HM Treasury

FCA
FINANCIAL CONDUCT AUTHORITY

FAMR

Financial Advice Market Review

Call for input

Contents

The Financial Advice Market Review team at the FCA and HM Treasury is asking for comments on this Call for Input by 22 December 2015.

You can send them to us using the form on our website at:
www.fca.org.uk/famr-response

Or in writing to:

FAMR Secretariat
Financial Conduct Authority
25 The North Colonnade
Canary Wharf
London E14 5HS

Email: FAMRSecretariat@fca.org.uk

In responding to this Call for Input, you consent to your response being shared between, and discussed by, the FCA and HM Treasury.

We make all responses to formal consultation available for public inspection unless the respondent requests otherwise. We will not regard a standard confidentiality statement in an email message as a request for non-disclosure.

Despite this, we may be asked to disclose a confidential response under the Freedom of Information Act 2000. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the Information Commissioner and the Information Rights Tribunal.

You can download this Call for Input from our website: www.fca.org.uk. Or contact our order line for paper copies: 0845 608 2372.

Abbreviations used in this document

FAMR	Financial Advice Market Review
FCA	Financial Conduct Authority
FSA	Financial Services Authority
FSCS	Financial Services Compensation Scheme
IFA	Independent Financial Adviser
ISA	Individual Savings Account
MiFID	Markets in Financial Instruments Directive
MMR	Mortgage Market Review
PIF	Personal Investment Firm
PRIIPs	Packaged Retail and Insurance-based Investment Products
RDR	Retail Distribution Review

1. Overview

Introduction

HM Treasury and the Financial Conduct Authority (FCA) announced the Financial Advice Market Review (FAMR) on 3 August 2015 to look at how financial advice could work better for consumers. The Review has a wide scope and aims to look across the financial services market to improve the availability of advice to people, particularly those who do not have significant wealth or income.

We recognise that not everyone wants or needs professional, face-to-face advice and we are aware that advances in technology, particularly the increasing availability of online services, are leading to changes in how people seek advice for their financial planning. In this paper we do not focus solely on services that would meet the regulatory definition of advice but instead use the word 'advice' to capture a wide range of provision of services offering support to consumers.

Consumer engagement with financial services is essential but some people may struggle to find the right support, at the right time, to help them make decisions. People face increasingly complex choices and need the right help to make financial decisions. Some of the main issues facing people at present include:

- increasing complexity in financial services products and how they are described
- increasing choice of products, product features and distribution methods
- increasing levels of debt in some consumer segments
- the impact of technology on how people engage with financial services products and services
- increased flexibility in how people are able to draw money from pension schemes at retirement, and
- changes to demographics, leading to an ageing population and the need to consider issues such as long-term care

In this context, the Review aims to consider:

- the extent and causes of the advice gap for those people who do not have significant wealth or income
- the regulatory or other barriers firms may face in giving advice and how to overcome them
- how to give firms the regulatory clarity and create the right environment for them to innovate and grow

- the opportunities and challenges presented by new and emerging technologies to provide cost-effective, efficient and user-friendly advice services, and
- how to encourage a healthy demand side for financial advice, including addressing barriers which put consumers off seeking advice

Alongside this consultation, the Government will publish a consultation on publicly-funded guidance, such as the Money Advice Service. This will consider how the Government should structure the provision of free, impartial guidance, including that given by the Money Advice Service and Pension Wise, to give consumers the information they need, either to make financial decisions directly or to seek the right additional advice to help them do so. The two Reviews will provide a complementary and comprehensive analysis of the advice landscape.

Where the market for financial advice is working well we expect to see consumers able to obtain the form of advice that best meets their needs, with firms offering them competitive prices, good quality, choice and innovation. Currently not all consumers may be able to find the form of advice that they want on a need they have, at a price they are prepared to pay but, in the context of increasingly complex financial choices, the aspiration must be to maximise the number who are able to do so.

There are a number of reasons why advice gaps may exist. There are barriers to people seeking advice; including, but not limited to, the cost of taking advice, lack of trust and lack of knowledge. There are also barriers to firms providing advice; including costs in searching for and providing products that meet consumers' needs, regulatory costs, ongoing liability for sub-standard advice and potential lack of clarity about regulatory expectations.

We want to focus the Review on situations where we can make the greatest difference in terms of meeting needs for advice and for those products and people where advice can have the greatest positive impact. This will mean focusing our attention on those areas where the complexity of decision making is greatest and advice could make the biggest difference. It will also mean focusing on those consumer segments where people may lack the means to afford traditional, face-to-face advice.

This paper is a call for input, asking readers to contribute their thoughts and evidence on the above matters. We welcome views from readers on the areas that they consider most relevant, but responses do not need to address all of the questions that we pose.

Equality and diversity considerations

This Review will consider whether there are particular difficulties in relation to advice for consumers in vulnerable circumstances.[1]

We will consider if there any groups of people with protected characteristics under the Equality Act 2010 that face particular difficulties in accessing financial advice. The protected characteristics relate to, in alphabetical order: age, disability, gender reassignment, marriage and civil partnership, pregnancy and maternity, race, religion or belief, sex, and sexual orientation.

1 See, for instance, FCA, Occasional Paper no. 8, Consumer vulnerability, February 2015: http://www.fca.org.uk/static/documents/occasional-papers/occasional-paper-8.pdf

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?

Next steps

We want to know your thoughts. Please send us your comments by 22 December 2015. To submit a response, please use the online response form on the FCA's website or write to us at the address on page 2.

Following consideration of this feedback, we will publish recommendations in time for Budget 2016.

2.
What do consumers need and want from financial advice?

In this chapter we consider some of the financial needs that drive consumer demand for financial advice and how these might vary according to different consumer groups.

The demand for advice

When consumers take advice it is a step towards addressing a financial need. Therefore consumers are more likely to focus on the end goal of a good financial outcome rather than the intermediate service of advice itself. Advice is also something that by its nature is often difficult for consumers to assess in terms of quality and value, both before and after purchase. Indeed the value of financial advice may not be apparent for many years after it is given, if at all.

People seek different types of support to help in their financial planning decisions. Consumers' needs fall on a broad spectrum, from needing basic information about products through to complex financial planning encompassing all their assets and liabilities.

