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

Dear Sir/Madam, 18 December 2020

Smaller Business Practitioner Panel Response to Call for Input on Consumer Investments

The Panel is pleased to respond to the call for input on Consumer Investments. Rather than respond to each question individually, we have taken the opportunity to comment in a broader basis on the points raised.

The intentions of the paper are well meaning, and this initiative is to be encouraged. However, our concern is that the paper is so broad, touching on every aspect of the consumer investment market. In addition, it is very difficult to address all the points raised without considering it in light of the FAMR follow up work as the issues are intertwined. We also have to acknowledge that there will always be criminals operating in the finance industry who are determined to commit fraud. Increasing the burden of regulation will not address this serious concern, rather it places the burden on firms operating within the regulatory environment who care about corporate governance and have already addressed major regulatory change in recent years.

The key to addressing the issues raised in the paper must be a well-defined, clear regulatory environment where the rules can be easily understood, and the outcomes of transgression are transparent. The creation of this governance culture combined with significant consumer education will enable us to address the shortcomings highlighted in the paper. This approach must go hand in hand with a regime which is "depoliticised"; governments with more short-dated political agendas can significantly influence the market and potentially lead to poor consumer outcomes. This is apparent in areas such as pension freedoms. Unfortunately, we must acknowledge that any change in tax and savings regimes will inevitably lead to disreputable people seeking to exploit the situation whilst the vast majority of compliant and conscientious firms seek to adapt to the change to the very best of their abilities. As I have already mentioned, we need to get better at targeting the criminals and achieving redress for their victims without creating a regulatory burden so great that decent professionals are discouraged from continuing to offer advice and services.

We believe that a step back needs to be taken; much of what can and cannot be done can only really be considered once Brexit negotiations are finalised. At this time, the government and regulator can determine how we can mould our regulatory landscape and potentially address areas where European regulation does not fit in the UK model. Let us remember that the wealth management model in Europe is fundamentally different from that of the UK. It is primarily a Life Insurance and Bank driven model, where the bulk of consumers' wealth is looked after by banks and life insurers (aside from those high net worth individuals who access the private banks). The role of advisers, wealth managers and the products / services available to consumers are therefore extremely different to those in the UK market. The DTC retail market in Europe is not as developed and deep as the UK market, It principally revolves around exchange traded instruments. There is no real concept of financial advisers or discretionary managers in Europe, likewise the tax efficient wrappers and solutions that are

available here. It is therefore important that this is acknowledged by the government and the FCA. Brexit gives us a unique opportunity for the UK regulatory and political leaders to address some of the square peg and round holes of current regulation, whilst acknowledging there are some strong universal cross border regulatory principles that should always prevail. Consumer protection can be improved by regulation that is targeted at the UK market and not generic to Europe as a whole and financial services firms can more easily implement rules that describe their role and services, rather than a model that does not exist locally.

In common with other regulators who have responsibility for market competition there seems to be assumption that because the public doesn't do something the regulator thinks it should, then it's not working well. We see this with Ofgem's dismay that not enough people switch utility accounts and FCA's concerns that not everyone switches a mortgage or ventures out of the safe havens of cash deposits. We would like to see more acknowledgement that perhaps people are happy where they are, for valid reasons. Historically, when some people have ventured out of safe havens (typically on the simplified advice of bancassurers) they have had a bad experience and hence retreat to the safety of cash. This may, however, change as the market is developing new distribution channels and there are increases in financial and technical literacy, accelerated by the Covid-19 crisis.

In addition to more relevant and targeted regulation, a second, crucial, consideration is the role of the FSCS. The fundamental issue that exists in the current market for consumer investments is that the FSCS levy system is not effective. It does not prevent consumer harm and recent huge increases are not a sustainable burden on the industry and have and will drive the good firms out of the market. This overhead, coupled with a PI market that cannot embrace the sector given the uncertainty of regulatory impact on claims, means that we are in danger of a dramatic reduction in consumer choice over the coming decade. These huge costs will create a situation where only the biggest firms can survive and we are left with a handful of huge operators where consumers are a number and not a name. This, in itself, poses systemic risks and could lead to increased consumer harm. It would stifle any real innovation in the market and would potentially lead to a widening advice gap as large firms may be more selective about clients and pricing. Finally, those vulnerable persons that have been the focus of so much regulatory thought recently would suffer most as they are in greatest need of the more personal service and help that the smaller firms provide.

The paper also seems to ignore the difference between investment services (DFMs) and products (one off investments). A piece of summary work that would be useful for the FCA to carry out and provide a one page summary of would be to analyse the UK market by distributer / service / platform / wrapper provider together with the services and products that they offer. This would cover banks and building societies through life companies and advisers, as they are all linked in one way or another. This analysis can provide a valuable insight into how providers and products feed through to the end Consumer and would provide useful information of the whole investment chain and wrappers and source. This would also be useful to educate the Broker and Underwriter section of the insurance market and enable them to identify higher risk areas to consider when undertaking PI.

We would be happy to comment further on any of these points.

Yours faithfully,

[Signed]

Marlene Shiels
Chair, FCA Smaller Business Practitioner Panel

Section Commentary

Making the mass market work well

This area really needs to be looked at in conjunction with the FAMR review follow up work on advice and guidance. With respect to investment products, work was done a number of years ago post Keydata; the regulator intervened to place all structured retail products on hold, and all future launches were forced to effectively template the risk disclosures and marketing format. This has led to a much more transparent offering in the retail space and, in my opinion, a very well disclosed and understood approach. This type of approach could work in the majority of investment products.

