

Our next Edition will be in May and letters from members are always welcome. The attendance at the President's December Luncheon was a record and demonstrates the expanding interest in the Association's activities. Our next lunchtime meetings will be on 9th February 1988 when Michael Summerskill will be discussing 'Mutual Insurance in the Professional Indemnity Field' and on 8th March 1988 when Mr John Cowell will have as his subject 'Insurance in the Environment – Perspectives for the Future'. Both these meetings will be held at 1 pm at the Institute of London Underwriters, 49 Leadenhall Street, London EC3

THE FINANCIAL SERVICES ACT Speculation on the Aftermath for the Insurance Industry

**A talk given by Marshall Field, CBE, FIA,
on 10th November 1987**

BACKGROUND

In my previous talk to the British Insurance Law Association on 12 February 1986 I described the causes of the introduction of Investor Protection Legislation and I outlined the Professor Gower documents of January 1982 and January 1984, the White Paper of January 1985 and the Bill of December 1985. I described the philosophy and structure of the proposed legislation and I commented on the then current state of play (the information of the Securities and Investments Board and its sibling, the Marketing of Investments Board Organising Committee – SIB and MIBOC – and of the various self Regulatory Organisations – SROs). Finally I noted some problem areas that seemed to be developing and in particular the requirements to be placed on Independent Intermediaries, the question of Disclosure of Product Details and especially benefit illustrations, the interaction with Personal Pensions and the situation of those in the Middle Ground after Polarisation.

Since that talk we have seen the passing of the Act, the merger of SIB and MIBOC and the delegation to it by the Secretary of State of the regulatory powers. We also have the SIB Rulebook and drafts of SRO Rulebooks. These latter have yet to be accepted by SIB and inspected by the Office of Fair Trading. Those professional bodies that are seeking recognition as Recognised Professional Bodies under the Act are also engaged in preparing their Rulebooks.

In the area of the Conduct of Business Rules some matters are clearer than in early 1986. The hard line has been held on Polarisation, there have been some clarifications and extensions of coverage and there has been a deferment of the start date, but there has been little or no progress on some matters.

I will assume that the concept of the Financial Services Act, the regulatory regime, its coverage and its structure are well known. I propose in this talk to draw attention to what, in relation to the ideal of Level Playing Fields, I have called The Rough Edges and I will speculate on how the insurance industry and those contiguous with it will look when the dust has settled.

THE ROUGH EDGES

The objective of the Financial Services Act was to level the playing fields. However there are still, and may continue to be parts of the field that are far from level. First, there are still differences of treatment between Life Assurance and Unit Trusts in that the assets in which they may invest are different, the treatment of tax on capital gains is very different and, it now seems, the pricing of units is to be differently conceived. In the case of life assurance policies linked to units in an authorised unit trust there is great scope for confusion.

Second, the deposit based Personal Pensions (such as may be provided by the Banks and the Building Societies) are still in no-man's-land and thus there might be important differences in the protection afforded to consumers in the areas of benefit illustrations, the cooling-off arrangements and the disclosure of commissions. However, a potentially much more important difference lies in the requirement of a salesman under the FSA regime to 'know his client' whereas deposit based Personal Pensions, not being 'Investments' may be sold freely and without that requirement. The point is of such importance in connection with Personal Pensions because 'knowing your client' extends to making a full study of the customer's existing and potential pension arrangements and so it should not be possible for a salesman under the FSA regime to persuade an employee to opt out of a good occupational scheme in favour of any form of Personal Pension. However, a salesman outside the FSA regime will be able to sell non FSA Personal Pensions without making such enquiries.

Third, the questions of how an Independent Intermediary is to comply with the 'Best Advice' requirement is not fully resolved. The salesman must offer the best contract in the light of all the material information (and not merely those of a financial nature) but how, in practice, will he assess value for money for a contract maturing many years ahead? He will not be able to use

bonus projections but how much emphasis will he put on records of past performance (such as are obtained from comparative pay-out tables) and how much on an evaluation of the company's strength?