The terms that have been developed to describe advice within the regulatory landscape (as set out in the Appendix, including labels like focused advice and basic advice, and the distinction between 'guidance' and 'advice') are not always consistent with people's understanding of what advice is. We welcome views on whether we should seek new ways for firms and parties to communicate with consumers about the different forms of financial advice available.

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

Professional advice

Professional advice includes regulated advice which a firm or individual is generally paid to provide. Mintel research indicates that consumers are more likely to seek professional advice for more complex products and when the decision might have a greater impact on their wealth.[2] When asked about areas in which they might need professional advice in the future, the top three responses were: savings and investments (30%), pensions and retirement planning (30%) and

2 Mintel, *Consumers and Financial Advice*, UK, May 2015

mortgages (26%). In comparison, only 11% of respondents expected to need professional advice for life/protection insurance, and 12% for general insurance.

A report by NMG Consulting also shows that consumers are more likely to seek professional advice for more complex needs.[3] For example, their research indicated that consumers are more likely to seek professional advice about starting a pension or retiring, while professional advice was rarely perceived as necessary in case of saving for a 'rainy day'.

The size of an investment is another relevant factor, with a majority of respondents stating they would seek professional advice for an investment above £50,000, but lower proportions when the investment amount is lower. See the section on consumer segmentation later in this chapter for further discussion on how different consumer characteristics affect the demand for advice.

Some consumers clearly place a high value on professional advice and are willing to pay fees for expert advice available from financial advisers. However, for less affluent consumers, even if such advice could be of real benefit, it may be unaffordable or be perceived to be poor value for money.

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

Other forms of advice

Simpler investment decisions may still require support obtained through other advice channels (e.g. advice that falls short of being regulated advice, information from public sources, or price comparison websites). So, for example, while the research quoted above shows that consumers are unlikely to demand professional advice on general insurance, a Mintel report shows that price comparison websites are the most common single source of information for car and home insurance purchases.[4]

While for general insurance products, online research might be sufficient for some consumers, it should be noted that in most cases consumers prefer to seek information from a variety of sources, and the sources preferred depend on the nature of the product. For example, individuals buying car insurance used sources such as price comparison websites (69%), product provider websites (26%), phone calls with providers (23%), and other online resources (20%). For comparison, individuals buying a mortgage reported consulting professional financial advisers (39%), speaking to bank/building society branch staff (31%), consulting price comparison websites (26%), reading material on product provider websites (19%), and speaking to providers over the phone (19%), as well as several other sources.

Some consumers make at least some of their financial decisions independently, using generic advice or using publicly-available information. This includes experienced consumers, as well as some who may be overconfident when it comes to making a financial decision. An NMG Consulting report shows that the primary reasons for people not taking professional advice in relation to investments were the desire to remain in control of their investments (18%), feeling as competent as an adviser (17%), completing an activity simple enough not to warrant seeking professional advice (14%), and not being willing to pay an adviser fee (14%)[5]. This data is supported by the Mintel report, which argues that the observed (marginal) shift towards channels that do not offer a personal recommendation could be explained by consumers wanting to stay in control of their investments and believing they were as capable as an investment adviser.

3 NMG Consulting, *Impact of the Retail Distribution Review on consumer interaction with the retail investment market*, 2014: http://www.fca.org.uk/static/documents/research/impact-of-rdr-consumer-interaction-retail-investments-market.pdf

4 Mintel, *Financial Services: the path to purchase*, UK, June 2015

5 NMG Consulting, *Impact of the Retail Distribution Review on consumer interaction with the retail investment market*, 2014: http://www.fca.org.uk/static/documents/research/impact-of-rdr-consumer-interaction-retail-investments-market.pdf

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

Do different consumers have different needs for advice?

Different consumers have different financial needs according to, among other factors, their stage in life, financial sophistication, income, debts and wealth.

In some cases, consumers will have only one or two specific needs to consider at one time. In other cases, they may wish to review their entire financial situation. Advice is likely to be more complex the more interactions there are between different needs.

Common financial issues for which consumers may need advice, in order of complexity and the potential risks to consumers arising from making a mistake, are set out in the box below:

Less complex

- Saving for short term needs
- Insuring valuable assets, such as a home or car
- Protecting against misfortune, such as death, disability or sickness
- Taking out an unsecured loan (e.g. to finance the purchase of a car)
- Financing a house purchase
- Saving into a pension for retirement
- Investing to meet other medium and long-term needs
- Coping with debts
- Saving for retirement
- Using pensions, savings, investments or home equity to provide an income in retirement

More complex

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

Consumer segmentation

The FCA uses a consumer segmentation model, called the Consumer Spotlight, in its work.[6] This model examines how people deal with money and financial services, with a focus on the capabilities and potential vulnerabilities of different groups. The model informs the FCA's ongoing work looking at the potential impact of emerging risks. We propose to use this model as the basis of the Review's work on consumer segmentation.

6 The Consumer Spotlight is the result of a specially commissioned survey of over 4,000 people across the UK. This has been combined with other large data resources to produce a detailed view of attitudes, behaviour and capability in dealing with financial matters. All data refers to 2013.

The segments are as follows:[7]

Starting out	Slightly below average income but technologically advanced with a high level of education. Mostly under 45, single, without children. Almost all are renting. Approximately 5m people in the UK adult population.
Living for now	Low incomes, with most working or studying. Confident using the internet but less confident about financial matters – although they will take more risks than average. Approximately 8m people in the UK adult population.
Hard pressed	Low incomes, with many struggling with everyday expenses. Many have no savings or investments, and are not confident with financial decisions. Approximately 6m people in the UK adult population.
Striving and supporting	Mostly in work, with low incomes. More than half have dependent children. Risk averse, but can struggle with bills or fall behind with payments. Approximately 6m people in the UK adult population.
Stretched but resourceful	Likely to own their home, many have savings, investments and pensions. Half have children at home. Confident about financial matters, but time-poor. Approximately 7m people in the UK adult population.
Busy achievers	High household income, with mortgages, pensions and some savings. In work, with children at home. Can access information and services easily but time is very limited. Approximately 3m people in the UK adult population.
Affluent and ambitious	Mostly aged between 35 and 60, with high incomes. Most own their homes and work full-time. Highly educated and financially confident. Approximately 4m people in the UK adult population.
Mature and savvy	Confident and well informed about financial services, with higher incomes and savings than average, and most in full-time work. Approximately 2m people in the UK adult population.
Retired on a budget	Mostly over 65, careful with their money, staying loyal to providers. Limited access to services and information. Approximately 4m people in the UK adult population.
Retired with resources	Mostly retired homeowners. Risk averse and rarely in debt, with high savings and a range of financial products. Well informed on financial matters, preferring traditional channels. Approximately 7m people in the UK adult population.

