Financial Conduct Authority

Guidance consultation

Retail investment advice:

Clarifying the boundaries and exploring the barriers to market development

July 2014

Contents

Executive summary

1.1 During 2013, we investigated the extent to which there is a difference between our expectations of firms and firms' understanding of what is required of them – what we termed the 'expectations gap'. This 'expectations gap' project considered how any difference in understanding might affect the availability of products and services offered to customers and the extent to which this may be affected by a lack of clarity around our rules, their implementation and their supervision. In particular, does this 'expectations gap' meant that firms are shying away from providing products or services that would be beneficial for customers for fear of falling foul of the rules? Furthermore, customers' online habits and the channels available to them have changed radically over the past decade.

1.2 The project identified three main areas for additional work:

- What is, and what is not a personal recommendation (the subject of this paper).
- How we might give firms more confidence to provide shorter, more useful disclosures to customers about their products.
- How we provide guidance to the industry and how this supports confidence and innovation in products and services.

1.3 The latter two will be covered in more detail in a separate publication from the FCA, though we will provide a brief outline of the scope of the work on guidance in this paper. The main focus of this paper is on what is and what is not a personal recommendation in relation to retail investments[1] and what scope there is for firms to provide a range of services in relation to those products. The paper covers the following issues:

- Clarifying the current regulatory landscape on personal recommendations in relation to retail investments and, in response to requests from the industry, bringing together in one place the existing FCA guidance that is available to firms (particularly on simplified advice) and from the Committee of European Securities Regulators(CESR) and the European Securities and Markets Authority (ESMA). We also ask if firms and customer groups would benefit from adding this guidance to our Handbook.
- Summarising the results of the thematic work that we have recently carried out examining the new distribution models firms are using to sell investment products to customers in the retail investment market, some of which provide a personal recommendation and some of which do not[2].
- This paper also reports on the customer research that we carried out specifically for this project, to understand how customers use services without a personal recommendation; and their perception of the service they receive.
- We provide detailed examples of business models and in each case offer a view on whether we think the example is regulated advice or not. We also ask if it would be helpful to include these examples in the Perimeter Guidance Manual.

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[1] This paper does refer to other products other than retail investment products

[2] The full version of the thematic report has been published separately. *Developments in the distribution of retail investments: Purchasing investments without a personal recommendation or with simplified advice* http://www.fca.org.uk/news/tr14-10-developments-in-the-distribution-of-retail-investments

- We also introduce Project Innovate, which is designed to encourage innovative business models in the interest of consumers.

1.4 We want your views on the boundary between sales models that provide personal recommendations on retail investments and those that do not – we discuss this in Chapter 5, focusing on the issues that may pose barriers to development in this market.

1.5 We believe that a well-functioning retail investment market needs different delivery mechanisms to be fully effective for a broad range of potential investors. There are benefits to well-designed, low-cost methods of meeting customers' straightforward needs – the challenge is to ensure that such methods deliver good outcomes for customers in a way that is viable for firms. We know that firms want greater clarity about how they can help customers to make informed decisions without stepping over the boundary into providing a personal recommendation.

1.6 We have published two pieces of work – a report on thematic work and the results of consumer research - alongside this paper. We are simultaneously calling for input on Project Innovate, which is an FCA initiative designed to support new and established businesses across the financial sector to bring innovative ideas that are in the customer's interests into the market. More information on Project Innovate is set out in a separate publication which is available via our website. We also encourage firms to review this document and provide us with their views.

Next steps

1.7 We have set out a number of questions in Chapter 5. Please send us your responses by 10 October 2014. You can send your response by email to: AdviceGuidanceConsultation@fca.org.uk, or by post to:

The Advice and Distribution team
Policy, Risk and Research Division
Financial Conduct Authority
25 The North Colonnade
Canary Wharf
London, E14 5HS

1.8 When responding, please state whether you are doing so as an individual or on behalf of an organisation. Please include your contact details with your response, in case we need any more detail on any issues you raise.

1.9 It is the FCA's policy to make all responses to formal consultation available for public inspection unless the respondent requests otherwise. A standard confidentiality statement in an email message will not be regarded as a request for non-disclosure.

1.10 A confidential response may be requested from us under the Freedom of Information Act 2000. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the Information Commissioner and the Information Tribunal.

2 Introduction

Background

2.1 In the course of the expectations gap project, we held a number of meetings with firms, trade associations and the Statutory Panels, gathering insights and evidence of potential problems. Overall, there was a general feeling that there were areas where greater clarity would help deliver good outcomes for customers, and we found a small number of examples of firms being reticent to bring products to market. Our thematic work also found an overly cautious approach to providing information that might help customers avoid poor outcomes.

2.2 The project identified three broad issues. The first, which is the subject of this paper, was about what is, and what is not a personal recommendation in relation to retail investments. There appeared to be clarity about the extremes – some services clearly involved giving a personal recommendation and some clearly did not. However, some firms were unsure about exactly where the boundary sat between a service that involves giving a personal recommendation and one that does not. There were also suggestions that there was a lack of clarity about our expectations for services that do not involve providing a full consideration of all of a customer's needs, what is commonly referred to as 'focused advice' or 'simplified advice'. To help firms and customers we have developed a simple table on page 19.

2.3 The second area for more work was about the provision of information about financial services to customers. Firms' communications often fail to provide customers with the information they need in an accessible and understandable format. We intend to explore how we might give firms more confidence to provide shorter, more useful information to customers about their products. We will support good practices in innovation (e.g. use of technology) in delivering good quality information and we plan to consult later in the year on removing certain product disclosure rules that we do not consider to be useful for customers and do not necessarily promote competition in the interests of customers.

2.4 The third issue was how we provide guidance to the industry and how this supports confidence and innovation in products and services. In addressing this issue, we have launched Project Innovate, an initiative which will help both start-ups and established businesses to bring innovative ideas into financial services markets. The objective of Project Innovate is to foster innovation that can genuinely improve the lives of consumers.

2.5 This paper represents the first output from these strands of work aimed to support firms in understanding what is, and what is not, a personal recommendation. This paper will be an important element in providing clarity to our stakeholders and, in so doing, improving industry understanding of the issues and limitations in this area. We will begin the discussion on Project Innovate in a separate paper, in which will ask for initial views.

Recent market developments

2.6 The development of technology over the past few years has allowed firms to introduce more innovative solutions for helping customers by providing services through the internet, some of which involve giving personal recommendations and some which do not. Firms are also developing mobile applications that allow customers to invest or trade via their mobile devices, and features from social media have started to make their way into firms' distribution models. We have seen a number of web-based tools, designed to aid decision-making and steer the customer to consider their investment options and solutions without necessarily providing a personal recommendation. These include tools that aid consumers in their budgeting and general financial planning (generic non-regulated advice) and allow customers to input details of their investments that are held in different forms and at different firms. These tools allow investors to obtain a 'portfolio' view of their investments.

2.7 Following the introduction of the Retail Distribution Review[3] (RDR) rules at the end of 2012, concerns have been expressed about the availability and accessibility of personal recommendations to some customers. This is something we are monitoring this year through the Post-Implementation Review. As part of this, we have recently conducted a large scale piece of quantitative customer research[4], looking at customers' interactions with the retail investment market before and after the introduction of the RDR. The research, found that there had been a small shift from sales channels that involved the giving of a personal recommendation to those that did not (2% of the overall research sample had moved) but a greater move from channels not involving a personal recommendation to those that did (4% of the overall research sample had moved). This suggests that the picture is far from straightforward. It also explored the main motivation for customers not to seek personal recommendations. The top reasons among those who had been active in the market post-RDR included the desire to stay in control of their investments (18%), and feeling that they were as capable as an investment adviser (17%).

2.8 However, concerns about access to personal recommendations and retail investment products have led to greater interest among firms to develop processes that will deliver products and services more quickly and cheaply to people who have straightforward investment needs.

2.9 For some time we (and our predecessor the Financial Services Authority) have set out our view that a well-functioning retail investment market needs different delivery mechanisms in order to be fully effective for a broad range of potential investors. We

[3] The RDR came in on 31 December 2012 and made significant changes to the market for retail investment products. The reforms required advisers to be remunerated by their customers (rather than being paid by commission from product providers); improved clarity for customers about the nature of the advice on offer; and, enhanced the professional standards of investment advisers.

[4] Over 4,000 respondents with more than £5,000 of investable assets took part in this research, which will be published as part of the Post-Implementation Review.

have recognised that there could be benefits from well-designed, low-cost methods of meeting customers' straightforward needs, and we encourage their development. The challenge, as always, is to ensure that such methods will deliver good outcomes for those customers in a way that is also commercially viable for those who supply the products and services.

2.10 We have therefore been discussing with our stakeholders the options for low-cost, simpler ways of recommending retail investment products, particularly for customers with relatively modest amounts to invest and relatively straightforward investment needs. It is clear that there has been some reluctance on the part of firms to develop these models and we are keen to understand more about the barriers firms believe they face.

2.11 We are also aware that firms offering retail investments without personal recommendations want greater clarity on how they can support customers in making informed decisions – increasingly via technology-rich solutions – without stepping over the boundary into providing a personal recommendation.

2.12 In April 2014 we held a roundtable discussion with around 30 representatives from trade bodies, customer groups and a number of firms. The attendees discussed a range of issues such as the needs and objectives of customers in this market, the barriers to developing simplified sales models, and the boundary between a service which involves giving a personal recommendation and one that does not.

2.13 The sessions raised some interesting questions around the potential barriers to providing simplified or automated services, many of which resonated with other work in this area. We will address these points in this publication.

2.14 Finally, it is important to note the close link between the outcomes from this workstream, and the project to develop the retirement income guidance guarantee announced in the recent Budget[5].

Related work

2.15 To better understand the development of this market, we have also undertaken two other linked pieces of work in this area:

- Thematic discovery work examining the new distribution models firms are using to sell retail investment products to customers within the post-RDR retail investment market. We wanted to take a closer look at the developments in this evolving market, assess how well services where customers purchase investments without a personal recommendation and services providing simplified advice are supporting the delivery of good customer outcomes, and investigate how well the existing regulatory framework is supporting firms.

[5] The 2014 Budget announcement included the proposals to increase flexibility in how individuals can use their pension savings and to support their choices through free, impartial guidance.

- Customer research to help us understand the customer experience of purchasing retail investments without personal recommendations. Our research also explored customers' motivations, understanding and the reasons why they have chosen not to seek a recommendation.

3 Existing regulatory regime and guidance

3.1 From our work with firms in 2013 and recent stakeholder events we gained a greater understanding of what firms think we expect of them. It is clear that there remains some confusion about the existing regime for the sale of retail investment products. In recent years, guidance documents have been issued in this area by the Financial Services Authority (to explain how simplified advice could operate), the European Securities and Markets Authority (ESMA) and its predecessor the Committee of European Securities Regulators (CESR) providing guidance on the MiFID definition of 'investment advice'.

3.2 One output from the workshops that we held was feedback from our stakeholders that they would find it useful to have all of the relevant information in one place when trying to develop new service models, in order that they can better understand the various options open to them. Our stakeholders have told us that having so many disparate documents creates a lot of 'noise', which can lead to uncertainty. We agreed to pull all the relevant existing information on rules and guidance on what is and is not a personal recommendation on retail investments into one document as a first step in supporting industry and, if it is helpful, to retire all other non-Handbook forms of domestic guidance on this topic.

3.3 We have also found that, while firms are clear on the requirements for full advice and for execution-only business, they are struggling to navigate the options in between such as simplified advice or limited advice services and sales without personal recommendations, that involve guiding the customer in some way. This section of the paper therefore aims to clarify the requirements for providing the various types of service and simplifies how we refer to the different options. It also draws together the guidance from CESR and ESMA and the non-Handbook guidance published by the FSA that already exists in one place so that it provides a single point of access for firms that want to provide services with or without personal recommendations.

