process should take less than 40 minutes. This reduced cost will allow firms to offer valuable advice to people with smaller amounts to invest, a market that is currently unattractive to them.

18. Informed Choice: As part of its Informed Choice programme the Department for Work and Pensions is promoting the greater use of the workplace for the provision of information and advice about pensions and saving for retirement. A DWP pilot study began in July 2004 which will test a variety of methods for delivering that information and

advice through the worksite. The findings of the pilot will help inform how reserve powers being sought in the Pensions Bill might be used to require employers who contribute little or nothing to their employees pensions and have low levels of scheme membership to provide their employees with access to a decent level of pensions information and advice. The economies of scale available through worksite marketing enables firms to market investment products at lower cost, meeting the needs of less affluent consumers.

19. The Treasury is currently consulting on whether employers should be provided with an exemption from financial services regulation in order to facilitate the promotion of pensions in the workplace.

20. Generic Advice: the role and provision of generic financial advice is key to engaging consumers with financial services in terms which are easily understood and which are product neutral. Although there are people who are able and willing to seek professional financial advice and pay for it, there are many people on low to middle incomes who are not easily able to access the advice they need.

21. The Government supports and is working with the FSA and others, as part of the national strategy for raising financial capability, to develop generic financial advice services. Such services and tools use information about individuals' circumstances to help them identify and understand their financial needs and to plan their finances. It does not however result in a recommendation for an individual product, service or provider, and it is distinct from any sales process or channel. It does not necessarily fall to be regulated under the Financial Services and Markets Act 2000, though it may lead to separate access to a sales process being offered, and it may help people to make better use of regulated advice if they choose to access it. Generic advice is most likely to work as a way to help consumers enter the regulated sales area, and do so in an informed and confident way, making their interactions with savings providers more productive.

22. Stakeholder Products: the Treasury and Department for Work and Pensions are committed to introducing transparent products that consumers can easily understand. The complexity and opacity in the market currently are a real barrier to consumers making their own decisions, forcing them to use advice. The stakeholder products initiative, together with tax simplification, will enable many more consumers to make their own decisions.

23. Commission: the Government supports the FSA's recent work on commission disclosure. The FSA's consumer testing provided evidence that the disclosure of charges under their "menu" proposals was far more effective than the current regime. This is an important development in helping consumers understand the costs that they are paying for advice in the financial services market – a key element to a fully functioning market.

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

24. The FSA sets the minimum standard of behaviour for firms, and it is a matter of concern if firms consider "ethical" to mean "what is within the FSA rules". Firms should be aiming for a higher standard of behaviour, and this is by no means confined to the independent advice sector, or indeed traditional "advised" channels of distribution.

25. The Government would encourage firms to put value for their customers at the heart of their business model. In doing so they would be securing their future consumers, and through this create profitable business. Trade bodies also have a role to play in demonstrating leadership for the firms they represent, to help their members understand better what processes and practices they will need to embrace to meet this challenge.

26. The Government and regulators recognise this and are developing a principles based approach to help move this agenda forward ensuring that consumers are core to any business model. Industry will need to fully embrace this challenging agenda.

With-Profits Products

27. The Government shares the Committee's concerns regarding market value adjustments (MVAs) and the perception by some consumers that these are an unfair exit penalty. At the same time the Government also recognises that when existing with-profits funds suffer falls in value because of negative investment returns there will be an inevitable impact on the value of investors' policies, which cannot always be absorbed within normal smoothing parameters. Consumers are concerned partly because policyholders often only become aware of this impact when they seek to exit the fund and when an MVA is applied to policy values. Nevertheless, the issue of fairness to policyholders has to apply both to exiting policyholders and to remaining policyholders. If exiting policyholders were to leave the with-profits fund with more than their fair share of the fund, this would create an unfairness to those policyholders who remain invested in the fund since they would effectively be subsidising the departing policyholders from their own policy values.

28. The FSA has been conducting a with-profits review since Spring 2001 and has already brought in significant changes to with-profits regulation. Following the Sandler review of medium and long-term savings the FSA has brought forward further proposals imposing greater disclosure requirements on with-profits funds, firstly in CP167 and subsequently in CPs 207 and 04/14 as well as changes to the way in which funds are operated. These proposals are subject to consultation with the industry, consumer groups and other interested parties. The proposals reflect the need to balance the interests of departing and remaining policyholders in the approach firms take to calculating surrender values in particular. As the operation of with-profits policies becomes more transparent and policyholders are provided with better information to improve their understanding of the fund in which they are invested, the imposition of an MVA can be more clearly explained. An MVA is unlikely ever to be welcomed by an exiting policyholder, but the regulator and firms are working towards enabling policyholders to understand, when an MVA is applied, what the reasons for it are and why it is set at the level that it is.

29. So for existing with–profits funds, the FSA's proposals will both tighten up how with-profits funds are run and provide clearer information to policyholders. The Government notes the Committee's concerns that it is not clear whether these proposals go far enough to satisfy consumer concerns in this area. It will be for the FSA to finalise its rule changes and to assess their impact once they are in place.

30. Looking to the future, the Government has made revised proposals for the smoothed investment fund as part of the stakeholder suite of investment products. The latest proposal is that firms should seek to manage their fund through a combination of

smoothing of investment returns and publishing a daily unit price. The smoothed investment fund would not be a with-profits fund as it would not share in the profits and losses of the company. A sharp fall in stock market values would be reflected in the daily unit price, so we have proposed that an MVA should not be imposed on exiting policyholders. Previous consultation has suggested that there continues to be widespread support within the industry for the ability to apply MVAs. However, the Government has removed the proposal that the redemption value of a policy should be set on an annual basis and that the value of the policyholder's unsmoothed asset share should be disclosed on exiting the fund. We are consulting on whether product providers consider it to be a practical proposition to provide smoothing without an MVA given the other changes that have been made to the proposed smoothed investment fund.