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

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

Consumer income and wealth

The central differences among different consumer groups relate to their level of income or wealth. For example in relation to investments, the net monetary benefit of professional advice is likely to be greater for those with higher levels of wealth or income, as the cost of advice is lower relative

7 Detailed information on the characteristics and numbers in each segment may be found here: https://www.fca-consumer-spotlight.org.uk/explore-segments#na

to their level of investments. By contrast, more expensive types of advice may not be cost effective for those with lower amounts to invest.

Data from a 2013 Bank of England survey shows the total pre-tax annual household income distribution as follows:[8]

Household total annual income before tax	Proportion of population
Up to £6,499	2%
£6,500 - £9,499	2%
£9,500 - £13,499	6%
£13,500 - £17,499	7%
£17,500 - £29,999	30%
£30,000 - £49,999	31%
Over £50,000	20%
Don't know/prefer not to state	2%

The following table, also drawn from the Bank of England data, shows household wealth held in savings and investments (excluding pensions) distributed across the population as follows:

Household wealth held in savings and investments	Proportion of population[9]
No savings/investments	20%
£1 - £4,999	25%
£5,000 - £9,9999	8%
£10,000 - £24,999	11%
£25,000 - £49,999	7%
£50,000 - £99,999	6%
£100,000 - 149,999	3%
Over £150,000	6%
Don't know/prefer not to state	13%

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

What stops people seeking advice?

There are a number of factors that prevent many people from seeking advice. These are likely to be particularly significant in relation to professional advice. They include:

8 Bank of England, *The financial position of British households, evidence from the 2013 NMG Consulting survey*, Q4 2013: http://www.bankofengland.co.uk/publications/Documents/quarterlybulletin/2013/qb130406.pdf and http://www.google.co.uk/url?sa=t&rct=j&q=&esrc=s&frm=1&source=web&cd=1&cad=rja&uact=8&ved=0CB0QFjAAahUKEwjgyaOj-ZnIAhUBHhQKHfihBL8&url=http%3A%2F%2Fwww.bankofengland.co.uk%2Fpublications%2FDocuments%2Fquarterlybulletin%2F2013%2Fnmgsurvey2013.xls&usg=AFQjCNESPDN9asMyE2DEn5n3P9sAGCXuQQ

9 Note that the sum of the categories may not add up to 100% due to rounding

- **Price** – consumers may view the price for advice, particularly for professional, face-to-face advice, to be too high. A survey by unbiased.co.uk found that consumers are paying an average hourly rate of £150 for professional, regulated advice (though this represents a 14% drop compared to 2013)[10]. Some consumers may also find it hard to judge the value of advice because the benefits are usually deferred over time and more intangible than for purchases of non-financial products.

- **Lack of trust** – consumers may not trust firms in the financial services market to act in their best interests, or be able to identify which firms are trustworthy and could provide valuable service.

- **Lack of knowledge** – consumers might not recognise the need for advice or be aware of it. They also may not understand how to obtain it. As many people engage only infrequently in the market this is not an area where people can easily gain experience to inform future decisions. In addition, consumers may lack confidence about the process, feel embarrassed about their lack of knowledge or concerned they may be judged for previous decisions – this may cause consumers to make non-advised financial decisions with poor outcomes. For example, the Mintel report shows that there might be a sizeable group of consumers who lack a basic understanding of what professional advice involves and how to obtain it. Of the consumers surveyed, 44% believe it is too complicated to understand how financial services firms can help them manage their finances, and 34% do not believe that professional advice is geared towards them. Moreover, 14% of consumers said they would not know where to begin looking for a financial adviser.

- **Engagement** – consumers who are disengaged with financial services generally are unlikely to engage with the process of seeking advice. Others may not recognise the complexity of their financial needs; e.g. longevity, tax, long-term care, benefits and investment returns may be relevant to a decision about retirement planning. Still others may feel they need financial advice but never be prompted sufficiently to seek it.

- **Overconfidence** – some consumers might believe they are as competent as a professional adviser even though they could benefit from using one. As a result, consumers might not seek professional advice or, if they do, not follow the advice.

- **Access to face-to-face advice** – depending on their location, some consumers may not have easy access to advisers, and others may not wish to make the time to meet with an adviser.

- **Access to the internet and concerns with sharing data online** – where advice is available via the internet (for example in the form of information, generic advice or an automated online advice service), lack of ability to use such channels and tools may prevent some consumers from getting advice in this way. Consumers may also have concerns about sharing sensitive personal data online.

- **Advice not necessary** – consumers may make a rational and reasonable decision that they do not need advice and are capable of making a decision themselves. This could be the case, for example, where the situation and options are simple and the risk is low, or where the effort or cost of seeking advice is disproportionate to the benefits.

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

10 Unbiased.co.uk, unbiased.co.uk reveals hourly fees for financial advice have decreased by 14% over the last year, November 2014: https://business.unbiased.co.uk/press-releases/unbiased-co-uk-reveals-hourly-fees-for-financial-advice-have-decreased-by-14-over-the-last-year-10-11-2014

3.
Where are the advice gaps?

In this chapter we ask for your thoughts on the gaps between the levels of advice that are currently available and what consumers need from advice.

The supply of financial advice

As explained earlier, we are considering a broad spectrum of advice services as set out in the box below.

