

Consumer Investments Call for Input
Financial Conduct Authority
12 Endeavour Square
London E20 1JN



14th December 2020

Dear Sir/Madam,

PRACTITIONER PANEL RESPONSE TO CONSUMER INVESTMENTS CALL FOR INPUT

The Panel is supportive of the 'Consumer Investments Call for Input' which, together with the FAMR/RDR Review, seeks to get to the heart of the issues in this market. The Panel recognises that this work is being undertaken in pursuit of a more effective, fair and competitive landscape which will deliver better protection and more consistently good outcomes for customers. We support this and wish to emphasise our belief that a fundamental rethink is required. The Panel wishes to raise the following comments for consideration by the FCA.

We have divided our response into two thematic sections. Part 1 focuses on the near-term issues impacting the industry and consumers, which primarily relate to financial loss, scams and the funding model for compensation. Part 2 focuses on the opportunities, both near and longer-term, that exist to build consumer engagement with their investments, the ultimate key to success.

We would be happy to discuss any of these points in more detail.

Kind regards,

[signed]

Tulsi Naidu

Chair, FCA Practitioner Panel

FCA Practitioner Panel response

For reference, the key questions outlined in this call for input are:

1. What more can we do to help the market offer a range of products and services that meet straightforward investment needs?
2. How can we better ensure that those who have the financial resources to accept higher investment risk can do so if they choose, but in a way that ensures they understand the risk they are taking?
3. How can we make it easier for people to understand the risks of investment and the level of regulatory protection afforded to them when they invest?
4. What more can we do to ensure that when people lose money because of an act or omission of a regulated firm, they are appropriately compensated and that it is paid for fairly by those who cause the loss?
5. How can people be better protected from scams?
6. What more can we do to facilitate effective competition and encourage firms to develop innovative products and services which help consumers to invest?

Part 1: Issues to Resolve

The current model for compensating customers for poor advice is broken.

There is no question that customers must receive the right levels of compensation for poor advice they receive and that these must be commensurate with the nature and scale of any harm that has been incurred. The financial services industry must have the right mechanisms in place to ensure this is delivered to them. However, the current model does not link accountability for compensation to the provision of poor advice. This link is vital to drive the right behaviours in providers of advice, incentivising good quality advice and creating financial consequences for those that fail to do this and who, in so doing, bring the industry into disrepute. The model needs to be revised, such that only those who can afford to be accountable for the consequences of poor advice are authorised to provide it, this is particularly important when higher risk investments are concerned. This accountability will also encourage cultural change and create a vital and compelling link between risk and return.

Currently the financial burden of providing compensation falls squarely on the better players in the advice market, who are carrying this burden in multiple ways: through capital requirements, rocketing FSCS levies, higher insurance premiums and higher levels of regulatory expectation and oversight. This is not sustainable. The Panel therefore believes the FCA should revisit the approach to who pays for compensation, such that this is directly linked to the risk profile of business activities conducted. Options may include: 1) adapting FSCS levies, FCA fees and/or firms' capital requirements such that these directly reflect the risk profile of business activities undertaken; 2) resetting how long capital should be retained after exiting the market, to ensure provision for poor advice that may emerge in the future can be compensated for; and 3) requiring more rigorous systems and controls (and the infrastructure to support these), as well as wind-down plans, for those holding permissions for higher risk activities. A model that makes it more difficult for the providers of poor advice to 'walk away' from their liabilities will also have a positive impact on the challenge of 'phoenixing' in this market.

These changes are likely to carry a fundamental consequence for the shape of the consumer investments market and its participants. The FCA must be cognisant of its competition objective and consider this in the context of how changes are implemented. However, the future reputation of the market and incentives to consistently deliver good advice are outcomes that should be prioritised.

A fragmented market does not necessarily lead to better customer outcomes and firms should be expected to hold capital commensurate with the risk they are undertaking.

The advice market is currently fragmented, predominantly made up of small firms and disjointed supply chains. This makes it more difficult to identify those giving poor advice and causing customer harm, especially given the regulator's limited resources. In fact, many smaller participants in the advice market may never have contact with the regulator. Given the extent of customer harm that can be caused, there is a need to think objectively about the structure of the market in place, which enables potential causes of harm to be identified and, ideally, prevented.

