



CFA UK is a member society of



Joanna Bibby-Scullion
Savings and Investment Team
Room 3.20
HM Treasury
1 Horse Guards Road
London, SW1A 2HQ

1st April 2011

Dear Joanna,

The CFA Society of the UK (CFA UK) is pleased to respond to HM Treasury's consultation document (conduc) on Simple Financial Products

The society represents investment professionals in the UK, most of who hold the CFA designation and work as front office investment professionals (managing portfolios, researching securities and advising on asset management). This response has been prepared by CFA UK's Professional Standards and Market Practices Committee, in consultation with CFA Institute. The society has not surveyed members in relation to HM Treasury's paper on the conduc due to the extensive number of questions within the paper. As a consequence, the committee's response is brief. However, we make a number of observations that we believe to be important and that we hope will be useful in directing HM Treasury's approach when it comes to achieving its policy objectives.

CFA UK is concerned that trust and confidence in the financial services industry is at a low level. The promotion of higher professional and ethical standards and individuals' adherence to those will play an important part in restoring trust and confidence.

About CFA UK and CFA Institute

The CFA Society of the UK (CFA UK) represents the interests of more than 9,000 leading members of the UK investment profession. The society, which was founded in 1955, is one of the largest member societies of CFA Institute and is committed to leading the development of the investment profession through the promotion of the highest ethical standards and through the provision of continuing education, advocacy, information and career support on behalf of its members. Most CFA UK members have earned the chartered financial analyst (CFA) designation, or are candidates registered in CFA Institute's CFA Program. Both members and candidates attest to adhere to CFA Institute's Code of Ethics and Standards of Professional Conduct.

CFA Institute is the global association for investment professionals. It administers the CFA and CIPM curriculum and exam programs worldwide; publishes research; conducts professional development programs; and sets voluntary, ethics-based professional and performance-reporting standards for the investment industry. CFA Institute has more than 100,000 members in 140 countries, of whom more than 90,000 hold the Chartered Financial Analyst® (CFA®) designation.

Opening remarks and context for the response

Nudge the demand side, supply already exists – CFA UK welcomes the condoc’s acknowledgement of the behavioural factors that can determine a consumer’s choices when it comes to financial products. This is a progressive development in policymaking. However, our view is that too much emphasis is placed on the supply side of the market instead of placing greater emphasis on the demand side. Applying greater emphasis on the demand side might be a useful way of using behavioural factors to the benefit of the consumer. **Consumers could be made aware of the key risks that they can manage using financial products.** The key risks that most consumers face can be identified as mortality and/or longevity risk and current and future income risk.

Reframe the objective. Where’s the “will” to bring about progressive change? The condoc should reframe the objective so that HMT focuses on categories of simple financial products and defines the features that would qualify them as simple. We would propose that such products already exist; examples include deposit accounts, National Savings, tracker funds, level term life insurance and income protection. Leaving it to product providers without input from consumer groups to provide the definition would create additional confusion especially as providers compete with each other using price and non-price features. The challenge is not whether such products exist but **how consumers can choose the right combination given their circumstances and to what extent they can afford them.** Most consumers need help in finding appropriate products, gaining an understanding of features and costs, choosing the right combination and ensuring that the combination is relevant throughout their lifetime.

Engaging in an exercise under which consumer groups and industry work together to develop a new set of ‘simple’ products might be unnecessary and could even work to reduce choice and stifle innovation. The more significant issues that need to be addressed are financial education for consumers, how to provide actionable, independent advice, and how to help consumers make comparisons between providers (in some cases this is already being done via comparison websites and other websites such as moneysavingexpert.com).

High professional and ethical standards are key – In the condoc, FSA research found many consumers in the UK lack the confidence and capability to make effective decisions about their money. The Gfk NOP research also found that consumers feel a lack of interest and engagement with financial matters and that they do not feel fairly treated by the industry. Consumers fear making ineffective decisions or being caught out by the smallprint when purchasing products.

