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

Telephone: 020 7066 9346
Email: enquiries@fs-cp.org.uk

10 March 2023

By email: retail.disclosure@hmtreasury.gov.uk

Dear Sir / Madam,

Financial Services Consumer Panel response to HMT consultation on PRIIPs and UK Retail Disclosure

The Financial Services Consumer Panel (the Panel) is an independent statutory body. We represent the interests of individual and small business consumers in the development of financial services policy and regulation in the UK.

The Panel welcome the opportunity to respond to this consultation on PRIIPS and UK retail disclosure. The Panel broadly supports the main measures set out in this consultation. In particular, the Panel supports:

- the decision to move responsibility for setting disclosure requirements for retail investments from legislation to the regulator, as this will provide the flexibility needed for the rules to evolve with market developments.
- the ambition to ensure that the disclosure requirements for both PRIIPs and UCITS will be the same in future, as creating a coherent and cohesive disclosure regime encompassing all retail investment products will benefit consumers.

However, the Panel would like to see a greater emphasis on enabling consumers to make effective decisions. A key part of this will be enabling consumers to use disclosure to compare key features of investment products, for example in relation to risk. While the Panel considers that considerable improvements could be made to the methodology currently used for risk disclosure, having effective risk indicators that allow consumers to compare the risks of different products can significantly improve their ability to identify the most suitable products.

In general, the Panel considers it important that the overarching regulatory regime governing retail investments, including retail disclosure requirements, 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 correctly 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:

[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

- 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;
- the use of client self-certification is removed;
- information, education, guidance and advice is 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;
- the use of guidance or advice should be the gateway to anything other than a range of default-based, simple, tax-efficient investments;
- 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.

We would also stress the need for a robust evidence base, preferably through consumer testing at the outset, to ensure that any prescribed disclosure requirements are fit for the purpose in setting the information consumers say they want and need in order to make informed, effective decisions.

Our responses to the questions posed in the consultation are included at Annex A below.

Yours sincerely,

Helen Charlton

Chair, Financial Services Consumer Panel

Annex A – responses to questions

Q1: Do you agree with the description of the various problems with the PRIIPs Regulation as stated above? Are there any other aspects of the regulation that you would like to raise as the government moves beyond PRIIPs into a new retail disclosure regime?

The Panel supports proposals that the regulatory rules governing aspects of governance such as disclosure for Packaged Retail and Insurance-based Investment Products (PRIIPs) should be set by the regulator, rather than in legislation. The Panel feels that this will create greater flexibility, and allow rules to evolve more effectively as markets evolve.

The Panel also agrees that it will be important to adopt the same disclosure regime for both PRIIPs and for Undertaking for Collective Investment in Transferable Securities (UCITS), particularly as some products qualify as both PRIIPs and UCITS. The Panel considers that providing a coherent and cohesive approach to the regulation of consumer investment products is important, particularly around disclosure. This will allow consumers to make effective choices.

For this reason, the Panel considers that as part of a package of regulatory change, it would be helpful to include a review of the wider regulatory landscape, in order to assess the combined effectiveness of all the disclosures consumers receive in relation to their investment products. The aim should be to assess whether different disclosures complement or undermine each other. This review should include not just PRIIPs and UCITS, but also disclosure provided under other regulation such as the Markets in Financial Instruments Directive (MiFiD), or the emerging ESG disclosure regulations.

In addition, the Panel considers that for consumers to be able to make effective choices about what to invest in, they need to have consistent, comparable information about two key elements, namely:

- costs and charges; and
- risk.

Therefore, contrary to proposals within this consultation, the Panel would like to see prescribed rules for these two aspects of disclosure, albeit with the rules being set by the regulator, rather than in legislation. The Panel agrees that the methodology underpinning the risk indicator for the Key Information Document (KID) for PRIIPs is very flawed. However, the Panel considers that alternative methodologies are available that could be used to underpin a more effective risk indicator. This would benefit consumers.

Q2: Do you agree with the principles set out in paragraph 3.2? If not, please explain.

The Panel does not consider that "to reduce the burden on firms" should be listed as the purpose and principle of retail disclosure. The purpose and principles of retail disclosure should be to:

- ensure that consumers have the information they need to allow them to make effective decisions;
- allow consumers to effectively compare different options, particularly in relation to risk, and costs and charges; and
- ensure that they know what their options will be, if things go wrong.

Q3: Do you agree that retail disclosure should aim to ensure that an investor is empowered to make well-informed decisions related to the product that they are purchasing, rather than focusing on comparability? If not, please explain.

No. The Panel considers that this is an unhelpful framing of potential options, as the availability of comparable information across different product offerings plays an important role in ensuring that consumers are able to make effective, well-informed decisions.

