The Actuarial Profession
making financial sense of the future

In Place of Micawber: Empowering Financial Consumers

A Lecture by the Chairman of the Inquiry into the Provision of Financial Information and Advice, set up by the Actuarial Profession

Contents

The Actuaries' Inquiry into the Provision of Financial Information and Advice was launched in February 2000, under a Panel chaired by Sir John Banham (Chairman of Kingfisher PLC and Whitbread PLC). The Panel was asked to review the different ways in which individual consumers receive information and advice on the suitability of different financial products and services, and to consider the effectiveness of existing arrangements.

The other members of the Panel are: Sir John Carter (Chief Executive of Commercial Union from 1994 to 1998); Professor Tim Congdon (Managing Director of Lombard Street Research); Mary Francis (Director General, Association of British Insurers); Michael Hepher (Non-Executive Director, Kingfisher PLC; Canada Life Financial Corporation; and Hambro Fraser Smith); Mick McAteer (Senior Policy Adviser, Consumers' Association); Barry Riley (Investment Editor, Financial Times); Paul Seymour (Non-Executive Director, Marlborough Stirling Group; Creechurch Underwriting); Paul Smee (Director General, Association of Independent Financial Advisers); and Derek Wanless (Non-Executive Director Northern Rock plc; Chairman, Financial Services National Training Organisation).

This Lecture sets out the Inquiry Panel's main findings about existing arrangements for the provision of financial information and advice, and about ways to improve personal financial planning. It is being published by the Actuarial Profession, in parallel with an account of consumer research conducted on the Panel's behalf in late 2000 and early 2001.

In Place of Micawber: Empowering Financial Consumers

Lecture by the Chairman of the Inquiry into the Provision of Financial Information and Advice set up by the Actuarial Profession

Introduction

Since the start of last year, a Panel, brought together by the Actuarial Profession, has been working hard to make sense of the future for financial consumers. I hope you will agree that, as providers of financial services, representatives of those providing financial services and advice, consumer advocates and respected financial commentators, the Panel's membership is made up of people whose opinions are worth listening to with some care.

Plainly, this is no time for platitudes. The Actuarial Profession brought the Panel together because it felt that not enough attention was being given to the real needs of financial consumers at a time when these needs were growing as a result of economic and demographic developments, and changes in the provision of financial products and services.

While the Panel has been at work consumers have received some contradictory signals. The Government is urging everyone to save more for the future and to look to do this through the private sector rather than the State. Yet customers are also warned by the media and financial regulators about the potential pitfalls of buying retail financial products, especially those linked to the equity markets. Such concerns have focused during the last year on the decision by some major financial services companies to close down their direct sales forces, on the past selling of endowment mortgages, on the sharp decline in technology, media and telecommunications shares, on the House of Lords judgement in the Equitable Life case and, most recently, on the problems faced by Independent Insurance. Such cases have highlighted the risks associated with financial products, and have underlined the importance of ensuring that consumers understand the nature of these risks. They must understand the need to spread risk, and have sufficient savings to cope with the fluctuations in the value of investments. In turn, the experience of the recent past points to the need for consumers to receive the best possible information and advice before they purchase.

What is going on? What should the UK financial services industry be doing to respond? What are the implications for Government, regulators and consumers? These are the questions with which the Panel has been grappling. The purpose of this Lecture is to present the Panel's broad conclusions and recommendations:

i) **Our main finding**: British society is, effectively, sleepwalking into a financial future for which it is ill-prepared. Less than one family in five is currently making anything close to adequate financial provision for retirement income and old age.

ii) **Our conclusion**: Families must be empowered to make informed choices for their financial futures. The road to financial perdition is paved with good intentions. Regulatory requirements for disclosure of product information, league tables of competing products, and badging with official kitemarks can all help – but they may simply overload individual consumers and add to confusion and apathy. Expert advice cannot be written out of the script. As traditional sources of advice dry up, new reserves need to be brought on stream.

iii) **Next steps**: Making financial sense of the future is a process not an event. So the final section points to what needs to be done, and by whom, in order to bridge the present information gap and to bring about personal financial planning for the many, not the few.

Personal Financial Futures

It was Groucho Marx who famously remarked that: "The future is not what it was".

The market for prophecies in Britain has always been notably thin; indeed, it is illegal for the Chairman of any public company to publish longer-term profit forecasts for fear of misleading potential investors. Moreover, it is well worth remembering that the most expensive words in British public life are: "I told you so".

So it is with some trepidation that I quote from a book that I wrote and had published seven years ago. It was called *Blueprint for a New Era*, and the second part called for a change to a "Nation of Investors":