Closed Funds

31. The Government agrees with the Committee that policyholders in funds that close to new business should be treated satisfactorily and that exit penalties where they do have to be applied should not be punitive. They should be fair both to departing and to remaining policyholders. Changes of ownership and possible consolidation among closed with-profits funds is a commercial matter in which we would not seek to intervene, but the Government is confident that the FSA fully appreciates the importance of this issue to the large number of policyholders affected and the extent to which the fair treatment of policyholders in closed funds can contribute to restoring confidence in long-term savings.

The Role of Actuaries

32. The Committee has noted the sweeping changes to the role of actuaries that the FSA has already introduced. The Committee has also welcomed the establishment of the Morris review of the actuarial profession. The Government awaits his report with interest.

33. The Government welcomes the Committee's view that the FSA should scrutinise closely changes and transactions in the with-profits area to demonstrate to investors that their interests are being preserved. The Committee might also wish to note that the Government passed legislation in 2003 requiring actuaries to step outside their company to provide information directly to the FSA under various circumstances, including where there is a significant risk that the insurer has not, or may not be able to, take into account in a reasonable and proportionate manner the interests of long-term business policyholders. We believe that this will help the FSA in their work in this area.

Stakeholder Products

34. The Government welcomes the supportive comments and findings the Committee have highlighted regarding stakeholder products. The Government has already announced that it will be assessing how the market has developed in 2008, and a key assessment will be the effect of the price cap. This accords with the recommendation of the Sandler Review that the price cap to apply to stakeholder products should be reviewed regularly.

35. The Government believes that stakeholder products will provide consumers with more simple, low-cost, risk-controlled savings and investment products for their short,

medium and long term savings needs. In a market where consumer confidence has been eroded, we regard these products as providing a significant step forward in helping to restore faith and trust in savings. We are pleased that the FSA have been able to continue to develop a 'basic advice' process and look forward to the results of their consultation. We also welcome the broad support from many parts of the financial services industry.

Existing stakeholder pensions

36. The Secretary of State for the Department of Work & Pensions will be consulting shortly on the amending regulations for the pension product within the stakeholder suite. The Government will ensure that the Treasury Select Committee is made aware of the Government's view once a decision has been made.

Independent Charge Cap Commission

37. The Government thanks the Treasury Select Committee for its recommendation that the charge caps be set by an independent body. The charge caps for stakeholder products will be reviewed again in 2008, and the Government will consider the options for establishing that review in advance of this.

The Role of the FSA

38. The Government welcomes the Committee's view that the new financial regulation framework introduced after 1997 has made a positive impact on levels of confidence in the financial services industry. We welcome many of the Committee's comments regarding the role of the FSA, and thank them for their insightful analysis.

Money Laundering

39. It is important that the UK has an effective and proportionate system of anti-money laundering controls which comply with European and international obligations. These controls aid the detection and prosecution of crime and help to protect the integrity of the financial system. However, effectiveness must be balanced with proportionality in order to ensure that private and public sector effort is commensurate with risk and that controls are imposed in a cost-effective way.

40. The UK's anti-money laundering regime provides a risk based approach by imposing high level obligations on the regulated sector to ensure effective anti-money laundering controls; it is left to the regulated sector, in consultation with government, to produce guidance on the detail of compliance. In relation to the specific matter of identity checks, the FSA is currently working with public and private stakeholders to review identification requirements to ensure that they are risk based and do not discriminate against the financially excluded. The government will continue to work with stakeholders to ensure a workable and cost effective anti-money laundering regime which is consistent with international standards.

Enforcement

41. In September 2003 the FSA's Chief Executive John Tiner announced an 'end to end' review of the FSA's enforcement process. The outcome of this review was announced by the FSA on 15 July 2004, when a summary of the review's key findings was published. Improvements include shorter time targets for each stage of the referral and investigation process, a faster process for referring cases for investigation, improvements to the speed and efficiency of investigations, and speeding up the decision-making process. This should address the Committee’s concerns over speed of enforcement.

Financial Ombudsman Service (FOS)

42. The creation of a single Financial Ombudsman Service (FOS) has brought benefits to both firms and consumers of financial services. Industry confidence in FOS decisions is important, but it is essential that we explore industry concerns in allowing firms to appeal against FOS decisions and on cases with wider implications.

43. The FSA and FOS, as part of the two-year review of the Financial Services and Markets Act 2000 are discussing with industry and consumer groups the issues around appeals and wider implications and issued a joint public consultation document in July 2004. Subject to the responses to the consultation and continuing dialogue with industry and consumer groups by the FSA and FOS, a decision on appeals and wider implications is planned for later in the year.

Public knowledge of the FSA’s role.

44. The Government gave the FSA clear statutory objectives, including to maintain confidence and protect consumers, within a framework providing the FSA with independence from the Government on operational matters. Any decision by the FSA to engage in a publicity campaign would be an operational matter for the FSA with the costs of any such campaign being borne by the industry through FSA fees.

Tax & Benefits

Improving the tax regime

45. The Government provides generous tax relief to encourage people to save for their retirement. Private pensions are the most tax-favoured form of saving. However, the existing eight taxation regimes have complex rules that limit annual contributions to, and final benefits from, a pension scheme. This imposes unnecessary inflexibility and complication, drives up costs and discourages people from saving in a pension.

46. Following two consultations in December 2002 and December 2003 the Government legislated in the Finance Act 2004 to implement a simplified regime in April 2006. It will replace the eight current regimes with a single lifetime allowance on the amount of tax-privileged pension saving. The overall package of tax simplification has been widely welcomed across the pensions industry and will benefit:

- *Individuals* – through greater choice and flexibility in when and how they save for their retirement. People can also save concurrently in a personal and occupational pension. Many people will gain from the option to take a larger lump sum.

- *Pension Providers* – through reduced administration costs and a reduction in the current burden caused by expensive administration checks. Government estimates of cost savings, endorsed by those members of the pensions industry who commented, are expected to be in the region of 5% of costs or around £80m pa.

- *Employers* – through lower administration costs, but more importantly the freeing up of tax rules will enable them to design pension schemes that best fit their business needs.