3.4 We are aware from feedback we have received from both customers and the industry that a lack of clarity may be inhibiting the development of different investment sales models. This may restrict engagement by customer with investments. We therefore believe that it is important to deliver greater clarity on the concepts of 'regulated advice', 'generic advice', and 'personal recommendation'.

What is regulated advice under the Regulated Activities Order?

3.5 The regulated activity of advising on investments under Article 53 of the Regulated Activities Order (RAO) is wider in scope than investment advice under MiFID. This is because MiFID requires advice to be of a personal nature whereas the RAO does not.

MiFID investment advice[6] involves the provision of personal recommendations to a customer, either upon the customer's request or at the initiative of the investment firm, in respect of one or more transactions relating to financial instruments. So, for example, if a firm provides recommendations to the public generally this will not normally be a personal recommendation. Our suitability rules only apply where a personal recommendation is made.

3.6 For advice to be regulated at all, it must relate to a specific investment and must be given to the person in their capacity as an investor or potential investor, or in their capacity as agent for an investor or potential investor, and relate to the merits of them buying, selling, subscribing for or underwriting (or exercising rights to acquire, dispose of or underwrite) the investment.[7] If it does not have all of these characteristics then it is generic advice and is not regulated. For example:

- Advice to a customer to buy shares in ABC plc or to sell Treasury 10% 2014 stock is advice about a specific investment and so is regulated.
- Advice to buy shares in the oil sector or shares with exposure to a particular country is generic advice because it does not relate to a specific investment.
- Advice on whether to buy shares rather than debt is generic advice and is not regulated.
- General advice about financial planning is generic advice and is not regulated.
- Guiding someone through a decision tree where they make their own decision, would not normally be advising on investments.[8]

When could generic advice become regulated advice?

3.7 Generic advice is a broad term that covers advice that does not relate to a specific investment or does not otherwise meet one of the other characteristics described in paragraph 3.6 above and so is not a regulated activity. However, when generic advice is given with regulated advice (for example, a personal recommendation on a retail investment), the generic advice becomes part of the regulated advice. For example, generic financial planning advice that also involves advice on the merits of investing in a particular product with a particular provider would be captured. So, advice that purports to be generic may in fact be regulated depending on the context and the overall circumstances. For example, advising someone to invest in one geographical area or sector would be regulated advice if there is also an associated recommendation for a particular investment.

[6] Markets in Financial Instruments Directive Annex 1 section A5 and Article 4.1(4)
[7] This must be a 'security' or a 'relevant investment' as defined in article 3(1) of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001
[8] The guidance in PERG that relates to this can be found in PERG 8.26 http://fshandbook,info/FS/html/handbook/PERG/8/26

Decision trees

3.8 Online services use decision trees as a key element of their processes. Decision trees involve using a form of sequenced, scripted, questions prepared in advance to gather information from a customer with a view to either providing a personal recommendation or regulated advice or facilitating the customer selecting a financial instrument themselves. Where this is facilitating customer choice, the process of going through questions will usually narrow down the range of options that are available to the customer to choose.

3.9 Effectively, a decision tree is a tool that helps deliver advice, which may be generic advice or a personal recommendation, depending on the questions asked and the solution presented to the customer. Hence, the use of a decision tree does not, in itself, determine whether a firm is providing regulated advice or not. Advice will be regulated if it meets the criteria identified in paragraph 3.6 above, regardless of the method used to deliver it.

3.10 A key consideration in deciding whether a personal recommendation is given will be if the decision tree process involves identifying one or more particular retail investments for the customer, rather than providing a list of products meeting the customer's criteria. To establish whether an activity constitutes advising on a retail investment, firms must consider whether the process is limited to, and likely to be perceived by the customer as assisting them to make their own choice of product that has the particular features that the customer regards as important. For it not to constitute a personal recommendation, the decision tree and, where relevant, the person asking the question it contains, would need to avoid making any judgement or assessment that would result in one or more products being identified as 'for' a customer, whether as a result of information that the customer provides or otherwise.

What is the difference between 'information' and 'investment advice'?

3.11 The difference between 'information' and 'investment advice' is the element of opinion or judgement on the part of the adviser, either in person or, for example, online. Regulated advice involves recommending a course of action or making a judgement on the merits of exercising a right (e.g. to sell or buy). Generally speaking, giving someone information and nothing more, does not involve giving regulated advice. So, for example, giving facts about the performance of investments, the terms and conditions of investment contracts, or the price of investments, does not involve regulated advice if the investor is left to exercise their own opinion on the action to take.

3.12 However, the circumstances in which information is provided can make it regulated advice. For example, if information is provided on a selected rather than balanced basis so that it influences or persuades, this may be regulated advice. If, for instance, share price information is given in circumstances which suggest that the firm is communicating that it is a good time to sell, then what appears to be the provision of information may, in fact, be advice. Providing definitive guidance on whether something is regulated advice depends not only on the facts of the individual case, but also the context.

What is a MiFID investment advice?

3.13 The regulated activity of advising on investments (for the purposes of Article 53 of the Regulated Activities Order) is wider in scope than investment advice under MiFID. This is because MiFID requires advice to be of a personal nature whereas the Regulated Activities Order (Article 53 of the Regulated Activities Order) does not.

3.14 MiFID investment advice[9] involves the provision of personal recommendations to a customer, either upon the customer's request or on the firm's initiative, in respect of one or more transactions relating to MiFID financial instruments. So, for example, if a firm provides recommendations to the public generally this will not normally be a personal recommendation. Our COBS suitability rules only apply where a personal recommendation is made.

3.15 A personal recommendation is defined in our Handbook glossary and follows the MiFID definition. It comprises three main elements:

- there must be a recommendation that is made to a person in their capacity as an investor or potential investor, or in their capacity as an agent for an investor or personal investor
- the recommendation must be presented as suitable for the person to whom it is made or based on the investor's circumstances, and
- the recommendation must relate to taking certain steps in respect of a particular investment

3.16 So, for example, a firm may provide a recommendation in the form of an investment bulletin that is not targeted at individual customers without it constituting a personal recommendation (and therefore triggering the suitability requirements) but it could still amount to regulated advice (i.e. the activity of advising on investments under Article 53 of the Regulated Activities Order).[10] Firms providing regulated advice on investments still need to be authorised and must adhere to other Handbook requirements, for example, our Principles for Businesses.

3.17 The examples set out in Section 4 aim to show the line between what constitutes a personal recommendation and what does not.[11] They are not intended to relate directly to the question of whether an activity constitutes 'advising on investments' for the purposes of the Regulated Activities Order (i.e. whether it is regulated advice). This is important because it is the definition of 'personal recommendation' that drives the application of the suitability rules set out in our Handbook.[12]

[9] Annex 1 section A5 and Article 4.1(4)
[10] A recommendation is not a personal recommendation if it is issued exclusively through distribution channels
[11] Article 52 MiFID Implementing Directive
[12] COBS 9

Tests that determine whether MiFID investment advice has been given

3.18 MiFID, together with the MiFID Implementing Directive, places various requirements on firms when they provide investment advice. Importantly, MiFID includes requirements to ensure the suitability of personal recommendations to customers and potential customers.

3.19 To help clarify the circumstances when a personal recommendation is being given by investment firms, the Committee of European Securities Regulators (CESR) launched a consultation paper entitled *Understanding the definition of advice under MiFID* in October 2009.[13] In its finalised Q&A[14], CESR set out five key tests that need to be met for a service to be a 'personal recommendation' and constitute investment advice under MiFID. We have replicated these tests in a flowchart in Annex A of this paper but also set out the five tests below:

- Does the service being offered constitute a recommendation? For example, firms would need to consider the difference between information and a recommendation and whether assisting a customer to filter information amounts to a recommendation.

- Is the recommendation in relation to one or more transactions in financial instruments? For example, firms would need to consider how to distinguish generic advice and general recommendations from MiFID investment advice. Also, whether recommending a firm or a service can amount to investment advice.

- Is the recommendation: a) presented as suitable, or b) based on a consideration of the person's circumstances? For example, firms would need to consider how a financial instrument might implicitly be presented as suitable, the impact of disclaimers, and what it means to consider a person's circumstances.

- Is the recommendation issued otherwise than exclusively through distribution channels or to the public? For example, firms would need to assess recommendations delivered via the internet, assess recommendations given to multiple customers at once, and the effect of distributing investment research.

- Is the recommendation made to a person in their capacity as: a) an investor or potential investor, or b) an agent for an investor or potential investor? For example, firms would need to identify investors and their agents. Firms would also need to consider the distinction between corporate finance advice and investment advice.

[13] http://www.esma.europa.eu/system/files/09_665.pdf
[14] http://www.esma.europa.eu/system/files/10_293.pdf

Suitability

3.20 Where a personal recommendation is being given, the person making the recommendation is obliged to ensure, and be able to demonstrate, that the personal recommendation is suitable for the customer, taking account of their personal and financial circumstances.[15]

3.21 To do this, a firm must obtain from a customer information necessary to understand the essential facts about them and have a reasonable basis for believing that the recommendation:

- Meets their investment objectives.
- Is such that they can financially bear any related investment risk consistent with their investment objectives.
- Is such that they have the necessary experience and knowledge to understand the risks involved.

3.22 This suitability requirement relates to all personal recommendations, no matter how they are delivered. Thus, a personal recommendation provided through a simplified advice process[16] must comply with the suitability requirements. However, it is important to note that the suitability requirement is flexible and allows firms to develop a simplified process dependent on the product and type of customer for which it is intended. For example, the suitability test is qualified by reference to 'the nature and extent of the service provided', and the information that must obtained is qualified by the condition 'where relevant'. The information that it is 'necessary' for a firm to obtain will vary from cases to case. The more complex and high risk the product, the higher the threshold of required information.

What is an 'implicit' recommendation?

3.23 MiFID also identifies the importance of presentation in determining whether investment advice is being given. Thus, one of the tests that the MiFID Implementing Directive sets out is whether a recommendation is presented as suitable, rather than whether it is actually suitable for the customer. From our discussions with firms, we know this is an area of concern, particularly when deciding if they have made an implicit recommendation.

3.24 A financial instrument might be presented as suitable to a customer either explicitly or implicitly. In both cases the firm will be providing MiFID investment advice if the other tests set out in the CESR Q&A *Understanding the Definition of Advice under MiFID*[17] are met. For example, a financial instrument would be explicitly presented as suitable if a firm was to say 'this product would be the best option for you'. However, if it was presented to the customer in some other way that would influence the customer to take a

[15] COBS 9.2
[16] http://www.fca.org.uk/static/pubs/guidance/fg12-10.pdf
[17] http://www.esma.europa.eu/system/files/10_293.pdf

course of action in relation to a specific financial instrument over others, this is likely to be an implicit recommendation. For example, for a recommendation to be 'implicit', it may be presented with a statement / scenario stating 'people like you buy this product' or, 'this is what I would do if I were you'. Such a statement gives the customer the impression that the product would be suitable for them.

Collecting customer information

3.25 A 'tick-box' approach should not be used either to collect customer information or to assess suitability. Suitability is not about collecting irrelevant information but such information as is necessary to achieve the outcome, a suitable recommendation.[18]

3.26 For example, MiFID makes the assessment of a customer's experience and knowledge a key part of the personal information that needs to be gathered from the customer. As elements of this, MiFID highlights information on a customer's 'level of education and profession or relevant former profession'. But MiFID is clear that this should only be collected 'to the extent appropriate to the nature of the customer, the nature and extent of the service to be provided and the type of product or transaction envisaged, including their complexity and the risks involved'. So, if a product is very simple, relatively little information may be needed on the customer's knowledge or experience.

3.27 MiFID[19] also states that, if a firm does not obtain the 'necessary information' to assess suitability, it may not make a recommendation. However, in practice, we believe that the MiFID requirement offers inherent flexibility in allowing a sensible assessment to be made of what 'necessary information' entails because it uses the phrase the 'necessary information *to assess suitability'*. The information that needs to be collected can be calibrated according to the type of customer and the nature and extent of the service provided. MiFID accommodates a range of advice, from comprehensive and sophisticated to 'limited investment advice' (i.e. where a customer requests advice on a limited range of investment products or strategies).