This is not to say that the market should be monopolised by a few larger players or that smaller Financial Advice firms do not add value, it is simply to call out that any firm, regardless of their size, should be expected to hold capital commensurate with the risk they are taking. The Panel notes the differences between the consumer investment market and the banking sector, in which this logic is applied. For example, if a bank wished to provide second charge mortgages, it would be expected to hold appropriate levels of capital. The same should be true for firms providing high risk advice such as Defined Benefit Transfers.

At the same time, the needs of most individuals, in relation to retail investments, are fairly similar and straightforward: the need for long term capital accumulation; the need for diversification of risk; income in retirement; and a fair deal. These needs can be met by single multi-asset/multi-manager liquid investment funds or portfolios, often contained within simple, tax-efficient wrappers such as ISAs and personal pensions. There is a case for adapting rules for such investment products, where a lighter regulatory format and lower capital requirements might be applied if consumers are appropriately supported along their journey.

Those designing and distributing unregulated and often high-risk investment products or those conducting scams, are a blight on the UK financial services industry and significantly erode public confidence.

Greater power needs to be given to the relevant regulatory authorities to intervene at an early stage to prevent customer harm, such as taking down advertisements relating to unregulated products, which the FCA believes to be fraudulent or inaccurate.

There is, of course, a place in the industry for high-risk investment products, but more consideration should be given as to whether they are included in the regulatory perimeter and powers to act more swiftly on unregulated high-risk products are needed. Any products or services that remain outside of the regulatory net should no longer be liable for compensation from the FSCS levy. As stated above, the cost of this levy is spiralling out of control and cannot be sustained in its current form. Clearly such a move cannot be made in isolation, customers must be explicitly informed of the risk that they are taking when buying such products or services.

Consumers must therefore also be better educated to help them identify such products and scams for themselves, to prevent harm from materialising in the first place. The Panel supports the work already completed by the FCA to raise awareness of scams through initiatives such as the ScamSmart website and Consumer Harm Campaign. However, further action clearly needs to be taken to continue to raise levels of education and awareness as such campaigns can only go so far. Lessons from other industries could perhaps be drawn upon, which make use of quality or safety marks that the public recognise and look for to make safe, informed decisions. For example, the cigarette market where regulation enforces the use of stark and graphic warnings on all packaging. One could consider applying a similar principle to high-risk investment products whereby standardised warnings are mandated which clearly state the product could result in them losing all of their savings if it fails to perform, as it is not protected by a compensation scheme. Although we recognise such stark warnings can be glossed over if they are not reinforced or explained appropriately, they are one mechanism through which one can seek to gain the consumer's attention.

Part 2 Opportunities to embrace

Regulation must encourage, not discourage, customers from engaging in their finances and allow firms to build relationships of trust, both of which could be facilitated by better access to and use of consumer data.

Evidence across multiple studies shows people are not saving enough for retirement and are limiting the growth potential of the savings they do make by holding these in cash. This shortfall, when combined with ever more complicated retirement decisions and the fact people are living for longer, looks set to cause considerable personal financial challenges for the UK in the years ahead.

The FCA is concerned that the industry is not adequately helping people to make the right decisions when it comes to their personal finances, citing research showing over 50% of people with more than £10,000 of investable wealth being held in cash, as evidence that the market is not helping people to make rational decisions. However, many people do not actively decide to hold cash. Instead the position is a result of the absence of a decision to invest, which research suggests is more likely if they are not engaged. A lack of confidence, borne out of a lack of knowledge, is the big barrier to people engaging with their finances. This shortcoming is not down to a product gap, however. There are a wide range of funds available that can be grouped into solutions such as Multi-Asset Funds or Managed Portfolio services, designed to provide either growth or income and often wrapped in a simple, regulated tax-wrapper like an ISA or a personal pension.