47. The Government is committed to promoting appropriate saving. It is undertaking a radical programme designed to enable individuals to make informed choices about working and saving for retirement. This programme is fundamental to ensuring that future pensioners receive the income in retirement that they expect. The recent DWP publication "Simplicity, Security & Choice: Informed Choices For Working & Saving" sets out the Government's strategy, which is based on activation, education and information, and includes:

- issuing 1.6 million state pension forecasts to the self-employed by May 2004, and sending out 8 million automatic state pension forecasts in 2005-06;

- ensuring 6.3 million combined pension forecasts are issued. The 2004 Pensions Bill provides the Government with reserve powers to compel employers to provide these forecasts, should evidence show that they could make a significant difference to savings levels;

- developing a web-based retirement planner to provide people with the opportunity to look at all their pension information together from both state and private sources, and this to any savings they may hold.

- the introduction of the stakeholder suite of products and reforms to improve employment opportunities for older workers will mean that people have genuine choices available when it comes to working and saving; and

- making information and guidance available to employers to draw attention to the benefits to themselves and to the wider economy of employing older workers.

48. A PSA target in the 2004 Spending Review included the commitment to improve working age individuals' awareness of their retirement provision such that by 2007/ 08 15.4 million individuals are regularly issued a pension forecast and 60, 000 successful pension traces are undertaken a year.

49. A number of commentators have suggested that improved tax reliefs should be introduced to encourage greater saving. However, pension saving already benefit from substantial tax reliefs, worth several billion pounds a year in aggregate. Contributions attract tax relief at the marginal rate. Furthermore, for a basic rate taxpayer every pound saved will benefit from 28p in tax relief from the Government. Employer contributions are

exempt from both employer and employee National Insurance contributions. There is also the option for individuals to take a tax-free lump sum. Those who save in a pension will also have the option of taking a tax-free lump sum worth up to 25% of the fund value. Despite these incentives, analysis set out in the Pensions Green Paper indicated that many people are still not saving enough or working long enough to meet their aspirations for retirement income. The Government therefore believes that ensuring individuals are in a position to make informed choices about working and saving for their retirement through the combination of activation, information and education set out above is likely to have a greater effect on those not saving or not working long enough.

Greater access

50. As described in the previous paragraph the Government offers generous incentives to encourage individuals to save in pensions. These incentives provided the recognition of the fact that individuals will be locking their money away for the longer-term.

51. There are a range of other savings vehicles for those who would like greater access their funds. ISAs provide one example. These were introduced in 1999 and have already proved to be very successful. Over 15 million people have an ISA, with over £130 billion subscribed, supported by around £1.6bn in tax relief for savers.

52. There are no restrictions on money being taken out of an ISA account. Furthermore, with the average level of ISA savings at £2,200 the vast majority of savers can also add to their savings.

53. The Government recognises that pensions and other, more liquid savings vehicles, such as ISAs, should not be seen purely as alternatives: both can form part of a lifetime savings strategy. Because of the radical simplification of the tax treatment of pensions and the introduction of a lifetime allowance it will be possible for most people to save in an ISA and transfer their funds (up to 100% of earnings of £215,000) into a pension later in life. As paragraph 4.126 of the Pensions Green Paper said, the Government would welcome views on the potential application of the United States' approach of 401k plans to private pension provision in the UK.

Pension Credit

54. A fair society guarantees security in old age and ensures that all pensioners can share in rising national prosperity. The Government is tackling pensioner poverty through personal tax and benefit changes which mean that the average pensioner household is now £1,350 per year (£26 per week) better off in 2004/05 than they would have been under the 1997 system. The poorest third of pensioners are now £1,750 per year (£33 per week) better off than under the 1997 system.

55. The Pension Credit was successfully launched in October 2003 offering extra financial support to the poorest and most vulnerable pensioners. The Pension Credit guarantees all those aged over 60 a minimum weekly income of £105.45 if they are single and £160.95 for a couple.

56. For the first time, the savings credit element of the Pension Credit rewards those with small savings or earnings in retirement. Pensioners aged 65 with low or moderate incomes or who have saved for their retirement are rewarded if they have incomes of up to £144 a week singles, or £212 couples. A single pensioner can be rewarded for having additional income from work or from savings by as much as £15.51 a week, £20.22 couples. Stephen Timms, Financial Secretary to the Treasury, wrote to John McFall, the Chairman of the Treasury Committee, about the Pension Credit and incentives to save on 27 September 2004.[4]

57. At end July 2004 there were 2.607m households benefiting from the Pension Credit, which is 857,000 more than when the campaign began in September 2003. Some 1.94m households, around 2.36m individuals, receive more money than under the predecessor system. The average Pension Credit award is £41.71 a week.

58. Because the Pension Credit was introduced in October 2003 and numbers of recipients are still building up, it is too early yet to assess the full impact of the measure on pensioner poverty. DWP are evaluating the impact of the Pension Credit.

Financial Capability

Raising Levels of Financial Capability

59. The Committee, and the Sandler Review before it, have rightly drawn attention to the low levels of confidence and understanding among consumers in the decisions they make about their financial circumstances and future. This leads to a lack of engagement with the financial services sector.

60. Raising levels of financial capability is a key element of the Government's wider commitment to tackle the causes and effects of social exclusion, while promoting the holding of assets and savings. The emphasis of many of the Government's initiatives on financial services is to create a simpler environment and to empower consumers to understand that environment when making choices. These initiatives include the Child Trust Fund, the Informed Choice programme, the stakeholder suite and basic advice process, work on financial exclusion and overindebtedness.

61. As part of this, the Government is playing an active role in the FSA-led development of a national strategy for raising levels of financial capability. Both Stephen Timms, Financial Secretary to the Treasury and Malcolm Wicks, Minister of State at the Department for Work and Pensions are members of the Steering Group chaired by John Tiner.

62. Working with partners across Government, industry and the voluntary sector the Strategy is about creating better informed, educated and more confident consumers, able to take control of their financial affairs and play a more active role in the financial services market. The Strategy will combine education, information and advice to help people acquire skills and knowledge.