Tailored/ personalised

- Holistic or focused face-to-face professional advice
- Professional financial advice delivered remotely (e.g. online)
- Generic advice which falls short of regulated professional advice but nevertheless helps consumers make better financial decisions
- Tools to facilitate financial decision-making, such as online tools and calculators
- Relevant information

Generic/ non-personalised

Traditionally, sales and distribution of retail financial products in the UK has been associated with professional and, often, face-to-face advice. For example, in 2007, two-thirds of retail investment products were sold with professional advice. This conjunction of professional advice and product sales is also a feature in other countries.

However, in recent years we have seen a decline in the number of financial advisers offering professional advice (from around 26,000 in 2011 to 24,000 in 2014). A number of major providers have cut back their professional advisory businesses, or left the market.

In addition it appears that a number of those firms offering advice are focusing more on wealthier customers rather than the mass market.

We have also seen a trend away from the provision of professional advice, toward consumers making purchasing decisions based on information and generic advice. The FCA's product sales data suggests that the proportion of retail investment products (which includes pensions, retirement income products, and investments) sold without advice has increased from around 40% in 2011/12 to around two thirds in 2014/15. There may be a number of factors behind these trends including:

- technological developments, such as availability of online support tools and information for decision-making and purchasing financial products
- people feeling more confident making their own decisions
- lack of trust from consumers in professional advisers
- an increase in regulatory and other costs in the provision of advice, including higher standards of qualification for financial advisers
- the continuing cost of paying redress to consumers where poor advice has been given in the past (directly and indirectly in costs of business through regulatory fees such as FSCS funding)
- transparency of the cost of advice to consumers following the RDR (as opposed to less visible costs in the form of commission), resulting in a reduction in demand for professional advice

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

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?

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

The economics of supplying advice

Understanding firms' economic incentives to provide advice is critical to establishing the causes of any barriers that firms may face and identifying practical solutions to overcome them. We want to understand the different business models for providing advice in terms of the factors that affect cost and revenues. We also want to understand how costs and revenues are affected by technology. In particular

- **What does it cost to provide advice?** The cost of providing advice can influence firms' economic incentives very strongly. Costs will vary significantly depending on how complex and personalised the advice is. The need to earn a direct return from the service will also vary. Some of the categories of cost include expenditure on marketing to attract customers; direct costs, such as staff training and the preparation and delivery of advice by financial advisers and support staff; cost of technology; direct regulatory costs, including compliance costs; and indirect regulatory costs, such as potential costs of future liability claims. Often the scale of the business can influence costs too – e.g. where a technology that may be costly to build can be delivered to consumers more cost-effectively on a larger scale. Some providers may be able to leverage fixed costs (e.g. in their branch networks) to enable advice to be delivered at lower marginal cost. The structure and level of these costs will have a direct impact on firms' incentives to provide advice.

- **What are the sources of revenue from providing advice?** Revenues need to be sufficient to meet the costs of supplying advice. It may be the case that for some business models, the cost of serving some customers, for example those with lower incomes or assets, is not met by the potential revenues from supplying the advice and/or selling products to those customers. We are aware that some advisers set thresholds for the minimum income or assets a customer needs to have. However some advisers may find ways of cross subsidising the cost of some types of advice between clients which may enable them to serve a wider range of customers. Others may have generated additional revenue streams on top of the fees from providing advice to clients.

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

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

Barriers to firms providing advice

There are a number of factors that may dissuade firms from providing advice, particularly in relation to professional advice, where a number of firms have left the market in recent years.

- **Establishing reputation and trust** – as noted in Chapter 2, consumers may lack trust in the financial services industry and it takes time for firms to establish a brand presence, and to build a trustworthy reputation.

- **Finding consumers** – with consumers finding it difficult to engage in the market and lacking knowledge of financial services, it may be challenging for firms to identify new consumers at the point at which they need advice.

- **Regulatory clarity** – when providing advice, particularly professional advice, firms need to consider the requirements of individual consumers. This involves a degree of judgement. Attempts have been made by the FCA to assist firms with guidance to help them understand their regulatory responsibilities, for instance on the boundary between regulated financial advice and non-regulated advice.[11] We recognise, however, that the legal framework is complex.

- **Business costs** – the costs involved in providing advice, including technology costs, staff training and achievement of qualifications, and adviser salaries, may be a barrier.

11 FCA, FG15/1, Retail investment advice: clarifying the boundaries and exploring the barriers to market development, January 2015: http://www.fca.org.uk/static/documents/finalised-guidance/fg15-01.pdf

- **The regulatory cost of providing advice** – costs arising as a result of complying with regulatory requirements may be a concern to firms. The Association of Professional Financial Advisers has published survey results on the cost of regulation. Their June 2014 report found that smaller firms are spending, on average, 12% of their income on direct and indirect regulatory costs. Of this, 3% is spent on direct fees and levies (including for the FCA, FOS, FSCS, and the Money Advice Service), and 9% on indirect costs (such as compliance checking, regulatory reporting, management time dedicated to regulatory issues, and insurance).[12] However, for the smallest firms the percentage increases to around 20% of revenue, with indirect costs accounting for 16%. Direct regulatory costs include the cost of funding the FSCS, whereby firms face the uncertainty of costs which vary depending on the level of poor advice given by others in the sector (and therefore the number of compensation claims against other firms) and the number of firms going out of business.

- **Lack of profitability** – advice for some types of business or in relation to smaller investment sums may not yield sufficient revenue to be worthwhile. Firms may adopt different business models to ensure supplying advice is viable and profitable (e.g. supplying low cost/ low margin advice to a large number of customers), but there may be limits to what is feasible.

- **Liability** – firms may be liable to pay redress in relation to advice that falls below the standards expected, where that failure leads to consumer losses. For example, advisers may be liable if they do not take reasonable steps to ensure that a personal recommendation is suitable for their client or do not act honestly, fairly and professionally in the best interests of clients. Advisers may also be liable under the common law where they act negligently (for example, do not exercise the expected standard of skill and care) or act in breach of any contractual duty to advise.

  The Financial Ombudsman Service considers consumer complaints which firms have not been able to resolve themselves. Use of the Financial Ombudsman Service is free for consumers and its determinations are binding on firms. Under the general law, defendants to a professional negligence claim can normally rely on a limitation defence if it is brought more than 15 years from the accrual of the cause of action. In contrast, although there are time limits for referring complaints to the Financial Ombudsman Service (subject to certain exceptions), there is no ultimate 'longstop' after which a complaint would be dismissed if the firm objected to the Ombudsman considering it.