> *"Intensified competition from the Far East, elsewhere within the European Community and ultimately Central Europe, will require a change in national attitudes. In place of a culture of speculation in property and spending we will need to become a nation of savers and investors in our collective futures.*
>
> *This shift entails reversing a well-established trend. From 1985, consumer spending in Britain has taken a steadily greater share of our national income, rising from 60% of Gross Domestic Product in 1980 to over 66% in 1993. This is in marked contrast with Germany and Japan, where consumer spending has been more or less stable at around 57-59% of GDP. In other words, Britain's consumers are spending over £40 billion a year – or £35 a week for the average household – more than their German or Japanese counterparts.*
>
> *What we spend they save and invest. As a result, a massive investment gap has opened up, constituting a serious competitive handicap for the economy as a whole … Creating a saving culture – for that is what is needed in the New Era – will be difficult. It will entail exorcising inflation from our economy, as well as a different attitude to housing and home ownership. It will also be necessary to eliminate waste in the public services, in order to finance the necessary investment in their futures. As is daily more evident, Britain has the worst transport infrastructure in Northern Europe, with an out-of-date rail and inadequate motorway network, each pointing in the wrong direction. We also have a serious emerging problem in our social infrastructure: once an urban underclass becomes established, the situation is extraordinarily difficult to reverse, as experience in North America and parts of South London bears all too evident witness."*

Major changes have indeed taken place since I wrote in those terms in the Spring of 1994 – and not just in the relative strength of sterling against Far Eastern currencies and the euro. All of them have made it more difficult for the average family to make sense of their personal financial futures. Let us consider the wealth of individual families.

The main components of family wealth are pension entitlements, housing assets and liquid savings. Data about these components are surprisingly hard to obtain, and have not been gathered in a comparable form, but such information as is available paints a worrying picture.

We can estimate that, in 1998, the distribution of the value of pension entitlements, among some 16 million members of pension plans, was as follows:

Quartiles	1	2	3	4	mean
(£k)	120	34	22	20	49

The *English House Condition Survey 1996* gives the most recent data for housing assets, in relation to the 70% of English households who were home-owners. The value of estimated equity in 1996 was distributed as follows:

Quartiles	1	2	3	4	mean
(£k)	120	58	37	12	57

Household Saving in the UK, a report by James Banks and Sarah Tanner published by the Institute for Fiscal Studies in 1999, provides a good insight into the distribution of financial wealth, drawing in particular on a 1997-8 Financial Research Survey carried out by NOP. It stresses that some 30% of individuals have no financial wealth, and the data on financial wealth presented in it can be broken down as follows:

Quartiles	1	2	3	4	mean
(£k)	26	2	0.5	0	7

Assuming that few home owners will wish to sell and rent back their properties, it seems that even the richest 25% of households could not anticipate retirement income of much more than £150 a week – around one-third of current average household income; for the average household the situation would be even worse: some £60 a week before any State benefits.

The main sources of family wealth are all showing signs of strain in an era of low inflation (and hence of lower overall nominal investment returns), reflecting the international competitiveness of businesses based in Britain. Of course, low inflation brings significant benefits, for example to those no longer in paid employment who are dependent on a finite "pot" of savings. But a sustained period of low inflation means that many familiar assumptions need to be revised. Specifically:

- Continued house price inflation is unlikely to deliver similar increases in inter-generational bequests to those which have been experienced over the last two decades. The boom in house prices that followed the end of World War II has resulted in many more families than in the past inheriting significant wealth from their parents; today's children will not be so fortunate.
- The outlook for State guaranteed pension income is much more guarded. The value of the State Pension will continue to fall well short of people's expectations, partly because the number of people of pensionable age is set to rise. In 1981 there were forecast to be 10.6 million pensioners in the UK by 2020; by 1999 that forecast had risen by 38% to 14.6 million (after adjusting for the equalisation of the State Pension Age). The Government is committed to major increases in public expenditure on healthcare and education, and cannot be expected to give equal priority to expensive improvements in the value of the State Pension.
- Meanwhile, there is a growing trend in occupational pension schemes away from defined benefits to defined contributions, as employers seek to reduce their pension costs in face of international competition. Consequently, beneficiaries will be carrying the investment risks associated with their pension fund in the future in a way that has not, hitherto, been the case in the UK. The impact on individuals could be dramatic. For example, the five largest FTSE 100 stocks are showing an aggregate 23% decline from their 52-week highs. This could represent around £14,000 for a pension fund member taking up his entitlement now – not far short of 30% of total mean pension entitlement in 1998.
- Growth in personal savings can also be expected to fall in an era of low inflation and intensified international competition for UK business. Annuity rates will remain low by historic standards, and total investment returns on FTSE 100 stocks are unlikely to sustain their performance during the bull market of the 1990s. Individuals will be expected to provide for a greater proportion of the costs of their children's university education and their own health and longer-term care.

From the point of view of individuals, the impact of these developments will be compounded by changes in demographics. Not only are people living longer – when universal State Retirement Benefit was introduced the average life expectancy was less than the retirement age – but families are fragmenting. At present, around half of all households in England consist of married couples; by 2021, married couples will account for less than 40% of households. By that date 35% of households will consist of a single person, which will impact on the supply and demand for property and will change the extent to which family wealth can be released from property disposals in particular. At current annuity rates, it would require a capital investment of £350,000 to secure an annual income equivalent to the current average family (household) income of £23,000 pa.

Of course, improving mortality isn't all bad news, especially when you look at the alternative. In the past, reaching the retirement age was almost an impossible dream for many. In fact, the age of 65 as the time when people should receive state pensions was chosen by Otto von Bismarck 130 years ago, at a time when the life expectancy for a male was about 40 years. Now, retirement is more and more the prelude to a "third age" of interest and activity. But this in turn further underlines the need for proper financial planning during years of employment.