[4] see Appendix 2, page 15

63. In May 2004 the FSA published "Building Financial Capability in the UK", setting out the initial seven priority areas for the Strategy as:

a) Families: being a parent;

b) Schools: laying the foundations;

c) Young adults: new responsibilities;

d) Work: reaching people through the workplace;

e) Retirement: planning ahead;

f) Borrowing: making informed choices; and

g) Advice: the role of generic advice.

64. The Government was pleased that these initial priority areas target the changing needs of consumers at different stages in their lives. In addition, we welcome the recognition by the FSA and those participating in the Strategy of the importance of ensuring the needs of those who are financially excluded and do not have access to the products or services available to others.

65. As has been recognised, the Strategy represents a major undertaking and there is no quick fix. However, it is important that this broad coalition of industry, Government and the voluntary sector exploit all the opportunities we have to improve consumer understanding and confidence in dealing with financial matters.

66. The Committee considers that it is appropriate for the financial services industry to make a substantial contribution towards the costs of any expanded programme aimed at improving financial capability. As noted in the report, the Government would expect that the financial services industry will be willing to make significant contribution to delivery the Strategy. While participants are currently developing individual workplans for each of the Strategy priorities, it would be premature to put a figure on the amount of funding that will be required. Government will continue to make its significant contribution to raising financial capability and literacy both through schools and formal education but also through life stage initiatives such as the Child Trust Fund and the Informed Choice programme.

Financial Advice

67. As the Committee recognise, voluntary community advice groups are a major source of help for people in the UK, while the workplace provides a key channel to deliver advice and information to consumers. The Government is anxious to improve the accessibility of help and advice for people trying to understand their personal finances. That means, amongst other things, help for employees and consumers, especially those who lack frequent access to financial advice and information.

68. The statement by the Financial Secretary to the Treasury in November 2003 announcing the two year review of FSMA noted that advice centres may be reluctant to provide advice on financial issues, for example to consumers with debt problems, because

they fear being caught by the requirements of financial services regulation. Similarly, the Government has been made aware of concerns amongst some employers about their ability to provide advice to employees about pension related issues.

69. At the end of February 2004, the Treasury published a consultation document "Financial Services and Markets Act two year review: Changes to secondary legislation". The consultation takes stock of the way FSMA secondary legislation works. In particular, chapters 3 and 4 of the consultation document considers the effect of the current scope of FSMA regulation on Citizens' Advice Bureaux and other advice centres and on employers offering pension products.

70. We pointed out in the consultation our intention that that the boundary of FSMA regulation does not give rise to any unnecessary obstacles (whether actual or perceived) to the services provided by advice centres or employers. We added that we want advice centres to be able to provide their clients with high quality advice, which keeps track with developments in financial products and services and with legislative development. We also want to remove unnecessary obstacles to employers providing good faith advice to their employees about pensions.

71. The consultation raised a number of questions on which we sought responses and pointed out that we are open as to how we should proceed.

72. We noted that forthcoming increases in the scope of financial services regulation, notably in relation to mortgages, mean that more of the types of advice traditionally provided by advice centres could be said to fall within FSMA regulation. The Pensions Bill and Informed Choice programme seek to make it easier for employers to provide employees with access to advice about their longer term savings needs.

73. In addition to seeking written comments, the Treasury held a series of meetings to encourage interest in the community advice and workplace pensions elements of the review. Meetings were attended in Glasgow, Belfast, Crieff and three further meetings were held in London with a pension provider, and under the auspices of the Association of Independent Financial Advisers and the National Association of Pension Funds. All of these meetings were helpful in illuminating the issues and we are grateful to those who made arrangements to host them.

74. We are pleased to report that we received a large number of written responses from both the voluntary and commercial sector to our proposals in relation to advice centres and the workplace and are continuing to review these responses. Our proposals have generally been welcomed by the voluntary sector, whilst some concerns have been raised by the commercial sector in relation to training and competence issues.

75. We aim to provide a feedback statement to the consultation later this year, indicating how we intend to proceed in this area. Prior to then, we expect to meet further with representatives of the voluntary sector to discuss issues arising out of the consultation.

76. The Government is taking a keen interest in the pilot scheme for the provision of financial advice via Citizens Advice offices. This is a welcome and timely initiative which we will watch with interest and seek to learn from in taking forward our proposals.

Overall Conclusions of Report

Industry Forum

77. The Government agrees with the Committee's recommendation for a forum that focuses on how the industry can better serve its customers. The Government believes that such a forum would send a strong signal to consumers that the industry is committed to tackling its problems. This should, of course, be industry led. Treasury officials would be willing to take part in the forum, and Ministers would be willing to meet the forum from time to time to discuss particularly important issues.

Conclusion

78. The Committee's recommendations are a welcome contribution to the debate, and the Government thanks the Committee for its report.

79. The long-term savings market is essential to the UK, and the Government is committed to addressing consumers' concerns. The Government's Stakeholder and Informed Choice initiatives are designed to address the information asymmetries inherent in the market, and the FSA continues to develop policy on disclosure, both in relation to product design and charges. The FSA's work on financial capability will be critical to helping consumers engage positively with the financial services market.

80. Restoring confidence in the long-term savings and investment market is indeed essential for the benefit of all in society. The Government remains committed to playing its part in meeting this objective.

HM Treasury
27 September 2004

APPENDIX 2

LETTER FROM THE FINANCIAL SECRETARY, HM TREASURY, TO THE CHAIRMAN OF THE COMMITTEE (SEE Qq 2186, 2191 AND 2192 OF HC 71-II)

PENSION CREDIT

When my predecessor gave evidence to the committee on 28 June she agreed to write setting out more fully the Government's judgement about the effect of Pension Credit on incentives to save. I am sorry that was not done before the Recess.

The Government aims to ensure all pensioners have a decent and fair income in retirement and that they share in the rising prosperity of the nation. We aim to promote saving for old age and to ensure people have opportunities and incentives to do so and we have taken a number of important steps in this direction. The Government is also determined (and has done a great deal) to tackle pensioner poverty while ensuring that the state pension system remains sustainable.