Fourth, there is the difference in scope between the classes of business covered by SIB and those covered by LAUTRO. The inclusion of these classes is surely administratively sensible and should not create any problems to LAUTRO members whereas for the Act to have included them would have caused the authorisation of numbers of additional firms trading or advising only in those classes.

Fifth, there is the definition of a Marketing Group. It is to be a requirement that any salesman gives 'Best Advice' from all the products provided in his Marketing Group. It was thought at one time that companies would be able to determine what constituted a Marketing Group with some discretion, thus permitting 'dual pricing' within a company, (i.e. setting different prices for the same product when sold via different parts of the sales organisation). The LAUTRO definition precludes this and a subsequent change in the SIB definition takes a similar line – the Marketing Group is to be virtually that of the Companies Acts. The consequence is that salesmen will have to be trained in as wide a range of products as the group of companies offers. This must act as a disincentive to extend a product range and potentially be against the public interest.

Sixth, the Polarisation debate is over but there are continuing skirmishes over the question of Conduit Advice. In the case of a financial services conglomerate (eg a bank) there may be product companies within the group and the bank may have decided to offer its own products to its customers by arranging for the bank to become an 'Appointed Representative' of the product companies. This causes no difficulty, but the bank may also wish to make fully independent advice available to those of its customers who want it and to do so via a bank-owned subsidiary company. In this case the Independent Intermediary company has to follow all the special rules for companies in that position but the point at issue is how its advice gets back to the customer. Some argue that, once the customer has been passed to the Independent Intermediary company he must be treated quite separately from the normal bank channels. To permit anything else would open the system to abuse. Others argue that this is too severe and would appear ridiculous. The independent advice should be capable of being passed to the customer via the bank conduit (eg by a VDU screen). In the case of banks, there may seem to be no great danger but in the case of an insurance company with a very limited product range the ownership of an Independent Intermediary company which uses the insurance salesmen as a conduit could be very confusing to the customer.

Seventh, there is continuing discussion on the remuneration scales for direct sales forces. It is an overriding requirement that all sales forces are remunerated in such a way as not to involve any 'Product Bias'. This applies equally to the LAUTRO Voluntary Commissions Agreement and so there will be one commission scale that will have been adjudged free of product bias. It is argued that a fraction or a multiple of that scale will also be free of product bias, but how far can a company depart from a direct relationship before being vulnerable to being accused of introducing product bias. I consider this question to be unanswerable as so much depends on the nature of a sales force, the character of its business and its clientele. A remuneration scale might be bias free for one sales force but not for another.

Eighth, what, if any, will be the knock-on effect on General Insurance? And where will be the 'composite' insurance intermediary?

These are the Rough Edges. Many have existed for a long time but, in a situation where much else has been levelled, these, perhaps formerly minor, differences may take on an increased significance and could come to dominate decision making. This could be very harmful.

CHANGES IN THE MARKET PLACE

The dominant causes of the changes about to arise are Polarisation, Best Advice, Product Disclosure and New Competition.

Polarisation

The principle has been accepted, it is being applied rigorously and it will have major consequences. The employed (or wholly tied) salesman will continue as before but the company will now need to train him in all its products (including unit trusts) or at least make him aware of cases where another product would be better.

The agent tied to one company for the greater part of his business but with other agencies for minor classes will need to change. His host company may need to complete its product range (and this is not without problems) and the extraneous agencies will cease (with consequences to those other companies).

The 'general agent' who has placed most of his business with one company but has some freedom in this and other matters will have to choose between becoming a Company Representative with his main (or another) company and going fully independent. He will need to balance freedom of operation

against the costs of independence. There will be consequences on business flows to his former main company.

The small 'independent' agent (perhaps a professional man) who has used just a few pet companies will need to choose between either doing the independent job properly (and meet the costs), or passing his enquiries to an authorised independent intermediary, or becoming a Company Representative. Again, there will be consequences on business flows and hence the current recruitment activity.

One important question arising from all these decisions is how many will remain in the independent intermediary sector? And of those who leave it to become Company Representatives, how many will find the loss of independence of operation distasteful (for example, the disciplines of insurance company management in such matters as new business quotas, zoning of territories, and postings to other areas)?