  The FCA has received feedback from industry in the past that the various routes by which they might be held liable to consumers for advice given add to the costs of advising (due in part to the need for proper professional indemnity insurance), and may act as a disincentive to new firms entering the market.

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

What is an advice gap?

Different commentators offer different definitions of what constitutes an advice gap. As a starting point for the Review, we suggest that the advice gap should be regarded as any situation where

12 Association of Professional Financial Advisers, The cost of regulation 2013 report, June 2014: http://www.apfa.net/documents/publications/apfa-cost-of-regulation-june-2014.pdf

consumers cannot get the form of advice that they want on a need they have, at a price they are prepared to pay.[13]

The advice gap may also include areas where consumer demand is low because the long-term benefits of advice may not be fully appreciated. However, we would not expect this to include situations where there is no real need for advice, for instance when a consumer has the appropriate knowledge to take decisions without assistance, or when the decisions they need to take are not complex.

Note that we do not intend to consider the savings gap – i.e. the gap between what people are saving and what they should be saving in order to meet their goals – directly as part of this Review. There may however be a relationship between an advice gap and a savings gap insofar as advice may also serve as a prompt for people to save. We welcome any evidence on this point.

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

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

Where are the advice gaps?

Our preliminary view is that the market works better for some consumer segments and some types of advice than others. As a starting point, based on the data in Chapter 2, we believe that:

- certain sectors of the market appear to be working well and to show no signs of a significant advice gap:
  - given the availability of high street bank and building society branches and phone and internet access to savings accounts, we think there is less chance of an advice gap existing in the deposit market
  - most retail general insurance is sold direct by providers or via online comparison platforms and brokers. There seems to be little demand for additional sources of advice
  - as credit products are available via bank and building society branches, online and over the phone, we do not believe there is a significant advice gap with the important exception of advice when debts become unmanageable. Access to advice in these cases is crucial and the separate public financial guidance consultation will consider this area.
  - property is the principal way of accumulating and holding assets for a large majority of UK consumers, thus appropriate access to mortgage advice is important. Under the FCA mortgage regime the great majority of consumers now receive advice, so we do not consider there to be an advice gap in this sector[14]
- wealthier consumer groups and those with complex needs are more likely to seek and to be able to afford professional advice

13 Recall that we use a broad definition of advice in the Review, so examples of advice gaps include consumers who want information, generic advice or professional advice to help them address a specific financial need and cannot get it or are not willing to pay for it.

14 The impact of the provision of advice on competition in the mortgage sector is being separately considered as part of the FCA's ongoing Call for Inputs on the Competiton in the Mortgage Sector: https://www.fca.org.uk/news/call-for-inputs-competition-mortgage-sector.
We will use any relevant intelligence gathered through this exercise to inform our work.

- people who have some existing savings but not significant wealth are less well served at present. Retirement income is one area where there is an obvious need in the light of the pension reforms, and where some people may be facing a complex financial decision without being able to access appropriate professional advice or without recognising the benefit of seeking such advice

In this review we aim to identify and prioritise where advice gaps exist for the different consumer needs by consumer segment. An illustrative framework is set out below. We welcome input as to where the most important advice gaps are on this 'heat-map'.

	Taking an income in retirement (including through equity release)	Saving into a pension	Saving for short-term needs	Taking out credit and managing debt	Investing	Getting retail general insurance cover	Getting life insurance and protection cover	Taking out a mortgage
Starting out								
Living for now								
Hard pressed								
Striving and supporting								
Stretched but resourceful								
Busy achievers								
Affluent and ambitious								
Mature and savvy								
Retired on a budget								
Retired with resources								

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

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?

Where we plan to focus our work

We propose to focus initially on advice in relation to investing, saving into a pension and taking an income in retirement. These appear to be the sectors where consumers could benefit most from increased access to advice. We will focus on consumers with some money but without large wealth. We invite feedback as to whether these are the right areas for our focus or if more should be done to assist consumers in other sectors.

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?

Q23: Do you agree we should focus our initial work on consumers with some money but without significant wealth? What exact income/wealth thresholds should we use to determine which consumers we will focus on?

4.
What options are there to close the advice gap?

In this chapter we summarise the regulatory framework and some previous attempts to increase consumer engagement, and then ask for thoughts on options that could help to address the advice gap.

The regulation of advice

Much of the regulation of advice is drawn from EU legislation. National regulators, like the FCA, may not impose lighter standards than are required by EU law. In some areas, equivalent standards have been applied to matters that are not covered by EU law on the basis that, for example, it is easier for firms to deal with one set of regulatory standards.

EU legislation defines how several very important aspects of the advice market can work in the UK. Specifically, EU legislation contains conduct requirements for firms that have a substantial impact on the UK market including:

- Obligations on firms to act in the best interests of clients
- Standards to ensure personal recommendations are suitable for clients
- Obligations for firms to ensure communications with clients are 'fair, clear and not misleading'
- rules on how firms communicate and disclose important information about their products and services to clients
- Conditions on what third party inducements (including fees and commissions) firms can pay and accept and the circumstances in which they are able to do so.

In some instances, EU legislation is currently under review by the European Commission and the Review may consider recommending representations be made by the appropriate authorities to the European institutions in respect of those obligations, if appropriate. We are also aware that the European Commission has recently proposed, as part of its Action Plan on Building a Capital Markets Union, a comprehensive assessment of the European investment markets – including the advice sector – and we will seek to work with the Commission on this work, drawing on the findings of our own Review.

We invite input on whether there are aspects of either domestic or EU legislation that could be changed to enable the UK advice market to work better. We will use this input to inform our responses to the EU's upcoming Green Paper on competition in cross-border retail financial services and insurance. We expect that the main recommendations of the Review will not be dependent on changes to the EU legislative framework. However, if significant opportunities for improvements to the UK advice market through changes in EU law are identified, the Review may consider recommending that UK authorities seek those changes.

