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MONEY BOX

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LEWIS: Hello. In today's programme, risk. Do you understand how much you're taking when you invest, and do advisers know how to explain it? Protect your savings against inflation. It sounds a good offer, but three new inflation protected savings schemes come with strings attached. Ben Carter's here today looking at insurance problems, Ben, for those with Middle East holiday plans.

CARTER: That's right, Paul. If your policy doesn't cover you for civil unrest, then you may well have problems if you do travel and problems if you don't.

LEWIS: Three major high street banks more than doubled the money they made from their retail customers in 2010. Why doesn't competition drive down prices?

But first, risk. On a scale of 1 to 10, how much risk would you take with your money? It's hard, isn't it, and whatever answer you give is probably fairly meaningless; and the Financial Services Authority says there's a good chance that the firm advising you will misinterpret your answer anyway. Its analysis found that failing to assess risk properly is responsible for more than half the unsuitable advice that customers are given. Bob Howard's been investigating.

HOWARD: Paul, Money Box was contacted by Brian from Kent whose wife Denise had invested £100,000 with HSBC 4 years ago. Before it decided what to do with the money, the bank wanted to assess Denise's appetite for risk. It used a system which Brian thought seemed clear.

BRIAN: The adviser asked my wife what her aversion to risk would be on a scale of 1 to 10, and he said that 1 would be putting the money in the Post Office, so it would be totally safe, no risk at all; and 10 would be sort of gambling on a horse or putting it onto red number nine in a casino. And her option was 2. So my interpretation of that would be pretty safe, not risking it too much.

HOWARD: In the financial planning report it wrote for Denise, the bank described her appetite for risk as "cautious" and that she was a "lower risk investor" willing to have a portfolio with "some equities". Brian thought that was an accurate description and says he accepted it was possible the investment might make a small loss in the short-term. But he was shocked when a combination of the bank's fees and the poor performance of some aspects of the portfolio meant in a few months his wife's £100,000 was down to just £73,000.

BRIAN: If we chose 2 and we lost £27,000, heaven knows what would happen if we'd have chosen 7, 8 or 9. We were really surprised at the attitude of the bank and of the Financial Ombudsman when we tried to make a complaint about this because their basic interpretation was well you got what it said in the report. Clearly the definition they have of 'cautious' is very different to my interpretation.

HOWARD: HSBC says it believes it did a detailed analysis of Denise's appetite for risk, only part of which involved her giving a number rating. It said if Denise had held the portfolio for the time period it recommended, it would have gained in value. But the FSA believes these sorts of misunderstandings between customer and financial adviser are all too common. In an analysis published just last month, it's concluded that of 366 investment portfolios it examined, more than half did not meet the FSA's assessment of the customer's attitude to risk and it didn't like banks using imprecise terms like some which Denise found in her report.

REPORT: The descriptions of risk categories use ill-defined words and phrases. This increases the possibility that customers will interpret the level of risk differently to the adviser. This is particularly a problem if customers read concepts like “some”, ‘reasonable’ or ‘moderate’.

HOWARD: But is that really all the fault of advisers? Steffan Huck, Professor of Economics at University College London and an expert in this field, believes in many cases we ourselves may not really understand our own attitudes to risk.

HUCK: Risk attitudes are very erratic, so they’re not constant over time. You put people in one situation and you try to estimate their appetite for risk. And then you put them in a slightly different situation and you would make predictions about their behaviour based on the early observations, and you find the prediction just doesn’t hold.

HOWARD: Professor Huck believes the way forward is to make detailed calculations of possible returns and losses.

HUCK: What does it mean to be a 2? I would want to know if I invest £10,000, you know what is the worst case scenario that I can face in 5 years time? What is the best scenario that I can face in 5 years time? What is the likelihood of you know losing 10%, gaining 10%? You have to look at you know the actual numbers instead of just saying, “Oh I’m a cautious 2”.

HOWARD: Do you know your own appetite for risk?

HUCK: No, I don’t. *(Howard laughs)*

HOWARD: Paul, you might ask if a professor in the field has trouble assessing his own attitude to risk, what chance is there for the rest of us and for advisers who have to interpret what we say and then act on it? And the FSA is pretty damning about the tools experts use to calculate the risk a customer is willing to take. Of the 11 it examined, 9 weren't up to the job. And it specifically used the example of on a scale of 1 to 10 - which HSBC says it still uses - as poor practice.