The result of all these developments should come as no surprise. Only a very small minority of households is engaged in adequate financial planning. The 2000 Financial Research Survey presented in the Financial Services Consumer Panel's latest Annual Report shows that the only financial products held by the majority of the population are current accounts, household insurance and savings accounts; and that the proportion of adults with private pension provision is still only 30%. It seems that only 10 –15% of the adult population understand and enjoy the intricacies of the financial markets. They are what might be termed financial hobbyists. In all likelihood, these will be the same householders who are forecast to be purchasing financial products on-line (via interactive television and the internet) in five years' time.

For the broad mass of British householders, it remains an uncomfortable fact that someone aged 45 now needs to save 2½ times more every year than did their father at the same age in order to secure a similar retirement pension in real terms.

Table 1 below shows how pensions paid have already much reduced over the last decade and by how much that trend is forecast to continue.

Table 1: Pension Payments

Assuming £1,000 p.a. invested in UK equities for 20 years		
1973 – 1993	1978 – 1998	1999 – 2019
£5,800 p.a.	£5,200 p.a.	£2,200 p.a.

The returns above are based on Barclays Equity Index, with gross income reinvested and no expenses. The real return for the last period is assumed to be 5%. Last year, total real shareholder return on a FTSE 100 tracking fund would have been a negative 10%.

From Protection to Empowerment

It is not at all difficult to explain the apparent indifference of the vast majority of British households to planning for their financial futures. Indeed, it is invariably a mistake to underestimate the financial good sense of British consumers who are as canny as any in the world when it comes to parting with their hard-earned cash. Apparently irrational, not to say irresponsible, behaviour demands an explanation.

First, the process of personal financial planning is complex and involves a series of judgements about risks and costs which few householders feel equipped to make unaided. They tend to seek advice almost as a last resort, when a particular decision cannot be avoided, rather than as a regular process which would respond to their evolving financial needs and the ways in which the financial services industry can help them.

There is the risk that they may go to the wrong source for information or advice; they may be sold the wrong product for their circumstances; the product they purchase may not perform as they expect; and there is always the risk of unexpected "exceptions" or penalties hidden in the small print. Certain products, such as pension transfers and income drawdown at retirement, require specialist advice. Consumers who purchase without advice in these circumstances run a high risk of making an inappropriate purchase.

At the same time, there is no easy access point for advice. The person most likely to have offered sensible advice in the past – the local bank manager – is either no longer in place or is debarred by potential conflicts of interest and the framework of regulation from providing impartial guidance and advice. Life insurance direct sales forces are dwindling rapidly; over the past year, Prudential have announced a reduction from 2,000 to 250, and cutbacks of a similar order have been signalled by Lincoln and by Britannic.

Consumers may be unwilling to pay directly for financial advice, assuming that their adviser will be paid a commission. There is a growing move away from paying commission in a single upfront instalment towards providing it in a more even flow across the lifetime of the product. The Panel sees this as a welcome development as it will encourage continuing contact between adviser and client. There is little correlation between the cost of providing advice and the commission paid, as Table 2 below suggests.

Table 2: Potential Initial Commission Payments

	Commission
£20,000 investment bond	£1,200
Establishing occupational pension scheme	£1,000 (per member)
£200,000 term assurance policy	£750
Stakeholder pension	£250 (per member)
Arrangement of ISA	£200

But this is only half the story for many advisers who rebate commission into their clients' funds, and who have a long-term association which leads to a much greater correlation between time spent on a client relationship and remuneration earned. Ultimately, it is crucial that consumers receive value-for-money advice, and that advisers' recommendations are not influenced by the commission that they receive.

For consumers disinclined to make the effort – or to forego current enjoyment to fund increased savings – there is no shortage of reinforcement in the media and Parliament: successive financial "scandals" and the reports of subsequent Inquiries and litigation must have served to deter the most determined would-be saver.

Secondly, there is the problem of what might be described as the regulatory paradox. Actuaries attempt to make financial sense of the future by reference to the past; whereas the UK system of financial regulation requires all providers of investment services to remind their clients at regular intervals that: "Past performance is no guide to the future". Although this is statistically correct, it is nevertheless counter-intuitive.

Of course, consumers should be discouraged from basing investment choices on false assumptions but, if they cannot trust their intuition, they do need a reliable alternative to help them make up their minds. This means that factors such as the identity of the fund manager, or what types of stock are selected, or what the fund's objectives are, become much more relevant and need to be highlighted and explained by the adviser.

As in many other industries, the regulator of the UK's financial services sector has a key role to play. In their zeal to protect consumers, regulators have often had precisely the opposite effect in recent years. In dealing with financial services, regulators have to tread a fine line between nannying the consumer, thereby making the process of getting advice too onerous or convoluted, and allowing a free-for-all which could lead to mis-buying and mis-selling.

We are very conscious of the current debate on polarisation, but our discussions have focused on the accessibility of advice, rather than adviser status. The main need is to provide financial advice to consumers irrespective of the status of the adviser. So long as full status disclosure is given to consumers and standards of adviser competency are assured, we feel that it is the provision of access to financial advice that is of paramount importance.

