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

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By email: ps237@fca.org.uk

Dear FCA,

Financial Services Consumer Panel response to PS23/7: Broadening retail access to the long-term asset fund

The Panel welcome the opportunity to respond to this consultation on broadening access to long term asset funds (LTAFs).

The Panel recognises that a much broader range of retail consumers could potentially benefit from investing in LTAFs, and we welcome that the stated intent behind the broadening of access is that the FCA does not want to impose unnecessary restrictions on where consumers can invest. However, LTAFs are not only high risk, but are also highly illiquid. Even with all the safeguards intended to operate in this space, such as warnings on risk, and assumptions that consumers can 'afford' the risk and have a greater ability to understand and take on those risks, understanding all the risks associated with individual LTAFs may still be challenging for many retail investors despite being deemed suitable for LTAF investments. This makes it important that all the usual protections consumers benefit from when buying regulated products should be available to consumers here.

The Panel would like the FCA to consider the following:

<u>Changing financial circumstances</u>
The impacts of the cost-of-living crisis and the speed at which the pandemic adversely impacted many consumers demonstrated that financial circumstances can change quickly. The nature of LTAF investments is that they present an option/opportunity for investors 'with long-term investment horizons' (who understand and can bear the risks of

such investments) to invest but with 'less or no immediate liquidity'. Recent events such as Covid-19 and the current cost of living crisis can impact consumer behaviour and attitude to risk. Recent rapid societal changes have shown us that when at one point in time LTAFs may be seen as an attractive and viable investment opportunity, that can quickly change, particularly if the personal financial circumstances of that consumer change. Yet, because of the generally illiquid nature of LTAFs those consumers would be unable to easily realise the value of those investments. This reinforces the need for LTAFs to be covered by FSCS.

Absence of FSCS coverage

The FCA has identified the benefits to consumers and markets of broadening the range of retail investors who will be able to access LTAFs. However, the Panel question whether this will be adequately achieved in the absence of the security and confidence of knowing that FSCS protection is in place.

The Panel question why any consumer should have to take on the risk of losing all or part of their investment value due to the failure of a provider when their ability to liquidate their assets is restricted.

The Panel would also encourage the FCA to consider the consumer journey. A consumer seeking investment advice may be told to spread their risk and may be advised to invest in both LTAF and non LTAF products. This means a customer would have coverage for one investment and not another. Coverage between products could change within the conversation being had with their adviser without the consumer being aware. A customer who is encouraged by their advisor to consider an LTAF as part of their portfolio will need to be made aware of FSCS coverage status.

Suitability for investors

In finalising the rules, even taking into account the degree of risk associated with investing in an authorised LTAF that predominantly invests in illiquid assets, coupled with the risk assessment and disclosure requirements, we do not believe the FCA has adequately taken into account the lower levels of experience and expertise of many retail investors who will be suitable for and wish to invest in LTAFs, and particularly their need to access their investments and their ability to absorb losses at any given point in time.

The FCA states that it has designed its measures ‘to reduce the chance of investors investing without a strong understanding of the risks’. However, this does not mean that such retail investors, even if all the other protections are properly in place, are automatically prepared or fully able to also take on the risk of losing all or part of their investment value if a provider firm is financially unable (or unlikely to be able) to meet the consumer's claim. Protection under the FSCS is therefore a key part of the suite of protections available, in particular to underpin consumer confidence in LTAFs as newly designated restricted mass market investments. FSCS does not protect against poor investment performance alone, but where consumer harm and losses arise as a result of events that would be covered by FSCS in other areas of the financial services market then that protection should also apply here. Consumers should not be denied the right to have FSCS determine whether there is a valid civil claim against a failed UK-authorised firm.

Poor advice

The Panel believe that consumers of LTAF products should not automatically have to bear all the consequences that may result from poor advice, conduct and any harm caused by firm failure. To remove FSCS coverage makes a number of dangerous assumptions, for example that the investor has received adequate information and advice about risks associated with the LTAF from the advising firm, yet this may not have been the case and all consumers who have suffered harm should not be denied the opportunity of having their claim tested through the FSCS claims process.

Conclusion

To conclude, The Panel agree that the proposed policies around LTAFs does not remove the risk from regulated activities and believe FSCS cover should remain. The Panel would encourage the FCA to conduct a strategic review and engage with the relevant stakeholders (consumers included) in order to gain knowledge and insights into how FSCS coverage and policies should apply to different products. If the FCA then feel there is something wrong with the current scheme, for example it is too costly, then they should consider this strategically rather than carving any new regulation out of the cover.

Please find the Panel's responses to questions posed in Annex A, below.