3.28 One area of particular concern for firms is the collection of information relating to customers' existing investments. The Financial Services Authority (FSA) discussed these requirements in its guidance on simplified advice.[20] It is worth restating here as the principles are applicable to all sales involving personal recommendations.

3.29 A sales process may ask a customer whether they want their existing investments (if they have any) to be considered in terms of (i) whether they are still suitable, or (ii) whether they would influence the suitability of a recommendation to purchase a new product. If the customer indicates that they do not want either (i) or (ii), and the firm has reason for believing that the customer understands the implications of this decision, the extent of information required on a customer's existing investments may be reduced.

[18] COBS 2.1.1R and COBS 9

[19] The relevant sections of MiFID are article 19(4) of the Level 1 Directive and Articles 25,37 and 52, and Recitals 57 and 58 of the Level 2 Implementing Directive

[20] http://fca.org.uk/static/pubs/guidance/fg 12-10.pdf

If the customer indicates that they would like (i) or (ii), or they are unclear on what they want or the implications of this decision, the firm should not continue with the limited process.

3.30 The extent of information required on a customer's existing investments may also be reduced, in that the firm may not need to know certain details about these investments, such as the broad asset allocation, product types or country / sector exposure. This is because this specific information may not be relevant for the limited service being provided. To understand a customer's regular financial commitments, firms should understand the level of any regular contribution products owned by the customer.

Personal recommendations and automated sales processes

3.31 The way that customers choose to buy products, including financial services products, has changed radically over the past ten years. Customers are more confident in using the internet to inform their buying decisions and therefore want to be confident about the type of service they are interacting with. For instance, ONS data shows that, in 2008, total e-commerce sales were valued at £335bn, reaching £492bn in 2012, an increase of £157bn. The average annual growth in e-commerce sales since 2008 was 10% over the period 2008 to 2012, with total growth since 2008 of 47%. Many commentators expect that growing numbers of customers will look to explore the options for accessing financial products and services by making use of developments in technology, in line with experience in other industries.

3.32 Research[21] by Mintel (April 2014) shows that around 40% of customers currently prefer to receive personal recommendations face-to-face rather than online, although 24% would be willing to receive personal recommendations online. The attraction for firms of offering services online is clear: economies of scale and the opportunity to deliver highly consistent customer experiences. Therefore we need to consider what impact technology is likely to have on areas such as automated sales processes and how innovation in the interests of customers can be facilitated.

3.33 One of the key concerns to firms and customers alike is clarity about the type of service being provided / used. This is particularly seen to be an issue in automated sales processes on websites, when filtering tools – a process that uses questions to the customer to filter out irrelevant products – are being used.

3.34 The CESR Q&A[22] paper provides some helpful guidance on whether a filtering tool on a website can lead a firm into the territory of a 'personal recommendation'. In this context CESR suggests that the following factors may be relevant:

- Any representations made by the questioner at the start of the questioning relating to the service they are to provide.

[21] Mintel, Consumers and Financial Advice UK April 2014
[22] Paragraph 23 http://www.esma.europa.eu/system/files/10_293.pdf

- The context in which the questioning takes place.
- The stage in the questioning at which the opinion is offered and its significance.
- The role played by the questioner who guides a person through the questions.
- The type of questions and whether they suggest to the customer the use of opinion or judgement by the firm.
- The outcome of the questioning (whether particular products are highlighted, how many of them, who provides them, their relationship to the questioner and so on).
- Whether the questions and answers have been provided by, and are clearly the responsibility of, an unconnected third party, and all that the questioner has done is help the person understand what the questions or options are and how to determine which option applies to their particular circumstances.

3.35 The CESR Q&A[23] also gives an example of a price comparison website that allows a customer to enter information to generate a list of investment products for which they are eligible or that meet criteria that the customer has chosen but does not otherwise make a recommendation. CESR considers that, in these circumstances, the ability of the customer to make their own choices about the features they are looking for and the absence of apparent judgement about which features or products they should choose, would make it unlikely that the service offered would be viewed as MiFID investment advice (i.e. a personal recommendation). An example is provided in section 4 of this paper.

Advice through public media

3.36 There is a specific exclusion in MiFID[24] for generic advice given through a distribution channel (such as a newspaper or other media, including the internet), where information is, or is likely to become publicly available. By its nature, generic advice given through these distribution channels will not normally be a personal recommendation. However, it is unlikely that this exclusion would apply to messages sent to individuals that are not publicly available. This is particularly relevant to interaction with customers through email and social media. The CESR Q&A[25] made clear that, in deciding whether a personal recommendation was being given, one criterion was whether it would be reasonable to think that a personal recommendation is being made.

3.37 To avoid any confusion in this area, ESMA has consulted on the removal of the exemption for recommendations that are 'exclusively through distribution channels' in favour of a

[23] Paragraph 25 http://www.esma.europa.eu/system/files/10_293.pdf
[24] Article 52 MiFID Implementing Directive
[25] Paragraph 6 http://www.esma.europa.eu/system/files/10_293.pdf

simple exemption for recommendations made 'exclusively to the public' in MiFID II.[26] This would make it clearer that newsletters and investment tip sheets do not constitute personal recommendations if published or distributed publicly, but may be viewed as personal recommendations if, for example, they are tailored and distributed to named individuals. However, they could still constitute investment advice under Article 53 of the Regulated Activities Order.

Social media

3.38 Social media[27] provides access to large numbers of potential investors and is used to provide a range of services including personal recommendations.

3.39 Many of the messages that are sent or 'posted' in batches to customers or potential customers are unlikely to amount to personal recommendations. The fact that a recommendation is made to multiple customers does not automatically mean that it could not be a personal recommendation, but it could be investment advice. Personal recommendations can be provided in many ways, including face-to-face, orally to a group, by telephone, by correspondence (including email and text messaging), using a website or through providing an interactive software system.

3.40 To assess whether a 'message' sent to several customers amounts to a personal recommendation, different factors need to be taken into account, for example, the target audience, and the content of the message.

- Target audience – the way the firm selects the customers to whom the message will be sent can have a bearing on whether the 'message' constitutes a personal recommendation. For example, when the internal procedures of a firm specify that a financial instrument may only be sold to a sample of customers selected on the basis of certain factors, such as customers under a certain age or who hold similar products, the selection of the target audience will not automatically mean that the firm is providing personal recommendations. However, highlighting the particular personal circumstances that led the individual to be contacted, for example, is very likely to mean that the product is being presented as suitable for the particular customer.

- Content of the 'message' – if, taking into account the context, tone and language of the message, it amounts to a recommendation, for example, because it contains a solicitation, an opinion or a judgement about the advisability of a transaction, which could lead to it being a personal recommendation.

3.41 In the sort of situation described above, 'messages' addressed to customers would be unlikely to be considered as issued exclusively through distribution channels or to the public (as described in paragraphs 3.36 and 3.37

[26] http://www.esma.europa.eu/system/files/2014-549_-_consultation_paper_mifid_ii_-_mifir.pdf
[27] In this paper we use the term 'social media' to refer to internet-based applications such as blogs, Linkedin, Facebook and Twitter

The range of possible investment sales models

3.42 Several trade associations and firms have expressed their concern that the lack of clarity when interpreting the boundaries of services involving and not involving personal recommendations is a barrier to firms developing innovative distribution models. Several have also discussed with us the viability of providing a simplified advice process.

3.43 To help firms and customers understand the material differences between the possible options, we have developed a simple summary in the form of a table. Table 1, Summary of the range of distribution models for retail investment products, sets out a range of sales options (i.e. execution only, appropriateness test, simplified advice, limited or focused advice and full advice) and provides for each:

- a description
- qualification requirements
- whether the appropriateness test or suitability requirements apply
- products available
- adviser charging options, and
- whether there is access to the Financial Ombudsman Service and the Financial Services Compensation Scheme

3.44 We hope that the table will help to standardise the language used to discuss these models. We want firms to be clear on the range of possibilities they have open to them, the requirements of each and our approach to them. In particular, we want firms to understand that there are options for them that sit between execution-only and full advice, that we believe that there are no regulatory barriers to providing these alternatives, and we want to help our stakeholders understand the requirements and boundaries for each.

Table 1 - Summary of the range of distribution models for retail investment products

	Execution only	Appropriateness test	Simplified advice	Limited or Focused advice	Full advice
Description	Intermediary executes a trade: (i) without a personal recommendation; (ii) in a **non-complex** MiFID product (e.g. UCITS fund), pension or insurance-based investment; and (iii) at consumer's initiative	Intermediary executes a trade: (i) without a personal recommendation; (ii) in a **complex** MiFID product (e.g. a complicated structured product), or in another product at the firm's initiative	Provision of personal recommendations where **the firm sets out the limited nature of the service** in line with the guidance provided on this issue, either face-to-face, on the telephone or electronically	A deliberate limiting of the range of personal recommendations **sought by the client** to suit their particular needs (e.g. to seek a recommendation on buying an ISA)	Full regulated advice which may be independent or restricted and will consider the full range of the client's needs, including their debt and protection needs. Also applies to discretionary investment management
Training and competency qualifications	N/A	N/A	QCF level 4 for any adviser, or for person designing the system if automated	QCF level 4	QCF level 4
Appropriateness client has necessary experience and knowledge to understand the risks involved	No	Yes	No		No
Suitability (a) meets the client's investment objectives (b) client able to bear investment risks consistent with his investment objectives;(c) necessary experience and knowledge to understand the risks	No	No	Yes Standard qualified by reference to 'the nature and the extent of the service provided'; information which must be obtained is qualified by the condition 'where relevant', but the process includes safeguards e.g. to exit consumers with more complex financial needs.	Yes Standard qualified by reference to 'the nature and the extent of the service provided'; information which must be obtained is qualified by the condition 'where relevant', but this remains at the instigation of the customer.	Yes
Limited range of product solutions	Non-complex MiFID products, pensions and insurance-based investments only	Complex MiFID products	Yes – we would expect the product range to reflect the limited nature of the suitability assessment	Yes – access limited dependent on the requirements of the client	Not if independent, but more or less limited if the advice is restricted
Adviser charging	No	No	Yes		Yes
Access to the ombudsman service	Yes – recognising the nature of the service	Yes	Yes – recognising the nature of the service		Yes
Access to FSCS	Yes	Yes	Yes		Yes

Key: Blue shading = models which do not involve personal recommendations
Green shading = full advice
Orange shading = "streamlined" models involving personal recommendations without full advice.

NB: Basic advice is not included within this table as it has its own regime outside of MiFID. Outside of these distribution models, firms might also be providing Article 53 RAO advice, for example, issuing research

When does the appropriateness test apply?

3.45 If a customer wants to purchase a complex product without a personal recommendation, the appropriateness test applies. If the product is non-complex, the customer can proceed down an execution-only route. This section describes how the appropriateness test applies to sales of complex products and how firms can integrate the test into their service model.

3.46 If a customer wants to purchase a complex product without a personal recommendation, an investment firm must seek information to enable the firm to determine whether the customer has the knowledge and experience (to the extent appropriate to the nature of the customer, service and product) to understand the risks involved in the transaction or service that is envisaged. Hence, it is a test of whether it is 'appropriate' to sell a potentially very complex product to the person, i.e. whether they will be likely to understand the risks involved. How the appropriateness obligations can best be integrated into a firm's particular business model and processes will be for each firm to determine (e.g. online, or face-to-face, over the telephone or in hard copy).