Finally, for many poorer households, there is the reality of what might be termed the "moral hazard" question to be faced. Why scrimp and save during a working lifetime when you will end up in no better position than your irresponsible neighbour who is content to rely on State benefits, secure in the knowledge that no Government could afford to pay the political price of refusing to meet the costs of care for those who have chosen not to save? Someone on below average wage who contracts out of the State Scheme and saves through a defined contribution pension plan will be hard-pressed to gain any advantage compared with the Government's guaranteed minimum income.

The discussion of whether lower-paid people should take out a stakeholder pension rather than rely on future State benefits strikes at the heart of the issue. The consultative document on Pensions Credit acknowledges the issue but, unless definitive guidance is provided, both consumers and advisers will still be in serious difficulty in deciding what course of action is appropriate. This is an unsatisfactory climate for providing consumers with the advice and products that they need. We should also be clear that for a significant proportion of the population with no disposable income the financial advice that is most critically needed is on handling basic debt.

Small wonder then that most households have responded to the challenge of making sense of their financial future by ignoring the problem and the associated risks. They are able to justify their attitude by punitive concerns about past financial scandals and generalised fears of "rip-off Britain". In such circumstances, "a plague on all your houses" is a perfectly reasonable and temporarily comfortable reaction.

Unfortunately, it will cause very serious problems in the future. Today's irresponsible majority are effectively mortgaging their children's future living standards since, if they do not provide for their own financial futures, their children will have to do it one way or another. The sins (or at the very least, the omissions) of the fathers will indeed be visited on the sons.

In a Personal View piece in the *Financial Times*, Will Hutton and Charlotte Thorne of the Industrial Society summarised the position thus:

> *"In short, Britain is coming to rely on an approach to pension provision that expects people to be both extraordinarily forward-thinking and unusually financially adroit when planning for their own retirement. The result is the exact opposite of what is intended: faced with some impossible calculations, individuals tend to put off considering their retirement income at all and instead rely on providence to make things right."*

But reliance on a Micawber strategy will be risky, to say the least.

The starting-point for the Panel was agreement on the following principles which, in its view, should apply to the process for imparting information and advice to UK consumers about financial products and services:

- **understandability**: advice and information must be clear and written in language that most consumers can legitimately be expected to understand; it must also draw attention to significant conditions and risks that could influence consumers' willingness to purchase;
- **transparency**: the consumer is entitled to have the information necessary to assess the possible returns and benefits, as well as the risks involved and the costs that they will be expected to bear (e.g. commissions);
- **ready accessibility**: it is important that information and, if necessary, independent and expert advice is available to those who need it most at the time that they are making decisions affecting their families' financial future;
- **affordability**: the cost involved in providing the necessary information and advice must represent reasonable value, and be affordable to the ultimate consumer;
- **expertise**: consumers are entitled to be confident in the quality of any information and advice that is provided to them;
- **timeliness**: the information and advice need to be available before the customer is committed to a particular course from which it might be difficult to withdraw;
- **accountability**: customers should have convenient and rapid recourse to redress if the advice and information they receive fall short of the standards described above.

The solution must lie in empowering people to take control over their own financial futures. This in turn will require:

i) **good information** about all financial products, so that the financial markets can operate successfully – and providers must play their part by delivering good quality, flexible products;

ii) **wider access** to regular and objective financial advice;

iii) **better education** in financial matters for the generality of UK households;

iv) **positive incentives** (or at least no serious deterrents) to saving for retirement and old age.

Good Information

No market can function effectively without reliable and up-to-date information. Last November, the Financial Services Authority (FSA) published a discussion paper: *Informing Consumers: a review of product information at the point of sale.* The executive summary claims that the existing regime has achieved only a modest degree of success in its aim to help "consumers to shop around by providing information which enables comparisons between products, and to give them the key information they need to make informed decisions about whether or not to buy". This finding was borne out by the consumer research published by the FSA in parallel, which showed that few consumers actually read key information (the so-called Key Features Document, KFD) and that those who do find the content confusing.

The FSA has consulted on a number of options for improving understanding of the KFD which the product disclosure regime now requires firms to give customers. These options include re-setting the mix between wording prescribed by the regulator and that devised by the firm; ways in which the FSA could increase the use of plain language; the possibility of requiring plain language accreditation (the Association of British Insurers has launched such a scheme – viz. *the Raising Standards Quality Mark Scheme*); and the option of requiring collective investment scheme firms to provide all "core information" for a particular product/fund to be presented together.

There is a risk that, in publishing comparative information about financial products, the focus will be on what can readily be measured. For many products, price may be the key determinant of value, but this will not always be the case. Whitehall is not the only place where it is easier to be precisely wrong than roughly right, or to confuse cheapness with value for money.

At minimum, wherever a client is effectively delegating the management of their savings to a third party – e.g. a fund manager or a provider of life assurance, endowment mortgage or with profits pension policy – regular reports should be provided to enable the client to evaluate their managers' performance and to take any necessary and appropriate decisions – for example, transferring funds between managers – and to make appropriate "in-flight corrections" to ensure that the destination is reached, such as paying off a mortgage with an endowment policy at the date originally planned. Unfortunately, switching might be difficult in the case of older-generation products where penalties may be imposed. The industry has started to address this issue, but in future all products must be designed to avoid penalising consumers who switch.