LEWIS: Bob Howard. Having too much fun there, I think. Live now to Birmingham to talk to Derek Capelin who's a Director of Capelin Financial Management and a chartered financial planner himself. Derek Capelin, how do you assess people's willingness to take a risk with their money?

CAPELIN: Well good morning, Paul. I think the most important thing to put at the centre of the way that a chartered financial planner would work is the client themselves. Everything that we do revolves around the client's desired outcome - i.e. his financial planning solution. Whereas I think when customers go into some other organisations such as banks, the outcome required is actually a product sale. So our process …

LEWIS: *(over)* Yes, I mean that's a familiar claim about banks, and I understand it and indeed I've made it myself many times. But you've got to be … I might come to you and say well I want 50% return a year. I mean people have very unrealistic expectations, don't they?

CAPELIN: They do and that's exactly the responsibility of a professional financial planner. The job here is, one, to understand the client at outset, and to put a range of outcomes in front of the client as to whether their objective will be met. And a chartered financial planner works in the way that the professor set out there and typically we would come out with a fantail chart of the range of possible outcomes, giving the experience of the past.

LEWIS: Yes, but it is very difficult - and Professor Huck made that clear - to assess someone's attitude to risk, isn't it? Indeed it may change over time.

CAPELIN: Oh it's terribly difficult. The process that we use, we do use some of these psychometric risk profiling tools, but we use them at outset. And I think the usefulness of those is that it puts risk firmly at the outset of the agenda and the relationship, and from there we can start to model and to form a quality conversation.

LEWIS: And how clear do you make it that risk doesn't just mean reward; risk means the chance of a bigger reward but an equal chance of a big loss?

CAPELIN: Oh absolutely. We concentrate very much on what we call the drawdown - i.e. the worst possible case scenario over the last 10 years specifically and going back as far as our data calculates, and how long the portfolio would be down for.

LEWIS: Stay with us Derek, but with me in London is Helen White who's the Acting Director of Life and Savings at the Association of British Insurers. And Helen White, you've recently changed the names the ABI gives to funds. Why have you changed that classification?

WHITE: Hi Paul. What we actually manage is the groupings of investment funds that are used for pensions and investment bonds rather than the names of the funds themselves, and these groupings are intended to help consumers and advisers compare similar types of investment funds and compare their performance. Now the names of the 'mixed asset' or 'managed funds' at the moment use terms such as 'cautious' and 'balanced', which are not intended to give an indication of risk, but we became aware during the course of last year that these terms were apparently causing people confusion because they …

LEWIS: *(over)* Well they thought a 'cautious' one was cautious.

WHITE: Yes, exactly.

LEWIS: Well it's not unreasonable, is it?

WHITE: No it's not. And it wasn't until last year that we realised it was causing that kind of confusion. And as soon as we realised this was the case, we undertook an awful lot of consumer research to find a new set of names to give to these sectors that would get rid of these terms that were causing confusion and that would be designed to help people make better judgements about their investment fund choices in pensions, for example.

LEWIS: So they're all called Mixed Investments now and then you have a percentage indication of how much is in shares, which can be 20% to 60% in the case of what used to be well what was the cautious one. But a glance at the Financial Times this week shows funds called High Income, Real Return, Opportunities, Absolute Return, Money Builder. This is what the individual funds are called. You have no control over that, do you?

WHITE: That's right. I mean you'll no doubt be aware that it's quite typical for investment fund names to follow the name of the sector which they sit in, the group in which they sit in. We will be publishing the announcement on Monday that we're going to be changing the names of these sectors, and we'll be publishing the research that we did with consumers. We'll also be providing guidance to our members who produce the investment funds, and encouraging them and helping them to review and to change the names of their investment funds in light of the research that we did and the new fund sector names.

LEWIS: So we might see the end of things called Balanced, Managed, Absolute return, UK aggressive. We may just have very practical things like 20% in Shares Fund?

WHITE: Absolutely. These names are intended to essentially say what's inside them - if you like say what's on the tin.

LEWIS: Helen White, thanks very much from the ABI, and thanks very much to Derek Capelin in Birmingham. And you can have your say, tell us what you think about your own attitude to risk - how it's been measured and your experience of it in investments - on our website: bbc.co.uk/moneybox. You can let us have that information now.

