

Smaller Business Practitioner Panel's response to the FCA's Guidance Consultation – Retail investment advice: clarifying the boundaries and exploring the barriers to market development

The Smaller Business Practitioner Panel was set up to provide input to the Financial Conduct Authority (FCA) from the point of view of smaller regulated firms. This is the Panel's response to GC14/3 Retail investment advice: clarifying the boundaries and exploring the barriers to market development.

1. Introduction

We have deliberately framed our input at the level of key issues. We will leave it to others eg the Trade Associations to comment on the detail of the proposals.

The GC is a welcome attempt to clarify the boundaries ranging between "full advice" on the one hand, where the suitability obligations of providing personal recommendations clearly apply, and (at the other end of the spectrum) execution only, where the suitability obligations clearly do not apply.

As the GC acknowledges, while an increasing proportion of consumers will be happy to go execution only (and it is encouraging to see that "the majority of self-investors do not appear to be exposing themselves to excessive risk and are making broadly appropriate investment choices...") there remains a desire from many to receive advice.

While the RDR has brought improvements and benefits for many consumers, including those seeking advice, there is a danger these have principally benefited wealthier clients. There is strong anecdotal evidence an "advice gap" has emerged for consumers who want to some financial advice but who either cannot afford the fees chargeable by full advice providers (which have risen in part due to the suitability obligations placed on the provider of a personal recommendation of a Retail Investment Product) or who want to receive advice on only part of their investments. A key aim of the GC is to encourage firms to serve those consumers.

The GC (1.1) asks "does [the] expectations gap mean that firms are shying away from providing products or services that would be beneficial for customers for fear of falling foul of the rules?" The ultimate test of the GC will be whether it provides sufficient clarity for those firms who would provide good outcomes to consumers to want to target the provision of limited (and simplified) advice.

2. Positives

We believe the GC has a number of positive elements:

- The tone of positive engagement with the sector is welcome. The GC shows systematic research into and a clear understanding of the principal issues that potential service providers believe they face (e.g. 4.2 and Annex B).
- The GC provides additional clarity in a number of areas as to what does and does not constitute a "personal recommendation", one of the identified principal aims of the paper (1.2.). For instance the GC is helpful in clarifying that providing generic information (for instance on a website) to help consumers determine their own investment risk profile, and for each profile disclosing a related model portfolio, may not constitute a personal recommendation.

- The intention to give firms more confidence to provide shorter, more useful information to customers about their products (2.3) is welcome: there is an increasing tendency of firms to protect themselves via ever wider disclaimers which means they do not get read. This does not benefit consumers.
- 3.29 is particularly helpful in clarifying re replacement business that, where the customer does not want a full review of existing investments, and the firm has reasons 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. There is evidence that some firms have been shying away from replacement business completely because of the perceived risks and the potential for customer dissatisfaction. This is because there is a considerable time cost to full replacement business reviews, which many knowledgeable customers do not want to pay. They see themselves as perfectly capable of analysing whether they should continue with existing arrangements, and if a firm insists it must carry out a full replacement business review at the start of a relationship it can be seen as excessively bureaucratic and a real barrier to establishing a strong client relationship.
- We believe the qualifications regime for advisers providing limited advice is clear. We agree that the requirements for such advisers to be qualified to QCF Level 4 should not be relaxed (3.67).

3. Areas for further clarification

The FCA acknowledges the consultation is a first step and asks (5.32) whether there are other areas where firms need greater clarification or other factors that act as a barrier to providing the services discussed in the consultation.

We believe the clarification in 3.29 is particularly welcome. However many firms will (we believe) continue to shy away from providing limited advice, despite the GC. The sector's likely response must be seen in the light of the trend identified by the GC that (in the view of the FCA) firms are taking an overly cautious interpretation of the FCA regulations. This view that firms are being "overly" cautious may or may not be correct. However firms would argue it is sensible from many angles to be cautious in a regulated business dealing with consumers and it is certainly not a mindset that will be easily reversed.

We have set out below some of the key remaining barriers as we see them. In regard to the GC itself:

- 5.13 states that if a firm is carrying out a limited advice exercise, but realises that there is a gap elsewhere in the customer's arrangements (e.g. protection), there would be an expectation that the adviser highlights this to the client.

While it is difficult to argue with this logic, firms will remain concerned about the potential for them to be penalised for being seen as not asking the right/sufficient questions to unearth this type of gap even within a limited advice exercise.

While this example of a gap is highlighted, what about if the firm uncovers a client holding an apparently unsuitable investment, which is not directly related to the limited advice exercise it has been asked to carry out? By implication it has an obligation to highlight the need for further investigation to the client. The conversation will rarely stop there. A natural question for clients would be "What would you do?" Clearly the adviser can counsel a wider advice exercise (which will carry attendant costs) or say nothing more. Behavioural science suggests the latter response might be resented by many potential clients and/or seen as an implicit sale recommendation.