Finally, there is the special case of the banks and building societies, and these are large players. With one notable exception most banks have chosen Appointed Representative route in favour of their own product companies. However, the building societies seem to be choosing to set up Independent Intermediary operations, with one very large and some other exceptions. Thus the swings of business will be large with consequences on new business flows to some companies.

Best Advice

The Independent Intermediary – the Broker – will continue very much as before but, as well as (in common with all salesmen) 'knowing his client' and only selling what is suitable, he will have to give best advice across the whole market. He must consider financial and non-financial aspects but surely there will be a tendency to go for one of the top 10 in the past performance tables? Will there be a concentration of business into a small number of successful companies?

If so, what will happen to the others? There will be some consideration scope for niche players – but it is necessary first to find your niche.

This will also bring major consequences on business flows and therefore on expense control. In this connection, there is a further concern for the company that has operated both agency business and has salesmen selling direct. With the proposed definition of Marketing Groups it may be that we shall see a polarisation of companies.

Product Disclosure

Apart from the obvious consequences of the direct costs and the costs of amending computer systems, there are secondary effects. It may be that the requirement to describe every feature of a policy will bring about a simplification in product design. Possibly the requirement to disclose the likely level of surrender values in the early years will change the balance of benefit between the early leaver and the stayer. Indeed, this consideration already seems to have affected the terms of the LAUTRO Voluntary Commissions Agreement – to the cost of the intermediary.

New Competition

The Insurance Industry is already much closer to other operators in the financial sector and for some years has been particularly close to the Unit Trusts. Moreover, recent trends in product design for life assurance and pensions have taken the products closer to those of the unit trusts and in the process have passed more and more of the risk to the policyholder. Now, the introduction of Personal Pensions will greatly expand the market for pensions but it will also remove the insurance company monopoly. Who will be the winners?

The insurance companies have the unique selling feature of risk (but are tending to avoid it), they have good marketing expertise and market penetration and they can cope with the complexities. However, they have some regulatory and tax disadvantages.

The unit trusts have a good reputation and marketing expertise but have much less market penetration and not much experience of handling complex products.

The building societies have excellent market penetration but, as yet, are restricted in what they can do. They have no access to the capital that would be needed for a major expansion and they may think of themselves as providing a service rather than selling products (as evidenced by their polarisation decisions).

The banks have excellent market penetration but tend to think of themselves as providers of loans rather than of selling financial products. However their polarisation decisions may indicate that they are waking up to the opportunities.

Perhaps the market orientated financial conglomerate of insurance company, unit trust, building society and bank will be the answer to the mass market? The choice of carrier for a particular product will then depend on secondary considerations (eg tax, risk management, regulatory supervision).

CONCLUSION

It is far too early to draw conclusions, except the obvious one that the market place of the future will be very different from that of today. It is to be hoped both that the consumer will not suffer too greatly in the process and that the various institutions have the necessary stamina to cope with the changes.

CIVIL JUSTICE REVIEW: GENERAL ISSUES PAPER – NATIONAL CONSUMER COUNCIL'S RESPONSE by **R.W. Hodgkin, Senior Lecturer in Law, University of Birmingham.**

1. Background to Civil Justice Review

Lord Hailsham, then Lord Chancellor, set up in February 1985 the Civil Justice Review, the terms of reference of which was, "to advise the Lord Chancellor and his officials on matters arising in the course of the conduct by him of a general review of Civil Justice."

The committee has published six consultation papers in an amazingly short period of time. The first three published in 1986 were concerned with Personal Injuries (see BILA Journal, January and May 1987 issues), Small Claims and the Commercial Court and followed these in 1987 with papers concerning Enforcement of Debt, Housing Cases and General Issues. The method used was to contract out to management consultants certain basic research on the individual topics, conduct interviews with litigants and members of the judiciary, publish the reports and ask for responses on each report.

The final report on General Issues "draws on information and experience obtained from the particular studies ... identifies problems common to Civil Justice as a whole and proposes important changes in jurisdiction, procedure and administration." The General Issues paper is the longest of the papers and runs to 114 pages divided into seven substantive chapters covering (i) Civil Justice and the Courts; (ii) Delay and Other Problems; (iii) Court structure; (iv) Civil Procedure;