INSURANCE COMPANIES TO FOCUS ON PRODUCT SUITABILITY

The UK has suffered several mis-selling scandals including Payment Protection Insurance (with billions paid in compensation) through to interest rate hedging products which appear to have been unsuitable for small businesses in 90% of cases investigated to-date. Little wonder the regulator is focused on improved customer outcomes.

In the investment arena, we have just seen the first quarter since the implementation of the Retail Distribution Review and it seems that there have been two main changes:

All of the retail banks have stopped providing advice via branch networks with advisory services only for those with £100,000 or more in investible assets

Whilst independent adviser numbers are heading for a c15% reduction, this has been coupled to a move to restricted or tied advice – 8:10 biggest advice firms are now using the restricted model, marking a substantial swing from a pre-RDR independence ratio of 4:1

Fewer advisers and less choice are the unintended consequences of a drive for quality and a significant advice gap is now apparent. Life and pension providers, fund managers and discretionary fund managers have started to look at new direct to consumer (D2C) operations, following on from the start-up firms from 2010 onwards that have looked to tap self-directed consumers.

All of the current solutions follow the same pattern, which is based on a stepped process to determine client suitability for a specific, but self-selected, product solution. This begins with the consumer determining a goal; quantifying a target amount and a timeframe. The user then tries to determine their risk appetite, typically via a questionnaire, followed by a check on risk capacity (the ability to sustain losses). The profile is then matched to a model portfolio which may be made up of ETFs, pre-packed funds or a fund of funds solution.

The process is not really aimed at the novice investor and concepts of risk, return, volatility and even investment horizon do not speak to a client that is tentatively looking at better returns than they can get from cash deposits. The mass affluent is looking for a greater certainty of outcome and capital protection – outcomes that currently tend to come from complex structured products with accompanying credit risk.

The result is that unless simplified products are designed, with better underwritten outcomes for the mass of consumers, there will be no uplift in consumer investment even with improved technologies and online education. Nor will the regulator be interested in dropping the bar on the regulation of the sales process until the consumer is better immunized against detriment from products and providers. This situation is not peculiar to the UK and authorities elsewhere have looked for suitable solutions. In the US, these have taken the form of "safe harbour" funds – protecting 401(k) plan sponsors from fiduciary liabilities and the UK tried once before with stakeholder products which were charge-capped.

Government-backed simplified product design thinking is so far only extending to general insurance, income protection and savings products – with investments deemed too difficult, or inappropriate for the mass of consumers. But between below-inflation returns on savings and corporate pension schemes where members are bearing all the risk, the need for product-based solutions are clear and the firms that recognize this could capture a significant prize.