Response of the Income Protection Task Force to the Financial Advice Market Review

Remit

The Income Protection Task Force (www.iptf.co.uk) was set up in 2005 to promote the value of income protection as one of the means of combatting the financial vulnerability of those who become unable to work for long periods, through sickness or accident.

We have published two White Papers looking at the future for Income Protection , held a Summit for the industry in 2012 and have recently launched a campaign ' Seven Families' (www.7families.co.uk) which provides practical insights on the financial and emotional aspects of long- term disability.

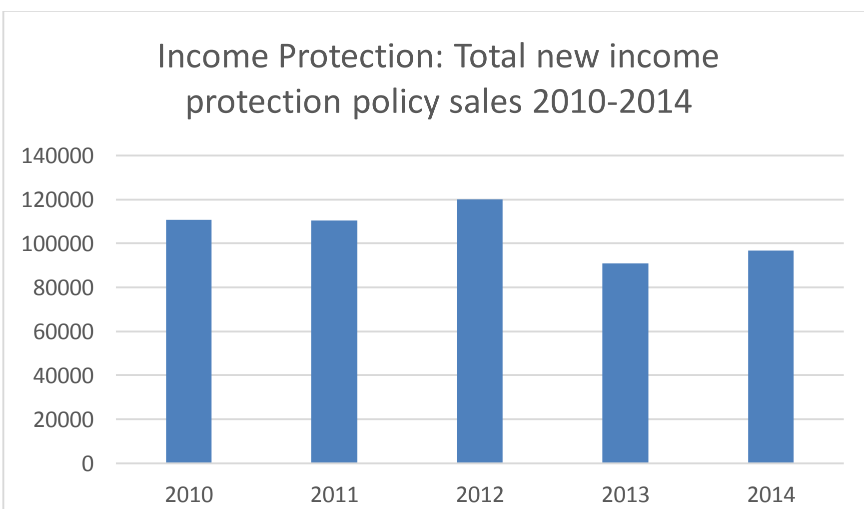
Because of the restricted remit of the Task Force we will confine our comments and observations to matters that impact on income protection although we may reference other protection products as well.

Matters under review

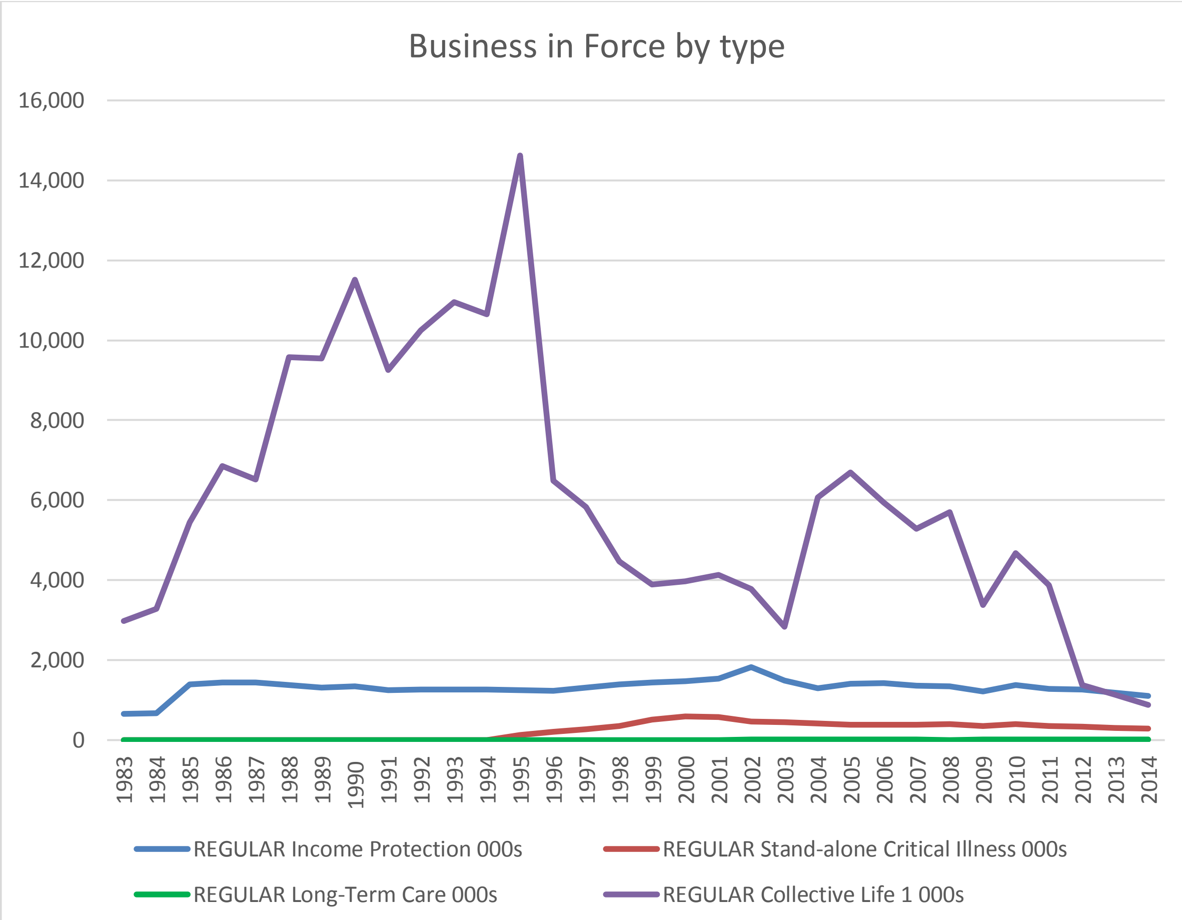
This FAMR consultation is tasked with getting views and input on the following areas:

- the extent and causes of the advice gap for those people who do not have significant wealth or income
- the regulatory or other barriers firms may face in giving advice and how to overcome them
- how to give firms the regulatory clarity and create the right environment for them to innovate and grow
- the opportunities and challenges presented by new and emerging technologies to provide cost-effective, efficient and user-friendly advice services
- how to encourage a healthy demand side for financial advice, including addressing barriers which put consumers off seeking advice

Size of the UK income protection market



Source: Swiss Re Term and Health Watch 2015



Source: ABI

These figures indicate the importance of these markets. Current estimates suggest that the individual IP market will grow by a considerable amount this year. At the half-year the market was showing growth of over 16% and this figure appears to be increasing because of greater adviser awareness fuelled by the Seven Families campaign and an increased industry focus on this aspect of financial planning.

Structure of this response

This response will focus on the following areas:

- Concise history of income protection in the UK from early origins to present day situation with ---brief reasons for its current position. Means- testing and income protection
- Impact of RDR on protection
- Research on the potential size of the income protection market sourced from research on Simple products and original work by IPTF, MacMillan and other organisations
- Lessons from Seven Families , the Government's Resilience agenda/ trend of welfare reforms and importance of stimulating individual IP sector as part of solution
- How FAMR might reference and support this going forward, specific answers to the matters under review in this consultation

The history of income protection in the UK

The origins of income protection (which was formerly called Permanent Health Insurance) lie in the friendly society movement. The Original Holloway Society developed a product to provide sick pay and income in retirement (known now as Holloway policies) to agrarian workers in Gloucestershire in 1880. From these beginnings the product has developed and is written in various forms in the UK.

More precise figures are contained elsewhere in this paper but the UK Group IP market covers over 3 million people, the individual long- term income protection market has in- force numbers of over a million and there are an unknown number of people covered under short- term income protection products. The number is unknown because participants in this market have no trade association which collates numbers at the present time. There is often confusion between the 'long- term and 'short- term' categories in the IP market. Some individual IP policies run until retirement age but the benefit paying period may be restricted to one, two or five years to reduce premium costs. These are long- term products. Short- term IP is annually renewable and normally provides cover for one or two years. In this submission we are primarily representing the interests of the long-term individual IP market.We have not focused on the Group market in any detail as it is not normally a market affected by individual adviser sales.

These definitions on the ABI website clarify the differences between the products:

- lomg- term income protection (IP)
  replaces your salary if you are off work for a long period of time (potentially up to the expiry date of your policy)

- short term income protection (STIP)
  gives you a monthly income for an agreed amount of time (usually up to 12 months)

This report from Legal and General, ' Deadline to the Breadline' illustrates very clearly the financial vulnerability of the average British family
http://www.legalandgeneralgroup.com/assets/portal/files/pdf_182.pdf.

Given necessary constraints on the level of social welfare benefits there is clear need for people to protect themselves from the consequences of extended (and possibly permanent) periods of ill-health or disability.