Higher Risk Investments

The recent bans on crypto assets are welcomed as benefitting both consumers and the vast majority of investment firms. It is clear, with SEC recent action targeting volatility products, that there are a number of assets that are unsuitable for retail investors. The definition of high net worth and the relevant exemptions are well defined, and we need to ensure that there is an element of consumer responsibility for their actions. So long as an investment product is legal, well defined, clear and not misleading, a consumer who purchases the product must be clearly responsible for the results. The culture of providing regulatory underwriting for consumers who lose money because of their own investment choices must stop. Again, a standardised template as described above may help in implementing rules, helping firms to achieve standards and for consistency for consumers in making choices. We have seen the difficulties caused for consumers when such templates do not exist recently in the implementation of the ex and post ante cost disclosure following MiFID II; a rule supposedly implemented to help clients caused endless confusion because of the variation between the way in which the information was provided by different firms, to say nothing of the difficulties in implementing this in the UK market due to our very different universe of providers, services in products.

In short, we must bear in mind that people often like to speculate on stock markets and cannot claim compensation if the investment drops. This is because all information is standardised on a disclosure perspective so there is no ambiguity. There should be no difference between this situation and that of consumers of financial services.

On the question of how the current high net worth and self-certified sophisticated investor exemptions are working in practice and the level they are set at (Q23), we believe they are used in too wide a range of scenarios – quite relative to venture assets but not to other sectors. They can be prohibitive. For example, for clients interested on community and social investment, typically these are unregulated but are accessible from £250 tranches allowing customers to start at low levels and benefit from social as well as financial dividends. They are therefore far more financially accessible than (though not as liquid as) a traditional collective investment – yet the access to platforms that deal in them leaves clients subject to a 'wall' of text relating to these criteria. Arguably, the current regulation and qualification inhibits the growth of a sector that could deliver real value and real jobs to our local communities.

Scams

It is very important that the FCA work with government to create a legally enforceable system to prevent search engines and social media platforms from hosting scam adverts on their sites as soon as they are notified. This can be achieved through the Online Harms legislation, scheduled to be introduced to Parliament next year. As soon as the FCA is informed of a potential scam, they would then be within their rights to require the search engine to immediately remove it. The same should apply with cloned websites and other sources of potential harm

At a high level, a consumer will generally part money in one of four ways in the financial services space (both points 1) and 2) below may be sold to consumers in direct wrappers or on platforms / exchanges etc):

1) To buy an investment product that offers a potential return over a period of time (advised or non-advised).
2) To give money to a service that makes the investment decisions for them eg discretionary manager where suitability lies with the discretionary manager or the adviser introducing the client to the discretionary manager. The discretionary manager is responsible ensuring that the assets to conform with the relevant Risk profile.
3) To place money in a bank or savings account.
4) To buy an insurance product or similar to underwrite certain personal risks.

We can assume that most potential consumer harm falls into the first category. It is our view that any provider who promotes a product in this arena, regardless of its nature, should be contributing into the FSCS. We also believe that any firm that seeks to participate in activity 1 should require regulatory approval. By requiring regulation and contribution, sales of unregulated high-risk investments will be addressed. In addition, to enhance the product responsibility created by regulation, the SMCR regime could potentially require a named Senior Manager to put their name on any promotion, providing personal accountability. Clearly, to ensure consumers are protected, such an environment would require PI insurance to be available to firms operating in this space.

The FSCS levy is the ultimate catch all for firms at the moment as companies can default liabilities onto the FSCS and then phoenix, creating greater moral hazard as irresponsible firms can take more risks with this backstop. Banning pheonixing outright would help this.

If the FSCS levy only covers regulated activities and these are clearly defined, then firms would be in a better situation. We remain unsure as to how a risk-based levy would really work, although the principle is good. Increased capital requirements for firms will not solve the problem in our view and would lead to a situation where only big firms can operate in the market. We have already described above the highly undesirable consequences of such an outcome for industry professionals and consumers. If the FSCS levy and PI market is operating within a clearly defined field, then this would potentially obviate the need for higher capital requirements. The FoS already only covers activities regulated by the FCA and such a move would mirror their current remit for dealing with customer complaints and losses, creating industry and regulatory consistency.

We make a further strong recommendation that the Treasury commits to using fines that it receives from the finance industry to bail out victims of fraud and lessen the burden on the FSCS's resources. This would help the industry and demonstrate a joined-up approach, additionally having the benefit of increasing the solidarity of financial services firms with the government and regulator against those individuals and companies committing harm. Again, the idea is to have an environment within which the regulator can swiftly remove any fraudulent online promotions and ensure standardisation across promotions provided by regulated persons only. In terms of outcomes, this will mean an educated consumer will know that there is standardisation in promotional literature and he has the protection of knowing that he is dealing with a regulated provider backed by regulatory compensation if that provider breaches regulation or law.

In conclusion, whilst our industry, regulators, governments and consumers have never faced greater challenges, we must balance consumer protection with individual responsibility and also regulate the vast majority of firms with relevant targeted rules, bringing the full weight of the law to bear on the fraudsters operating without care for regulation. We have a unique

opportunity post Brexit to create an environment that works for the structural, advisory and product dynamics of the UK and gives firms clear rules within which they can responsibly operate. Those consumers who suffer harm from investing in regulated products can be supported by the FSCS with financial input from the Treasury for those suffering harm from fraud; but simply because a consumer loses money on an investment we must move away from a culture that automatically blames the adviser. Finally, more must be done to prosecute the fraudsters who could care less about any regulation the FCA might impose and diminish the reputation of our sector daily with their criminal activities. The financial services industry provides a great service to millions every day and we need the support of the regulator to provide rules to guide us and the government to enforce the law against those who would harm consumers.