For example, research for the Associate of British Insurers in 2010 demonstrated that providing consumers with disclosure documents using a single risk indicator design led to an improvement of over 20% in the likelihood of participants being able to identify the most suitable funds compared to text-based disclosures. In contrast, when participants were shown disclosure documents that used different risk indicator designs, the likelihood of them being able to identify the most suitable funds fell by 3% compared to participants seeing text-based risk disclosures.[2]

While it is important to ensure that an effective methodology is used to underpin the parts of disclosure designed to enable consumers to compare options, comparability can be an important tool in allowing consumers to make well-informed decisions.

If the goal of retail disclosure is not to allow consumers to compare options, then this suggests that there should be significant restrictions on who should be able to purchase all but the most basic retail investment products in the absence of advice.

The Panel is already concerned about the use of self-certification for whether investors qualify as sophisticated or high net worth investors. The Panel notes that the FCA has proposed banning the use of self-certification for crypto-assets, if these are brought within the Financial Promotions regime. However, the banning of self-certification for other products is not within the FCA's remit and instead would need HMT input. The Panel considers that banning the use of self-certification for other investment products would significantly help to reduce the likelihood of consumers ending up with unsuitable investment products and urges HMT to take action on this issue. It notes that London Economics' research into the non-transferable debt securities (mini bond) market, which was conducted to inform HMT's 2021 consultation on the Regulation of non-transferable debt securities, demonstrates why allowing self-certification is problematic, as illustrated by the findings in Section 5.3.2 of the research, which states:

> *"A few received cold calls from finance company's [sic] trying to sell a mini bond to them. One spoke of receiving a follow-up call from the provider when the online application form said she wasn't eligible for the mini bond; the caller told her to complete the form again and answer in such ways [sic] as to ensure it accepted her application. She has since lost £80,000 as the company went into administration."*

Q4: Do you agree that disclosure requirements should be flexible, with prescriptive requirements for format and structure only when deemed necessary by the FCA? If not, please explain.

The Panel agrees that it will be helpful to move disclosure rules under the regulator's remit, rather than having the rules set out in legislation. This will allow the regulator to adjust rules on what and when consumers see as part of disclosure, in response to evolution within the market. An example of this is the FCA's recent proposals on ESG reporting, which propose using the layering of information to reflect the fact that nowadays most

---

[2] R Driver, N Chater, B Cheung, M Latham, R Lewis and H Scott (2010) "Helping consumers understand investment risk: Experimental research into the benefits of standardising risk disclosure", ABI Research Paper No 25.

consumers will access information online, rather than the historic paper-based approaches to disclosure.

The Panel considers that it will be important for the FCA to ensure that certain key elements of disclosure are provided in a way that will allow consumers to compare different options for investment, and that they should be given the necessary powers to achieve this. In particular, the Panel considers that being able to compare costs and charges, and the level of risk associated with different products will be important for consumers.

Q5: Are you content with the decision to resolve the UCITS interaction through empowering the FCA to determine a future retail disclosure regime, as discussed above?

The Panel is very supportive of proposals that the FCA should be given powers to integrate UCITS and PRIIPs regulation as part of a future retail disclosure regime. The Panel considers that it is important to have a disclosure regime that works for all retail investment products, rather than considering products in silos, as well as having a regime that works for the different sales channels that are available.

In order to ensure that the new regime is effective, the Panel considers that it will be important for the FCA to future proof its work in this area, by considering both PRIIPS and UCITS when designing the new regime, rather than purely focusing on PRIIPs.

Q6: Do you agree that there is no need to maintain any PRIIPs-related retail disclosure elements in legislation? If not, please explain.

Yes. The Panel agrees that it is better for retail disclosure rules to be set by the regulator, providing the FCA has sufficient powers to do so.

Q7: Upon revocation of the PRIIPs Regulation, do you agree with the government's view that the FCA will not require any new additional powers to deliver a retail disclosure regime in line with the objectives stated in Chapter Three? If not, please explain.

The Panel is not aware of any specific legislative gaps that would undermine the FCA's ability to implement effective rules in this area.

However, the Panel considers that it will be important to have a regulatory disclosure regime that benefits consumers along the principles identified in the Panel's answer to Question 2 of this consultation. This includes ensuring that certain key parts of disclosure are provided in a way that facilitates consumers' abilities to compare products. Therefore, the Panel considers that it will be important for HMT to provide the FCA with the necessary powers, if any legislative gaps are identified, for example in the ability of the FCA to ensure that overseas funds marketed to retail investors will abide by the same disclosure rules as domestic funds.

In considering whether any legislative gaps exist, it will be important to consider potential gaps not just for PRIIPs regulation but also for UCITS, in order to future proof the new regime (noting also our response to Q1 in relation to disclosure under other regulation such as the Markets in Financial Instruments Directive (MiFiD), or the emerging ESG disclosure regulations).