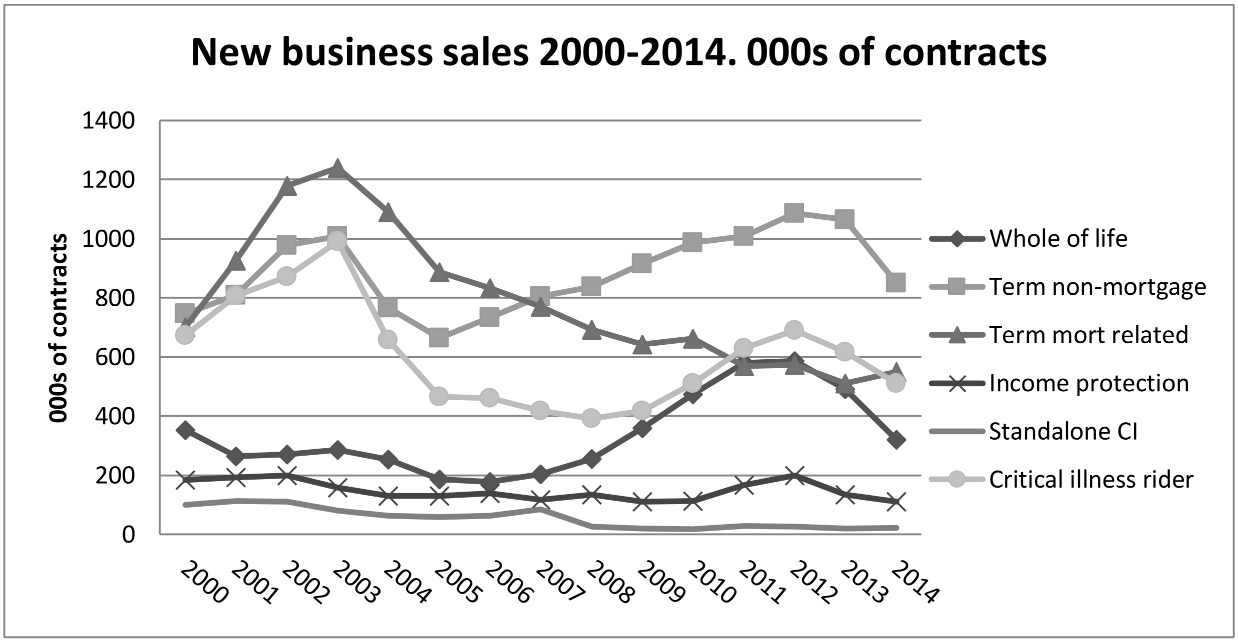
The Simple Products initiative attempted to look at the potential number of people who would definitely benefit from an income replacement product.This indicated that the market was sized at around 23million people. The in- force market for Income protection covers barely 20% of this number even counting group cover.

At the moment the Employment and Support Allowance (E&SA) is the most common benefit paid to those unable to work through sickness or accident. The current rates of this benefit are as follows:

Work Related Activity Group	£102.15 per week
Support Group	£109.30 per week

The overall effect of these various factors is to leave a significant part of the UK working population very vulnerable to the risk of financial meltdown if they become unable to work through sickness or accident. As earlier figures indicate insurance sales that mitigate against this risk are frustratingly low. Our contention at IPTF is that protection sales generally have been hampered by the influence of the Retail Distribution Review.

RDR and its impact on protection



Source: Protection Review:
http://protectionreview.co.uk/images/uploads/Chapter_AC_Sales_Indices_2015.pdf

It is estimated that since the Retail Distribution Review, sales of protection have been negatively impacted. The figures above indicate the trend in protection sales which show a general downward trend since the RDR came into force. The main impacts of RDR were reviewed in a briefing paper for the House of Commons Library

http://researchbriefings.files.parliament.uk/documents/SN05528/SN05528.pdf

Among the key findings were estimates by FCA consultants that;

- there would be an 11% reduction in the number of advisers

- an 11% reduction in the number of advised clients as a result of market exits

- a 25% reduction in the number of adviser firms especially those with ten advisers or less.

The combination of a shrinking adviser market with a focus on investment business at the expense of protection, contradicts the idea propounded by many people that RDR would lead to an increase in the size of the protection markets because of the desire by advisers to preserve a chunk of commission earnings.

Exacerbating this is the likelihood that some segments who need income protection would be unlikely to be accessed in the new landscape. This segmentation model created during the Simple Products consultation illustrates how the market might be segmented in terms of income levels.

Source: Scottish Widows

This does not correlate well with the need and demand for protection products especially income protection and it is our contention that the current distribution landscape creates major customer detriment.

Seven Families

The Seven Families Project was conceptualised in 2014 and began in October of that year (www.7families.co.uk). The last payment to a family under the scheme will come in August 2016. The idea of the project is to underline financial vulnerability by taking seven families where someone has been struck down by severe ill- health or accident. None of the families had income protection. We have supported them as if they did have IP and have also provided some of the add-on benefits like Best

Doctors and Red Arc that provide second medical opinions or emotional support for families trying to cope with the trauma of disability.

Financial Advice Market Review (FAMR)

The IP Task Force believes that the FAMR is long overdue and needs to address the consumer detriment described in the previous paragraph. It also supports the agenda outlined in this government publication from May 2015 issued by the Cabinet Office:

'Building a more resilient society will help ensure that we are better prepared for and able to recover from emergencies. This responsibility needs to be shared between central and local government and the emergency services, the private sector (particularly those providing essential services to the public), civil society and communities.'