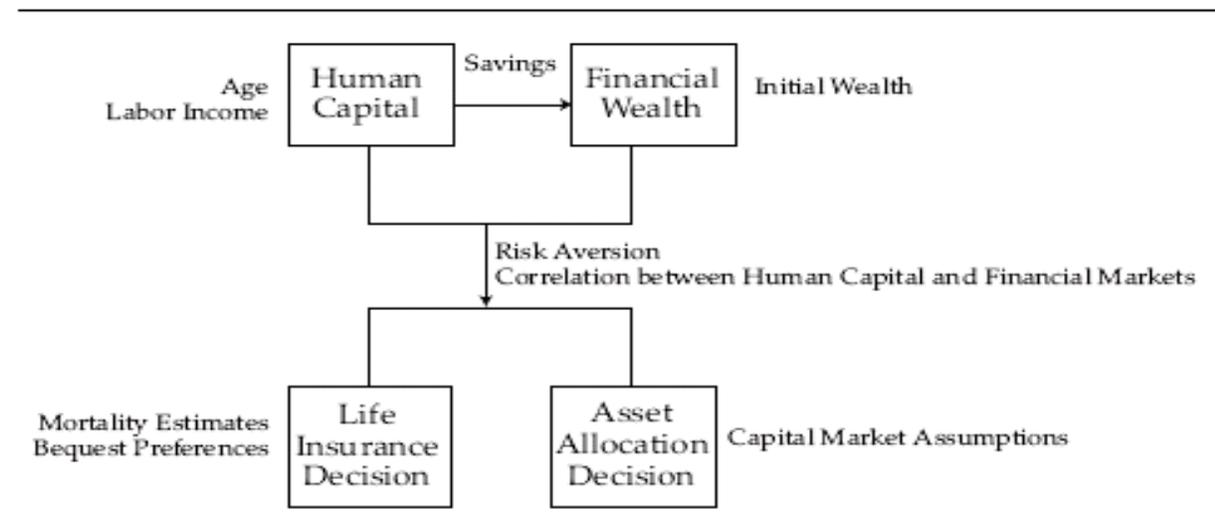
To address these concerns it would be important for consumers to seek out advisers that are well qualified, place clients interests first at all times and adhere to the highest professional and ethical standards. The proposals under the FSA’s Retail Distribution Review are a step in the right direction and the next step would be to help consumers identify advisers that place client interests first. In doing so consumers will have more confidence in the industry and this will also contribute to enhancing the integrity of the market.

Gaining understanding – The condoc defines simple products as those that are easily understood and can be compared between providers. The key here is how the consumer gains this understanding and how such products can be selected so that they are aligned to the consumers’ circumstances, objectives and biases. Figure 1 below highlights the importance of understanding the relationship between human capital, protection and investment. By understanding this relationship consumers can determine the combination of financial products required to meet their requirements. This framework highlights the

requirement for consumers to be aware of the risks they run and how to combine products to meet these needs. Only a small proportion of consumers may be able to recognise these interdependencies.

Many consumers may lack the knowledge and skills to create the appropriate combination to meet their needs. The Consumer Financial Education Body (CFEB) initiative on money advice is an important contribution, although making the specific choices to achieve the appropriate combination of products will require professional advice from appropriately qualified advisors that place clients' interests first. The need for qualified, responsible advice is essential given that consumers are heterogeneous and will have a diverse array of requirements and needs; needs that may not always be met by a narrow range of 'simple' financial products. Rather than focusing on the development of 'simple' financial products, might it not be more productive to focus on the development of 'simple' financial advice that would help consumers then make appropriate choices from the selection of products already available?

Figure 1 - Relationships among Human Capital, Asset Allocation, and Life Insurance¹



Clearly, it would also be valuable for product providers to be encouraged to simplify marketing and enrolment materials so that consumers can more easily gain a clearer understanding of product features and costs, thereby leading to greater confidence in their investment choices. The recent financial environment has certainly not contributed to enhancing consumer confidence and assurance that products are promoted with consideration for their needs and circumstances. As noted earlier, while obtaining the services of a trusted adviser is preferable unless it is uneconomic to do so, not all consumers will do so. It is, therefore, important that product features and costs be outlined as clearly as possible to assist consumers in making appropriate choices. Perhaps products that were regarded as providing clear, simple and accurate information about their purpose, risk and return characteristics could receive some form of 'kite mark' to indicate their accessibility.

¹ Lifetime Financial Advice: Human Capital, Asset Allocation, and Insurance, Roger G. Ibbotson, Moshe A. Milevsky, Peng Chen, CFA, and Kevin X. Zhu. CFA Institute Research Foundation Publications, Lifetime Financial Advice: Human Capital, Asset Allocation, and Insurance (April 2007): 1-95.

