

13. (1856) 26 LJ Ch 433
14. *Portavon Cinema Co Ltd v, Price* [1939] 4 All ER 601
15. Schedule 3
16. [1978] 2 Lloyds Rep 440
17. (1902) 18 TLR 815
18. [1940] 2 KB 388
19. [1963] Ch 459
20. at 492
21. (1848) 11 QB 368 at 376 - admittedly a passing reference to the point
22. [1963] Ch 459 at 492-3
23. *Woolcott v. Sun Alliance and London Insurance Co Ltd* [1978] 1 WLR 493
24. [1948] WLR 489
25. at 500A
26. at 497H 498A
27. Working Paper 109
28. *Collingridge v. Royal Exchange Insurance Corporation* (1877) 3 QBD 173
29. See Working Paper 109, para 2.2 - no authority is cited for the qualification
30. *Castellain v. Preston* (1883) 11 QBD 380
31. (1881) 18 Ch D1 - vendor did not hold sums recovered on trust for purchaser
32. (1975) 7 ALR 667
33. [1976] 1 NZLR 766
34. [1980] Conv 7 - Professor J T Farrand
35. Paragraph 2.19 of the Working Paper
36. Law Society Condition 11
37. Paragraph 2.28

LUNCHTIME ADDRESS

by Sir Gordon Borrie, Q.C., Director-General of Fair Trading

1. I should begin by thanking you for inviting me to speak on this occasion. What I propose to talk about is, first, my general role under the Financial Services Act and, second, the particular views that I have taken on the marketing of life insurance.

2. My duties under the Act are quite specific. Before A-day, I was required to report to the Secretary of State as to whether anything in the rule-books of each of the new regulatory bodies, SIB, SROs and RIEs was likely to restrict competition to a significant extent. If I concluded that in any way the rules were significantly anti-competitive, and the Secretary of State agreed, then he could only designate SIB, or allow the SIB to recognise the other regulatory bodies if he decided that the anti-competitive effects were outweighed by the benefits to the protection of investors. Perhaps because the Fair Trading Act gives me a general consumer protection role, many commentators have not understood that, in this area, I am required to take a narrow view and to deal solely with competition effects. Any balancing that ought to be done between competition and investor protection is for the Secretary of State, not me.

3. The task of preparing reports in time for A-day was not a light one: indeed between March 1987 and April 1988 I made twenty-six reports on eighteen institutions. However, A-day has come and gone and my on-going task is less time constrained. It is to examine any changes in the rule-books to see if they may restrict competition to a

significant extent *and* to assess the practical operation of the rulebooks. In several of my reports I put up markers against certain rules that might adversely affect competition but said I needed to see how they worked in practice. I have, for example, expressed concern about the effect of the costs of the new regulatory system on the continued availability of independent financial advice. My role is limited - to identify problems of competition and to comment on them without proposing solutions - but it can be important especially if you believe, as I do, that competition promotes consumer welfare in the investment sector as in any other sector.

4. The interplay of competition and consumer welfare - or investor protection - comes to the fore in consideration of my second theme. The issue here - the marketing of life insurance - has aroused considerable controversy. Why has this issue proved so important? The answer lies partly in the Act itself and the decision of the Government to include long-term life insurance within the definition of investments laid down in the Act. This has drawn attention to the nature and objectives of life insurance and has held it up to comparison with other forms of investment covered by the Act such as unit trust and investment trust savings schemes, personal pension plans and personal equity plans.

5. We all know that life insurance usually has two distinct objectives. The first is risk protection, that is the protection of families and other dependants from unforeseen eventualities such as loss of income due to illness, incapacity or death. The other objective is not protection against unforeseen eventualities, but planning for events which are expected to occur such as a drop in income on retirement. Life assurance with this objective is a mechanism for re-distributing income between different periods in life or between different generations.

6. The definition of investment in the Act has invited investors to weigh up the merits of life insurance against the merits of other forms of investment. But investors have a major difficulty. It has been very difficult to draw any real comparison not only between life insurance and other forms of investment but also between one life insurance policy and another. An investor buying equities knows the price he is paying for the shares, the price he is paying to his agent, and, day by day, the current value of his investment. In contrast, the investor in life insurance pays out his money with a certain amount of blind faith. He has not known what part of that payment goes to investment, what part to his agent or the company's agent, or what he can expect as return at the end of the day. Thus, the merits and demerits of life insurance are far less transparent than those of other investments.

7. The reasons for this lack of transparency lie partly in the nature of the product. The

eventual value of a with-profits policy has to be taken on trust and will not be known for perhaps twenty-five years or more. Unlike other investments its value cannot be seen day by day. The investor cannot intervene actively to maximise the return by buying and selling at what he considers the right point: he can only leave this to his Life Office's investment manager. But the investment manager himself has no control over some factors, such as the rate of inflation, or the overall performance of the stockmarket. These uncontrollable factors make it important that the potential investor should have as much information as possible about the factors which the investment manager can control so that his skill and efficiency can be judged. Clearly it is skill and efficiency that will produce the most favourable result but, until now, the investor has not yet held the information which would enable him to judge whether these qualities have been - or are likely to be - brought to bear in the management of his affairs.