This is an admirable aim. The provision of income benefits through insurance is both vital and very effective but will only be feasible if the marketplace and more particularly the adviser base for products like income protection does not contract. The initial scoping of the market for the Simple products initiative suggested that 23 million people would struggle if they lost their main source of income. If anything we believe that this could be an underestimate and that if can definitely be seen that we have two important issues developing;

A system of financial advice which is skewed towards wealth management and the needs of the top 10% of the population in terms of earnings and a very clear requirement for access to a means to protect income which will not be delivered effectively by the distribution system which is evolving in the UK.

There has been considerable speculation about the 'advice gap' both before and after the Retail Distribution Review came into force. The law of unintended consequences regularly manifests itself in financial services as markets move contrary to the presumed direction. We believe that the flat production figures for protection reveal a market that is not working in the best interests of a UK population that is already vulnerable to financial problems should they suffer illness or an accident which prevents them from working for a prolonged period.

Key challenges of the consultation paper

Responding to the specific questions you ask for opinions on, our comments are as follows:

This FAMR consultation is tasked with getting views and input on the following areas.

The extent and causes of the advice gap for those people who do not have significant wealth or income

It is difficult to calculate any ' advice gap' precisely because it relates to something that doesn't exist ! The key concern must be that a fee based adviser environment is likely to both discourage people from accessing products that they need and make financial advice the province of those who are perhaps more financially astute already. The predisposition to receive fees for advice has caused the distributor base to increase its focus on wealthier segments most able to pay those fees. This is disenfranchising a significant part of the population from access to financial advice. Certainly any extension of RDR to cover protection would be potentially a significant blow to that part of the industry but more importantly may mean that many financial obligations undertaken by people in the lower sociology-economic groups would not be covered.

The complexity of protection sales particularly those where medical underwriting becomes problematic might make a time - based fee system totally impractical. Protection products are mass market products designed for a range of segments and not just a market where there is high disposable income.

The regulatory or other barriers firms may face in giving advice and how to overcome them

We have already alluded to the reality of selling protection business. Advice is important in buying protection as few people have detailed understanding of how to match product to need and which package of price and features represents the best combination for them . It is necessary to deliver advice economically and the use of telephone based advice has proved very effective in selling protection business. The challenge in developing an advice model that is cost- effective but meets the needs of customers is a big one but is vitally important in providing the right environment to enable people to effect very necessary cover.

How to give firms the regulatory clarity and create the right environment for them to innovate and grow

It is reasonable to suppose that a high level of regulation may discourage innovation as the priority for companies becomes compliance. General management thinking suggests that the key to achieving client satisfaction is to create a culture that focuses on customer need and fulfil those needs as effectively as possible. The current regulatory system is failing to do this and one of the consequences is the relative downgrading of protection as a priority in regulatory thinking and consequently in distributor attention.

The opportunities and challenges presented by new and emerging technologies to provide cost-effective, efficient and user-friendly advice services

The opportunity to use technology to facilitate protection sales is a large one. We have seen the development of underwriting models which reduce the time taken to complete sales and there is considerable potential in harnessing the data collected from the vast array of wearable technology that is developing. This can facilitate more efficient processes which can dovetail effectively with online protection sales. This is a burgeoning area of opportunity which may accelerate a major change in the way that protection can be bought and may provide a much more user- friendly buying experience that is closer to buying other forms of mass- market insurance like motor and household insurance. This may prove particularly interesting to younger buyers who might find the traditional way of accessing and purchasing protection cover somewhat off-putting.

How to encourage a healthy demand side for financial advice, including addressing barriers which put consumers off seeking advice

This response has focused on protection, particularly income protection. This is an area that receives relatively little promotion in the media and it would seem unlikely that there would be great interest in buying protection cover without it.

However protection websites and online propositions report considerable interest from consumers in purchasing protection online. Google enquiries for protection insurance have doubled over the course of 2015. The obstacle to increasing sales has been converting this interest into a product purchase for reasons articulated previously.

The conclusions that appear to emerge for a healthy protection market are the need to retain commission as the main form of remuneration, to encourage models that provide robo advice for simplified products that can be sold online or in conjunction with telephone based advice.

One particular concern that is related to the juxtaposition of advice and regulatory change is the sale of mortgages. Since the advent of the Mortgage Market Review sales of protection alongside mortgages have dropped to an estimated 7%. In the Republic of Ireland it is compulsory to buy term cover to protect a mortgage. We believe this would be a prudent step to take in the UK as well. Advisers selling mortgages feel that the process adopted since the MMR came into force makes the additional sale of what is a very necessary form of protection impractical. This is another example of potentially serious customer detriment and one that needs to be considered alongside the other concerns being articulated in this consultation process.

We welcome this consultation and would be keen to put our experience and product understanding at your disposal if you feel this would be of value to you.

If you have any questions relating to this response please send them to

Peter Le Beau, MBE, Chairman, Income Protection Task Force

(peter@lebeauvisage.co.uk)