Information has been available for decades to the beneficiaries of many defined contribution pensions plans. There is no reason why similar information should not be available to all investors in the future; nor is there any acceptable reason why beneficiaries of publicly funded pension and other savings schemes should not be treated in exactly the same way.

We support the move to combine private and state pension benefits in one statement and welcome *Raising Standards* initiatives that recognise other specific needs. However, if we genuinely approach these issues from the point of view of the consumer, we are forced to acknowledge that there is still a long way to go before individuals are properly equipped with a single and comprehensive analysis of their financial position. Information technology is starting to make such aggregation possible, and holds out the prospect of further development towards this goal. This too is a challenge for product providers and financial advisers.

The market for financial products has undoubtedly been influenced by the recent trend towards price control for ISAs and stakeholder pensions. In January of this year, with the publication of HM Treasury's consultation paper on *Standards for Retail Financial Products*, the Government set out the case for defining so-called "CAT standards" for further types of financial products, as a means of providing reliable information so that "consumers who want to will be able to exercise informed choice".

There is a good deal of common ground between the Panel's analysis of the difficulties faced by financial consumers and some of the discussion in the Treasury consultation paper. Signposting value for money products has clear advantages, but it should not destroy the option of providing financial advice where required. Consumers can become more self-sufficient if they are confident about the credibility of the product being purchased, but they still may require advice regarding the suitability of the purchase, given their own particular circumstances. We must not create a market place where this advice is either difficult to access or is expensive. Nor will it ultimately be in the interests of consumers if the financial strength of the UK's investment institutions is undermined by the introduction of more and more politically promoted loss-leading products. Government Departments can lose money and survive – businesses do not have that luxury.

We should also bear in mind that greater complexity in people's lives – changes in marital status, movement between jobs and employers – points towards greater flexibility in the products being offered. The challenge for the industry is to respond effectively to consumers' changing needs with products which meet expectations of transparency and intelligibility.

Wider Access to Advice

It is ironic that a nation that boasts the largest professional accountancy body in Europe, that is widely regarded as being 'over-banked' on the High Street, and that has a well-developed – and internationally renowned – financial services industry, should see such a high proportion of its citizens lacking regular access to the financial advice that they need:

- a reasonably comprehensive understanding of their personal financial circumstances and prospects;
- an appreciation of their longer-term expectations for retirement income and their attitudes to risk;
- the development of a personal financial strategy that meets their needs and expectations (of purchase and non-purchase).

Consumer research suggests that, with more complex products – a mortgage, a pension, an endowment or an investment pension – consumers may well understand, in principle, what they are buying without understanding the product nuances. The challenge for the financial services industry is whether these products need to be so complex and difficult for consumers to understand (and, indeed, for the industry to sell).

Trusted sources of information and advice vary depending on the social environment of the consumer, their age and financial sophistication. Thus:

- family and friends and the bank/building society branch are the most important sources for lower income families and the elderly who are often advised by their children;
- professionally qualified financial advisers are an important source of advice for the whole range of consumers, but particularly for the up-market, non-financial hobbyist (especially from age 40 upwards);
- the financial media (articles/comments and advertising) and, increasingly, the internet are important information sources for financial hobbyists. The internet and digital TV will increasingly allow an even wider range of consumers direct access to financial information and the opportunity to purchase most types of financial product on-line. This must be welcome provided the regulator strikes the correct balance between imposing controls to protect consumers, inhibiting the provision of information, and accepting the possible adverse consequences for consumers taking more responsibility for their own decisions.

Any of the above may be supported from time to time by leaflets from a variety of sources – especially if the consumer is going through a specific decision process, such as arranging a mortgage.

The use of friends and family and staff in the bank/building society branch as sources of information and advice is often a function of the more naïve customer having nowhere else to go. When trusted advice is needed, consumers reach for what they already know. That said, endorsement is a powerful means to lead the consumer to new sources of information and advice. The endorser may be the friend, the estate agent, perhaps the employer (especially if it is a large, blue chip company). The endorser is trusted and that trust is transferred to the (unknown or less known) provider or adviser.

To say that these are "trusted" sources of advice is not to say that consumers can necessarily judge the quality of the advice they are being given. It is often only with hindsight that the consumer will discover whether a good financial decision has been taken or not. Confirmation that the advice was "good" typically relates to whether or not the product performed to expectations, or even exceeded expectations. The topical issue of endowment mortgages highlights this. Consumers who are discovering that they may face a shortfall feel now that they were given "poor advice" a decade or more ago. They had no means of making any such judgement at the time of the sale – far from it.

Because poor advice may only come to light some years after the event, few consumers have the expertise, confidence or tenacity to pursue a complaint, or to know necessarily where to turn. Hobbyists are comfortable complaining about poor performance, as companies discover when products such as bonds do not match expectations. Otherwise, complaints are more likely to be about administrative errors (direct debits going astray, money being moved erroneously from accounts) than the more nebulous concept of being given poor advice.

There is an important distinction to be made here, between poor advice (e.g. recommendation of an unsuitable product) and disappointing investment performance (e.g. of a product which was indeed suitable). No-one knows how markets are going to develop over a period of time; advisers cannot be condemned for not being clairvoyants. What can be expected, however, is that individuals will not be guided towards high-risk products when their needs are for low risk, and that they will not be misled by unrealistic promises about what a product can deliver.

