FCA Smaller Business Practitioner Panel

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and

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Response to the Financial Advice Market Review Call for Input

22nd December 2015

This is a joint response from the FCA Practitioner (PP) and FCA Smaller Business Practitioner (SBPP) Panels to the Call for Input on the Financial Advice Market Review (FAMR)[1]. The Panels are statutory bodies which provide input to the FCA from the industry in order to help it in meeting its statutory and operational objectives in an effective manner. The two Panels operate separately but on this subject they have many common views and have therefore chosen to submit a joint response.

Many of the Panel members have provided input via their own firms, either directly or via trade associations, and two Panel members, Andy Briggs (from the Practitioner Panel) and Robin Keyte (from the Smaller Business Practitioner Panel) are members of the FAMR Expert Panel. This response reflects joint discussion by the Panels and not the individual views of any one particular firm.

General points

The Panels' general view is that although some sectors of the advice market are functioning and sustainable, there is a sector in the middle ground which is not being addressed, and unless changes are made to the regulatory environment, this situation is likely to get worse rather than better. Our main point is that there is a lack of clarity and consistency in regulation in the middle market for advice, which is leading to a restriction in supply. A good outcome of the Review would be that it is clear to the industry how far it can go with advice without overstepping the regulatory boundaries. This applies not only to the FCA but also to the rest of the regulatory family.

It is important to recognise that the regulatory actions taken in respect of mis-selling/similar conduct issues were generally valid and we support the FCA's work here, but this has left firms concluding that the risk/reward trade-off for personal financial planning/advice is unattractive. As a result, inadvertently, regulatory pressure (including fear of sanctions) has driven most potential providers of advice away.

Looking at the future of advice the specific barriers to entry which we focus on in this response are:

- The economics of providing advice
- The issue of liability and whether there should be a longstop
- The balance of consumer versus provider responsibility

[1] https://www.fca.org.uk/your-fca/documents/famr-cfi

Q1: Do people with protected characteristics under the Equalities Act 2010, or any consumers in vulnerable circumstances, have particular needs for financial advice or difficulty finding and obtaining that advice?

It is important to note that neither financial capability nor vulnerability are necessarily related to income or net worth, and that vulnerability is a situation in which consumers may find themselves temporarily or over an extended period of time. Customer needs are as much about live events as they are about income segmentation, and it is important to look at individuals' circumstances, which will be subject to change.

One particular set of vulnerable customers, although not included in the provisions of the Equalities Act, is those who already have problem debts. These are often customers who are seen by the Credit Union sector. The experience of this sector is that such customers often tend to avoid dealing with their debts, making the situation worse, which provides a particular set of challenges for advisers. It is likely that if they do seek advice, it will be from providers such as Citizens Advice.

Q2: Do you have any thoughts on how different forms of financial advice could be categorised and described?

There is a need for a common language around advice. To a certain extent, both the industry and the regulator spend their time trying to squeeze consumers into boxes and label the boxes. A good outcome would be for all organisations to be able to describe their services in a fair and not misleading way and charge as appropriate. The Smaller Business Practitioner Panel has made recommendations for disclosure of advice services, which were referred to in the FCA's Smarter Consumer Communications work[2], in which providers would provide a brief standardised proforma description of their advice services.

Q3: What comments do you have on consumer demand for professional financial advice?

A significant proportion of consumers continue to want and receive professional advice. However, the economics of providing full advice has resulted in an increasing focus by advisers on higher net worth customers. This focus, largely as a result of advisers up-skilling and professionalising their consumer offerings, may have driven consumer perceptions that advice is costly. There may also be less consumer demand for advice due to a lack of clarity about the benefits of receiving advice, which is in part connected to the lack of a common language about the difference between 'advice' and 'guidance' and the restrictions placed on firms that are not providing full advice.

Q4: Do you have any comments or evidence on the demand for advice from sources other than professional financial advisers?

We have anecdotal evidence that customers are experiencing poor advice from insolvency practitioners and that this can be exacerbating their financial difficulties at a time of stress.

Q5: Do you have any comments or evidence on the financial needs for which consumers may seek advice?

No comment

Q6: Is the FCA Consumer Spotlight segmentation model useful for exploring consumers' advice needs?

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[2] Discussion Paper 15/5 Smarter Consumer Communications

Although the Consumer Spotlight segmentation has some practical value, we consider it does not fully capture the dynamics of customers' lifestyles, and the fact that they will move from one segment to another over time. We are also aware that the Money Advice Service is carrying out a segmentation exercise, and it would be helpful if the two bodies were to coordinate in this area to ensure consistency of approach.

Q7: Do you have any observations on the segments and whether any should be the subject of particular focus in the Review?