Rather, the challenge is that many people who want help with their finances face barriers to assistance. The current regulatory regime is designed to ensure an individual giving advice, regardless of its materiality, must meet the highest regulatory standards which involve significant costs of doing business and potential long tail liability. While consumer protection is essential there is a legitimate concern that these barriers limit the ability (and willingness) of firms to offer sufficient help relative to the complexity of the customer's needs and wants: Firms can either offer full, holistic advice services with the associated increases in time taken and fees charged (and risks borne); or, they can consciously limit their service and retract from providing helpful guidance for fear of being retrospectively judged to have tipped over the 'regulatory line in the sand' and provided advice. The loser in this construct is the customer.

Regulatory mechanisms for enabling firms to simply be helpful and therefore increase consumer engagement, are badly needed. Engagement is achieved through the development of trust and relationships and is more effective the more personalised it becomes. Through the building of this trust, consumers will be more likely to respond to "prompts" to consider what to do next with their finances or to engage in their finances at key stages in their life, rather than being suspicious of them.

One such opportunity for this lies in the innovative techniques, which are used by online companies to engage with their existing or potential customers using data. The recent MaPS trials have shown the FCA first-hand the power of using nudges and how much more effective they can be when used at the right point in a consumer's journey. There is room for innovation in how data can be used to help nudge people along their journey to engage with investing and regulatory focus should support this.

There are also opportunities to further simplify fee types and disclosures.

The UK has a highly transparent pricing regime due to the elimination of retrocessions, but it is still challenging for the average consumer to understand the price they pay relative to industry averages. Fee types could be standardized across the industry (similar to the way they are in

UCITS fund disclosures) and disclosure requirements enhanced to present the customer with an estimate of how fees incurred compare to unbundled industry averages.

Additional data sources could also be used by regulators to further inform the prevention of customer harm and target risk-based supervision.

The FSCS and PI insurance markets have extensive data sets, which could be mined to inform risk-based regulatory oversight and yet this data is not currently shared. The call for input paper notes that in 2019/20 the FSCS received 14,034 claims about Life Distribution and Investment Intermediation. These totalled £282m and covered the failure of 549 firms, showing that the costs of this class of complaint involved many small firms failing with large redress liabilities. This example could provide valuable insight into the characteristics of the firms that have caused harm or are unable to take responsibility for compensating customers. These insights would enable targeted regulatory scrutiny; used to determine who is granted authorisation; the levies associated with different types of activities; and the risk insurers need to factor into their premiums. The data held by the PI insurance market could provide similarly valuable insight.

The digital revolution, that has provided benefits to consumers in many industries, has yet to firmly embed itself in the provisioning of guidance and advice for consumers. There is an opportunity to create a digitally connected investment industry.

Whilst the work of the Open Banking initiative still requires greater validation, work to date appears to have highlighted some opportunities for connection. If pursued, these could enhance the overall consumer experience, as long as they are supported by strong cyber security and data privacy capabilities across the industry. Firstly, firms could become connected with each other through industry standard interfaces, designed to allow a customer to give permission for one firm to share the digital information with another firm. This would enable the aggregation of customers' financial information to provide robust, up to date guidance and advice.

Secondly, firms could become more digitally connected by automating the transfer of assets between firms. This would decrease cost and enhance the ability of investors to consolidate assets with a preferred provider, putting them in control, reducing complexity and the risk associated with withdrawals and replacement of business elsewhere. Given the often lengthy waiting periods currently experienced by clients and incoming providers in the transfer process, the FCA could consider publishing guidance to investors on how long a transfer should take and also require firms to publish transfer times, whether an average, quickest or longest duration.

Thirdly, in line with comments earlier in this response, permissions could be given to firms to provide behavioural nudges to clients (advised or execution only clients) that prompt them toward better investment outcomes. An example could be clients that are investing a high proportion of their assets in cash. Digital engagement with clients holds the promise of educating clients through well timed interactions that encourage engagement with investments and discourage the inertia that can harm investment outcomes.

We would, as always, be happy to discuss these points with the FCA further in support of our shared aim of delivering positive improvements to the reputation, safety and effectiveness of the UK's consumer investments market.