3.47 The appropriateness test is only required for sales of complex instruments. Not all products involving high levels of risk will be hard to understand (e.g. some funds and shares) and so the appropriateness test does not apply to them. In contrast, options, swaps and other derivative contracts are examples of instruments that are considered complex, as well as spread bets and other contracts for difference. If a customer could lose more money than their initial investment, as with a spread bet, or if an instrument is infrequently traded so it would be hard to value or sell, this would mean that a product is considered complex. More information on the distinction between complex and non-complex financial instruments for the purpose of the MiFID appropriateness test can be found in CESR's paper from November 2009.[28]

3.48 With the introduction of MIFID II, the type of investments which will be considered complex will be extended to include, for example, shares, bonds or other forms of securitised debt that embed a derivative, or contain instruments that incorporate a structure which makes it difficult for the customer to understand the risks involved. However, it remains unlikely that most retail customers would want to access such products without a personal recommendation, so the appropriateness test is unlikely to be particularly relevant to most firms setting up sales processes without personal recommendations for the mass market. Instead, it will be more relevant to firms offering services without personal recommendations to confident and experienced investors.

3.49 The appropriateness test allows firms to collect the amount of information that is relevant to the product or service. In certain cases, firms will need to do little more than determine whether the customer is a sufficiently experienced investor in the type of product envisaged. However, we would expect an appropriateness assessment to be particularly rigorous if a firm were offering more complex products to less experienced customers who may be less likely to understand the risks.

[28] http://www.esma.europa.eu/system/files/09_559.pdf

3.50 Firms may also wish to use targeted questions designed to establish the customer's knowledge in order to understand the risks relevant to the specific type of product or transaction envisaged. It is also possible to seek to increase the customer's level of knowledge about a product or service through providing pertinent information to the customer before assessing appropriateness (though in doing so, firms should be mindful of the risk of this amounting to a personal recommendation).

3.51 In principle, and indeed in practice, the assessment could work online. For instance, a firm could use electronic application forms that automatically process customers' answers to targeted questions to help the firm come to a decision.

3.52 Our rules[29], which implement the MiFID Implementing Directive, indicate what information may be relevant. This includes:

- the types of services and products with which the customer is familiar
- the nature, volume and frequency of the customer's previous transactions
- the customer's level of education, and
- the customer's profession or former profession

Disclaimers

3.53 It is important to remember that even a clear, prominent and understandable disclaimer stating that no advice or recommendation is being given is unlikely to be sufficient to avoid having presented a recommendation as suitable for the customer. For example, if a firm stated that its product would suit a particular customer's needs, including a disclaimer saying that this was not advice would not necessarily change the basic nature of a communication and it may still constitute a personal recommendation.

Assessing risk

3.54 In March 2011 our predecessor, the Financial Services Authority, published guidance on *Establishing the risk a customer is willing and able to take*.[30] This document set out the findings of a review that focused on three key areas:

- whether methodologies for assessing the risk that a customer is willing and able to take with their money are fit for purpose, including the use of risk-profiling tools
- whether descriptions firms use to reflect and check the level of risk a customer is assessed as being willing and able to take are fair, clear and not misleading, and

[29] COBS 10.2.2R
[30] http://www.fsa.gov.uk/pubs/guidance/fg11_05.pdf

- whether processes for choosing investments result in selections that are suitable for the risk a customer is willing and able to take, including the use of asset-allocation tools

3.55 The findings suggested many firms did not understand how the tools they use work, including what they are (and are not) designed to do. Firms should use a tool only where they are satisfied that it provides outputs that are appropriate and fit for purpose. Firms need to recognise where a tool has limitations and mitigate these.

3.56 These tools can be used to help advisers when used in the full advice process but also to help customers who are using an online process that does not provide a personal recommendation. They are also particularly relevant when using a simplified advice process.

3.57 Where firms use a questionnaire to collect information from customers, it is important that the question and answer options are balanced, and use an appropriate weighting to answers.

3.58 Risk profiling and asset-allocation tools can usefully aid discussions with customers, by helping to provide structure and consistency. However, they often have limitations that mean there are circumstances in which they may produce flawed results. Where firms rely on tools, they need to ensure they are actively mitigating any limitations.

3.59 Firms remain responsible for the integrity of any sales process, whether it is providing a personal recommendation or not. Tool providers have a role to provide clear supporting information to firms that will use the tools, to help them use them as designed, but it is the investment firms that must take on the responsibility to ensure they are satisfied that any tools they provide are accurate and robust.

Model investment portfolios

3.60 Whether or not providing a customer with access to a model investment portfolio amounts to giving a personal recommendation will depend on the particular circumstances, as we have described in other parts of this paper.

3.61 If a firm were to provide, via its website or through another medium, the possibility for investors to determine their investment profile, and for each profile discloses a related model portfolio, composed of specific financial instruments, this **may not** amount to giving a personal recommendation. **Section 5 provides some examples of how this may apply.**

Rules applicable to simplified advice

3.62 In March 2012, the FSA published guidance on simplified advice[31] in which it set out the requirements for firms when developing a simplified, automated, advice model for customers with straightforward investment advice needs.

3.63 The FSA explained that the suitability standards for simplified advice are the same as for all other forms of retail investment advice that involve a personal recommendation[32], although the information required to assess suitability would be that for a simple product meeting simple needs. If the customer agrees to an automated advice process, firms are not absolved of their suitability obligations. Firms must also, as appropriate, review the relevance of other products already held by the customer.[33] Knowing your customer and risk profiling will be important tools in any sale involving a personal recommendation.

3.64 Where an individual is involved in delivering a simplified advice process, the training and competence requirements for anyone making personal recommendations to customers through the process are the same as for a fully qualified retail investment adviser. The Retail Distribution Review's (RDR's) adviser charging and remuneration rules also apply to the delivery of simplified advice.[34]

3.65 The simplified advice process falls into the category of 'restricted advice', as the products available are likely to be limited to one or more particular product providers and particular types of product will be ruled out. If a firm provides simplified advice (which is restricted advice) in addition to independent advice, it should not promote itself as a provider of independent advice for its business as a whole (nor would it be appropriate for the firm to include the word 'independent' in its name).[35]

3.66 In the guidance document the FSA set out three options relating to the professional standards expected of firms when providing simplified advice. These remain relevant:

- Simplified advice provided through a fully automated system, i.e. one in which the customer will not at any stage in the process have the opportunity of discussion with an employee. The design, testing and review of the operation of such a system is likely to be more complex than the design of procedures to provide advice to customers face-to-face, or over the telephone. The design of such systems would need to involve competent individuals with expertise in a number of different areas, including IT specialists. However, given that the purpose of the system would be to provide advice on investments, a fully qualified retail investment adviser should be fully involved in the design process.

- Individuals who give simplified advice. An individual provides personal recommendations on retail investment products delivered through an automated system with support for the customer over the telephone, face-to-face, or using

[31] http://www.fca.org.uk/static/pubs/guidance/fg12-10.pdf
[32] COBS 9.2
[33] Refer paragraphs 3.25 & 3.26
[34] COBS 6.1A
[35] COBS 6.2A.4G

web-based channels such as Skype and web-chat or directly over the telephone, face-to-face or web-based channels. The individual must meet the training and competence standards of a retail investment adviser.

- Individuals who do not give simplified advice. An individual provides some support to customers but does not provide regulated advice or a personal recommendation. This individual must not provide personal recommendations if they do not meet the training and competence standards of a retail investment adviser.

3.67 The requirements for firms are clear in relation to these options. We do not believe that the relaxation of the requirements for individuals who give simplified advice is in the best interests of the customer.

Development of simplified advice models

3.68 The guidance stated that "simplified advice processes have the potential to meet the wants and needs of those customers who might benefit from investment advice but who can't, or do not want pay for full advice". It went on to say, "Our aim is to ensure that we have a regulatory regime for retail investment advice which provides for an appropriate level of customer protection, and within which firms can offer simplified advice processes if they think this is an attractive proposition for them and their customers. Our other priorities are (i) to ensure that our rules are compatible with EU law, and (ii) that our regulatory approach maintains sufficient flexibility so that firms are able to develop individual solutions which suit their business models and target market[36]."

3.69 The industry has told us that there are two main barriers to the development of widespread simplified advice models:

1. Most customers will not buy an investment product purely online; they require some type of human interaction to confirm they are making the correct buying decision.

2. The liability for the provision of a personal recommendation through simplified advice, which rests with the firm providing the recommendation as with any advice service.

These issues are explored in further detail in the next section.

[36] http://www.fca.org.uk/static/pubs/guidance/fg12-10.pdf

4 Thematic review and customer research of services that do not provide personal recommendations and simplified advice investment services

Approach

4.1 Following our work with firms in 2013 and recent stakeholder events identifying industry uncertainty on the boundary between sales involving personal recommendations and sales which do not, a thematic review[37] was agreed focusing on the new distribution models firms are using to sell investment products to customers in the retail investment market. We also undertook customer research to understand the motivations, needs and drivers of customers who purchase retail investment products without personal recommendations. Both pieces of work informed our thinking and the development of this guidance. The thematic review aimed to better understand the drivers influencing the development of new distribution models and assess how well services where customers purchase investments without a personal recommendation and services delivering simplified advice were supporting the delivery of good customer outcomes. It also provided the opportunity for us to find out why firms appeared to be struggling to develop simplified, automated advice models and identify whether there was more the FCA could do to enhance firms' understanding of all of the options available within the existing regulatory framework.[38]

Summary of the thematic review findings for simplified advice services

4.2 The firm visits and wider discussions with trade and industry bodies highlighted a number of issues that are influencing firms' decisions – particularly larger firms – not to develop simplified advice models. We therefore focused our attention on identifying these potential barriers and developing a more detailed understanding of firms' concerns.

- First, some firms are uncertain on the suitability standards for delivering personal recommendations online, particularly the necessary 'breadth' of the suitability

[37] The full version of the thematic report has been published separately. *Developments in the distribution of retail investments: Purchasing investments without a personal recommendation and simplified advice* http://www.fca.org.uk/news/tr14-10-developments-in-the-distribution-of-retail-investments

[38] Refer Annex B paragraph 2

requirements for advice on a focused scope. Firms suggested further clarification in this area would be helpful.

- Second, firms are concerned that automated advice processes providing personal recommendations could risk systemic mis-selling if parts of the process produce unintended, unsuitable recommendations for certain groups of customers. This led many firms to include significant compliance and mis-selling liability costs within their business plans, limiting their commercial viability.

- Third, firms are concerned that if they deliver online personal recommendations using a contingent adviser charging model (where the customer receives a personal recommendation ahead of paying to implement the recommendation), customers may decide to transact their recommendation on an execution-only basis with a different firm. Firms believe that if they have liability for these 'incomplete' transactions (which could be numerous), the risk premium they need to price into their business models challenges their commercial viability.

- Finally, firms suggested that, even if the FCA were able to clarify the issues above, they are still concerned with how complaints on simplified advice cases would be handled by the Financial Ombudsman Service (the ombudsman service). Now that the ombudsman service publishes Ombudsman decisions, firms believe this could result in significant, focused activity by claims management companies (CMCs).

4.3 These issues have led a number of major firms to conclude that simplified advice is not currently commercially viable. Some firms have opted to develop services which do not involve giving personal recommendations instead.

Summary of the thematic review findings for services where customers purchase investments without a personal recommendation

4.4 For services where customers purchase investments without a personal recommendation, the review found that most firms had taken steps to identify the target market their service was likely to be appropriate for and used this analysis to inform its design. However, the way this was done varied and some firms were less able to articulate how their service supported their customers in making informed purchase decisions and were less able to identify and monitor potential customer risks.

4.5 The range of investments firms made available to customers through these services varied. Firms' choice of investment proposition was often driven by the analysis they had undertaken on the target market for their service. This helped them to determine the kinds of products that were likely to meet their customers' objectives and the supporting information that would help customers make informed decisions on which investments were appropriate for their needs.

4.6 Firms had considered how to design their customer interface to try and equip customers with the information and tools necessary to support good decision-making with most identifying and attempting to mitigate potential risks linked to customers making their own investment decisions. However, it was clear that uncertainty on the boundary between sales involving personal recommendations and sales that do not was having a significant influence on the design of some firms' customer interfaces. Within these firms we were concerned that uncertainty regarding the application of the regulatory framework (or an overly cautious interpretation of how it applied) had led firms to exclude information and/or tools that were likely to support customer decision-making, or help reduce the impact of common behavioural biases and prompt better decisions.