We designed Pension Credit with all these considerations in mind. Pension Credit tackles pensioner poverty, easing the highest marginal deduction rates faced by pensioners (which tend to undermine incentives to save) and keeping our system sustainable in the long term. It is an innovative approach to a familiar problem – the tension between the need to ensure there is a floor below which pensioner incomes do not fall, and the need to ensure that people are rewarded for saving.

Pension Credit rewards pensioners aged 65 and over who have made modest provision for their retirement by giving them extra benefit above the guaranteed level of up to £15.51 a week for single pensioners and up to £20.22 for couples. This ensures that pensioners who have saved and have income above the level of the basic state pension are better off than they would be if they had not saved. Many pensioners who have saved will now be eligible for extra help as a result of the introduction of Pension Credit but would have received no reward for saving under the Minimum Income Guarantee (MIG).

Under MIG 1.8m pensioners faced a 100% withdrawal rate. This means their benefit entitlement was reduced pound for pound for any extra pensions or savings they had built up. For those entitled to Pension Credit we estimate around 940,000 of pensioner households could have a 100% taper. The remaining 860,000 pensioner households that became entitled to Pension Credit will now have a taper of 40% or more (but in no circumstances as high as 100%) under Pension Credit. Others who were not entitled to the MIG but are now entitled to Pension Credit gained overall but have similar tapers.

When we were introducing Pension Credit we sought the views of the Financial Services Authority on the effect Pension Credit would have on incentives. They said then, 'The Pension Credit will mean that for most people most of the time it will pay to have saved.'

Therefore a choice to postpone expenditure until retirement does not reduce lifetime consumption and can increase people's satisfaction if it helps them to meet whatever aspiration they may develop for their living standards in retirement.

There is little information on how people make decisions about saving for retirement or how the availability of state or private pension provision affects this. The Government recognised last year in its response to the Work and Pensions Select Committee's Third Report on The Future of UK Pensions that it is important to improve our understanding of savings decisions and how savings incentives work.

These are complex questions and we want to engage with academic and other experts on how best to assess the influences on savings behaviour. This is an area that is currently being considered as part of forthcoming programmes of work. The Government has already established the independent Pensions Commission to monitor and keep under review the voluntary system of private pensions and long term savings.

Stephen Timms
Financial Secretary
HM Treasury
27 September 2004

APPENDIX 3

RESPONSE BY THE FINANCIAL SERVICES AUTHORITY TO THE EIGHTH REPORT OF THE TREASURY SELECT COMMITTEE SESSION 2003-04 (HC 71)

Introduction

1. This note is submitted in response to the Committee's eighth report of the 2003-04 session on long-term savings. In response to recommendations which are for the FSA we refer to the relevant paragraphs in the conclusions and recommendations section of the report.

Improving Product Information – (conclusions and recommendations paragraphs 3-6)

2. We agree with the Committee that "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". This is reflected in our published priorities. Our current work on product disclosure builds on the principles we set out in CP170 in February 2003:

'By regulating the information given to consumers at the point of sale – the disclosure regime – we seek not only to ensure that the consumer is informed, but to help him or her make effective use of the information provided…our efforts to improve consumer understanding must set priorities and focus on material we have identified as central to the consumer making a sound decision at point of sale…we must accept that less is more.'

3. Our approach to re-structuring the current disclosure regime has been driven by our understanding, based on extensive consumer research, of how consumers react to and take in information when buying an investment. This research has shown that visual appeal, simple language and clarity of layout are often more significant factors in conveying messages to consumers than the length of a document. So while we have been at pains to stress that 'less is more', and encourage firms to be concise, we have generally sought to avoid imposing an arbitrary limit on the length of documents and thus possibly deny consumers adequate information about the risks they are taking in buying complex investment products.

4. In CP 170, we proposed a new format for product information – branded 'Key Facts'. This is designed to focus the consumer's attention on key information that is likely to impact on a product's suitability. Our aim is to ensure that firms set out, in the first page (or at most two facing pages) of their Key Facts, short bullet-point answers to four or five questions, together with signposts to where the consumer can find out more.

5. We have started convening a working group which we expect will meet shortly to explore further and constructively the feasibility both of devising a short summary box along the lines recommended by the Committee, and of developing and publishing simple risk indicators for investment products. We will report back to the Committee at the end of the year on our progress.

Fees and Commissions – (conclusions and recommendations paragraphs 9 –15)

6. The FSA's aim in this area is to provide consumers with the information they need about the cost of advice that will help them in shopping around between different firms and in negotiating fair deals with individual firms. Our menu system will play an important role in this (see paragraph 10 below).

7. The Committee recommends a shift away from commission-based sales. Our consumer research has shown that many consumers prefer a commission-based method of remuneration to payment by fees. The main reasons seem to be a reluctance to pay for advice by way of a separate fee, and the fact that there is no payment to be made under a commission system if a product is not purchased. We would not consider a direct ban or limit on commission to be a proportionate response to the risk of commission bias. Instead, our plans for a menu will provide consumers with the information they need to shop around and negotiate with firms, so increasing competition. And it will encourage consumers to think about the choice between fee and commission-based payments.

8. However, in the context of our work on Treating Customers Fairly (TCF), we will be identifying good and bad practice in how firms build TCF into the way they carry out their business. One aspect of this will be a focus on the remuneration structures within

firms and the relationship between product providers and distributors with the aim of ensuring fairer outcomes for consumers. The outcome of this work will feed into our next TCF publication which is due in the summer of next year. We will keep the Committee informed of progress.

9. The Committee suggests that a fee structure that contains a stronger linkage to subsequent investment performance would help align more closely the long-term interests of the saver and the industry. This is a matter for the industry. There is no regulatory barrier to firms creating a fee structure which is linked to investment performance. It is also common for on-going charges on investments to be calculated on the basis of a percentage of funds under management. This means that both the reward to the fund manager and the level of trail commission payable is, at least to some degree, related to the value of the fund.

10. The Committee expressed some concerns about the structure of the menu, and recommended 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." Firms' menus will have to show whether they operate a fee or commission paid service, or both. If firms do not offer a fee option, they will have to make this clear. They will show the maximum rate of fees charged for advice, and/or the maximum rate of commission taken for various product groups, and the market average commission for each group. They will also need to spell out whether the service they offer includes on-going advice.