No comment

Q8: Do you have any comments or evidence on the impact that consumer wealth and income has on demand for advice?

In general, the economics of providing advice are driving firms towards the high net worth market therefore this sector is likely to be better served. The general focus of the advice gap work would be more effectively targeted by concentrating on the mass affluent and lower income sectors.

However, as noted in the response to question 1, capability and vulnerability are not necessarily related to wealth and income. Within the high net worth sector there are consumers - for example those who suddenly have to deal with new financial decisions following bereavement, illness or redundancy - who may be temporarily considered as high net worth customers whereas they would not normally fall into this category. Such customers would need appropriate advice, and it is important that they are able to obtain it.

Q9: Do you have any comments or evidence on why consumers do not seek advice?

At a base level there is a range of behavioural reasons why consumers don't seek advice, such as inertia around making financial provision or a failure to recognise the importance of financial provision. However for consumers that do want to seek advice it is our belief that consumers may not seek advice due to its cost and possibly a lack of trust in the financial services industry in general.

Q10: Do you have any information about the supply of financial advice that we should take into account in our review?

The Panels welcomed the aim of the RDR to improve the professionalism of the advice sector and the fact that this has been achieved. There is, however, a gap in the smaller premium, simpler product market, for a simpler advice qualification than QCF Level 4. In an environment where firms may be operating on tight margins providing low premium products, it can be difficult to incentivise advisers to remain with the firm once fully qualified, when attractive alternatives exist elsewhere. This is a further driver pushing the supply of advice towards the high net worth market. We believe there is scope for investigating a middle ground of lower qualifications for simpler products.

Q11: Do you have any comments or evidence about the recent shift away from sales based on professional advice, and the reasons for this shift?

No comment

Q12: Do you have any comments or evidence about the role of new and emerging technology in delivering advice?

No comment

Q13: Do you have any comments on how we look at the economics of supplying advice?

There are several inter-related factors which affect the supply of financial advice. The length of the overall review process for providing full advice is such that there is a substantial cost involved, which drives such advice up the value chain. The regulator needs to understand more clearly the high cost of operating in the low-income, low premium market, and that the structure of the industry post-RDR does not lend itself to operating in this market. This is a key driver of the advice gap. There is a demand for simple financial products, but it is not economic to provide them to the mass market post-RDR.

Additionally, the financial capability of low income customers can be low (although, importantly, this is not always the case) and their financial issues complex. This can result in a need for lengthy face to face advice and subsequent follow up, which is correspondingly expensive to provide. It is difficult to extend guidance to such customers because of a lack of clarity in the boundaries of regulated advice.

Q14: Do you have any comments on the different ways that firms do or could cover the cost of giving advice (through revenue generation or other means)? Do you have any evidence on the nature and levels of costs and revenues associated with different advice models?

The current high cost of providing advice may increase the potential risk of misconduct in the future, as firms recommend higher cost products/services, and cross-sell as they endeavour to ensure cost (plus) recovery in the medium term. The Retail Distribution Review (RDR) partly mitigates risks here for activity in scope for RDR purposes, as the RDR aims to eliminate incentives for bias; this may change if firms attempt to address demand in lower value segments.

Q15: Which consumer segments are economic to serve given the cost of supplying advice?

Given the fixed costs of complying with regulation, such as meeting qualification standards or carrying out factfinds, it is difficult to provide a sustainable service to the lower premium end of the market, particularly in the case of products where premiums are collected frequently. In order to maintain a sustainable business model, many firms are being driven towards the larger premium high net worth sector. The industry is developing in such a way that relatively few firms can generate sufficient economies of scale to serve the mass affluent or low premium market in the longer term.

Q16: Do you have any comments on the barriers faced by firms providing advice?

There is a general lack of clarity of the boundaries of guidance versus advice, and this is not helped by a lack of a common language to talk about the advice/guidance process, combined with perceived limited scope for restricted advice.

For example, many customers will approach the provider looking for ‘a bit of help’ and may ask ‘what would you do?’. A logical and helpful response would be to be able to say ‘people in your situation often do…’, but currently this type of scenario risks crossing the boundary into regulated advice, with the costs and barriers this entails. The costs apply not only to the providers, but also to the customer, who may not be willing or able to provide the time or information for a full factfind.

A further barrier to providing advice is a fear amongst providers of retrospective action from the regulator. In future, we believe the FCA’s House Views could provide a useful tool to indicate what its thinking was at a given time, in order to give context to any future regulatory decisions. We continue to encourage the FCA to publish its House

Views as we consider they could provide useful planning tools for the industry and a means of working with the regulator.