Customer research findings

4.7 In order to inform our thinking in this area, we commissioned a study[39] of the motivations, needs and drivers of customers who purchase retail investment products without personal recommendations. A series of qualitative face-to-face depth interviews and customer workshops were carried out in March 2014 by NMG Consulting on behalf of the FCA. This involved a total of 92 customers who had purchased a retail investment since 31 December 2012 without a personal recommendation.

4.8 The research found that:

- There is no single, dominant profile of the customer who buys without a personal recommendation.
- Misconceptions and a lack of knowledge are evident amongst investors who are less comfortable dealing with the complexity of investment decisions, while more experienced investors – either those that also use advice channels or have been self-investing for some time – have developed a much greater awareness of the key points for consideration when choosing an investment.
- Investment decision-making is often heavily influenced by behavioural biases.
- Trust – either in a preferred brand or in the recommendations of family and friends – plays a significant role in decision-making. This also tends to limit the amount of shopping around and discourages investors from using unfamiliar brands.
- A high percentage of research and purchasing is being carried out online and for the majority the purchase journey is quick and efficient.
- There are both positive and negative drivers towards choosing to self-invest rather than take advice.
- One finding from the research was that, across the attitudinal segments, a degree of cynicism towards financial advisers exists, with some belief that the benefits of a personal recommendation do not justify the costs. There is a sense that moderately

[39] The full findings from this research have been published in a separate document. *The motivations, needs and drivers of non-advised investors: A qualitative research report* http://www.fca.org.uk/your-fca/documents/research/the-motivations-needs-and-drivers-of-non-advised-investors

to highly experienced self-directed investors believe they can do just as well as an adviser, without the cost or bias that may come with adviser involvement.

- These attitudes towards personal recommendations are very much influenced by the amount being invested. For investments without a personal recommendation, this is typically below £20,000 in any single transaction (and often aligns to annual ISA limits). The likelihood of seeking a personal recommendation increases significantly as the value of the investment and/or the complexity of the need increases.

- There is clarity when using online, 'execution-only' services, that a personal recommendation has not been given. However, some ambiguity exists when human interaction is involved.

- Customers using channels without personal recommendations take responsibility for their investment decisions.

- The majority of self-investors do not appear to be exposing themselves to excessive risk and are making broadly appropriate investment choices based on current circumstances.

Conclusions

4.9 The research found that customers would like to see the following:

- Simple, bite-sized chunks of information, in very plain English, covering the 'must know' basics.

- A clear and consistent format for this 'must know' product information to help with identification of key features and comparability across providers.

- Charging structures to be communicated in a clearer and more comparable format.

- Inclusion of telephone support and easily found phone numbers.

- Clear and bold information at point of purchase on paths for recourse.

- Reminders on the key points of the purchase being made before the final decision is made.

Fuller details of the research results can be found in Annex B.

5 Issues and examples

MiFID II

5.1 On 12 June 2014, the revised Markets in Financial Instruments Directive (MiFID II) was published in the Official Journal of the European Union, along with the new Markets in Financial Instruments Regulation (MiFIR) and both will apply from 3 January 2017. The revised Directive does not alter the definition of investment advice.

5.2 MiFID II does not fundamentally change the requirements on firms in regard to the suitability of personal recommendations, or the appropriateness test that they are required to perform for transactions of complex products not involving personal recommendations. The changes to the rules that MiFID II brings include, for example, making clear that when a firm recommends a bundle of products, the overall bundled package must be suitable. The list of products which would be considered complex is also being widened to automatically include, for example, shares and bonds that embed derivatives. Similarly, ESMA's proposals to alter the more detailed measures on suitability and appropriateness, included in its current consultation[40], chiefly seek to add to the existing implementing directive some of the standards previously communicated in ESMA's *Guidelines on certain aspects of the MiFID suitability requirements*.[41]

5.3 Given the relatively minor nature of the changes that MiFID II is set to bring in regard to suitability and appropriateness, we do not believe that the new directive will create any significant uncertainty to prevent firms from designing and operating new business models to distribute retail investments at this stage. Firms wishing to find more information on MiFID II can look at our website[42]. As MiFID does not apply directly to insurance-based investments, we will need to consider whether or not there is a case for applying some or all of the revised MiFID standards to such products in the UK.

Example scenarios

5.4 To help firms and customer groups to understand what constitutes a personal recommendation and what does not, and to build upon the existing published guidance, we have developed a number of examples. For each we have provided our opinion on whether or not it constitutes a personal recommendation. We have also added our reason why we have reached this opinion. We have tried to cover a range of sales processes that we have seen operating in the market, but obviously we cannot cover every possible

[40] http://www.esma.europa.eu/system/files/2014-549_-_consultation_paper_mifid_ii_-_mifir.pdf

[41] http://www.esma.europa.eu/system/files/2012-387.pdf

[42] http://www.fca.org.uk/firms/markets/international-markets/mifid-ii

variation. When considering the examples, firms should be aware that we have based our conclusion on the assumption that nothing is done, beyond what is stated in the examples, to suggest that the customer is given a recommendation, or to suggest that the output is presented as suitable for them or based on a consideration of their personal circumstances.

5.5 We encourage all of our stakeholders to consider these examples and provide feedback to us on our opinion. You can send your response by e-mail to adviceguidanceconsultation@fca.org.uk or by post to the Advice and Distribution team, Policy, Risk and Research Division, Financial Conduct Authority, 25 The North Colonnade, Canary Wharf London E14 5HS. In particular, we are interested in views on:

1. Have we provided a sufficient range of examples for customers and firms to be more confident on the boundaries between services that provide a personal recommendation and those that do not?

2. In example D we set out an opinion of how filtering may be used to help provide more help to customers without providing a personal recommendation. Do you agree with this interpretation? Please provide reasons for your views.

3. Based on the examples do you agree that our rules provide sufficient customer protection? If not, please provide feedback on areas where you believe our rules may need to be enhanced.

5.6 Table 2, Example scenarios must be read in connection with the guidance provided throughout this guidance consultation paper and in particular with the guidance in paragraphs 3.13 to 3.63. This table is based on the assumption that the firm in the scenarios is exclusively carrying on the described activities.

Table 2: Example scenarios

Example	Personal recommendation or not
(A) Website without filtering with general generic information	
Firm A has a website through which it provides a range of information about the world of investments. This includes generic explanations of the different asset classes available and the likely risks that may attach to each, the benefits of diversification and the different types of investment strategies used in the market. The information does not bias towards a particular type of investment, strategy or asset allocation. There is no interactivity. The website provides lists of investments for purchase without additional comment (bar links to the relevant disclosure material for the individual products).	Not a personal recommendation. This is because the giving of generic information does not involve advising on investments as described in Article 53 RAO (‘regulated advice’) or giving a personal recommendation. (Please refer to the answer to Q.21 in PERG 13.3).

(B) Website without filtering but which classifies the available products In each example the categorisation by Firm A is not interactive. The investments are not displayed or filtered in accordance with information input by the customer. The ranking is set out in the way it would be in a hard copy document.	
(1) Firm A ranks its products into risk categories. One set of categories could be Low Risk, Low-Medium Risk, Medium Risk, Medium-High Risk and High Risk. Firm A allocates each investment using its own opinion on the level of risk of each product (i.e. it is self-generated and not drawn directly from each product's disclosure material). The website also has material elsewhere explaining investment risk and material to help customers self-determine the level of risk they are willing and able to take. Each risk category description includes notional customer attitudes, the types of investments that may be found within funds/portfolios matching this risk level and also historic factual data on volatility of such investments. Customers are prompted to read the risk category descriptions and use this material to think about which category best fits their circumstances.	Not a personal recommendation and, depending on the circumstances, likely to be regulated advice. As explained in the answer to Q.19 in PERG 13.3, material will only amount to a personal recommendation if it is presented as suitable for the customer or based on a consideration of their personal circumstances. In this example the material is not presented in this way.
(2) Firm A classifies the products it sells by reference to high-level investment objectives, for example capital growth, income or a balance of both. It also classifies the investments by reference to whether they are suitable for long or short investment. There is material elsewhere on the website to help customers self-determine what their investment objectives should be.	Not a personal recommendation and depending on the circumstances, likely to be regulated advice. The reason is the same as it is for example B1.
(3) Examples (B1) and (B2) are combined. So the investments are classified by reference to a number of factors. For example, each fund may have three boxes next to it on the website. One has a riskiness rating. One box is about the investment objectives. The other is about whether it is designed for long or short-term investment.	Not a personal recommendation and depending on the circumstances, likely to be regulated advice. The reason is the same as it is for example B1.

(4) Same as Examples (B1) to (B3). In addition Firm A gives each fund it lists a star rating based on whether the fund is good value. The star rating is supplied by an external unconnected party. The rating is not exclusive to Firm A and is widely used in the industry. This might be something like the Morningstar rating.	Not a personal recommendation and depending on the circumstances, likely to be regulated advice. The reason is the same as it is for example B1.
(5) Same as Examples (B1) to (B3). In addition Firm A gives each fund it lists a star rating based on whether it thinks that the fund is good value. Firm A uses skill and expertise in putting together the ranking by, for example, adjusting figures from the product providers to take into account the different ways that the product providers calculate growth and the different reporting periods and by taking into account management charges.	Not a personal recommendation and depending on the circumstances, likely to be regulated advice. The reason is the same as it is for example B1.
(C) Website with pop-up boxes	
Same as Example (A). In addition the website has pop-up boxes that come up when the customer picks a product to buy. They prompt the customer to think about the customer's circumstances, such as the customer's health, financial circumstances and retirement date. The pop-up boxes have links to website material explaining the importance of those factors.	Not a personal recommendation and depending on the circumstances, likely to be regulated advice. The reason is the same as it is for example B1. The pop-up box only prompts the customer to think about various factors rather than advising the customer based on the customer's personal circumstances.

(D) Website with filtering Firm A decides to make its list of the investment products it sells easier to search. It adds filtering functionality that allows the customer to filter products based upon the filtering factors. Therefore only products that meet the information input by the customer are displayed.	
(1) The website enables the customer to filter the products by reference to objective factors of the type in section (A) of this table (e.g. 'UK Equity funds').	Not a personal recommendation and depending on the circumstances, likely to be regulated advice.
(2) The filtering is based on riskiness as described in Example (B1).	Not a personal recommendation and depending on the circumstances, likely to be regulated advice . Please see the reasons in Note 1 below.
(3) The filtering is based on investment objectives as described in Example (B2).	Not a personal recommendation and depending on the circumstances, likely to be regulated advice for the same reason as example D2.
(4) The filtering is based on a number of factors as described in Example (B3).	Not a personal recommendation, and depending on the circumstances, likely to be regulated advice for the same reason as example D2.

(5) The filtered results are ranked in accordance with the ratings of a third party as described in Example (B4).	Not a personal recommendation, and depending on the circumstances, likely to be regulated advice for the same reason as D2.
(6) The filtered results are ranked in accordance with Firm A's views on how good they are as described in Example (B5).	Not a personal recommendation and depending on the circumstances, likely to be regulated advice for the same reason as D2.

(E) Guided sales and limited advice	
(1) The filtering process is not based solely on the customer's risk appetite and preferences in relation to other factors. The filtering process is also based on facts relating to the customer's life and situation. For example, it might take into account the customer's current use of tax wrappers, the customer's age, the customer's marital status and whether the customer is in a long-term relationship, the customer's financial resources and commitments, the customer's plans for their family in the short and longer term (e.g. a new car, work on the family home or school fees), what other investments and assets the customer has and the customer's career and retirement plans. Like the examples in section (D) of this table, the customer inputs information to the website. The difference is that the information not only relates to the investor's wishes but is personal factual information. The filtering is not based solely on what the investors wants but also on what is good for them.	This is a personal recommendation and regulated advice. Firm A collects information about a specific customer's circumstances and uses an element of opinion and skill (albeit automated) in translating this into a display of a particular product or products. Either explicitly or implicitly this is presented as meeting the customer's requirements and wishes. If the customer has to input a large range of personal information then Firm A cannot argue that it has not taken into account the customer's personal circumstances when in fact it actually has. The difference with the examples in section (D) of this table is that the input from the customer is much more extensive and the way that they interact on the website is much more complicated.