We believe further clarification of the responsibilities in this type of situation will be required, as firms will be concerned about potential liability and also other issues such as how this type of situation should be documented, measured and monitored.

- There is confusion among firms about model investment portfolios and the role and responsibilities of a discretionary manager. The inference in the CP is that a model portfolio could be a product, which could be self selected by a client with no obligation on the investment manager to confirm suitability. Is this what is intended? If so it seems to run counter to the importance being placed on suitability elsewhere by the FCA, and is a move opposed by many discretionary managers. It is particularly important that it is clear where the responsibility for implementing changes in model portfolios lies. We believe this an important area given the well-publicised potential new entrants in this area.
- The GC is very clear (3.65) that “the simplified advice process falls into the category of “restricted advice””. However no equivalent clear statement is made about whether limited advice is by definition restricted or can be independent. We understand from conversations that the clear intention is that limited advice – for instance advice on the establishment of an ISA - can be independent advice. We agree with this, and to avoid any doubt we believe it should be clearly stated. It would also be helpful if Table 1 on Page 19 could clearly state whether each type of service is by definition a restricted service or can be provided by independent firms.
- Section 5 includes some useful examples and guidance on when personal recommendations can arise when filtering on a website. Section 3.34 also acknowledges the work that CESR undertook in this area, including how many products are highlighted to the customer at the end of the process. The differences between example D in section 5 (not a personal recommendation) and section E (a personal recommendation) do not appear to take this into account. Under the previous position, which appeared to be advocated by CESR, where a number of investments are presented in a filtering process, notwithstanding the number and depth of questions asked, if the number of investments presented to the client are so numerous as to be non-specific, this will not constitute a personal recommendation of a specific investment. Has the FCA discussed this interpretation with ESMA?

4. Other barriers

Definition of Independence

One area the SBPP has focused on is independence. The FCA is keen to maintain the independent label despite warnings (from the SBPP and many others) that independent status as defined by the FCA is very difficult to achieve. We are pleased that it is intended that limited advice can be independent (see above). The CP is very open that any simplified advice process “...falls into the category of “restricted advice” (3.65). While one can see the logic behind this, it may impact the number of advisers who wish to remain independent as any firm providing simplified advice will have to give up independent status for the business as a whole.

Financial Ombudsman Service (FOS)

The GC acknowledges openly (5.17) firms’ concerns about the FOS’ interpretation of FCA regulatory practice, and that this could be a particular deterrent to establishing new types of services where there is not established regulatory clarity. The concern is that even if firms believe they are acting in accordance with FCA regulations, FOS could interpret issues differently, particularly several years down the road. There is widespread concern that firms are vulnerable to the view taken by individual Ombudsmen i.e. there is not consistency between the judgements reached by individuals. The GC plays down this concern in 5.19-5.21 on the basis that each case is different but no evidence is given to back up this view. There is no doubt that the industry perception – justified or not - is widespread and is deterring the

development of new services, including in areas such as limited advice. It would be helpful if more evidence could be provided to show that the industry view of FOS is indeed misguided.

New businesses

If existing firms are reluctant to innovate, what about new business models from new entrants? There is again a widespread industry perception that there are substantial regulatory barriers to establishing new businesses (eg the time and cost necessary to gain FCA approvals for new firms). At the very least the view is the whole process is time-consuming and therefore impacts the business case for new firms. While not directly relevant to this GC, it would be helpful if the FCA could demonstrate that this perception is incorrect. This could perhaps be done by measuring and publishing the length of time that new firms are taking to get authorised (or existing firms are taking to get new services and products agreed), and showing if it is shorter than industry perception and that it is reducing.

We welcome the introduction of Project Innovate in this regard. The sector is keen to hear how decisions reached on the regulatory implications of e.g. new advice models through Project Innovate will be disseminated, so that in these developing areas other providers can get guidance on what is and what is not within the regulations. For instance some new business models appear to others in the sector to be breaching the rules as they understand them. How does regulatory interpretation emerging in discussion with new technology and business model providers get disseminated (while balancing this with the right of developers of new models to benefit from their innovation)?

In due course it will be helpful to demonstrate how Project Innovate has helped to assist the development of new limited advice models eg via case studies.

5. Other feedback

We believe it would be helpful to settle on one term ie either limited or focused advice.

The other two questions asked in 5.32 are whether it would be helpful if the guidance set out in the GC is codified in the Handbook, and the examples used are included in the Perimeter Guidance section. The answer to both questions is undoubtedly yes. It would also be helpful to firms if eg the guidance on areas such as replacement business in 3.29 (see above) could be highlighted to those who read the original CP.

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