Next steps – We welcome the desire to call upon the industry to assist in this worthwhile initiative. Equally important will be the contribution from consumer groups. A way forward might be -

- i) HMT should promote collaboration between investment firms, investment bodies and consumer groups to define the risks faced by consumers; to categorise the product types required by consumers to manage the key risks that they face; and to establish within each product type, the features and characteristics that products would need to qualify as 'simple'.
- ii) Following the product assessment, the next step would be to see where improvements are needed and to what extent intervention (in the form of a kite mark) might be viable without distorting the market.
- iii) The final step would involve how to engage consumers. How can Government encourage consumers to identify the role that financial planning (savings, insurance and investments) can play in improving their quality of life? We need initiatives to encourage and promote informed financial planning and to guide consumers to seek out appropriate solutions. Access to cost effective simplified advice would complement the simple financial products initiative.

Responses to questions

Question 1: The Government would welcome general comments on the vision and objectives for a new regime of simple products.

CFA UK welcomes this initiative although the key challenge exists on the demand side and not the supply side. Our observations presented above indicate where the Government can obtain the maximum consumer benefit when it comes to individuals taking responsibility for their financial needs. Instead of focusing on the supply of simple financial products the emphasis should be on making consumers aware of the types of risks they face and how financial products can assist in managing these risks.

Question 2: Should this work be led by industry and consumer groups and not Government?

Collaboration between the Government and stakeholders is key to the success of this initiative although it has to be carried out in a manner that always places the consumers' interests first. Government can create the appropriate infrastructure so that consumers can be assured of the integrity of the market and that advisers will place their clients' interests first at all times. The additional requirement for the Government will be to ensure that any regulation (current or future) is effective. As simple financial products already exist, the collaboration with stakeholders should be focused on helping consumers identify the risks they face and how best to manage them using simple financial products.

Question 3: How can industry and Government ensure a voluntary set of standards offers sufficient protection for consumers?

As we stated in our response² to the consultation on "A New Approach to Financial Regulation," last year; market integrity can be enhanced by having regulation that is supervised and enforced. Voluntary standards may not be as effective in restoring trust and confidence. Industry and Government will also need to collaborate with consumers.

Question 4: Are there any reasons that simple products should have price caps or other standardised pricing features?

The pricing of the product should be determined by the interaction of consumers and providers and competition between providers. The key issue here is that the consumer has the appropriate understanding of the costs and willingness to make the appropriate choice in managing the risks they face.

Question 5: How could simple products be used as a benchmark or a comparator? Is there a case to support this with regulation, as with the RU64 rule?

The benchmark should be based on the risks consumers face and how they want to manage them. Consumers could be given at a high level, a suite of generic products in demonstrating how to manage risks. However, when it comes to specific product choices and combining them in a meaningful manner, many consumers will require professional advice.

Question 6: Are there any groups in particular that simple products should be targeting? If so what implications would this have for the development and promotion of simple products?

Many consumers face similar risks and it is their appetite to mitigate/manage them that will determine which ones they should choose. In addition, affordability of the simple financial products will also determine the extent to which consumers can purchase them. Low income families may need life insurance but may feel they cannot afford the level of cover required, resorting to a lower level of cover, none at all, or seeking alternative means of protection.

If there is a place for simple products, it would be among those consumers whose potential investment or premiums are so low as to make independent advice uneconomical.

Question 7: Is it practical or desirable to have a range of completely standardised products? Is standardisation more practical for some products than others?

We do not believe it is desirable to have a range of completely standardized products.

There already exist groups of products that share common features and benefits. However, not all simple financial products share the same risks. For example a fund that tracks an equity index by buying the constituents of the index will have a different risk characteristic than a fund that uses derivatives to replicate the performance of the same index. On the surface, the use of derivatives may be cheaper but it does involve some counterparty risk. Similarly, deposit accounts may differ in the rates they pay savers although savers need to be aware of counterparty risks. As savers in Icelandic banks and investors in Lehman Brothers products found out, the ultimate counterparty risk cannot be assessed by the cost or return on a financial product.

²CFA UK response to "A New Approach to Financial Regulation,"
https://secure.cfauk.org/assets/2028/HM_Treasury_response_final_version.pdf

Question 8: Beyond standardisation what other measures could be used to help improve consumer understanding of product features?

Accessible, impartial advice would be helpful in helping consumers appreciate all the risks and benefits associated with the products they are buying (please see response to Q7). For example when a consumer invests in a fund, the consumer should be aware of the risk adjusted return of the fund net of fees³. Consumer education is important so that the financial amnesia of the past is not repeated in the future. Simplified advice that results in specific recommendations may also be helpful.

Question 9: Should someone police the standardisation of products?