(2) Firm A provides advice on a limited straightforward issue at the request of the customer, such as which ISA product to invest a sum of money in. The wider financial situation is not covered. The advice is limited to the specific issue in hand and the information collected on that basis. The treatment of suitability reflects that narrower customer objective.	This is a personal recommendation and regulated advice. This example is not about filtered sales. It is included to make a point about example (E1). The answer to example (E1) is not based on the approach that there is no personal recommendation unless the advice takes into account a wide range of factors. The point in example (E1) is that the range of the factors taken into account is relevant in the specific context of filtered sales.

Note 1: Reasons why example D2 is not a personal recommendation.

There are two main reasons why this example would not be a personal recommendation. One is that there is no recommendation. The other is that even if there is a recommendation it is not personal.

In principle this example involves a recommendation (i.e. regulated advice). Regulated advice includes any communication with the customer which, in the particular context in which it is given, goes beyond the mere provision of information and is objectively likely to influence the customer's decision whether or not to buy or sell.

It is true that a factor like riskiness is itself neutral, being neither necessarily a good nor a bad thing. So the filtering is done on the basis of what the customer wants and not what is right for the customer. However in this example this does not stop it being regulated advice and a recommendation because the customer has told Firm A, via the website, what his investment objectives are and the purpose of the filtering process is to identify products for the customer to buy.

However the fact that regulated advice and a recommendation are involved does not necessarily mean that there is a 'personal' recommendation. As explained in the answer to Q19 in PERG 13.3, material will only amount to a personal recommendation if it is presented as suitable for the customer or based on a consideration of his personal circumstances. In the FCA's view, therefore, there is no personal recommendation because the material in this example does not meet this requirement, for the following reasons.

It would be perfectly possible to arrange the products Firm A sells into categories based on riskiness in a hard copy. It cannot be said that a hard copy arranged in that way is based on the personal circumstances of the person reading it. All the filtering does is to eliminate products that do not fall within the specified categories.

The filter is a simple one in the sense that the number of inputs by the customer is small in number and the translation from the customer's input to the list of displayed products does not involve any opinion or complicated processing: if the customer chooses high risk products then there is a pre-existing list of products that are displayed for that customer. The same results will be displayed for any other customer that chooses that category of risk. This sort of filtering is just a form of indexing pre-existing information. It does not become a personal recommendation just because it is on a website or just because the website screens out information the customer does not want to see.

It should be noted that this example does not fall outside the definition 'personal recommendation' on the grounds that investment objectives (such as riskiness) are not part of a customer's personal circumstances or that there is no personal recommendation where the advice is about whether a product meets the customer's objectives rather than being good or bad. Information about a person's circumstances could include both factual information (e.g. the customer's address, income or marital status) and more subjective information about the customer's wants and needs (e.g. the customer's overall risk appetite, short- and long-term investment objectives or the customer's desire for protection from particular risks).

Equally, this example does not fall outside the definition of personal recommendation merely because the website only takes into account a narrow range of factors. The fact that Firm A has not in fact considered all the customer's circumstances does not mean that there is no personal recommendation.

The conclusion that this example does not involve a personal recommendation is given some support by ESMA's guidance on the meaning of personal recommendation. That says that where the filtering process is limited to assisting the customer to make his own choice of product which has particular features which the person regards as important, then it is unlikely that the process will involve a personal recommendation.

As described in paragraph 3.24 and 5.15, whether or not a personal recommendation is given depends in part on whether the customer is led to think that one is being given. Therefore it is important that the customer understands that Firm A is not advising on whether the products are suitable for the customer. If buying the products identified in the website's output is positioned as the appropriate action for the customer to take, the overall service might be viewed as a personal recommendation. The customer should understand that because the website takes into account such a narrow range of the customer's personal circumstances the result may be that the customer ends up with products that are unsuitable for the customer.

As per paragraph 3.53, including a disclaimer is not enough on its own to prevent there being a personal recommendation. For example, if Firm A says that the filtered products displayed by the website would suit the customer's needs, the inclusion of a disclaimer saying that this was not advice or a personal recommendation would be unlikely to change the nature of the communication. A legalistic disclaimer will not be enough on its own: the material must prominently and clearly explain the limited nature of the service that Firm A provides and the risk that the customer will end up with unsuitable products.

General Note

As noted in paragraph 3.17 the examples in this table are not intended to relate directly to the question of whether an activity constitutes regulated advice. Where the table expresses a view as to whether an activity amounts to the regulated activity of 'advising on investments', as described in Article 53 of the RAO, that is what in our view is the most likely analysis. However, firms should refer to PERG in respect of specific guidance on that activity.

Limited and focused advice

5.7 In addition to full financial advice and services that do not involve giving a personal recommendation, table 1 shows that other services can be provided, depending on the need of the customer. Thus, it is perfectly feasible, within both MiFID and our domestic regulatory framework, to provide a service that focuses on a specific need of the customer and which does not require the detailed factfind of a full advice offering.

5.8 An example of this might be a customer who had a modest amount to invest and was looking for advice on how to invest this money in a stocks and shares ISA. In this situation the customer and intermediary could agree that the service provided would be limited to this one situation and would not include wider discussion of, say their customer's pensions or mortgage situation, or indeed of their other investments beyond assessing the attitude to risk and capacity for loss.

5.9 The intermediary would be able to focus on a smaller number of questions, including around the aims and objectives of the customer, for instance, and come to a suitable recommendation. Thus, if an intermediary and customer agree to look at just one specific need/ objective, this would be limited advice. In this situation, an intermediary can give a recommendation on a specific need or objective and only on that need or objective. Another way of looking at this would be to say that the intermediary is able to limit the scope of a service, but the depth of the suitability obligation cannot be limited. That is to say, firms would need to collect the relevant information to make sure they provide a suitable recommendation within the specific scope of the advice they have agreed.

5.10 How does limited/focused advice work in practice? A customer might approach a firm with a specific objective, for example to find out what they should do with their existing with-profits policy. The firm could agree with the customer that it will do so, although it should explain to the customer this will mean their other financial needs/ objectives will not be addressed. In other words, the firm would need to outline the level of service they will provide and what they will not be providing – that way the customer is clear about the level of service they are receiving. If a customer believes they are getting a full financial review, this is what they should receive.

5.11 However, it is not possible to specify what personal information an intermediary would typically need to obtained from a customer when limited/focused advice is provided, as it will depend on both the scope of the advice and on the circumstances of the customer.

5.12 With limited/focused advice, an intermediary may not be expected, for example, to advise the customer on whether they should review their protection needs, their regular savings needs, their mortgage or their life cover if none of these relate to the specific need/ objective agreed. However, if it became apparent, for example, that the customer might be better off using their with-profits policy to pay off their mortgage than keep it, then that should be explained to the customer. This is because it would be an issue that arose from the information needed to deal with the specific objective or need the intermediary has agreed to advise their customer on.

5.13 It is also important to highlight that, even within limited advice, there remains a duty of care. If, for example, the intermediary is dealing with a customer who is receiving limited/ focused advice in relation to a specific element of their investments, but the firm realises that the customer has a family and no protection, there would be an expectation that the adviser highlights that need to the customer. That is not to say they have to deal with that need, but it would be right in their professional capacity to highlight what they have concluded so that the customer can decide what to do. The ability to provide a focused or limited advice offering is something that is clearly anticipated and allowed by MiFID and which we have previously made clear is an option to the industry.

Customer's perception of service

5.14 We have also been asked about the relative importance of the customer's perception of whether they have received a recommendation. In particular, firms want to understand what is the driver for the FCA and the Financial Ombudsman Service (the ombudsman service) in deciding whether the firm has given a personal recommendation or not – is it the customer's perception or is it the substance of the actual service?

5.15 CESR[43] set out that a particular customer's understanding of the nature of the service they have received may not always be accurate:

> "..whether or not a particular client feels that he is receiving a personal recommendation will not determine, on its own, whether or not investment advice is actually being given."

5.16 Firms should be mindful that if a recommendation is put forward in such a way that a reasonable observer would view it as being based on a consideration of a customer's circumstances or presented as suitable, then this is likely to amount to a personal recommendation. However, while the customer's own perception of the service received is very important, it is feasible that the customer will not always be correct in their understanding.

Financial Ombudsman Service

5.17 Firms have told us that the threat of action by the Financial Ombudsman Service is a barrier to developing new systems that match the requirements of our Handbook. This view emerged in our roundtable discussion and through the thematic review. This risk may be perceived to be more significant for firms using automated systems where there is potential for systemic mis-selling.

5.18 The Financial Ombudsman Service has explained on its website its approach to dealing with complaints received on basic advice and simplified advice:

[43] http://www.esma.europa.eu/system/files/10_293.pdf

"We are already used to dealing with complaints about many financial products where there is no specific requirement in relation to 'suitability' or 'know your customer'. In such cases – as long as they have not been misled – we expect customers to be responsible for their own choice.

"We assess any complaint we deal with involving the sale of a 'stakeholder product' on the understanding that the customer received 'basic advice'. We will not, for example, expect a 'fact find' to have been completed – or the adviser to have made detailed enquiries to 'know the customer'. As with other products, we take the regulator's rules and guidance into account. We also look at good industry practice.

"'Simplified advice' processes must comply with the same regulatory requirements as those involving full advice – including the requirement that the advice has to be 'suitable'. But in any complaints we might receive, we would judge the advice in the specific context in which it was given. So we would not expect a 'full fact-finding' exercise. But we would look at the questions asked and the options open to the particular customer concerned.

"Where the 'simplified advice' involves an automated process, we would look – as part of our consideration of any complaint – at whether there was a good record of the information the customer gave and the choices they made".

5.19 The law requires the Financial Ombudsman Service to decide each complaint on the basis of what it believes is fair and reasonable. In doing so, its rules require it to take account of the law, our rules and good practice in the industry. The Financial Ombudsman Service's approach is to ask questions, listen to both sides of the story, and decide each case on its individual facts and merits, not on how cleverly or persuasively either side argues their case.

5.20 The fact that the Financial Ombudsman Service may arrive at different outcomes on separate cases should not be seen as surprising. It is not a question of inconsistency, but a matter of the Financial Ombudsman Service looking at each complaint individually and making a decision on what it believes is fair and reasonable in the circumstances of that particular case. There may be surface similarities between some complaints. But when looked at in detail, the Financial Ombudsman Service generally finds that very different facts and issues are involved. This reflects the reality that everyone's personal and financial circumstances will be different.

5.21 Deciding a complaint, like financial advice itself, can involve a complex balance of judgement, often based on a wide array of seemingly contradictory facts. The 'right' outcome in one case will not automatically be the right answer in other 'similar' cases.

Liabilities/Responsibilities

5.22 Firms have raised concerns about where the responsibilities (and therefore liabilities) lie with automated advice services. It is felt that some of the risks may be higher for these types of services than for traditional face-to-face services. The main concern lies around where a customer enters a simplified advice model, receives a personal recommendation to purchase a product but then buys exactly the same product elsewhere on an execution-only basis. What liability will the firm that provided the personal recommendation have if that product turns out to be the wrong product later down the line?

5.23 This is a complex issue and the question of liability will be dependent on the facts in a given scenario. However, as with 'full' advice, simplified advice involves a firm giving regulated advice and so the adviser must comply with the relevant Handbook requirements (in particular COBS 2.1 and the requirement to take reasonable steps to ensure that a personal recommendation is 'suitable' for the customer (COBS 9)). A firm also owes duties to the customer under common law (duty of care as a professional adviser). It may also have contractual duties depending on whether a contract has been entered into with the customer.