The provision of certain kinds of financial advice on certain products in the UK is a regulated activity and only those firms authorised to do so by the FCA (or another EU regulator) may provide such advice. The rules relating to the provision of different kinds of regulated advice differ depending on the financial product and service.

In general, where a firm provides a personal recommendation to a client in the UK, it must take reasonable steps to ensure that its recommendation is suitable for its client. If a firm fails to meet this obligation and provides unsuitable advice and a consumer suffers financial harm as a result, the consumer may complain and seek redress. As a rule of thumb, the firm should put the client back into the position they should have been in had they not provided the unsuitable advice. If the client is dissatisfied with how the firm has dealt with the complaint, the client may be able to refer the complaint to the Financial Ombudsman Service.

If the firm has gone out of business, the consumer may be able to seek compensation from the Financial Services Compensation Scheme (FSCS) – or another EU scheme if the adviser is authorised elsewhere and their home state compensation scheme covers unsuitable advice[15]. The cost of compensation paid by the FSCS is paid from levies on authorised financial services firms.

The FCA's Retail Distribution Review (2012) changed a number of aspects of the way financial advice is provided in the UK for retail investment products, setting new standards for professional standards, independence and remuneration. See the Appendix for more detail on the regulatory framework.

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?

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?

Previous initiatives to improve consumer engagement

Previous initiatives have aimed to encourage increased participation in financial services by people on low-to-medium incomes and with little experience of the sector and limited existing provision. Notably there have been attempts to introduce straightforward products at low prices, to be supported by simplified advice requirements.

Simple products and basic advice

A number of 'simple product' initiatives have been operated in the past in the UK, including:

- CAT standard ISAs (which meet certain criteria in relation to charges, access and terms) that aim to offer reasonable returns, and
- special rules for the provision of 'basic advice' in relation to stakeholder products (such as stakeholder pension schemes, certain deposit accounts and child trust funds)

15 In some cases the FSCS can provide compensation if an EEA authorised firms carries on business from an establishment in the UK.

Most analyses of these 'simple product' initiatives characterise them as having failed to create the anticipated increase in engagement or advice provision, particularly in the main target markets.[16]

Consumers did not have the knowledge, confidence or enthusiasm to seek out simple products on their own initiative, meaning that potential levels of business were insufficient to encourage providers to offer such products. The combination of relatively low charges, free movement in and out of products without penalty and the relatively low amounts invested by many users, meant there was little incentive for firms to invest in the sales and distribution of these products. In particular, the low fee cap on stakeholder products was seen as incompatible with the provision of professional advice.

While these 'simple product' initiatives did help many people, they are not considered to have been as successful as might have been hoped. We would be interested in your thoughts on why these initiatives did not succeed as fully as they might have done, to help ensure that our work can learn from them.

International experience

We are also keen to hear examples of best practice for bridging advice gaps in other jurisdictions. We are particularly interested to hear about international experience in:

- fostering an environment where technology-based advice models can be effectively developed;
- finding ways to deliver high quality advice at an affordable cost to consumers with modest sums to invest; and
- finding an appropriate balance between protecting consumers interests and preserving the economic incentive for the industry to deliver advice.

Below we include three examples of varying approaches to advice regulation internationally. These are provided by way of comparison for illustrative purposes only, as we have not assessed their effectiveness. At this stage we are interested in views on whether we could learn from any of these or other examples.

16 *Literature Review on Lessons Learned from Previous 'Simple Products' Initiatives*, Professor James F Devlin: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/81571/lessons_learned_from_simple_products_initiatives.pdf

International Example A) Australia

Australia introduced the Future of Financial Advice (FOFA) regulation in 2012-2013.

The objective of FOFA was to improve the trust and confidence of Australian retail investors in the financial services sector and ensure the availability, accessibility and affordability of high quality financial advice. FOFA includes:

- A requirement that the adviser act in the client's best interest, including a safe harbour which advisers could rely on to show they have met the best interest duty. This included a 'catch all' clause to 'take any other steps reasonable in the circumstances'.
- An opt-in requirement to renew fee agreements every 2 years.
- A requirement for annual fee disclosure.
- A ban on conflicting remuneration structures such as commissions for investments (not including life insurance)

Following this, in 2014-2015, a set of technical amendments were made, mainly to correct errors in the original legislation.

The Australian Government is currently considering whether to legislate in relation to professional development and training of advisers and is considering reducing high up front commissions on life insurance products.

International Example B) Netherlands

The Netherlands' Authority for Financial Markets introduced a number of reforms similar to the UK's Retail Distribution Review (RDR). The objective was to shift the culture in the market from product-driven sales to consumer-focused advice by removing the incentive for advisers and intermediaries to recommend products that were not in the best interests of the client. These reforms included:

- A ban on remuneration through commission, including (packaged) investment products and mortgages. This was recently extended to cover other retail investments.
- Rules on product governance, setting standards for the product oversight and governance process as well as for suitability of products.

International Example C) U.S.

Under current US securities regulations, brokers must make "suitable" recommendations, meaning that investments must fit the customer's needs and tolerance for risk. These brokers are not subject to a fiduciary standard.

In contrast to this, investment advisors must follow a fiduciary standard which is generally defined by the Investment Advisors Act 1940. There are limited competence requirements for investment advisors and no specific restrictions are placed on conflicts of interests and fee structures. Instead, advisors are a "fiduciary" to their advisory clients, and therefore have a fundamental obligation to provide investment advice in the best interests of their clients. Investors are responsible for selecting their own advisors and negotiating arrangements with them based on the disclosure they receive.

While the market is still developing, there has been a large degree of recent innovation in the US advice market and there are a number of significant advice websites serving customers.

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

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

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

Options for bridging advice gaps

We set out below some of the broad types of proposal that could be used to address the advice gap. We then pull out two specific areas – limiting liability and automated advice – where debate has recently been focused. However, we welcome views on all the proposals and indeed others.