As it currently stands, the Financial Services Compensation Scheme (FSCS) levy is a barrier to the provision of advice. For smaller firms in particular the cost of the levy, and the substantial recent increases, have a significant impact on the profit margins of their business and make the provision of advice increasingly uneconomic. The structure of the levy is not currently fit for purpose; it is in effect an insurance policy priced without reference to the underlying risk, in that firms must pay for compensation related to products which they would never have recommended to a customer. We have encouraged the FCA to consider this as part of its forthcoming review of the funding of the FSCS.

The lack of clarity and consistency about liability extends beyond the FSCS. There is also an issue with consistency between the Financial Ombudsman Service (FOS) decisions and the views of the FCA. This is compounded by differences in approach from professional indemnity insurers, contributing to an overall lack of clarity for firms about liability in general and liability for advice in particular. (See also response to question 32 on longstop).

Q17: What do you understand to be an advice gap?

and

Q18: To what extent does a lack of demand for advice reflect an advice gap?

and

Q19: Where do you consider there to be advice gaps?

We consider there is a gap in advice between the basic provision of guidance and the full advice sector. The economics of providing full advice are such that advisers are being pushed upmarket in order to be able to meet the regulatory requirements and therefore full advice is becoming the preserve of the higher net worth customer. We do not consider there is a gap in the high net worth market, but for the mass retail market it is increasingly uneconomical to provide advice under the present regime. We do not consider there is an advice gap in the mortgage market, which is mostly intermediated and in which building societies tend to use intermediaries where this is more cost effective.

Q20: Do you have any evidence to support the existence of these gaps?

Q21: Which advice gaps are most important for the Review to address?

and

Q22: Do you agree we should focus our initial work on advice in relation to investing, saving into a pension and taking an income in retirement?

and

Q23: Do you agree we should focus our initial work on consumers with some money but without significant wealth (those with less than £100,000 investible assets or incomes under £50,000)?

As discussed in the answers to questions 1 and 19, it is important to focus on the circumstances of the individual, not necessarily on their income or assets. Although the higher net worth market will tend to be better served, there are those who may find themselves in that sector, either permanently or temporarily, who may be considered vulnerable and who will have specific and different advice needs that are not being currently addressed, either through lack of awareness or financial capability.

There are currently particular issues relating to pensions and the recent regulatory changes and therefore we agree that resource should be spent on specifically addressing the at-retirement market. With the sweeping and regular shifts in government policy towards pensions, and consequent unpredictability for long term financial planning, the underlying need for financial planning advice and education seems higher than ever. Unfortunately the pensions uncertainty does not seem to lend itself to being easily handled by simple/generic advice, as it raises quite complex issues, for example, for financial modelling.

Q24: Are there aspects of the current regulatory framework that could be simplified so that it is better understood and achieves its objectives in a more proportionate manner?

An outcomes-based regulator needs to look at its remit through both a consumer lens and a supplier lens. We have a concern that the current objectives of the FCA appear to be 'protecting the consumer from advice'. Although somewhat outwith the scope of this consultation, an additional objective for the regulator of promoting good financial advice and guidance would provide a better framework for a sustainable regulatory environment.

The advice gap is a problem for the whole regulatory family. An important aspect of the current regulatory framework is the FCA's relationship with other members of the family, including the FOS and FSCS. Lack of coordination with between these bodies is a driver of uncertainty which makes it more difficult to operate in the advice market – an example is the need for harmonisation of assumptions about cash-equivalent transfer values between the FCA and the FOS.

The FCA could be more explicit about how accountable if feels it is for ensuring that gaps in the provision of advice are closed. More specifically, does the objective of avoiding potential industry mis-conduct in respect of financial advice trump an objective of creating the environment through which adequate advice might be more readily forthcoming? Previously the FSA regularly emphasised that it did not believe it should seek a 'zero failure regime[3]'; it is not obvious that FCA now comments in such terms.

Q25: Are there aspects of EU legislation and its implementation in the UK that could potentially be revised to enable the UK advice market to work better?

No comment

Q26: What can be learned from previous initiatives to improve consumer engagement with financial services?

No comment

Q27: Are there any approaches to the regulation of advice in other jurisdictions from which we could learn?

No comment

[3] FSA Annual Report 2002/3 page 96

Q28: What steps can be taken to address behavioural biases that limit consumer engagement without face-to-face advice?

No comment

Q29: To what extent might the different types of safe harbour described above help address the advice gap through the increased incentive to supply advice?

We consider that safe harbours are not necessarily the answer to addressing the advice gap. If the regulatory environment is clear, and firms are aware of what they must do to comply with it at the time, they can and do operate within the boundaries. If they fail to comply with regulations which are clearly articulated, they should be liable for their behaviour. The difficulty arises when there is perceived retrospection, when firms are held liable for behaviours or activity which they believed at the time to be within the rules. Therefore a better solution is not safe harbours, but better clarification of the existing regulations. Any safe harbours would need to consider FOS adjudications that appear to contradict or change the anticipated safe harbours.