5.24 A breach of the COBS rules could give rise to a claim for negligence and/or breach of statutory duty under section 138D(2) of FSMA (if the customer is an individual customer and if the breach relates to an FCA rule to which s.138D applies) and this is no different where a firm has given simplified advice. If there is a prima facie breach of statutory duty or negligence, whether a firm will be liable depends on the usual tests: a causal link must be shown between the breach and the loss, contributory negligence is a factor, and the claimant cannot have waived his rights after the breach has occurred or otherwise received redress from another avenue (e.g. the ombudsman service).

5.25 There may be factual reasons that could contribute to why a claim would fail the causation or foreseeability tests, for example, if the advice was good at the time it was given but a long period of time elapses during which the customer's circumstances have changed and it is as a result of those changes in circumstances that the product is no longer suitable. However, ultimately these questions would be for the court to decide on a case by case basis.

5.26 The options available to a firm that is concerned about this situation arising would appear to be:

a) To ensure that its system and processes for making a personal recommendation are compliant with the relevant COBS rules and that the design of the process is not negligent in any way, and subsequently rely on the usual defences of causation and remoteness of loss if a claim is brought by a customer.

b) In relation to its general, non-statutory liabilities (but not its liability under section 138D for breach of COBS rules), a firm could include a provision in the terms and conditions of the simplified advice process that limits its liability or excludes liability (both contractual and tortious) if the customer does not buy the product recommended in the process from the firm. The exclusion clause must be compliant with common law and statutory requirements such as the reasonableness test under the Unfair Contract Terms Act 1977 and the Unfair Terms in Customer Contracts Regulations 1999. In our view, a prominent and clear exclusion clause is likely to be effective in these circumstances (although this is ultimately a decision for the court).

Existing customers

5.27 One particular area where there appears to be confusion is in situations involving providing information to existing customers (e.g. about a change of fund manager / asset allocation of their existing fund). In our view, where the firm sends factual information to its customers without regard to the specific customers' investment positions, for example to notify that a fund manager is changing or to offer additional or alternative products, that would not constitute regulated advice. On the other hand, factual information may constitute regulated advice where it is provided to customers because, in the firm's view, the customers' portfolio could/should be 'improved' and in the context the factual information contains an implied recommendation, for example, advising the customer to reconsider the portfolio and sell an investment or buy an alternative product.

5.28 For example, if a firm believes that some of its customers are in a poorly performing fund with a poor prospect of performance improving in the future, the firm may want to highlight this to its customers and help them move to alternative funds. However, the firm is nervous of writing to customers as this could constitute an implied recommendation and so may decide to take no action to help its customers. A possibility in this situation is that the firm could contact its customers to offer factual information about the performance of the fund, and perhaps also offer information about a range of alternative funds that the customer may consider. It cannot offer an opinion on which fund(s) may suit the customers' circumstances, to do so would be a personal recommendation.

Customer responsibilities

5.29 There is some evidence (for example from research[44] conducted for the FCA Practitioner Panel) that one of the barriers discouraging customers from accepting more responsibility for their decisions is impenetrable disclosure documents. Our recent research outlined in Section 3 above found that respondents wanted clear and simple fund information (risk level, access, charges, term etc.) at an easy click of the button (when using automated services) with key information that would help customers make better informed decisions clearly highlighted.

5.30 In services that do not amount to full advice, the customer must be made aware of the limitations of the service and, assuming they have been properly described, accept those

[44] *Customer Responsibility; Identifying and Closing the Gap*. Jackie Wells & Associates. September 2013 http://www.fs-pp.org.uk/documents/fca_practitioner_panel_customer_responsibility_report_september_2013.pdf

limitations. Where the service does not involve giving advice, but is execution-only, the customer will, inevitably, be taking responsibility for the decision themselves and recourse to redress would be limited, for instance to cases where there was misrepresentation.

5.31 The 'disclosure' element of the expectations gap work will seek to work with the industry to understand what is stopping firms from disclosing information in a customer friendly way and what is perceived to be good and innovative practice in terms of disclosing product information to customers. This work will also review our Handbook to check whether our requirements are supporting customers to understand products. Taking all this together, we will publish a paper, alongside consultation on Handbook changes, towards the end of the year reporting on the outcome of this work, identifying how the regulator can help firms disclose in a smarter way.

Next steps

5.32 We believe that this document will help to clarify our requirements for firms. However, we see this as the first stage. We would ask firms, trade bodies and customer groups to consider the following questions:

- Are there other areas where you would need greater clarification or other factors that you believe act as a barrier to providing the services discussed in this paper?
- Would you find it helpful if the guidance set out in this paper was codified in our Handbook?
- Would you find it helpful if the examples were included in the Perimeter Guidance section of our Handbook?

5.33 We launched Project Innovate at the end of May to encourage and support positive developments in the financial sector that promise to improve the lives of customers. One of the priority areas identified was online investment where, as we have discussed above, we have seen innovations to take advantage of technology to deliver cost-effective advice to customers seeking help in this area.

5.34 It is important that the FCA offers the right degree of support to help firms understand the regulatory framework and gain confidence to pursue new developments. To this end, as outlined above, the FCA is opening its doors to financial service firms (large and small) that are developing innovative approaches in the area of automated, simplified or limited investment advice. We want to encourage firms to approach us with their models at an early stage of development and we will provide our support, particularly advice on compliance, so they can navigate the regulatory system.

ANNEX A the five key tests for investment advice[45]

Is it investment advice?

1. Does the service being offered constitute a recommendation?

YES

2. Is the recommendation in relation to one or more transactions in financial instruments?

YES

3. Is the recommendation at least one of the following…

…a) presented as suitable?

…b) based on a consideration of the person's circumstances?

YES YES

4. Is the recommendation issued otherwise than exclusively through distribution channels or to the public?

YES

5. Is the recommendation made to a person in his capacity as one of the following…

…a) an investor or potential investor?

…b) an agent for an investor or potential investor?

YES YES

INVESTMENT ADVICE

Examples of issues to consider:

- the difference between information and a recommendation
- whether assisting a customer to filter information amounts to a recommendation

- how to distinguish generic advice and general recommendations from investment advice
- whether recommending a firm or a service can amount to investment advice

- how a financial instrument might implicitly be presented as suitable
- the impact of disclaimers
- what it means to consider a person's circumstances

- assessing recommendations delivered via the Internet
- assessing recommendations given to multiple customers at once
- distributing investment research

- identifying investors and their agents
- the distinction between corporate finance advice and investment advice

[45] Reproduced from CESR's Q&A *Understanding the definition of advice under MiFID*

Annex B Findings from the thematic review and customer research

Approach

1. Following the 'expectations gap' work identifying industry uncertainty on the boundary between sales involving personal recommendations and sales that do not, a thematic review[46] was agreed focusing on services where customers purchase investments without a personal recommendation and services delivering simplified advice. The review was also driven by the FCA's forward-looking and pre-emptive supervisory strategy. Given the increasing growth in sales not involving personal recommendations and the emergence of some streamlined, simplified advice models, a piece of thematic discovery work was undertaken to take a closer look at the developments in this evolving market.

2. The review aimed to better understand the drivers influencing the development of new distribution models and examine whether these models supported the delivery of good customer outcomes. The review also provided the opportunity for us to find out why firms appeared to be struggling to develop simplified, automated advice models and identify whether there was more the FCA could do to enhance firms' understanding of all of the options available within the existing regulatory framework.

3. The review included visits to 13 firms from different sectors and with a range of both established and newer business models. The visits focused on the design of firms' distribution models and whether they supported the delivery of good customer outcomes. As part of the project, we also spoke to a range of firms interested in developing these distribution models.

4. In addition to the work with firms, we carried out extensive engagement with trade and industry bodies to discuss market developments and how the regulatory framework was influencing the different distribution models used by the industry.

5. We also commissioned a piece of qualitative customer research[47] focused on sales not involving personal recommendations. The aim of the research was to better understand

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[46] The full version of the thematic report has been published separately. *Developments in the distribution of retail investments: Purchasing investments without a personal recommendation and simplified advice* http://www.fca.org.uk/news/tr14-10-developments-in-the-distribution-of-retail-investments

[47] *The motivations, needs and drivers of non-advised investors: A qualitative research report* http://www.fca.org.uk/your-fca/documents/research/the-motivations-needs-and-drivers-of-non-advised-investors

the motivations, needs and drivers of customers who had recently purchased retail investment products without recommendations and use this to inform our work.

Summary of the thematic review findings for simplified advice services

6. The firm visits and wider discussions with trade and industry bodies highlighted a number of issues that are influencing firms' decisions – particularly larger firms – not to develop simplified advice models. We therefore focused our attention on identifying these potential barriers and developing a more detailed understanding of firm concerns.

7. First, some firms are uncertain on the suitability standards for delivering personal recommendations online, particularly the necessary 'breadth' of the suitability requirements for advice on a focused scope. Firms suggested further clarification in this area would be helpful.

8. Second, firms are concerned that automated advice processes providing personal recommendations could result in systemic mis-selling if parts of the process produce unintended, unsuitable recommendations for certain groups of customers. This led many firms to include significant compliance and mis-selling liability costs within their business plans, limiting their commercial viability.

9. Third, firms are concerned that if they deliver online personal recommendations using a contingent adviser charging model (where the customer receives a personal recommendation ahead of paying to implement the recommendation), customers may decide to transact their recommendation on an execution-only basis with a different firm. Firms believe that if they have liability for these 'incomplete' transactions (which could be numerous), the risk premium they need to price into their business models challenges their commercial viability.

10. Finally, firms suggested that, even if the FCA were able to clarify the issues above, they are still concerned with how complaints on simplified advice cases would be handled by the Financial Ombudsman Service (the ombudsman service). Now that the ombudsman service publishes Ombudsman decisions, firms believe this could result in significant, focused activity by claims management companies (CMCs).

11. These issues had led a number of major firms to conclude that simplified advice was not currently commercially viable. Some firms have opted to develop services that do not involve giving personal recommendations instead.

12. In the firms we visited that offered simplified advice, we found that firms faced challenges in how to effectively exclude customers for whom their service was not appropriate (i.e. where customers' financial circumstances meant it was not appropriate for them to invest) and in assessing the level of risk customers were willing and able to take in an online environment. More generally, we found that the concerns some firms had about assessing suitability using an automated process was leading them to operate with extra pre and post-sale compliance oversight.

Summary of the thematic review findings for services where customers purchase investments without a personal recommendation

13. The review found that most firms had taken steps to identify the target market for which their non-advised service was likely to be appropriate and used this analysis to inform its design. The detail of firms' target markets varied. Some firms were able to define the characteristics of prospective customers very accurately and used the output to inform the design of key elements of their service such as their investment proposition and the type and content of supporting customer information. However, there were a small number of firms that had a very broad target market (for example, "any person that wants to manage their own investments"). As a result, these firms were less able to articulate how their service supported their customers in making informed purchase decisions and were less able to identify and monitor potential customer risks from purchasing investments without a personal recommendation.

14. The number and type of investments firms made available to customers through these services varied. This ranged from firms providing access to the widest range of investments, (including complex and non-mainstream products) to firms with a narrow range of simpler products. Firms' choice of investment proposition was often driven by the analysis they had undertaken on the target market for their service. Firms were able to use this information to determine the kinds of products that were likely to meet their customers' objectives and the supporting information that would help customers make informed decisions on which investments were appropriate for their needs. Some firms also decided to exclude certain types of product from their range of investments after identifying that their customers were unlikely to have sufficient financial knowledge and experience to understand the key features, benefits and risks involved and make an informed purchase decision.

15. All of the firms explained the nature of their service to potential customers. However, in some of the firms this disclosure was not displayed prominently or did not contain all of the relevant risk warnings.

16. The majority of firms had considered how to design their customer interface to try and equip customers with the information and tools necessary to support good decision-making. Most firms had also identified and attempted to mitigate potential risks linked to customers making their own investment decisions. Some had also used behavioural economics research to identify the typical behavioural biases of their customers and put in place relevant mitigants to try and encourage better customer decision-making. For example, to try and prevent customers from selecting funds based solely on their popularity ('herd behaviour').

