SANDLER PRODUCTS
–INDEPENDENT ADVICE IS ESSENTIAL TO AVOID 'MIS-BUYING'

We now have the specification proposals for the Sandler suite of 'stakeholder' products. They are meant to offer better access to low and middle income groups, comprising some 15 million 'novice' potential savers and another 10 million or so who need to save more than they currently do. The products are to be simple, low cost and low risk, to ensure they 'could be purchased safely without regulated advice'.

Well, I believe that, as proposed, this will not work. In fact, the target group may actually end up worse off. Many of these people should not put money into the Sandler products at all, but no-one will be expected to tell them this. However cheap, simplified or low risk they are, the products may just not be suitable. The potential investors may need to pay back debt first, or buy an ISA, rather than a pension (for example, if they will end up on pension credit), but there will be no adviser to assist them.

The Sandler Review claims that it is not economic to give advice to lower and middle income groups, so the products themselves should be regulated, to enable them to be sold without advice. This is very worrying. If the current advice structure is too expensive, we need to find ways of reducing the cost, rather than trying to do away with the advice. A majority of the population, especially those in the target group cannot manage financial planning and investments on their own.

Why is independent advice essential?

1. Most people do not find financial matters easy to understand. Even the simplest leaflets or decision trees are likely to be too daunting for many to comprehend on their own. They do not find basic investment concepts easy to grasp.

2. Potential investors generally need to be persuaded to buy financial products. Especially after the recent scandals and loss of confidence in financial services, people are not sitting at home wishing there were cheap, simple products for them to buy. They are not going to rush down to their supermarket or other stakeholder outlet as soon as the products are launched. Someone will need to encourage them, to hold their hand through the process, otherwise they will probably not bother.

3. Individuals are unlikely to be able to assess which product will be suitable for their circumstances. 'Self-suitability' checks will not work. Should they have the guaranteed fund, the unit trust, the with-profits fund or the pension? How will they know whether they should buy a pension or an ISA? The checkout person at Tesco's won't help them with this. If they take out the Sandler pension and end up losing most of it in pension credit, they will have 'mis-bought'.

4. Investment risk is not always an easy concept to understand. In fact, it is intriguing that the document describing the specification of these new products and how they will be 'risk-controlled', does not actually define what 'risk' is! It states that a maximum 60% exposure to equities will be sufficient to ensure the products are 'low risk'. This is far too simplistic. Officials seem to believe that risk is best controlled by 'appropriate' diversification of asset allocation and claim that 'in practice, this means setting a maximum level of equity exposure'. Risk control is about far more than this. 60% in equities will still mean potential for significant capital losses and will not participate fully in rising markets. The characteristics of equities and non-equity assets held, and what level of global diversification there is, will be critical to the performance of the portfolios. I will not go into this debate here, but people may be lulled into a false sense of security that Government has designed a 'safe' product for them. However, someone will need to explain the difference between 'low risk' and 'no risk'. Most of the target group say they do not want to take any risk at all, which means they do not want to

lose money. This suggests that they would prefer some kind of 'guaranteed' product. But they need to understand the difference in potential returns from the various options in the Sandler range and perhaps the concept of having a diversified portfolio of products, rather than just buying one type of investment from one company. If not, many purchasers may end up disappointed.

Without ensuring that people receive advice, we may thus move on from 'mis-selling' scandals of pensions and endowments, to 'mis-buying' scandals of Sandler products. At least with mis-selling, the victim has some potential claim for redress. With mis-buying, there will be none. How does this improve things for the consumer?

<u>Independent advice cannot be given within the 1% charge cap:</u>

Giving advice costs money and it cannot be done for most people within a 1% charging structure. This is another fundamental flaw in the Sandler proposals. 'Government believes that the 1% charge cap on stakeholder pensions and CAT-marked ISA's has brought considerable benefits to the consumer' because they have driven down charges for all products. In fact, it could be that the target group have hardly benefited at all. These people have been 'locked out' of the advice process, because it is not economic to advise them in a 1% world. Therefore, the charge caps succeed in driving down costs for products bought by *higher* income groups, while the target consumers may end up with no advice, the wrong products or no products at all!

To suggest that reducing the cost of selling these products will improve 'access for those on low to middle incomes, without sacrificing consumer protection' is misguided. Access may be worsened, because there will be no adviser to help the buying process and the risk of consumer confusion will increase. This could weaken consumer protection.

Another problem with the 1% charge cap is that providers may just not offer the products. Particularly after the disappointing experience with stakeholder pensions, they may decide it is not financially viable to develop these new Sandler vehicles. If providers are unable to earn a sufficient return from selling pensions at 1%, they are even less likely to be able to do so on other products. This is because pensions are long-term investments, locked in for many years, and consumer inertia tends to mean they stay with the original provider. Other financial products are generally not held for as long and, as it is estimated that stakeholder pensions require a 12-15 year period before the provider can make a profit, the pay-back time horizon may be too long to justify developing the new range.

Furthermore, many companies may just decide it is too difficult to sell into the UK retail market and switch their attention elsewhere. Why should they develop products for the UK market, where the charges are capped, when they could offer similar products in other countries and make much higher returns? This would end up reducing competition, weakening the UK retail financial services sector and worsening the position of the consumer.

<u>What could be done?</u>

A 1% charge (or even slightly less) to run the product would be fine, but extra charges are needed to cover advice. This could be structured as traditional commission, or a one-off up-front charge, or perhaps a minimum and maximum permitted deduction. Maybe there could even be a sum to pay for a financial planner's time.

The independent 'specialist' advice required with these products should focus on financial planning, rather than being product-driven. There need not be a full fact find, as we know it today, but could be a set of basic questions to assess suitability for those without complicated financial affairs.

The most effective method of delivering such independent financial planning advice would be through the workplace. Employers could be incentivised to arrange this for their employees and the economies of scale for advisers would enable the advice to be delivered more cheaply. The FSA would need to approve a 'less onerous' advice process for people with uncomplicated circumstances. Perhaps this could be based on the Sandler 'financial healthcheck' product that is being proposed?

With a little creative thinking, it should be possible to design a system that would truly benefit the target group of potential investors. Sadly, I fear the current proposals will not do so.

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