Q30: Which areas of the regulatory regime would benefit most from a safe harbour, and what liabilities should a safe harbour address?

No comment

Q31: What steps could be taken to ensure that a safe harbour includes an appropriate level of consumer protection?

No comment

Q32: Do you have evidence that absence of a longstop is leading to an advice gap?

and

Q33: Do you have evidence that the absence of a longstop has led to a competition problem in the advice market e.g. is this leading to barriers to entry and exit for advisory firms?

Unlimited liability is one of the drivers of the gap in supply of advice. It is difficult to make a profit in the mass market when liability for providers of advice is unlimited. The advice market has become liability driven with market participants unwilling to engage in riskier areas of business and looking to assess consumers on their economic worth and likelihood of complaints. Given the relatively low rewards of working with the mass affluent together with the asymmetry of risk and associated costs where advice is found to be wrong, the advice market has sought to focus on higher income/wealthier clients. In addition, in recent years the balance of responsibility has shifted significantly away from the consumer towards the provider of advice, and in the current environment there appears to be no duty of care on customers themselves. There is a cost to this – it will eventually become detrimental to consumers as it is both a barrier to entry and a driver to exit amongst firms and a constraint on the supply of advice in the longer term.

Q34: Do you have any comments about the benefits to consumers of the availability of redress for long-term advice?

No comment

Q35: Do you have any comments or suggestions for an alternative approach in order to achieve an appropriate level of protection for consumers?

No comment

Q36: Do you have any comments on the extent to which firms are able to provide consistent automated advice at low cost? Are you aware of any examples of this, either in the UK or other jurisdictions?

There is room in the market for developing an online advice solution to address the advice gap but to cover all circumstances is prohibitively complex and it does not replace full advice. Simple or restricted advice can be delivered in an automated way, but there is a need for regulatory clarity as it needs to operate in the middle ground where the overlap between advice and guidance occurs. Automated investment processes are more common in continental Europe and these generally operate successfully and give rise to fewer consumer complaints.

Currently much of the IT spend in financial services firms, large as well as small, is focused on regulatory requirements, such as implementing the changes required by MiFID II and Solvency II. This leaves little in the way of resource for innovation – regulatory stability would help firms to develop more innovative solutions. For smaller firms in particular, this is a competition issue in that automated advice solutions have high start-up costs therefore there are barriers to entry for individual small providers who wish to develop them.

Q37: What steps could we take to address any barriers to digital innovation and aid the development of automated advice models?

No comment

Q38: What do you consider to be the main consumer considerations relating to automated advice?

No comment

Q39: What are the main options to address the advice gaps you have identified?

The landscape which needs to be addressed is around the broader issue of guidance, not just regulated advice. Consumers themselves do not generally differentiate between regulated advice and guidance, and tend to use the terms interchangeably. There is currently a clear divide between the full advice process on the one hand and simple guidance on the other. The key issue is that the rules in the area in between, where customers need some personalised direction but not a full factfind, are not clear. Firms are wary of operating in that space, which is where the majority of potential customers are found.

We suggest that the way to address this is to adjust the rules to allow advisers more scope to provide personalised or semi-personalised advice without entering the fully regulated space. Currently, we believe the threshold of full advice is set too low – advisers who are asked for 'a bit of help' cannot give it, beyond the most basic information, without crossing the boundary for full advice.

We suggest that the remedy is to extend the scope of what information can be given to customers in the non-advised space – a form of 'generic plus' advice, such as being able to give examples of what people in a given situation often do, which might include product advice or recommendations of specific actions. The boundaries of this should be clearly articulated, and the rules of the regulatory family, including the FCA, FOS, FSCS and PII insurers, should be clearly aligned. This would give firms more confidence to operate in a market which they are currently wary of serving and give customers the service they need and want.

We suggest there is scope for investigating the level of qualifications required to provide such information, in order to provide a more accessible entry point for such advisers and a more cost-effective service whilst ensuring that customers are adequately served by appropriately qualified people.

Within this construct guidance can include scenarios and "people like you" type discussions; but advice must be post-status disclosure and personalised, albeit offered at 2 levels:

1) a "foundation" version for simple products able to be provided by level 3 qualified advisers;
2) as now – level 4 qualified, full process for more complex scenarios.

Q40: What steps should we take to ensure that competition in the advice markets and related financial services markets is not distorted and works to deliver good consumer outcomes as a result of any proposed changes?

Our view is that competition only appears an issue in the respect that there is lack of appetite for firms to participate in the advice markets, as noted above.

Q41: What steps should we take to ensure that the quality and standard of advice is appropriate as a result of any proposed changes?