11. The menu will be given to consumers before the advice process begins. At this stage, the firm will not have sufficient information about the customer's circumstances to decide which product or products would be suitable and so will not be able to say exactly how much commission it will receive (the exact amount will be given to the customer once a specific product has been recommended and while the customer still has a right to cancel the contract). Similarly, at the time the menu is given, the firm will not know how long it might take to deal with the customer's circumstances where the customer chooses to pay by fee.

12. On trail commission, the Committee states that it is unacceptable for IFAs to receive trail commission whether or not they are providing any real on-going advice to the client and that 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.

13. An IFA must describe the services it will provide to clients in the terms of business document it must currently give out before a transaction. This requirement will also apply in the menu. A description of those services would normally state whether ongoing advice will or will not be provided. The payment of trail commission is sometimes presented for the purpose of on-going advice, but in fact no product provider makes the payment of trail commission dependent upon an IFA maintaining contact with a client. We welcome the work commissioned by the ABI on the role of commission and specifically the role of trail commission and measures which might foster on-going advice.

14. When the menu is introduced, if a client chooses to pay for an IFA's services by a fee our rules will require the firm to ensure that the full value of any commission it subsequently receives, whether trail or otherwise, is passed on to the client. There are, however, some serious practical difficulties in expecting firms to account for very small amounts of trail commission. To get around this problem we have provided a facility for the client and the firm to agree that the firm may retain trail commission up to an annual amount agreed with the client.

15. The Committee asks us 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.

16. As outlined in paragraph 10 above, a feature of the menu will be the inclusion of information about the average commission paid for the various groups of mass-market products. These "market averages" will be calculated by the FSA, published on our website and updated annually. We decided against including an equivalent market average for fees in the menu for a number of reasons. These include the fact that, as with other professions such as accountants, fees can be calculated in number of different ways (eg per hour, or as a flat fee) each of which would have to be reflected in the average and that there may be greater variations than with commission on the fees commanded in the market according to regional location or a firm with a well known name. Furthermore, whilst commission data can be collected from a small number of product providers, data for fees would have to be collected from a large number of individual IFAs, which could make the process disproportionately onerous and expensive. In the light of the Committee's request, however, we will consider further whether it is possible to produce figures for average fees in a way which is cost effective.

With-Profits – (conclusions and recommendations paragraphs 17-19)

17. The report refers to the FSA's programme for reform of with-profits, commonly referred to as "Principles and Practices of Financial Management". The aim of our reform programme is to promote transparency in with-profits and improve information provided to consumers.

18. The introduction of Principles and Practices of Financial Management (PPFM) is one component of our much larger package of reforms for with-profits and should not be thought of as an umbrella label for the proposals set out in CP 207, Treating with-profits policyholders fairly (December 2003). See paragraph 22 for further detail on our wider reform programme.

19. Since April 2004, with-profits firms have been required to produce a document called a PPFM for each of their with-profits funds. These publicly available documents capture the way in which a firm uses its discretion in running its with-profits business, and must cover areas such as amounts payable under a with-profits policy; investment strategy; business risk; and charges and expenses.

20. The requirement to produce a PPFM was driven by a desire to introduce greater transparency and better governance arrangements in the with-profits sector. Our intention was that the PPFM would be used by market analysts, IFAs and sophisticated investors to

help them improve their understanding of how a particular fund is run and decide whether to recommend investment. It is no surprise therefore that a number of expert witnesses cited in the report questioned whether PPFM would be of direct benefit to policyholders, since it was not our intention that this group should be the primary audience for PPFM.

21. However, the PPFM contains essential information and, to ensure that this information reaches a wider audience, we have proposed that firms also be required to introduce consumer-friendly versions of the PPFM from mid 2005. Our consumer testing of these documents has shown that they can help increase consumer understanding of how a with-profits fund is run. In addition, we recognise that consumers also get their information about different products from other sources, such as the media. In this respect, both PPFM and the consumer friendly version should prove helpful in informing wider market commentators.

22. Besides PPFM and the consumer-friendly versions, other components of our reform package to drive up transparency and improve information provided to consumers include:

- the requirement for with-profits firms to report to with-profits policyholders on whether they have complied with their PPFM obligations (from end of 2004);
- the requirement for the new with-profits actuary to report publicly on whether in his/her opinion the firm's report to policyholders can be viewed as having taken policyholders interests into account in a reasonable and proportionate way (from the end of 2005 - one year after the new actuarial functions have been introduced);
- guidance on governance standards for with-profits business to underpin the new reporting requirements to policyholders. This includes the desirability of an element of independent judgement over the assessment of a firm's compliance with PPFM and how it handled any conflicts of interest between different groups of policyholders and also shareholders, where applicable;
- work on enhanced disclosure at and post point of sale. This work includes the replacement of the Key Features document with Key Facts, which will improve clarity and transparency at the point of sale. We aim to publish the next CP on disclosure in the first half of 2005; and
- greater transparency over the financial strength of with-profits firms with the introduction of realistic reporting.

23. The Committee points to critical comments made in the Penrose Report into Equitable Life. These comments need to be read in the light of Lord Penrose's overall conclusion about the FSA's programme of reform, noting that it "…has sought to anticipate many of the lessons drawn by the inquiry" and that the work so far "..has reflected a major comprehensive reassessment of the requirements of an efficient regulatory system for the insurance sector."

24. Against this background, Lord Penrose's concerns appear to centre on the inadequacy of rules expressed in relatively high-level terms without effective supervision. While the FSA places great emphasis on the responsibility of the senior management of

regulated companies to run their businesses in accordance with our rules, this must be accompanied by vigilant and intelligent monitoring by the regulator. We have recently published a report that reviews the progress that retail firms across all sectors have made in delivering their obligation to treat customers fairly and considers next steps that firms need to take. It also describes the targeted supervisory work on fairness that we will be carrying out in 2004/05.

