



IMA Response

“Consultation on “stakeholder” savings and investment product regulations”

September 2004

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The IMA represents the UK-based investment management industry. Its members include independent fund managers, the investment arms of banks, life insurers and investment banks, and the managers of occupational pension schemes. They are responsible for the management of about £2 trillion of funds (based in the UK, Europe and elsewhere), including authorised investment funds, institutional funds (eg pensions and life funds), private client accounts and a wide range of pooled investment vehicles. In particular, our Members represent 99% of funds under management in UK-authorized collective investment schemes (CIS, ie unit trusts and open-ended investment companies).

The IMA believes that stakeholder investment products need to meet the very highest standards of investor protection. Those standards are represented by the rules governing collective investment schemes, which are the only fully regulated financial services products. It would be perverse if some products were subject to a lighter touch sales regime while others – subject to higher standards of product regulation – were not. The IMA believes such an outcome would be unacceptable and would undermine confidence in the whole stakeholder concept. It follows that the CIS rules should represent the minimum acceptable standard for stakeholder products. We do not believe that is yet reflected in the Government’s proposals.

There are three concerns in particular to which the IMA would draw attention.

- 1. The structure of the charge cap and the penalty for switching or transferring.** The proposed rules for saving and investment products have the unfortunate consequence that any investor who decides to transfer from one provider to another or to switch from one product to another will incur higher charges than by staying put. This is effectively a penalty for switching or transferring. As a result, the products fall short of what should be the highest standards of investor protection.

It creates two undesirable incentives. First, it may encourage mis-selling by providers encouraging investors to switch to them. But second it undermines the important open-ended nature of the CIS product, creating a disincentive for investors to move to another provider or switch to another product which may be able to offer better performance, or to adjust their investments to take account of changing circumstances. This will disenfranchise investors from investment decisions and effectively lock investors in to potentially unsuitable products. The overall effect is to reduce the competitiveness of the market. To justify such limitations on the basis that it discourages churning by advisers is wrong. As FSA authorised persons advisers must already comply with conduct of business regulations. If there are perceived to be problems with churning they should be dealt with through that route, not through Government product design. ***Possible solutions to this problem are discussed in Appendix 1.***

- 2. The need for a level playing field between different types of product.** As the proposals stand, they do not appear to offer equal treatment of different product types, in particular in two respects.

First, "smoothed" linked long-term products will be free to levy higher charges on investors than the price cap, through the imposition of a smoothing charge. This charge will not itself be the subject of any price cap and thus "product providers will be able to set their own parameters ... for charging for smoothing"¹. Although we note that such a smoothing charge will not necessarily benefit the manager, this would appear anomalous. ***At the very least, a more transparent approach would be to set a higher cap for "smoothed" products, which would include the smoothing charge, and to require providers to include the cost of smoothing within the quoted charge.*** Investors could then be in no doubt as to the cost of the product.

Second, the draft regulations do not require (unregulated) life products to conform to the same standards as (regulated) CIS products in a number of respects such as valuation, pricing and investor engagement. These are again discussed further in Appendix 1. It would seem very odd that, unregulated life products should be granted Stakeholder status whilst not have to meet the standards and rules for regulated CIS that have been laid down by FSA regulation for the protection of investors. ***A potential solution to this problem would be to require that a stakeholder unit-linked life product could invest only in CIS or a product which complied with the rules governing CIS; there might need to be further rules, for example to require the life wrapper to use the valuation of the underlying fund.***

- 3. Consistency of rules across different products.** The IMA has argued in a number of contexts that government products should fit into a consistent framework to provide the industry with the flexibility to build attractive products for consumers. We have carried out an analysis of the four stakeholder products and stocks and shares ISAs, which is at Appendix1.

It is clear from this that there are several inconsistencies still, for example in the ability to invest in property funds. Stakeholder pension and investment products may invest in property, but stakeholder CTFs may not. Also, property funds are not eligible for ISA status, unless via the Stakeholder savings and investment product, although the IMA are discussing this last issue with the Inland Revenue arising from products governed by the FSA's New CIS Sourcebook. As things stand, however, a stakeholder investment product which had property within the portfolio could not have direct ISA status and would be ineligible for investment by a CTF. This is anomalous because a stakeholder investment fund should surely be eligible for both to ensure consistency and to prevent investor confusion.

Attached at Appendix 1 is the IMA's more detailed response, while Appendix 2 deals with the specific questions posed in the consultation document.

¹ Consultation on "stakeholder" savings and investment products regulations June 2004 – HM Treasury Paragraph 2.20.