Although further improvement is still required, the quality and professionalism of the adviser is certainly seen to have progressed over recent years. Since 1994, the number of professionally qualified advisers has increased by some 20% to 25,000. The regulator has imposed higher standards which have come to be seen as the industry norm by those who work in it. The increased use of computers as part of the fact finding process, coupled with a more professional approach overall finds favour. The efforts made by the industry in the last few years to improve overall quality must be sustained and extended. We need a greater supply of advisers, all of whom provide a professional and highly regarded service to consumers. And advisers as a whole need to make the most of the capabilities offered by improvements in information technology, to provide the most effective service to their customers.

Across the mass market, however, advisers' "independence" is far from clear and the polarisation debate has largely passed people by. Consumers value independent advice, but many are simply concerned to have access to a qualified financial adviser, irrespective of status. They are becoming clearer about what they are paying in the way of commission and are alert to the fact that advice offered might be affected by commission bias. In many cases, advisers have responded by offering to rebate part of the commission on certain deals. The presence of commission in the sale, however, does not appear to be a deterrent to purchase. Once the consumer is in front of the adviser there is a tacit acceptance that part of any transaction will be related to the payment of that individual and that it would be the same whoever they were speaking to.

Indeed, adviser objectivity is often a more appealing concept than independence, which is questioned, given the role of commission in the sale – hence the appeal of sources of advice such as friends and the media who are felt to be more objective than the professionals.

While consumers may need advice, most do not want nor expect to pay for it. At present, most consumers assume that their adviser/salesman will be paid through commission. It is only at the very top end of the market that fees are becoming acceptable.

None the less, just as all UK citizens have access to General Practitioners, so they also need access to competent and independent – or at least disinterested – financial advice. A reasonably routine interview might take around an hour and cost up to £150.

Unfortunately, there is no realistic prospect that most people needing advice will be prepared to pay even such a relatively small sum on a regular basis for consultation which they have good reason to believe will add up to "bad news" in the future, if not immediately. It is arguable that society as a whole will have to meet some of the costs that will result from the absence of general access to financial advice, but even so, history suggests that it is unlikely that the Treasury would agree to some form of tax credit to enable individual tax payers to offset the cost of financial advice against their personal income tax liabilities. The tide may, however, be turning. The Treasury has recently stressed, in describing the proposal for a Saving Gateway account for lower-income households in its April 2001 document *Savings and Assets for All*, that access to financial education, information and advice is a crucial part of the scheme; and the document moots the possibility of a "personalised financial health-check", perhaps in the context of New Deal careers advice programmes.

The Saving Gateway proposals would not be aimed at the majority of households. However, it is possible that employers generally would be prepared to facilitate a personal financial advisory service for their employees, with the cost being an allowable business expense for the purposes.

Regular medical health checks for employees are commonly provided by a number of employers. Acting as a conduit for getting financial advice to their employees would be a similar role. In one case it is a medical health check, the other is a financial health check. The importance of both is apparent, and the positive experience for employers of providing the medical benefit to their employees should equally apply to the provision of financial health checks.

Employers who wished to benefit their employees in this way could make arrangements along the following lines:

- Access to personal financial advice (at the rate of two hours a year per employee) would be part of the employee's contract of employment.
- The employer (and the relevant Trades Unions) would identify suitable qualified providers of advice and engage them to offer a defined range of services to employees, for an agreed cost per participating employee. The providers would be responsible for marketing their services to individual work force members.
- It would be for employees to decide whether or not to avail themselves of the service; and the relationship between individual clients and the adviser would be governed by the normal rules of client confidentiality. There could not be any question of individuals' personal financial circumstances being communicated to their employer.
- The cost involved would be a deductible business expense for the employer; and expenses could be audited by the independent auditors in the normal way.
- Advisers, once selected by the employer, would find that a good deal of new business came to them rather than that they had to go to it; and the time saved as a result could be ploughed into a better service to their customers.

There are obvious objections to any such scheme. Some employers may be concerned about liability for advice about which their employees became dissatisfied. Small businesses who already feel that they are doing too much of the Government's work might see this as a further burden which they would prefer to avoid. But employers will also be mindful of the need to attract and retain skilled people; and the reputation for caring for individuals will be very helpful as competition for talent intensifies. Meanwhile HM Treasury would do well to ponder the longer-term costs of benign neglect of a problem which is certain to become more difficult in the not-so-distant future.

The Panel saw a need for proper feedback on this approach, of employers as a means of widening access to advice. In January of this year, Consensus Research tested the proposition on our behalf with representatives of the different interested parties – employees, employers and providers. The research has shown good support from employees, so long as the confidentiality of contacts between individuals and advisers is assured. Some employers and providers already offer such a service to employees, and experience is being built up which could serve to inform a wider approach. From the employers' point of view, the question of potential employer liability is clearly a concern, particularly as the employer is involved in selecting the provider. But the fact that there is practical experience of providing such a service points to ways of dealing with this concern.

Improved Adult Financial Literacy

Clearly, there is no point in providing financial information if the client lacks the skills, knowledge or confidence to use it to make informed judgements and effective decisions regarding their own financial circumstances. In February 2000, the Adult Financial Literacy Advisory Group (AdFLAG) was established by the Secretary of State for Education and Employment with a remit to make recommendations on ways to improve the financial literacy of the adult population of the United Kingdom, with specific reference to those who are currently disadvantaged.