Now with inflation topping 5% - or 4% if you believe the government's preferred measure - any savings product that promises to match that is bound to be popular. National Savings of course withdrew its Index Linked Certificates last July after it became too popular, but in the last few weeks three inflation busting savings products have been launched by the Post Office; Birmingham Midshires, which is part of Lloyds Banking Group; and Yorkshire Building Society. But are they as good as they seem? Live now to Norwich to talk to Louise Holmes from Moneyfacts. Louise Holmes, are these a lifeline for savers, as some people have portrayed them?

HOLMES: Hi there, Paul. Well they are seen as a lifeline for savers. Like you say, in the face of high inflation and low interest rates, they're certainly a positive move by providers.

LEWIS: Yes, but look at the Post Office, for example. I mean that offers you Retail Prices Index plus 1.5%, but it comes with certain conditions, doesn't it?

HOLMES: That's right, yes. The actual term of the deal is for 5 years; and, as we know, a lot can happen in the financial world over 5 years. So with RPI predicted to fall, savers need to bear this in mind when taking the deal out really.

LEWIS: Yes, so you have to tie your money up for 5 years.

HOLMES: Yes.

LEWIS: The interest, as I understand it too, goes into a separate account, so it's not rolled up. And it's also subject to tax, which of course National Savings wasn't, was it?

HOLMES: Absolutely, yes it is subject to tax. Essentially it is a good deal, but, as you say, savers need to bear this in mind. And the actual interest if you like is rolled up each year, so if RPI falls then so will the interest rate.

LEWIS: Yes. And of course the Bank of England likes to tell us that interest rates will be on target by some time next year, so RPI probably about 2.5%.

HOLMES: Absolutely.

LEWIS: Now Birmingham Midshires and Yorkshire are similar, though they offer you much less on top of RPI, don't they?

HOLMES: They do, yes. The Yorkshire Building Society offers RPI plus 0.1%, and Birmingham Midshires is 0.25 plus RPI. Now again they're over the course of 5 years, so if RPI does fall then so will the rate. The investor will always get the guarantee of the 0.1 or the 0.25 though.

LEWIS: Yes, that's not a great guarantee, is it?

HOLMES: No.

LEWIS: And of course the Yorkshire one, as I understand - am I right - it can be put into an ISA, so at least you can get the interest completely tax free on that?

HOLMES: It can. Yeah, that is the advantage with that one.

LEWIS: Now you mentioned all of these are 5 year investment products, so you either have to leave your money in or face a hefty penalty if you take it out. But you can get good rates on standard 5 year bonds if you're really happy to tie your money up, can't you?

HOLMES: Absolutely, yes. Northern Rock currently offer a rate of 4.3% on their market leading 5 year fixed rate and there's a host of 4 and 5 year deals that offer fantastic rates at the moment.

LEWIS: Yes. And of course they may look very good rates if inflation really does fall over the next couple of years.

HOLMES: That's right, yes. It's all to do with how inflation pans out and also interest rates as well.

LEWIS: Yes. Well we expect … Well they can only go one way.

HOLMES: Well yeah.

LEWIS: It's when they go up that matters, doesn't it? And, finally, do you expect better products or similar products to come on the market and, crucially, do you think National Savings and Investments will come back into the market?

HOLMES: Well, like you say, there was a gap in the market since they pulled their deals last July, so it will be interesting to see whether any other providers decide to launch any inflation linked deals. But at the moment, I think with interest rates obviously predicted to rise in the next couple of months, it will be interesting to see how providers sort of play the game really.

LEWIS: Indeed and we'll keep listeners up to date. Louise Holmes from Moneyfacts, thanks very much for that.

Tunisia, Egypt, Bahrain, Libya - civil unrest and indeed revolution spreading across North Africa and the Middle East. It's touching all our lives, even here in the safety of our own country. Thousands of people planning trips to those places are having to reconsider, and in many cases they can't be sure they'll get their money back. Money Box listener John Ahearn told us his experience.

AHEARN: We were due to fly out to Bahrain on Tuesday this week, the 22nd, but because of the situation and the government's advice was that all but essential travel was to be avoided, we decided to cancel the flight; and we understood that if we'd have flown against this government recommendation, that the travel insurance would have been invalidated. Now the airline - KLM - refuse to reimburse us as the actual flight did take place; and our travel insurance company, they won't pay out due to being classed as a 'civil unrest'. Now this just seems a bit of an unfair situation because we're losing money. Just what can we do about it?