Yours sincerely,

Helen Charlton
Chair, Financial Services Consumer Panel

Annex A – Response to consultation questions

Interim findings

Q1. Do you consider that we should consult on removing FSCS protection for either (a) some activities relating to LTAF – in which case which ones; or (b) all activities? If not, why not?

Yes, the Panel consider the FCA should consult on any policy that would result in removing or restricting FSCS protection for LTAF investors. The broadening of access to LTAFs represents a significant transition from investment activity classified as non-mass market to a potentially much broader market with some protective safeguards built in. Those changes are specifically aimed at enabling a much wider range of consumers to benefit from an ability to invest in LTAFs.

Now that the previous restrictions on the retail promotion of LTAFs have been lifted, any proposal to remove or restrict FSCS protection for these investments will have significant impacts on those consumers. This is because LTAFs will now be potentially distributed to a much wider group of mass market retail consumers than under the previous regime. As a result, consultation on removing FSCS protection for some or all activities is essential.

The Panel believes the FCA is likely to hear from strong and loud voices from industry but comparatively little from consumers and consumer bodies. The Panel would ask the FCA to ensure they recognise and address any imbalance between the consumer dimension and the industry-driven approach/perspective.

To conclude, The Panel agree that the proposed policies around LTAFs does not remove the risk from regulated activities and believe FSCS cover should remain. The Panel would encourage the FCA to conduct a strategic review and engage with the relevant stakeholders (consumers included) in order to gain knowledge and insights into how FSCS coverage and policies should apply to different products. If the FCA then feel there is something wrong with the current scheme, for example it is too costly, then they should consider this strategically rather than carving any new regulation out of the cover.

Q2. If you support removal of LTAF from FSCS coverage, do you agree that steps should be taken to confirm the policy rules for this as soon as possible, so that these changes are made at this early stage in the process of LTAFs being distributed directly to retail investors?

The Panel do not support the removal of LTAF from FSCS coverage as set out in our response to Q1 and Q3.

Q3. If not, do you consider this should be kept under review as part of our wider work on FSCS cover for activities relating to investment products?

The Panel do not believe that the removal of LTAF from FSCS coverage is in the interests of consumers, nor is it fair to exclude retail claimants from the protection afforded by the FSCS simply because they can expect to receive greater information about risks, be expected to understand those risks, and because there is an underlying assumption that LTAF investors are able to 'bear the risks' of their chosen investment opportunities.

For those that do choose to engage in the market, our vision for this market is that when harm does occur, there must be easily accessible and efficient redress and compensation solutions. If any retail consumer makes the decision to invest in LTAFs, as these now sit within the regulatory perimeter then those consumers should also have the benefit of the protections and redress options that they have with their other more mainstream investments.

The Panel believes that it is necessary to keep FSCS protection under review as part of the FCAs wider work on investment product protection. As with the introduction or reclassification of any regulated activities and products an ongoing review process is essential. We also believe that such a review should be carried out to evaluate whether broadening the availability of LTAFs to a wider range of retail investors has been successful and appropriate, the extent to which consumer trust has increased and retail consumer behaviour affected by the availability of FSCS protection on these products, and what the levels and types of claims on the FSCS from LTAF retail investors are over time.

The FCA needs to set its consultation work in the context of other initiatives such as the Consumer Duty. The Panel have welcomed and supported much of the work the FCA has done aimed at reducing consumer harm. Many of these initiatives, if successful will reduce consumer losses that the FSCS would otherwise have to fund. Consumer certainty around the availability of protection in this market is key to instilling consumer confidence in the investment process. To exclude particular products from the FSCS scheme would appear to be the wrong approach and poor timing. The Panel believe it is best to improve those things that need improving with the current system and then engage in a wider review once the Consumer Duty and Consumer Investments Strategy are in place and can be assessed.

Q4. Are there any other amendments to FCA rules, for example, on distribution and the operation of LTAFs that you would make if FSCS coverage was limited, to enhance consumer protection?

We do not have any specific suggestions for other amendments as we do not believe that FSCS coverage should be limited in any specific way.

However, the Panel has proposed that in addition to the current FSCS funding model the revenue from fines issued by the FCA should be directed into the FSCS pool. This would offset levy payments by firms, increase the percentage of the pool paid by 'bad actors' and help in the funding of any transition from levy relating to claims to a levy relating to business written approach. The Panel would encourage the FCA to identify how this income could be allocated to protect consumers and reduce the overall burden on firms.

The Panel are of the view that this work appears to be targeted at reducing or limiting the FSCS bill. The Panel believes the size of the levy should not be used as a driver for the policy approach to the detriment of consumer protection.