It seems that education for adult financial literacy has never been systematically addressed. There is no defined curriculum or set of learning objectives. There has only been a limited amount of research carried out into the need of consumers, as opposed to the need for new products or methods of delivery. While there is a vast range of initiatives with either a primary or secondary objective to deliver improved financial literacy, there needs to be a systematic approach to content, delivery, co-ordinating activity and spreading good practice. National learning objectives and standards need to be set, with the aim of equipping everyone with the necessary skills to take care of their financial futures.

AdFLAG made the point that, tempting though it is to believe that the problem would be resolved once people had access to a bank account, the reality is that they need skills to make best use of it and, more importantly, to make decisions regarding other financial services which may or may not be appropriate for their particular individual circumstances.

Consumers need to be empowered through generic advice and equipped with the skills to interpret this advice. Any and every opportunity needs to be taken to provide a financial dimension to information given when people are receiving advice on work or learning opportunities.

For example, during the transition from unemployment to work, individuals will need, and are likely to be particularly receptive to, information on different ways of operating financially. People need to be engaged and encouraged to learn at all the key events in their lives, when they are most likely to need advice: on leaving school, starting employment, becoming unemployed, getting married or divorced, having children, suffering bereavement or on retirement.

The challenges facing ordinary households have increased recently, as more choice is available for such basic services as telecommunications, gas and electricity as well as television. Impartial basic information from a trusted and respected local source is particularly important to those with limited access to financial services.

AdFLAG observed that new bodies such as the University for Industry and Learning Centres provide new delivery channels for financial literacy. Lessons ought to be learnt from financial education activity in schools and shared with providers of post-16 education. Individual Learning Accounts provide an opportunity to develop financial literacy. Indeed, finance could be used as a context for basic skills education; and public funding should be enhanced to develop financial literacy programmes for older people and other communities with a special need for financial literacy education (e.g. in particular the immigrant communities).

The FSA is undoubtedly making good efforts in this field. It is for example pioneering a scheme by which material from financial services providers can be accredited as meeting certain educational standards – an initiative which should allay teachers' concerns that such material might be of greater commercial than educational value. And the review of enterprise and the economy in education, which Howard Davies is conducting, will have as a particular focus the level of financial literacy in schools and further education institutions.

Those teaching financial literacy do not need to be authorised Independent Financial Advisers (IFAs). But there should be access to training and development opportunities to ensure that they are fully equipped. For their role they need to be competent in financial matters if the public is not to be misled. In particular, they need to understand the difference between specific and generic advice and what they can and cannot say.

The voluntary sector has been particularly successful at reaching key groups at risk of financial exclusion – e.g. lone parents, ethnic minorities, people with disabilities and social housing tenants. Partnerships need to be formed and funding made available to ensure that these organisations are an effective channel for financial literacy. Many financial service providers are producing, or beginning to produce, appropriate materials but they are not exclusively designed for those who currently do not use financial services. For example, many companies have produced or funded financial education resources for schools, which could be made available to a wide range of voluntary organisations or education providers for use by adults where appropriate. Similarly, credit unions that have a legal responsibility to educate their members could share examples of good practice more widely between them.

Obviously, opportunities to make financial education accessible on a wider scale will need to involve partnerships with the media. The BBC's Money Essentials is an example of the kind of steps that could be taken. More will be needed. While the introduction of Stakeholder Pensions will be a trigger to draw general attention to individuals' long-term financial arrangements, Government agencies should signpost people to financial literacy education opportunities in their communication programmes for these new pensions. The Government's decision that, from 2003, the Benefits Agency will move away from paper-based benefit payments to using the banking system with transfers into banks and building society accounts will provide a further opportunity to help people gain new skills through, say, education programmes and a public information service campaign.

Because financial services products are often complicated, and consumers are generally uninterested, it is often the case that consumers do not fully understand the benefits and risks of the product. We are concerned that despite the industry's recent improvements in customer communication, in particular the improvements proposed under the ABI's *Raising Standards* initiative, there is still a lot of apathy and confusion amongst consumers. We need a better understanding of consumer perceptions of risk and how these impact on their financial planning decisions.

Positive Incentives

In the real world, if individuals fail to make adequate provision for their retirement income or for their care in old age, the burden will fall directly or otherwise on their children: as taxpayers, if not as concerned family members. The political implications are likely to be uncomfortable, to put it mildly. Even HM Treasury will find it a challenge to finance increases in State pension entitlements and world-class public services simultaneously.

I have already commented on the moral hazard question and the dilemma facing lower-paid people in relation to whether to save for their retirement or rely on any future State provision.

At minimum, it seems perverse that individuals should be deterred from saving by the requirement that 75% of any accumulated private pension plan entitlements should be used to purchase an annuity. This effectively eliminates the possibility of passing on capital to the next generation and condemns the pensioner to a total return well below that likely to be available from investments in equities – where total shareholder returns typically exceed 10% a year. Small wonder that this issue is being flagged up by many serious commentators; the heat can only increase as defined contribution pension plans replace final salary schemes, in the private sector at any rate.