LEWIS: Well that's one listener's experience. Money Box reporter Ben Carter's been checking up on this. Ben, John was booked with KLM, a Dutch airline. Would British airlines have treated him differently?

CARTER: Well they would, Paul. As we saw with Egypt, when the Foreign and Commonwealth Office advised against anything but essential travel, British companies followed that advice. Rochelle Turner from Which? Holiday.

TURNER: UK based airlines have allowed people to change their flights or even get their flights refunded if the advice to Egypt was don't travel to Cairo, Luxor, etcetera. But if you are working or travelling on a foreign based airline, which doesn't have such a policy and their advice from their country is different, it will depend completely on what the airline says you can do.

LEWIS: Now, Ben, John was travelling - as we said - with KLM. What have they said to you?

CARTER: Well I should start by saying that if a foreign airline chooses to cancel flights, then they have to refund customers under EU law. But in John's case, KLM chose to fly to Bahrain even though the Foreign and Commonwealth Office advised against anything but essential travel. Now KLM have been updating their policy on a daily basis. They are offering refunds to anyone who was due to travel to Libya between February 21st and March 6th. People going to Egypt can't get a refund but can rebook, although the government have now lifted the advice stating only travel if it's essential. But KLM will not refund people with flights to Bahrain despite the Foreign and Commonwealth Office currently advising against anything but essential travel there. So the refund policy is inconsistent.

LEWIS: And bad news for John. He paid nearly £1,000, I think, for two flights. And most people would assume, as John did Ben, that if the air operator doesn't refund you, then insurance will cover your cost?

CARTER: Well absolutely, people do make assumptions that they will be covered for events like this; but, as people found out with volcanic ash, it really pays to read the small print of the policy.

TURNER: People unfortunately work on the basis that somebody always picks up the bill and I don't see nowadays that that is indeed the case at all. We can try and make sure that we are covered, but buying a policy with every potential eventuality in it is nye on impossible these days.

CARTER: That was Rochelle Turner from Which? And I spoke to the Association of British Insurers and they told me that some policies will cover you if you follow advice offered by the Foreign and Commonwealth Office not to travel, but some won't. But I've spoken to a number of the big insurers and I couldn't find any that did. What I found is that anything classified as 'civil unrest' invalidates your travel insurance policy. And another issue is what do you do if you had travelled to Egypt, Libya or Bahrain before the trouble broke out and then found yourself caught up in it? Would your insurer cover you for any problems you encounter? Well one of the big insurers, Axa, has said that due to the ongoing level of civil unrest, they will be looking at any related claims on a case by case basis. But another big player, Saga, has said that any customers currently in an area deemed by the Foreign and Commonwealth Office to be unsafe are not covered by their insurance.

LEWIS: So Ben, in future if people are travelling to places where there might be a chance of what you call "civil unrest" - and there's a lot of it about - what's the advice to them?

CARTER: Well in short, if you can book through a tour operator, then do so. As Rochelle Turner told me, they offer you a lot more protection.

TURNER: The regulations are quite strict, so that if one were to offer a holiday to a destination where Foreign Commonwealth advice was not to go, then the regulations could mean that the companies would be responsible for compensation payments should anything happen and it's not a risk that many travel companies are willing to take. You'll find that package companies will tend to cancel those holidays and offer alternative destinations or a refund.

LEWIS: And of course with a package holiday, that covers everything - flight, hotels and pre-booked trips. That was Rochelle Turner from Which? and of course our very own Ben Carter.

Three of the four big high street banks have now told us how much money they made or indeed lost in 2010. But it's becoming clear from the figures that although bits of their business continue to lose lots of money, one part of their work remains profitable: retail banking, the stuff of high street banks that we all do - current accounts, savings, loans, mortgages, credit cards, insurance. Every one of the banks made money from its retail operations right through the recent crisis and all three of the big banks made a lot more from us in 2010 than in 2009. With me is Ralph Silva, Managing Director of SRN and a banking specialist. Ralph Silva, retail banking always profitable and these three banks have more than doubled their profits from you and me over the last year.

SILVA: That's right and technically they've never lost money on retail customers. You've got to realise that the British public is actually a great customer base. Only the French actually make more money off of retailing banking than the British to. We pay our debts. We use a lot of products, we use a lot of the banking services, so it's great customers to have.

LEWIS: But why doesn't competition work to drive down prices? There are four big banks and there are a few smaller ones. Surely that should bring prices down?