8. Some improvement in transparency has now been achieved by SIB. It requires the standardisation of projected values, that information about past performance should be relevant, and that surrender values in the first five years of a policy should be disclosed. I welcome these changes. They improve transparency and help the investor towards rational choice. However, I have to ask myself whether the degree of transparency which has been achieved is enough to enable investors to judge skill and efficiency, and hence, through the pressure of their choices, to push the life offices to improvements in these qualities.

9. By withholding information which would enable customers or their advisers to compare one product with another, the industry has isolated itself from some of the forces of competition. That has been the burden of my reports.

10. I have already referred to SIB rules which will require the disclosure of certain information. To my mind the investor needs to know yet more to make a rational choice. Most important he should also be told what part of his payments will be unproductive - that is what part will go to meet a company's expenses, and will not be invested for his future profit. Put another way, life office expenses represent the price of the investment management service. There should be competition on this price, as on any other, but that can only happen if the price is revealed. Further, that information has to be revealed in a way which makes sense to the investor. There is also other information which it helps him to have: for instance, there may be innate differences in the administrative costs of different types of policy, for example between endowment and pensions policies. The life office also has choice about how it allocates its profits between different products and different years and will presumably have a policy on this. That to my mind is relevant information. Some part

of profit may go to share-holders not to policy holders: that, too, is relevant. All these factors will affect the ultimate value of the investment and there is a case for them to be disclosed and for disclosure to be detailed. Knowledge promotes effective competition but secrecy inhibits it.

11. The public is provided with more information when buying goods. Anyone who wants to buy a car can readily discover its engine capacity, its fuel economy, its acceleration and its top speed. Why should they be denied comparable information about what is, after all, another product in the market competing for custom? Different people have different objectives in buying a car, and it is by matching those objectives to the range of cars available that they make their choice: they may opt for a sports car or family saloon car or may even decide that an alternative product, such as public transport or a bicycle, meets their objectives better. Why should they not have that same ability in their choice of life insurance?

12. There is resistance in the life insurance industry to even the principle of such transparency. Whether the subject is disclosure of surrender values, or of intermediaries' commission, or of company's expenses the arguments advanced are:

- the customer is not interested;
- the customer will not understand;
- the customer will give this factor undue importance.

I am sceptical of such arguments. I believe it is better to give customers or investors adequate information about the product they are buying. The more educated judgment which they can then make promotes a more competitive environment and the consequent benefits of greater efficiency and innovation in the industry whether it is insurance or some other. I therefore welcome the recent statements by SIB and DTI of a programme for the introduction of greater disclosure of commission, expenses and charges on 1 January 1990.

13. Of course, I recognise that the more complex the information, the more difficult it is for the investor to choose and the greater is the scope for misleading information which may itself distort competition. I also recognise that complexity does not just lie in the comparison of one life insurance product with another. Sensible investors should compare life insurance with other forms of investment. That is why I so firmly favour the ready availability of independent advice. Effective competition will be enhanced if investment products are subject to the scrutiny of expert advisers. Equally, however, I do not think that the desirability of independent advice is a reason for isolating the independent adviser from the forces of competition. Thus I am

pleased that the Secretary of State accepted my argument that the intermediary should not be isolated from these forces by a maximum commissions agreement and "soft" disclosure: there seems no reason why there should not be competition between intermediaries as well as competition between life offices.

14. As I said the Securities and Investment Board has recently announced plans for introducing requirements for the disclosure of commissions, charges and expenses. It has also made clear that it wants to introduce this requirement in a comprehensive and comprehensible form and thus ensure that the investor has all the relevant information, whether it relates to past performance, projected value, commission or whatever, in one digestible package. I welcome this. These requirements are to be made known next April and to be in effect by the beginning of 1990. The coming months will see changes in its traditional methods of operation and the forces of competition will come into play even more keenly than they now do. For my part I shall scrutinise these changes and any others both when they are proposed and when they come into practical effect and will report as necessary if competition is at risk.

**Report on the Annual General Meeting held at University College,
London on Tuesday 20th September, 1988.
by R. Hanson - James, Hon. Secretary**

The Chair was taken by Mr J A Pincott.

APOLOGIES

Apologies were received from Mr Davidson and Mr McCrindell.

MINUTES

Minutes for 1987 Annual General Meeting which had been published in Journal no 65 were approved and signed.

AUDITORS

The recommendation of the Committee that Messrs Charles Rippin and Turner should be re-elected was proposed by Bryan Lincoln, seconded by Derek Cole and carried unanimously.

HON. SECRETARY'S REPORT

Adoption of the Hon. Secretary's report, a copy of which was attached to the notice convening the meeting, was proposed by Mr Cornish, seconded by Mr Foster, and carried unanimously.