25. Lord Penrose also expresses doubt that with-profits can exist without mystery. It is important here to distinguish between mystery and discretion; the latter being a central characteristic of the way in which with-profits is operated. This characteristic need not operate against consumer interests, so long as the discretion has parameters that are adequately described in a company's PPFM and is exercised in accordance with these and with the other obligations to which with-profits firms are subject.

26. The report cites a figure of £161bn for assets invested in closed funds out of a total with-profits market of £365bn. Analysis of our year-end returns for 2003 shows £191bn of assets are invested in closed funds (both with-profits and non-profit) out of a total market value of £940bn for long term assets. Measured in terms of liabilities, the with-profits liabilities in closed funds amount to £84bn out of a market total of £333bn for with–profits liabilities.

27. Notwithstanding these figures, closed funds are a significant and growing issue for industry, consumers and the regulator. The potential impact on consumers is something that we are particularly concerned about and we agree with the Committee that a high priority must be placed on ensuring that policyholders in closed funds are treated fairly. Consumers in all with-profits funds, open and closed, should benefit from the introduction of PPFMs and the forthcoming consumer-friendly versions. Our consumer research shows that policyholders should gain a greater understanding of this complex product from the Consumer Friendly PPFM, but we will keep under review whether these documents actually deliver this objective in practice.

28. In response to the Committee's interim report into Mortgage Endowments, we noted the difficulties that arise in relation to the sale of closed funds and in particular, the feasibility of transferring policyholders out of closed funds at no cost. Market-based solutions are now beginning to emerge (by way of third party acquirers seeking to achieve efficiency gains) and we are encouraged by industry participants' appetite to engage with the challenge of safeguarding the fair treatment of policyholders in these funds. We are in dialogue with a wide variety of industry players about their plans in this respect. Our current consultation on fair treatment of With-Profits customers includes requirements for firms to notify policyholders when a fund is closing to new business and limiting the deductions firms can make – including in the form of MVAs – when policyholders leave a fund. In addition, we will be extending our programme of targeted supervisory work on the treatment of policyholders in closed funds later this year and into next.

29. We welcome the Committee's recognition of our reforms to the Appointed Actuary regime. These should improve the effectiveness of actuarial advice in protecting policyholders' interests as from the end of this year (in advance of any reforms stemming from the Morris review). Senior management of firms have a responsibility to treat

policyholders fairly, and should not be focused purely on the interests of management and shareholders.

30. More non-actuaries are becoming involved in safeguarding policyholders' interests, for example as a result of bringing policyholder liabilities within the scope of the audit and through independent input to governance (noted under point 22) where our guidance indicates that this can be provided by persons other than actuaries, such as those with experience of consumer protection, the life industry, regulation, the law and accountancy.

Money Laundering – (conclusions and recommendations paragraph 24)

31. Under Treasury's Money Laundering Regulations 2003 (which replaced the 1993 Money Laundering Regulations with effect form 1 March 2004) and our Money Laundering Rules, there is a legal obligation on financial services firms to verify their customers' identities. However, neither the regulations nor the rules specify exactly how identity verifications should be undertaken. The financial services industry, through the Joint Money Laundering Steering Group (LMLSG) of some 16 trade associations has, over many years, developed good practice guidance which outlines a variety of means that can be used to identify an individual.

32. There is wide recognition, as the Committee notes, that the present approach to identification can be improved, including in its impact on customers. We are leading a review involving all the stakeholders (consumers as well as the industry, law enforcement, government and others). We expect this to result in the development of a simpler regime that will streamline the process for firms and customers while retaining the value of identification in the fight against crime.

Speed of the enforcement process – (conclusions and recommendations paragraph 25)

33. We have conducted an 'end to end' review of the Enforcement process which was divided into 3 parts and published the results on 15 July 2004 . Separate teams looked at each of the case referral, investigation and decision making stages.

34. Although we concluded that the criteria for referring cases could stay as they are, we have tightened up the process and made it more streamlined. We have made or are in the process of making a number of changes to the management and conduct of investigations to ensure that they stay focused and transparent and are currently working on improving our IT capabilities. We are considering how to tighten the procedures of the Regulatory Decisions Committee (RDC) but we also need to ensure that the outside world is better informed about the RDC and has more realistic expectations of it.

35. Over the last two years we have reduced the average time taken to complete an enforcement case by around 30%. As a result of the new arrangements, we expect that time to reduce further. Implementation of the changes is well under way and speedier results are already occurring in investigations we have conducted this year. Our investigations into Shell and trading in Marks and Spencer plc shares are recent high profile examples.

Financial Ombudsman Service – (conclusions and recommendations paragraph 26)

36. As part of the two-year review of the Financial Services and Markets Act, Treasury asked the FSA and the Financial Ombudsman Service (FOS) to review the circumstances in which the FSA takes regulatory action instead of individual cases being determined by the Ombudsman and to consider whether Ombudsman decisions should be subject to some form of appeal in specific circumstances. FSA and FOS issued a joint consultation paper on 2 July.

37. The consultation paper sets out proposals to clarify the differing roles and responsibilities of the FSA and FOS when "wider implications" cases arise. It explains how and when the FSA may deal with such cases through the use of regulatory powers and it sets out proposals to improve the coordination between FSA and FOS in cases with wider implications. FOS proposes to build on its existing Industry Liaison Group arrangements which should provide a more formal mechanism to achieve input from stakeholders.

38. The consultation paper concludes that there are significant disadvantages and practical problems with a general appeals process against Ombudsman decisions. The consultation closes on 1 October and we will publish the conclusions of the review later this year.

Public Knowledge of the FSA's role – (conclusions and recommendations paragraph 27)

39. Our policy is to target our communications at particular groups of consumers who need help. This means that consumers get reliable, clear and up-to-date information at the right time to help them take specific decisions. Two high profile areas where we have done this include mortgage endowments and the pensions review. On mortgage endowments for example, more than 33 million copies of our factsheets were distributed to help consumers understand how their mortgage endowment worked and to explain the options open to them. We believe this targeted approach has more impact on consumers than general advertising campaigns which are not linked to particular concerns or issues consumers may have. In addition, our consumer website is a significant source of information about the FSA and financial services from a consumer point of view. We are looking at ways in which we can raise awareness of the service we provide consumers – e.g. our comparative tables – more effectively.

