Financial Services Consumer Panel
AN INDEPENDENT VOICE FOR CONSUMERS OF FINANCIAL SERVICES

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By email: POATR@fca.org.uk

Dear Sir / Madam,

**Financial Services Consumer Panel response to FCA consultation on Non equity securities – Engagement Paper 4**

The Financial Services Consumer Panel (the Panel) welcome the opportunity to respond to this consultation on updating and improving the UK regime for non equity securities. The Panel recognises that the change to the disclosure regime for non equity securities (particularly debt instruments) in 2005 reduced the number of products offered to retail investors. However, we have concerns about the proposals set out in Engagement Paper 4. In particular, we would like to highlight seven key issues, namely:

1. ***The importance of ensuring that consumer protection and benefits to consumers are used to prioritise regulatory change***. Consumer protection is a primary objective of the FCA and cannot not be traded off against the secondary objective of the UK's international competitiveness and growth.
   The Panel is concerned that the FCA has interpreted a reduction in the number of non-equity securities being offered to retail investors, following the change to regulatory disclosure requirements in 2005, as synonymous with consumer harm or consumers missing out on opportunities. The FCA's reliance on feedback to underpin this assumption will only be valid if the feedback has come from consumers and consumer representatives, rather than industry. In practice, retail investors should be investing only if they fully understand the products they are selecting and the risks they are taking on. In that context, a reduction in the products offered, especially complex products, **may** benefit consumers, if they had previously been investing without fully understanding the products they were investing, but robust evidence is required to support this assertion.
2. ***The need for consumer testing***. The proposals in this engagement paper largely concern changes to the disclosure requirement for retail investors. The Panel is concerned that there has been no consumer testing of these proposals, to assess the ability of consumers to understand, compare and make effective decisions if they are implemented. The Panel would urge the FCA to undertake such research, before making any decision on how to proceed.
3. ***Failure to assess the impact of informational asymmetries on the ability of consumers to operate in the non equity securities market***. If the disclosure requirements for retail investors are reduced to align with the wholesale market requirements then the FCA is implicitly placing significant weight on the ability of institutional investors to exert pressure on issuers as a way of protecting retail consumers. The Panel has two concerns with this approach. First, it relies on institutional investors being equally active for all issues, which may not be the case. Secondly, there is considerable information asymmetry between professional and retail investors operating in the market, as well as between retail investors and issuers. This

information asymmetry could be exploited by firms having first mover advantage to the detriment of retail investors.

4. ***Risks from lack of diversification***. Retail investors may be at particular risk of harm if their investment in financial products does not represent an appropriately diversified portfolio. The Panel notes that there are other methods for retail investors to gain exposure to corporate and government debt markets other than investing directly, such as Open Ended Investment Companies (OEICs) and Unit Trusts. These options give consumers the opportunity to invest based upon the knowledge, experience and due diligence of investment professionals that have fully investigated the opportunity and made a risk-weighted-return based evaluation. It is also important to diversify within certain asset types, such as diversifying duration within a debt portfolio, this is easier for the consumer to achieve by accessing these asset types via a collective instrument rather than investing directly.
There is also a risk that through direct investment in debt markets that consumers may unwittingly end up more exposed to a sector or firm than they intend or would wish to be – for example holding equities, property and debt that are all linked to one sector or even one firm. Therefore consumers are not necessarily harmed by being excluded from direct investment in debt markets, indeed indirect investment may provide greater diversification benefits. The Panel considers that the risks associated with lack of diversification reinforce the need to ensure that retail consumers will fully understand all aspects, opportunities and risks of any non equity securities that they may invest in.
5. ***Lack of consistency between the Prospectus and Bond Framework***. The Panel agrees with the FCA that this could be harmful and would support FCA initiatives to address this type of problem. This will be particularly important if changes to the disclosure regime are made that aim to increase participation by retail investors, as retail investors are unlikely to understand the different legal status of a prospectus and a bond framework.
6. ***Sustainability labelling of debt instruments***. The Panel believes that the approach to sustainability labelling and disclosure requirements for debt instruments must be aligned to the FCA's approach to sustainability labelling and disclosure requirements for investment products as a whole. This would allow consumers to apply a consistent approach across their investment portfolio and to be confident that where the same terms are used for different products their meaning is consistent. The Panel broadly supported the proposals in the FCA's CP22-20 on sustainability disclosure, which was backed by robust consumer testing to identify what works. The Panel considers that it is important for consumer confidence for there to be an approach that consumers can rely on to identify the types of investment that best align with their preferences on sustainability, noting that greenwashing has a very negative impact on consumer confidence.
7. ***Access to redress***. The Panel considers that the FCA should consider the extent to which retail investors should have access to redress where things go wrong, particularly where investors have relied on the disclosure documents provided. Consumers should have access to redress, but even if if redress is limited, the retail disclosure regime should include requirements to make it clear to consumers what access to redress (or lack of access) they will have. The Panel notes that as many issuers will not be regulated by the FCA, (and does question just how clear this will be to the consumer), consumers will not necessarily be able to rely on the Consumer Duty to ensure good behaviour. This will make it particularly important for consumers to be able to claim redress in cases where the disclosures provided have failed to make clear, in a way a retail investor can be expected to understand, how the product will operate and its likely risks.

In general the Panel considers it important that the overarching regulatory regime governing retail investments provides a coherent approach to setting regulation that meets consumers' needs. Our response should be considered in the context of our vision for how the market should function, which is set out in our response to the FCA's call for input on consumer investments. The foundation of this vision is a robustly implemented and supervised Consumer Duty[1]. This would make the firm responsible for consumers' overall suitability for and understanding of the products which they invest in. This would create a market where:

- more of the population with investible assets, and where the decision is right for them, make an active and informed choice to invest, so maximising their own returns and supporting the real economy;
- the information disclosed to potential investors is designed in a way that will allow them to make effective decisions, and to compare the risks, rewards and sustainability not only of different options for a given product type, but also of different products;
- it is not possible to use regulatory arbitrage to circumvent rules designed to protect consumers;
- information, education, guidance and advice are readily available and tailored to the consumer to ensure they are supported in taking decisions both pre-investment and on an ongoing basis. This will require the re-engineering of current thinking to better integrate these aspects and blend them throughout the customer's investment life-cycle. Only in this way will trust be established;
- information asymmetry is removed and avoided so that consumers do not end up bearing the risks and impacts of becoming last-movers in markets
- the use of guidance or advice should be the gateway to anything other than a range of default-based, simple, tax-efficient investments;
- the use of client self-certification is removed;
- products must be better designed, labelled and described to enable consumers to better understand fully the opportunities, risks and costs involved and easily compare these across options; and
- when harm does occur, there must be easily accessible and efficient redress and compensation solutions.

Yours sincerely,

Helen Charlton

Chair, Financial Services Consumer Panel

[1] For our comments on the FCA's proposed new Consumer Duty, please see here: https://www.fs-cp.org.uk/sites/default/files/final_fscp_response_cp21-36_a_new_consumer_duty_20220214.pdf