CFA UK supports regulation that is supervised and enforced as this contributes to enhancing market integrity.

Question 10: How could the simple products brand be developed?

The simple financial product brand already exists, an example being National Savings. However, it is the demand side that needs attention. Financial products such as investment products are experience/credence goods that are difficult to assess ahead of time. Policymakers should not try to homogenise financial products or fall into the trap of aligning these products with other types of non-financial standardized goods such as groceries. Buying groceries from a major supermarket involves a completely different set of assessments than seeking to purchase financial products from the same supermarket chain.

Question 11: How can consumers be reassured that these products meet the required standards?

There are three ways in which this is possible –

- 1) By seeking professional advice from advisers that always place clients' interests first and adhere to the highest professional and ethical standards.
- 2) Confidence that the regulator will hold to account those advisers and product providers that undermine market integrity.
- 3) Encourage product suppliers and marketers to focus on simplifying marketing materials in an effort to enhance consumer understanding and confidence.

Question 12: Do you agree that deposit savings products and protection products should be the initial areas of focus? Are there significant features or product characteristics in these categories that would lend themselves to standardisation?

Deposit savings products and protection products would be useful starting points with respect to managing mortality and income risk. Furthermore these products may be more suited to homogeneity than investment products. However, consumers will need to be aware of the risks associated with these products, for example the compensation limits on savings accounts, insurance contracts, counterparty risks etc.

³CFA UK response to the FSA's Financial Promotions Guidance Consultation
https://secure.cfauk.org/assets/2126/CFA_UK_responseFSA_Fin_Prom_Guidance_SENT.pdf

Question 13: Do you have views on how simple financial products could be developed to benefit particular age-groups or sections of the market?

No

Question 14: The Government would welcome any evidence about costs and benefits of developing a new regime of simple products, preferably drawing on experience of implementing previous simple products initiatives or introducing new products lines.

We believe that there is no need to develop a new regime of simple financial products as they already exist.

Question 15: What would be the benefits and disadvantages of linking simple products to CFEB's national financial advice service, including within the financial health check?

There are benefits for consumers to obtain advice from an impartial source although the Consumer Financial Education Body's (CFEB) will need to ensure that those providing the advice meet the standards required of regulated advisers. When it comes to achieving the appropriate combination of products to manage the risks faced by an individual, only those qualified to do so should provide it. For example, can the CFEB assess the risk attitude of a consumer? Can the CFEB calculate the amount of insurance a person requires and identify the most suitable policy? Can the CFEB construct a portfolio to meet the requirements of the consumer and make the necessary changes to address potential shortfalls/surpluses? If the answers to these questions is 'yes' then the CFEB is well equipped to provide regulated advice. If the CFEB cannot meet these requirements, then its limitations should be made clear to consumers.

The CFEB financial healthcheck is a good starting point for consumers although more should be done to ensure that there is greater engagement with this service. In addition, CFEB could enable consumers to identify the risks they face and be given a generic suite of products that could help guide and inform the consumer as to what type of products are required. From this point there may be a need for a cost effective simplified advice regime to provide specific recommendations.

Question 16: Should the new regime of simple products be linked to regulated advice? If so, how might this work?

We propose that the focus of the initiative should be on risk management rather than a new regime for simple products. In helping to choose the appropriate combination of financial products the majority of consumers will require professional regulated advice. RDR will be a step in the right direction although there may be more emphasis on a simplified advice regime.

Question 17: The Government would welcome evidence on the role of savings stakeholder products in the market and the effects of removing or keeping them.

No comment

Question 18: The Government would welcome evidence on how the basic advice regime is working, if it is understood by consumers and profitable for providers.

No comment

Question 19: The Government would welcome views on any other wider issues that need to be considered alongside simple products, including the impact on the wider market.

As we stated in our opening remarks the market may not be functioning effectively because many consumers lack the understanding, knowledge and awareness of the key risks that can be managed by using financial products. With trust and confidence in the financial sector at a low; the emphasis should be on improving market integrity and ensuring that financial professionals adhere to the highest professional and ethical standards so that they always place their clients' interests first at all times. The role of the regulator will be to assist consumers in identifying those advisers that place their clients' interests first and hold those that do not to account.

We trust that these comments are useful and would be pleased to meet the HM Treasury team to explain or to develop them for further with the policy team.

Yours,



Natalie WinterFrost, CFA FIA
Chair Professional Standards & Market Practices
Committee, CFA UK



Will Goodhart
Chief executive
CFA Society of the UK