Improving access	Options to improve access could include: • encouraging workplace advice • encouraging advice in accessible locations like libraries or post offices • supporting the development of online advice • sharing the costs of advice with employers, or subsidising the cost through some form of levy on the industry
Improving trust	Improving the alignment of industry interests with those of consumers may help address concerns of those who lack trust.
Increasing awareness of the value of advice	Making consumers more aware of the long-term benefits of seeking financial advice could help stimulate engagement among those who have a need for assistance but are not currently willing to pay. The Review may consider whether the Government could work with industry and employers to enhance awareness through methods such as signposting (pointing consumers towards advice) or public information campaigns.
Reducing risks and uncertainty for firms	The potential risk for firms of having to pay redress when providing advice that causes consumer loss is likely to be a major concern for the industry. It may be that one recommendation from the Review is to look at whether there are product or advice types where potential liability can be reduced in certain instances or where consumers can reasonably take more responsibility for their investment decisions (see below). We would be interested to hear whether the FCA can build on previous guidance on the boundary between regulated advice services and non-regulated advice[17] and provide more support to help reduce uncertainty for firms.
Reducing the cost of providing advice for firms	We are particularly interested to hear from the industry where direct and indirect regulatory costs are highest and where they can be reduced without leading to increased detriment for consumers. There may be certain types of advice or certain types of financial product that could be sold on the basis of more limited regulatory requirements.
Promoting innovation and competition	New and emerging technologies present opportunities and challenges to provide cost effective, efficient and user friendly advice services. There may also be options that address structural issues – such as barriers to entry – that hinder innovation and competition. Similarly, it may be possible to improve incentives for firms to encourage new entrants into the market.

17 FCA, FG15/1, Retail investment advice: clarifying the boundaries and exploring the barriers to market development, January 2015: http://www.fca.org.uk/static/documents/finalised-guidance/fg15-01.pdf

Limiting certain liabilities

If firms follow FCA rules and guidance when giving advice and are not negligent then they will not incur liability and will not need to pay compensation to consumers for advice given. However, there is concern that there is a degree of subjectivity involved in judging whether firms have complied, and there is also fear among industry (whether well-founded or not) that retrospective action may be taken if standards change in the future, or if there are unexpected developments in the market. Therefore firms have argued that uncertainty exists which discourages firms from providing advice as this could lead to potential future liability.

One question we will consider is whether any 'safe harbours' may be appropriate for financial advice, and if so, whether they would be possible given, amongst other things, the constraints of EU law. By safe harbour, we mean a regulatory provision which reduces or eliminates uncertainty and potential liability in certain circumstances or if certain conditions are met. Some safe harbours already exist, for example, in FCA guidance on rules, in confirmed industry guidance and where the FCA modifies or waives rules.

There are a number of factors to consider before we can specify what form any additional safe harbours might take. FAMR has not made any judgment on this at this stage, and examples are purely illustrative. The factors are:

- <u>What the safe harbour might be in respect of</u> – it could relate to regulation regarding a particular type of advice, or specific products. For example, liability could be reduced in the case of focused advice, or advice without a personal recommendation. Alternatively, it could be reduced in the case of simple products where a specified set of actions to determine suitability have been taken pre-sale.

- <u>What the firm is 'safe' from and how this benefits consumers</u> – this could range from protection from FCA penalty in respect of breach of a rule, or from liability to consumers more generally, for example in court or before the Financial Ombudsman Service.

- <u>The extent of the protection the safe harbour provides for firms</u> – the FCA could specify actions firms can take that 'tend to establish compliance' with particular rules in certain circumstances (the effect of evidential rules). Alternatively, the FCA could specify precisely conduct which complies with a rule and conduct which does not. This is a more 'hard-edged' safe harbour that would give the firm greater certainty.

- <u>How reasonable it is for firms which have charged to provide a service (advice) to be able to avoid liability for that advice</u>

The intention of regulatory safe harbours is often to reduce the uncertainty that firms may face when regulation does not specify exact requirements, or is outcome focused. They are designed to protect firms where they have behaved in line with guidance. Therefore in circumstances where regulatory uncertainty could increase barriers to firm innovation, a safe harbour might reduce that uncertainty and so remove some of the barriers to firms providing advice. We are interested in hearing your views about what form a safe harbour might take to encourage firms to provide advice and innovate to a wider range of consumers.

We are also equally interested in your view of the impact a safe harbour could have on consumers. We are interested in your views on consumer protections and any increased risk to consumers, particularly around the quality of advice they receive and their ability to secure redress.

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?

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

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

The longstop review

A longstop is a limitation period which prevents claims being brought after a set time following the act or omission which the claim relates to. The FCA has previously committed to review the question of whether there should be a longstop limitation period in relation to liability for long-term advice. This review will now be incorporated into FAMR.

There is currently no longstop after which the Financial Ombudsman Service (Ombudsman) will no longer consider a complaint, although there are some time limits. Very broadly, the time limits can prevent the Ombudsman from considering complaints where what is being complained about took place more than six years earlier or, if later, three-years from when the complainant realised (or should have realised) that there was a problem.

The FSA previously reviewed whether a longstop was needed[18]. The FSA deemed that it was important that consumers were provided with a means by which to claim redress from a firm in relation to advice about long term products or services where they could not earlier have reasonably known that they had cause to complain. This could be the case for example in relation to advice on pensions, investment and mortgage products, the terms of which can be 25 years or longer and where the outcome is often uncertain until the end of that term. The ability of consumers to be able to complain helps to ensure that consumers have the confidence to take advice knowing that they will be compensated if the advice is unsuitable.

However, the effect on firms is that they can remain liable in the long term for unsuitable advice which they might have provided to clients many years ago. There is a concern that firms perceive that the risks they face are too high as a result of their ongoing liability, and so may be discouraged from providing advice about long-term products. Similarly, the absence of a longstop could potentially cause a barrier to entry or exit from the financial advice market, either for individual advisers or firms.

The absence of a long stop may further contribute to higher costs to firms through greater professional indemnity insurance premiums (PII) across the industry.

We understand that there are relatively few awards by the Ombudsman made against financial advisers in response to complaints relating to incidents longer ago than fifteen years (which would be likely to be barred if a longstop were in place); there were only 254 such cases taken to the Ombudsman against financial advisers during 2014/2015, out of 6,297 complaints against all firms

18 FSA, FS08/06, Retail Distribution Review: including feedback on DP07/1 and the Interim Report, November 2008: http://www.sfc.hk/web/doc/EN/general/general/lehman/Review%20Report/Exhibit%203.pdf

not relating to payment protection insurance (PPI). Of these 254 complaints only 30% (76 cases) were upheld.