SILVA: Well there is no real competition. We have the same four banks. We actually have fewer banks now than we did 3 years ago, so there's not that much competition. And, secondly, the banks are looking at building up their capital base. It's those reserves, that money that they have in case of a rainy day. They're trying to build them up because in 3 years they're required to almost double the amount that they used to have; and they don't have that money now, so they're trying to be as profitable as possible.

LEWIS: And also I suppose the more money they keep in the safe, so to speak, the harder the money that's out there being used has to work to make them a return?

SILVA: True.

LEWIS: And that complaint we get very much is how hard it is to get a mortgage, how much you have to pay for it because that money is working very hard.

SILVA: Yeah and this is one of the problems that we have now - is that the banks are actually giving mortgages to people that actually are less risky: people who have jobs and have had jobs through this crisis, who have money and are taking less percentage. So they should in fact be giving you favourable numbers, but instead they're so concerned about building up their capital reserves that they're not giving us the prices that we should be getting if we had more competition.

LEWIS: So just so I'm clear about that. You're saying that they're taking less risk on us but also charging us more, which is the opposite of what they should be doing?

SILVA: They're charging us the same amount as if we had more risk is what I'm trying to say.

LEWIS: Right, so not charging us more, but they're not giving us any share of that lower risk?

SILVA: Exactly.

LEWIS: And of course if you look at the figures, at least my interpretation of them is that one of the reasons they're making money this year is because there are far fewer bad debts in those …

SILVA: *(over)* There are considerably fewer bad debts, especially in the mortgage business where the actual default rates on mortgages has been going down considerably because if you were going to default, you were going to default 2 years ago.

LEWIS: Now we've had a number of banks making payments and fined and criticised for customer service. I mean just this week Lloyds customers were told that there'd be a £500 million what they call 'customer good will' payment to people who took out mortgages with Halifax. How have they got things that wrong with their customers?

SILVA: Well you have to think about when you develop a product or a service in a bank, it requires about 100 people to get involved, and Halifax will be the first one to admit somebody made a mistake along it and 99 people missed it.

LEWIS: A very big mistake, half a billion, isn't it?

SILVA: Well for Halifax, it's not that much money. And I know how ridiculous that sounds, half a billion here. But I talked to them last weekend. They're incredibly embarrassed. This was not a malicious action. They weren't trying to take advantage of the customers. This is a mistake that should never have happened and frankly would not have happened if they hadn't laid off as many people as they have.

LEWIS: Yes, I mean these were Halifax customers who appeared to be promised a fixed capped rate when in fact their rate wasn't capped - mortgages between September 04 and 07. And just briefly Ralph, to conclude. If people are fed up with the service or the prices of the big four, what can they do?

SILVA: Not much. The safest bet right now is in the big organisations for one simple reason: when we do start to build up competition, the banks that are going to reduce their rates the fastest are going to be the large organisations because they have the ability to do so. So right now all the banks are pretty well the same price, but when things start to change you're going to get favourable pricing with the large organisations.

LEWIS: Ralph Silva from SRN Network, thanks very much for talking to us. And just time for one short item of other news. With the banks still, the big four high street banks have agreed to reform the way they sell us will writing and executor services. Ben Carter's got the details. And, Ben, executors of course the people who are in the will to sort out the finances of someone when they've died?

CARTER: That's right. And that person doesn't have to be a professional. The Office of Fair Trading reckons that people have been spending 40 million pounds a year too much on executor services. Barclays, HSBC, Lloyds and RBS have agreed with the regulator that they will insure clients who make a will are not misled into thinking that they must appoint a professional executor and that they will not encourage clients to appoint professional executors unless this is clearly in their best interests.

LEWIS: Thanks, Ben. And of course someone who is a beneficiary can also be an executor which not everyone realises. But that's it. That's all we have time for. Find out more from our website: bbc.co.uk/moneybox. There's lots of information. You can listen again, you can send us your ideas, and of course have your say on investment risk as one or two of you are already. I'm back on Wednesday with Money Box Live. This week we're taking your questions on the state pension, sort of my specialist subject really, including pension age and boosting that pension. Send a question through our website now. I'm back with Money Box next weekend. You can read my money thoughts every day on my Twitter, Paul Lewis Money. Today the reporters were Bob Howard and Ben Carter, the producer Ruth Alexander, and I'm Paul Lewis.