Q8: Are there any wider obstacles that prevent or discourage firms from offering investment products from different jurisdictions to UK retail investors, and what actions would you suggest that the government take on this issue?

No comment.

Q9: Do you have any views on digital disclosure, and in particular to what degree do you think a less prescriptive disclosure regime will facilitate innovative disclosure formats going forward?

The FCA's recent research into ESG disclosure found that, while digital disclosure can be effective, it is still important to impose certain rules to ensure consumers benefit. For example, the research found that layering can be used to enhance the consumers' experience, but it is important that:

- all products provide a sustainability disclosure (even if the product has no sustainability ambitions), as having this information for all products allowed consumers to make better decisions; and
- the use of the proposed ESG labels should be part of the top layer of information.

The Panel considers that one of the benefits of moving disclosure requirements to be part of the regulator's rules, rather than legislation, is that it will be able to adapt to evolution within the market. This includes developing digital options.

However, the Panel considers that it will be important that effective consumer testing is done by the FCA, in order to identify where consumers will benefit from a standardised approach. The Panel notes that it will be important for the FCA to take a central role in assessing the benefits of standardisation, as individual firms will not be able to achieve standardisation within the market without FCA intervention. Where standardisation benefits consumers, the Panel considers that the FCA should impose rules to ensure that a standardised approach to disclosure is introduced, albeit one that is adapted to different potential channels.

The Panel also considers that it will be important for the FCA to set rules to ensure that consumers using digital channels will be able to document the information they were provided with, so that they make a claim for redress in the event that things go wrong.

Q10: Do you have views on other priorities for retail disclosure reform that the government and FCA should consider in future? Similarly, are there other challenges or trends in retail disclosure that regulators and policymakers should consider?

The Panel notes HMT's scepticism about the benefits of standardising risk disclosure. For the reasons set out in the Panel's answer to Question 3 of this consultation, the Panel considers that a standardised risk metric has the potential to significantly improve the ability of consumers to make effective decisions about the suitability of different investment products. In addition, the thermometer design for risk disclosure used in both UCITS and PRIIPs regulation performs well in consumer testing in terms of improving decision-making. For this reason, the Panel considers that a standardised risk metric should form part of the rules set by the FCA for retail disclosure.

However, the Panel considers that while the pictorial design of the risk metric used in both PRIIPs and UCITS disclosure has the potential to improve consumer decision making significantly, in practice the chosen methodology used to allocate risk scores is flawed from the perspective of what matters for consumers. This is particularly true of the methodology used for PRIIPs, which was based on the Sortino Ratio. However, the methodology used for the UCITS risk disclosure was also problematic, albeit for different reasons.

The Panel considers that from a consumer perspective three features are important when designing the methodology to underpin a standardised risk indicator, namely that the chosen methodology will:

- deliver consistent risk scores over time. A consumer does not want to buy what they think is a low risk product today, only to discover that tomorrow the methodology used would indicate that it is a high risk product; and
- allow the consumer to differentiate between products with different risks. In other words to avoid creating risk buckets that will cause bunching, with the majority of products in only a few buckets.
- be easy to replicate to ensure consistent results, if different providers were to calculate a risk indicator for the same product.

The Panel considers that one of the priorities for retail disclosure reform should be to develop a standardised risk methodology based on these principles that can be used in conjunction with a pictorial risk indicator. The Panel considers that it is possible to develop a risk methodology that delivers against these requirements, and that identifying the most appropriate methodology is an empirical question.

Testing of different risk metrics conducted for the ABI and IMA in 2010 suggested that the most effective methodology from a consumer perspective would be to use a standard deviation measure based on ten years of data, as this delivered the most consistent (and intuitive) risk rankings. The proposed methodology that emerged from this work also suggested that risk rankings should be calculated using the risks inherent in broad asset classes, rather than individual product returns. This matched industry practice at the time and also created a framework that would accommodate new products. The benefits of this methodology could be enhanced further by adjusting where the boundaries between different risk buckets are drawn in the current regulations.

The reason why this research suggested that a standard deviation-based methodology would be preferable to the Sortino ratio is illustrated by the consistency of the risk rankings produced by the two methodologies over time. Calculations using three years of monthly data for twenty-three asset classes showed that recalculating the resulting risk rankings each month over the period 1990 to 2008 produced much more consistent rankings in the case of the standard deviation methodology. In particular, the average correlation in the risk rankings of the 23 asset classes over time was over 83% when a standard deviation methodology was used, but less than 14% in the case of the Sortino ratio.[3] Given consumers care about how stable risk indicators are, because they do not want to buy what they think will be a low risk product only for it to change into having a high risk ranking, the low correlation in the rankings for the Sortino Ratio is problematic.

[3] See A Clare (2010) "Developing a risk rating methodology", Joint ABI and IMA Research Paper.