17. Firms had identified the areas where their customers needed the most support in making their own investment decision, including financial planning, selecting an appropriate tax

wrapper and selecting appropriate investment products. Firms sought to support customers in these areas in a number of ways that included:

- The production of supporting information for customers on relevant areas. For example, explaining the features of the different tax wrappers available or explaining the principles of good investing.

- The provision of interactive tools for customers. For example, a number of firms provided financial planning tools that supported customers in better understanding their investment objective and whether and how it was likely to be met by investing.

- The ability for customers to compare and assess potential investments products based on different criteria.

18. However, it was clear that uncertainty on the boundary between sales involving personal recommendations and sales that do not was having a significant influence on the design of some firms' customer interfaces. Within these firms we were concerned that uncertainty regarding the application of the regulatory framework (or an overly cautious interpretation of how it applied) had led firms to exclude providing information and/or tools that were likely to support customer decision-making or help reduce the impact of common behavioural biases and prompt better decisions.

19. One of the significant challenges firms are facing is in translating rules and guidance (designed with the face-to-face advice process in mind) into an online, technology-driven environment. An additional challenge – for the firms that have undertaken the necessary research/analysis – is in deciding how to reconcile identified limitations in customer decision-making with what they can legitimately do without it amounting to a personal recommendation. For example, some firms have highlighted the tension between protecting customers from making bad decisions (through the use of choice architecture, defaults and 'nudges') and not providing a personal recommendation.

Customer research

20. In order to inform our thinking in this area, we commissioned a study of the motivations, needs and drivers of customers who purchase retail investment products without personal recommendations. We believe the findings will be useful for firms in this market (in particular, those that cannot meet the expense of this type of research themselves but would benefit from incorporating it into the development of their models). From a wider perspective, this research should encourage firms to better consider customer needs and put them 'at the heart' of their businesses and may complement their own.

21. In particular, our objectives for this research were to determine:

- The motivations, needs, level of understanding and decision-making ability of customers using sales channels without personal recommendations since 31 December 2012.

- Whether customers are aware of the implications of purchasing investment products without personal recommendations, and are confident transacting on this basis.
- Whether there are any identifiable limitations to customer decision-making that firms need to take into account when designing and delivering services that do not involve personal recommendations.

Methodology

22. A qualitative research methodology was chosen, as an exploratory approach was best suited to meet the research objectives, enabling the researchers to dive deeply into customer stories and experiences of buying investments without a personal recommendation.

23. A series of qualitative face-to-face depth interviews and customer workshops were carried out in March 2014 by NMG Consulting on behalf of the FCA. This involved a total of 92 customers who had purchased a retail investment since 31 December 2012 without a personal recommendation.

    This excluded the following products:

    - Pensions decumulation products (such as annuities and drawdown).
    - Protection and General Insurance products.

24. All participants were the main or joint financial decision-maker in their household for long-term investing and saving.

25. NMG Consulting recruited a cross-section of customer types based on the following criteria:

    - Channel experience (e.g. always 'direct', multi-channel, previously advised, new to investing).
    - Level of investable assets (minimum of £5000+).
    - Gender.
    - Life stage.
    - Regional spread.

26. A mix of respondents with varying financial capability and levels of sophistication were recruited and allowed to emerge naturally across the sample in addition to a mix of purchase channels (i.e. online, telephone, face-to-face, postal).

Findings

There is no single, dominant profile of the customer who buys without advice.

27. The research identifies three broad customer types in the 'without a personal recommendation' population with the distinguishing trait being the degree of comfort felt when investing. This emotionally-led characteristic shapes overall attitudes to investing and can influence behaviour. This research report refers to these three types as: Confident Self-starters, Eager Learners and Hesitant Hopefuls.

Confident Self-starters

28. These more relaxed, and often (but not always) more informed and experienced, investors may have been transacting on a direct basis for some time (sometimes in parallel with an advised relationship). They have a greater capacity for loss and will tolerate more risk in their investments. Confident Self-starters see real benefits in self-directed investing and are more confident in their decision-making abilities based on their perceptions of the market and/or a strong self-belief in being able to pick the best investments.

Eager Learners

29. Often new to self-directed investing, these customers are engaged and excited to be 'dipping their toe in the water'. They are keen to learn and will spend time conducting research before making a decision. They will search online, review third party websites and try and compare information to the best of their ability. This group are making more considered decisions on the whole and as such, feel more comfortable with their investment than Hesitant Hopefuls.

Hesitant Hopefuls

30. This category of customers often feels 'out of their comfort zone' when investing by themselves. This group of often inexperienced investors is more likely to be investing simply to achieve a slightly better return than that available from their preferred cash ISAs and deposit accounts. They commonly display low levels of understanding around the product features and risk profile of their investments, combined with a lower capacity for loss and risk tolerance. They seek reassurance and particularly like the perceived security of trusted brands.

Misconceptions and a lack of knowledge are evident amongst investors who are less comfortable dealing with the complexity of investment decisions.

31. Hesitant Hopefuls rarely invest sufficient time in research and tend to bypass some of the information gathering and evaluation stages often conducted by the other two types. In lieu of comparison of key product features, they will often use shortcuts, which may result in them making sub-optimal choices. This is particularly true of first time investors, who may have low awareness of features, such as penalties for withdrawal or waiting periods and a poor knowledge of product structures and risk implications, for example knowledge about the underlying funds contained in a product.

32. More experienced investors – either those that also use advice channels or have been self-investing for some time – have developed a much greater awareness of the key points for consideration when choosing an investment.

Investment decision-making is often heavily influenced by behavioural biases.

33. Given the perceived complexity of investing for many participants in the research, behavioural biases play a significant role. This is particularly commonplace in an unfamiliar buying environment, as is the case for the investor buying on a self-directed basis for the first time. Participants (most commonly Hesitant Hopefuls but seen across the types) 'shortcut' the more complex stages of the decision-making process, with little or no evaluation or comparison of options and use 'rules-of-thumb' to help make their decisions. Typically, as investors become more experienced, they are increasingly likely to take a more considered approach to their decision-making, although this is not always the case. Common behavioural shortcuts seen in the research included:

    - Sticking to the status quo – i.e. not searching beyond existing bank / building society / insurance providers.
    - Relying on recommendations from influential others – taking guidance from others within their social network whom they assume to be knowledgeable without any further validation.
    - Relying on provider simplification – i.e. using filtered lists of recommended funds.
    - Resorting to defaults – for example, simply picking the balanced fund for a pension investment.

34. Trust – either in a preferred brand or in the recommendations of family and friends – plays a significant role in decision-making. This also tends to limit the amount of shopping around and discourages investors from using unfamiliar brands. This is seen across all segments although Confident Self-starters appear most open to trying out new propositions.

    A high percentage of research and purchasing is being carried out online and for the majority the purchase journey is quick and efficient.

35. Despite the popularity of high street brands for many participants in the research, online has become by far the preferred channel for purchasing investments without advice. Key drivers are the ease of access to online services, the withdrawal of face-to-face service

amongst many high street brands and the increasing familiarity that many have with transacting in this way. There is a group of less confident customers that will only go part-way through the process online, preferring to purchase and transfer funds via more traditional channels. There also remains a strong need for telephone support to provide information and clarification at key points along the process.

There are both positive and negative drivers towards choosing to self-invest rather than take advice.

36. Customers who more willingly and actively choose to self-invest are frequently the ones more comfortable generally with investing (Confident Self-starters and more experienced Eager Learners). They may have learned about the pitfalls of investing via advised relationships or from prior direct experience. They demonstrate positive drivers towards self-investing including confidence in being able to understand the products and monitor performance, a sense of enjoyment in meeting the challenge of self-investing and satisfaction at the convenience and ease of use of online channels. Several of these investors are keen to avoid the perceived performance drag of advice fees.

37. Those less comfortable taking investment decisions are generally put off by the complexity perceived to be inherent in investing and display negative drivers to self-investing. These individuals would generally have preferred to have stayed in savings-based products (and so may revert to these as and when interest rates increase) or would have considered taking regulated advice if they did not have to pay an explicit charge or if they were investing larger amounts.

38. One finding from the research was that, across the attitudinal segments a degree of cynicism towards financial advisers exists, with some belief that the benefits of advice do not justify the costs. There is a sense that moderately to highly experienced self-directed investors believe they can do just as well as an adviser, without the cost or bias that may come with adviser involvement. As noted in the Overview to this paper, a large scale research study commissioned by FCA found that one of the most popular reasons for engaging with the market without personal recommendations was because they felt that they were as able as an investment adviser (17%).

39. It should be noted that these attitudes towards recommendations are very much influenced by the amount being invested. For investments without a recommendation, this is typically below £20,000 in any single transaction (and often aligns to annual ISA limits). The likelihood of seeking a recommendation increases significantly as the value of the investment and/or the complexity of the need increases.

There is clarity when using online, 'execution-only' services, that no advice has been given. However, some ambiguity exists when human interaction is involved.

40. Customers are generally able to distinguish between sales involving personal recommendations and those that do not. The key cues of a channel involving a recommendation are that the customer pays for the service and the adviser is giving a tailored recommendation after reviewing the customer's personal financial situation. The

key cues that signify a service where no personal recommendation is given are that the customer does most or all of the research and the provider does not recommend particular products or funds over others.

41. Customers appear clear about the scope of service from providers who do not provide personal recommendations and platforms when an online channel is being used. But when there is a degree of human interaction, particularly face-to-face, there is potential for information provision or product guidance to be misinterpreted as a recommendation. The confusion is compounded by the fact that customers' understanding of when a personal recommendation has been given can be very different from the actual position. This was evident within a few examples in the research where customers believed they had received a recommendation but when probed, it was clear they had not paid a fee or received a recommendation based on their personal circumstances.

Customers using channels without recommendations take responsibility for their investment decisions.

42. Customers are aware that responsibility for the investment decision lies with them when making purchases without a recommendation. However, they do expect a regulator to be their 'customer champion', by making it easier for them to understand what they need to know before investing, providing a means of checking on the reliability and security of providers, and advising on the best channels to seek recourse for poor provision.

The majority of self-investors do not appear to be exposing themselves to excessive risk and are making broadly appropriate investment choices based on current circumstances.

43. In the context of the rest of their financial world and capacity for loss in their investments bought without a recommendation, the majority of investors are not exposing themselves to excessive risk and appear to be making broadly appropriate investment choices based on current circumstances. However, a minority are making choices that could be deemed to be sub-optimal. The most common mistakes being made are:

   - Investing in high risk products / funds without being aware of the risk profile of their investment (or the implications of being in a high risk investment).
   - Holding a product that was different to the one they thought they had bought.
   - Buying an investment product that was not tax efficient when ISA thresholds had not yet been reached.
   - Uncertainty around whether or not they had received and/or paid for a recommendation.

Conclusions

44. Firms need to respond to the diverse needs of customers who purchase without a recommendation and ensure that channel design, communications and support services help deliver good outcomes for the whole range of self-investors – from the least to the most capable. While the research did not include a detailed exploration of provider propositions, it is evident that some firms have already started to target and tailor their services to suit the differing needs in the market. However, the direction of travel for the industry should be to focus on the need for greater customer engagement to both support behavioural biases and limit any potential for detriment.

45. Providing information in a format that the most inexperienced self-investor can follow and absorb would be a good starting point. NMG found that customers would like to see the following:

    - Simple, bite-sized chunks of information, in very plain English, covering the 'must know' basics.
    - A clear and consistent format for this 'must know' product information to help with identification of key features and comparability across providers.
    - Charging structures to be communicated in a clearer and more comparable format.
    - Inclusion of telephone support and easily found phone numbers.
    - Clear and bold information at point of purchase on paths for recourse.
    - Reminders on the key points of the purchase before the final decision is made.

46. Different segments, based on comfort with investing, will have differing information needs and providers need to reflect investors' range of capabilities in the way information is presented.