Public Forum – (conclusions and recommendations paragraph 37)

40. The Committee recommends the creation of a forum so that the industry, the regulator and consumers can establish a collective, forward looking joint agenda. As John Tiner said in evidence to the Committee on 23 June, a forum could be helpful but not one which repeats work already being done in other collaborative forums. We already have in place effective mechanisms to engage in dialogue with Government, industry and consumer groups. This happens generally through for example, the Practitioner and

Consumer Panels and regular contact with consumer bodies such as the Consumers' Association and the NCC. It also happens in specific circumstances through for example, the Financial Capability Steering Group which brings together all the relevant stakeholders. In the context of Treating Customers Fairly, we will shortly establish a Consultative Group made up of industry and consumer groups to help us take forward our work in this area. So, collective action between the main players is extensive and will continue.

41. The range of issues proposed for this forum is very wide, including broad issues which affect consumers' confidence in long term savings and incentives to save and invest. If such a forum were established we would play our part. Given the wide range of issues it would cover, including many outside our responsibilities, it would not be appropriate for the FSA to take the lead or chair such a forum.

Financial Services Authority
21 September 2004

APPENDIX 4

MEMORANDUM FROM THE FINANCIAL SERVICES AUTHORITY: INFORMATION REQUESTED BY THE TREASURY SELECT COMMITTEE AT THE HEARING ON 23 JUNE 2004

Introduction

1. When we gave evidence to the Committee on 23 June, we undertook to provide further information in a number of areas. This memorandum covers:

- standardised risk rating systems;
- information on companies that are not time barring complaints;
- clarification on commission payments; and
- softing and bundling.

Standardised risk rating system (See Q1973 of HC 71-II)

2. We gave the Committee a commitment that we would work with the industry to see if a standardised risk rating system would be viable. As part of our wider review of the information received by consumers (CP 170: "Informing consumers: Product disclosure at the point of sale") we will consider whether there is a practical and consumer-friendly form of standardised risk indicator which can be adopted. We publicised this intention on 5 July in our press release about the review of projection rates.

Time barring mortgage endowment complaints (See Qq1937-1939 of HC 71-II)

3. In evidence to the Committee Callum McCarthy said that 13 out of 20 major firms were not, at that point, relying on time bars to reject complaints. The Committee asked us to provide the names of firms who are not time barring mortgage endowment complaints.

As at 20 July 2004 there are 13 firms who are not currently relying on time bars to reject mortgage endowment complaints. 9 of the 13 firms have given us permission to disclose their name to the Committee for publication and a list of these firms is attached at Annex A.

Of the other seven, some are applying time bars selectively, in that they are considering the broader circumstances of the complaint before deciding whether or not to use limitation to reject the complaint. One firm, for example, has said that it will judge mortgage endowment complaints on a case-by-case basis and not reject complaints on time barring grounds alone.

Clarification on commission payments (See Q2023 of HC 71-II)

4. The Committee asked if clients were guaranteed to get all commission rebated to them if they opted to pay a fee for advice from an intermediary under the new depolarised arrangements. The position is that the client is guaranteed to get the value of all commissions but there are some technical restrictions that would prohibit certain arrangements (such as refunding commission to a client in cash in respect of a pension contract subject to tax relief - this would contravene Inland Revenue requirements).

5. The draft rules on which we have consulted require the firm to ensure that the transfer of the value of the commission occurs by one or more of:

- reducing the amount of the fee by the amount of commission received;
- increasing the client's investment amount; or
- refunding the amount of the commission directly.

6. In addition, we proposed a provision to deal with the difficulty that renewal or trail commission can often not be reinvested for a client's benefit, and where the practical difficulties and costs of reconciling would probably outweigh the net potential benefits to clients. So a firm may retain an amount of trail or renewal commission when acting on fee terms, but only up to an annual amount specified in the fee agreement.

7. The Committee also asked about trail commission if a client severs all links with an IFA. There is no automatic cessation of the trail commission in these circumstances. However, where a client asks a new IFA to take on responsibility for oversight of an existing portfolio carrying trail commission that would otherwise continue to the originating IFA, it is standard market practice for a request to transfer the trail commission entitlement to the new IFA to be granted.

Softing and Bundling (See Qq 2070-2071 of HC 71-II)

8. Our work on soft commission and bundled brokerage practices has been driven by our concern to promote transparency and accountability. Both these practices involve fund managers using their clients' funds to generate a flow of goods and services to the fund manager and so generate conflicts of interest for the fund manager. We believe it is important that clients understand what they are paying for. Armed with that information, clients can use their bargaining power to enforce change where that is necessary.

9. In our recent policy statement (Policy Statement 04/13), we said that we intend to restrict softing and bundling to the provision of investment research and execution. During the past year or two, some firms have developed innovative solutions to this issue, putting the investor in a stronger position to establish value for money from the fund management service. We have said we want to see market wide solutions and we expect the industry to develop a workable and effective disclosure framework by the end of this year. If not then the FSA will consider what further regulatory action is necessary.

10. We must now define the scope for the new regime. What should "execution" and "investment research" mean for this purpose? To help us decide, we are arranging meetings with representative interested parties. We shall in due course need to consult formally and publicly when all firms and consumers will have an opportunity to comment.

11. We understand that some of the firms who currently provide or obtain goods and services through softing and bundling arrangements may need to change the way they do business. Our work is, however, concerned with the manner in which goods and services are paid for. If a particular good or service is valuable to fund managers, we believe that they will pay for it.

Annex A

Firms who are not currently time-barring in handling complaints by policyholders about mortgage endowments[5]

Aviva; Barclays; CIS; Legal & General; Nationwide; Prudential; Royal London; Standard Life; and Zurich

Four further firms are not currently time-barring but have not given the FSA consent to disclose their names.

Financial Services Authority
20 July 2004

[5] As at 20 July 2004

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	*HC 1054*
Eighth Report	Restoring confidence in long-term savings	HC 71	

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.