Michelle Cracknell explains why a consumer-led approach to financial solutions allows little room for old style products, such as with-profits.

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time for a new model

Sliding returns and mis-selling scandals have left the reputation of with-profits funds in tatters. Yet, despite their tarnished reputation, with-profits policies seem to have enjoyed something of a recent revival, with sales up over the past year.

So why is this happening? One explanation could be that investors are seeking the 'smoothing out' of returns as a way to protect themselves from the risks of investing in current markets. Unfortunately, on a number of occasions the 'smoothing' offered by with-profits policies has often proved to work better in theory than in practice. Funds that have employed cautious investment strategies in the past have often failed to enjoy the subsequent benefits of exposure to soaring equity markets.

client-focused, not provider-focused

At our Trailblazer roadshows we have spoken about the opportunity and importance of creating an industry that focuses upon the needs of the end customer and how that can build the consumer's trust in the industry as a whole. With-profit policies are increasingly looking like an ill-fitting, old-style solution that suits providers' needs rather than clients. The inherent inflexibility and opaque nature of with-profits policies means they cannot be directly matched to the specific needs and risk profiles of individual clients over what is often a long-term investment horizon. Indeed, asset allocation is set by the provider's own risk profile – not the customers.

Their structure makes it extremely difficult for clients to understand what to expect from their investments – which may in turn result in their expectations not being met. There are new model solutions which are transparently structured and understandable, and which can deliver an investment solution suitable to meet the needs of the client.

Increasing consumer understanding of their personal risk profile is crucial in helping to build trust. Of course financial advisers have a key role in helping their clients understand their attitude to risk, as well as building a portfolio that matches this risk profile and monitoring the investments to ensure they remain in line with the investor's expectations. In order to achieve this, advisers need access to modern, flexible solutions that are built around a client's goals and risk profile.

The FSA recently published a discussion paper on consumer responsibility in financial services. The paper stresses the importance of ensuring consumers are engaged with their finances. Skandia welcomes this paper but acknowledges that providers of financial products must also be responsible for delivering solutions that can be tailored to investor needs, and where there is no intrinsic bias towards a particular product provider or asset class – something the old style product world fails to deliver.

Inherited estates

Nowhere is the provider-centric focus of with-profits policies more evident than in the treatment of with-profit fund inherited estate attributions. Our own research during the Skandia Trailblazer roadshow revealed that nine out of ten financial advisers believe the inherited estate of a with-profits fund should belong to policyholders rather than the shareholders of the with-profits product provider.

Yet with-profits providers claim that the inherited estate belongs to them and have gained the ABI's support in this view. Skandia believes the structure of the with-profits product, with pooled policyholder and shareholder capital, leads to conflicts of interest and can result in customer money being diverted to support shareholder benefits.

'hidden' charges

It is also a concern then that the recent rise in with-profits sales would suggest that consumers may be taking out these types of policies while unaware of the actual potential cost of investing. Further research conducted by Skandia shows that on average investors are paying 100 pence for 91 pence of investment value when they take out a new with-profits policy with a typical life insurer.

The analysis was based on the weighted average 'market value reductions' (MVRs) levied by six of the UK's largest with-profits providers, and identified the nine pence up-front early surrender charge built into the typical with-profits contract. This analysis is representative of 62% of the total realistic assets reported by UK with-profits funds as at 31 December 2007 in the latest FSA returns.

In effect, incoming policyholders are paying existing policyholders for any reduction in the value of the investments underpinning a with-profits fund – creating an unfair subsidy from new to existing customers.

In contrast, many of the recent developments you have seen from Skandia, such as the innovative Spectrum funds and the clear and improved pricing structure on the platform, have been introduced with the aim of improving customers' understanding of their finances and the ultimate goal of improving their outcomes.

existing holdings

Many advisers have rightly recommended with-profits in the past – but recent experience shows funds today are all too often very different from the funds promised only a few years ago. Providers have added charges for guarantees and charges for their cost of capital, they have adjusted the portfolios from equities to bonds with consequentially lower growth for customers, and they often have different owners with different strategies. It is now time to re-examine with-profits to ensure past advice remains appropriate after all these changes – something the FSA is expecting advisers to do in their regular client reviews.

building integrity

The regulator is actively encouraging the industry to change in such a way that builds greater consumer confidence. Both providers and advisers have an opportunity to smarten up the industry and demonstrate greater integrity through building long-term relationships that focus on modern, flexible and clear solutions, rather than opaque old style products.

We believe expert financial advice, together with flexibility and transparency of client-centric products, and supported by the evolution of today's platform infrastructures, lies at the heart of the solution for rebuilding consumer confidence in the savings and investment industry.

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with-profits uncovered

In the first of a series of 'One to One' interviews, Philip Hayton talks to Ned Cazalet about the with-profits industry, including:

- the with-profits industry today – an analysis of the market
- with-profits policies compared
- advising on with-profits
- the future for with-profits

Submit your questions for Ned Cazalet to **informerlive@skandia.co.uk**

You can register to receive e-mail reminders for the event – visit