Next Steps

In a career of warning of dangers and difficulties ahead – in Inner Cities, the transport infrastructure, local government or the Health Service – it has become evident to me that warnings alone will not stimulate action, however explicit and well-founded the prescriptions may be. The temptation to remove the bearer of bad tidings – or to seek to discredit him if he cannot be removed – is seemingly irresistible to those who feel compelled to defend the current situation or who see difficulties in implementing the necessary changes. And time is a great dampener of anger and enthusiasm – just as rain is the best means of riot control.

It is only right that I should conclude this lecture with a checklist of questions which the Panel feels should be rigorously monitored over the next few years. The importance of doing so flows not from being called upon by this Panel, but from the genuine needs of financial consumers in this country:

- Are the warnings contained in this Lecture being borne out by events? Are new challenges emerging over the horizon? Or were this particular soothsayer and his acolytes too pessimistic (the actuarial equivalent of the economist who successfully predicted eight of the last two recessions)?
- Is the financial services industry still providing more facts and small print and less information than the average client has the right to expect? Do service providers keep their clients adequately informed of their performance (and options for change) in difficult times?
- What has happened to the FSA's review of product information at the point of sale? How is the ABI's *Raising Standards* initiative progressing? How has HM Treasury taken forward its proposals to develop Government standards for more financial products? How has it built on its ideas for a Saving Gateway account and accompanying information and advice? And what progress has been made with the review of the long-term savings industry under Ron Sandler?
- Is there evidence that more households are accessing qualified financial advice? Are employers, Trades Unions and the Government stepping up to the challenges involved?
- Is there any evidence that personal financial planning is becoming part of the way of life for the average household? Or is it still the preserve of a small, relatively well-to-do, minority?
- Have the AdFLAG recommendations to DfEE been pursued with the vigour they warrant? Or have the causes of adult financial literacy been buried in the Whitehall long grass along with so many other worthwhile initiatives?
- Above all, have all these good intentions, be they from Government Departments, regulatory authorities, product and service providers, employers or Trades Unions, been subject to a "reality-check"? Are they genuinely empowering individual consumers to plan for a financial future that best suits their needs?

The Actuarial Profession has contributed both directly and indirectly to the Panel's work over the last year and is committed to following it up, with two initiatives in particular. Firstly, it intends to do more work on consumer understanding of risk, both from a mathematical and from a psychological standpoint, in conjunction with other specialists. We believe that this further work will significantly improve the industry's knowledge in these areas. Secondly, the profession intends to work with other organisations in making regular checks on the progress being made by the industry in achieving the changes identified in this Lecture. There is undoubtedly much to be done.

Lest you feel depressed, let me remind you of the legendary Marshal Lyautey, who colonised Morocco for France. Towards the end of his distinguished tenure as Governor, the Marshal instructed his gardener to plant a row of poplars outside his headquarters in order to provide some shade for the sentries. He was then well into his 80s and the gardener was less than enthusiastic: “I suppose you realise, Marshal, that these trees will not provide any shade for at least 20 years”. “In which case”, came the indomitable reply, “plant them today!”.

Sir John Banham

5 July 2001

References

Banham, Sir John: *Blueprint for a New Era* (1994)

DfEE : *AdFLAG (Adult Financial Literacy Advisory Group) – Report to Secretary of State for Education and Employment* (December 2000)

DETR: *English House Condition Survey 1996*

DSS: *The Pension Credit: a consultation paper* (Cm 4900 – November 2000)

FSA: Consultation Paper 28: *Comparative Information for Financial Services* (October 1999)

FSA: Response Paper 28: *Response to Consultation Paper 28: Comparative Information for Financial Services* (June 2000)

FSA: Discussion Paper: *Informing Consumers: a review of product information at the point of sale* (November 2000)

Financial Services Consumer Panel: *Annual Report 2000* (March 2001)

Financial Times: *An inequitable pensions policy (Will Hutton and Charlotte Thorne, 10 January 2001)*

HM Treasury: Consultation Paper: *Standards for Retail Financial Products* (January 2001)

HM Treasury: *Institutional Investment in the United Kingdom: A Review* (The "Myners Review", March 2001)

HM Treasury: Consultation Paper: *Savings and Assets for All* (April 2001)

HM Treasury: *Productivity in the UK: Enterprise and the Productivity Challenge* (June 2001)

Institute for Fiscal Studies: *Household Saving in the UK* (James Banks and Sarah Tanner, October 1999)

Faculty of Actuaries
Maclaurin House
18 Dublin Street
Edinburgh EH1 3PP
Telephone: +44 (0)131 240 1300
Facsimile: +44 (0)131 240 1313
E-mail: faculty@actuaries.org.uk
http://www.actuaries.org.uk

Institute of Actuaries
Staple Inn Hall
High Holborn
London WC1V 7QJ
Telephone: +44 (0)20 7632 2100
Facsimile: +44 (0)20 7632 2111
E-mail: institute@actuaries.org.uk
http://www.actuaries.org.uk

Institute of Actuaries
Napier House
4 Worcester Street
Oxford OX1 2AW
Telephone: +44 (0)1865 268 200
Facsimile: +44 (0)1865 268 211
E-mail: institute@actuaries.org.uk
http://www.actuaries.org.uk