As part of our review we will be evaluating the options around implementing a longstop. This will include considering if it may be possible to put in place an alternative approach to providing an appropriate level of protection for consumers which might also remove or reduce the burden of indefinite liability on individual firms. We will be actively seeking views from stakeholders on options during the coming months.

The options the review will consider include:

- **Maintaining the current regime** – not putting in place a longstop
- **Introducing a single longstop** – for example, a longstop of 15 years (such as that applying to certain causes of action under the Limitation Act 1980), or using a different time period recognising the long life of financial services products
- **Introducing varied limitation periods linked to the terms of products** – for example, differential time limits which reflect the nature of products or advice, so that liability extends for a longer period when it relates to longer-term products (for example, 25 years for a mortgage).
- **Enhanced professional indemnity insurance (PII)** – strengthening PII for firms so that it includes cover sufficient to meet claims relating to long-term advice, whether the firm is still in business or not
- **A compensation fund** – setting up a compensation fund which would pay out in the event of a justified claim older than fifteen years against an individual firm, which all firms would contribute to, but which would not require the firm concerned to be insolvent before paying

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

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?**

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

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

Automated Advice

A number of new digital models are emerging in the industry. The range of web-based services being established includes execution only services, advice (ranging from simplified advice to full advice), and fully managed investment solutions. The level of automation in these models varies. There are examples of fully automated models as well as hybrid models, which include interaction with a qualified adviser during the process.

It is clear that these new technologies could have a significant role to play in meeting customers' needs around financial advice in an efficient and user friendly way. We are interested in the opportunities and challenges presented by new and emerging technologies to provide cost effective advice services

We are particularly keen to understand how the regulatory environment can be supportive of technology-based advice models that can meet consumer needs at low cost. While some firms have successfully launched automated and semi-automated models within the current regulatory frameworks, others have reported that they have developed new automated models of advice but have not felt able to take them to market.

We also want to understand consumer issues that may arise from automated advice. FAMR will consider:

- The economics of automated advice - automated advice has the potential to be much cheaper and quicker than face-to-face advice and we are interested in the effect this could have on the cost and availability of advice.

- Consumer attitudes to automated advice - we will consider whether consumers trust automated advice and if automated advice can meet consumer needs.

- Any potential risk to the consumer, particularly regarding the quality of advice received.

We are working closely with the FCA's Project Innovate[19] to understand the regulatory barriers to innovation in the advice sector. We would be interested in your views on what steps we should take to develop and encourage digital models.

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?

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

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

Considering the options to bridge gaps

We invite feedback on the advantages and disadvantages of these various options (including the broad types of proposal in the box above) and ask respondents to suggest alternatives that could be considered.

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

The Review will consider the impact of possible solutions on the competitive dynamics of the relevant markets, in order to ensure good consumer outcomes. This primarily means a consideration of effects of the proposed solutions on competition in the advice market. Where

19 Project Innovate is an FCA initiative which helps innovative businesses get to grips with the regulatory dimension of their innovations as easily as possible (see appendix for detail)

appropriate, we may also have regard to the effects on competition in the markets for the financial services concerned, e.g. retirement income.

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?

Whatever solution is pursued, the Review aims to ensure consumers still receive advice that is of appropriate quality. There is a balance to be struck between reducing costs and uncertainty for the industry and providing an appropriate degree of consumer protection. Measures that lead to significantly lower standards or make it harder for people to seek redress for losses caused by breaches of, for example, regulatory requirements when receiving advice, are unlikely to encourage demand or successfully close advice gaps in the longer term, or indeed to foster trust.

Equally, if there is a lack of an economic incentive for the industry to provide advice services to all consumers who need it, then some consumers may suffer detriment through being unable to access advice. This detriment may be incurred to a greater extent by consumers of average or below average income and wealth. The Review will work to provide the foundations for solutions that result in an advice market that works for all segments of consumers and are economically viable for the industry to deliver.

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

Annex
List of questions

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?**

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

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

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

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

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

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

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

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

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

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?**

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

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

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

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

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

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

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

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?**

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?**

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)?**

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?**

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?**

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

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

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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?**

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

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

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?**

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

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

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

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?**

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

Appendix: The regulation of financial advice

Why is regulation needed?

1. For many financial products it is hard for consumers to understand how such products can help satisfy consumers' financial needs. Often, the benefits for consumers from buying financial products are not immediately apparent. If someone buys an item of food they do not like, they will know not to purchase it again. But if they buy the wrong pension, they may not know for 35 years. This creates the possibility that firms may sell consumers expensive products that are unsuitable for their needs and may be harmful. Advice can help bridge the gap in understanding and experience – but it needs to be trusted and good value advice. The implications of getting it wrong are significant and could lead to a much reduced quality of life.

Examples of previous problems with investment and pension planning advice

Pension transfers – In the late 1980s, new legislation came into force that, for the first time, allowed employees to save for retirement themselves, rather than rely on the state pension or participate in an occupational scheme. Between 1988 and 1994, more than five million personal pensions were sold. By 1993 the Securities and Investments Board was sufficiently concerned about the possible mis-selling of pensions to launch a study of past advice. By 2002, the FSA reported that over one million people had been mis-sold pensions and the industry had to pay out over £11.5bn in compensation.[20]

Pension switching – In 2008, the FSA reviewed the quality of advice to switch from one personal pension to another.[21] Advice was assessed to be unsuitable in 16% of cases, with a further 7% of cases judged unclear.

Retail bank investment advice – An FSA mystery shopping exercise found that approximately three-quarters of investment advice by retail banks was suitable but in 11% of cases the advice was unsuitable and in a further 15% the adviser did not gather enough information to make sure the advice was suitable.[22]

Structured products – An FSA review into the quality of advice on structured investment products after the collapse of Lehman Brothers, found that advice was suitable in only 31% of cases, with unsuitability clear in 48% of cases and file quality insufficiently clear to determine suitability in the remaining cases.[23]

20 FSA, press release on the pensions review, June 2002: http://www.fsa.gov.uk/library/communication/pr/2002/070.shtml

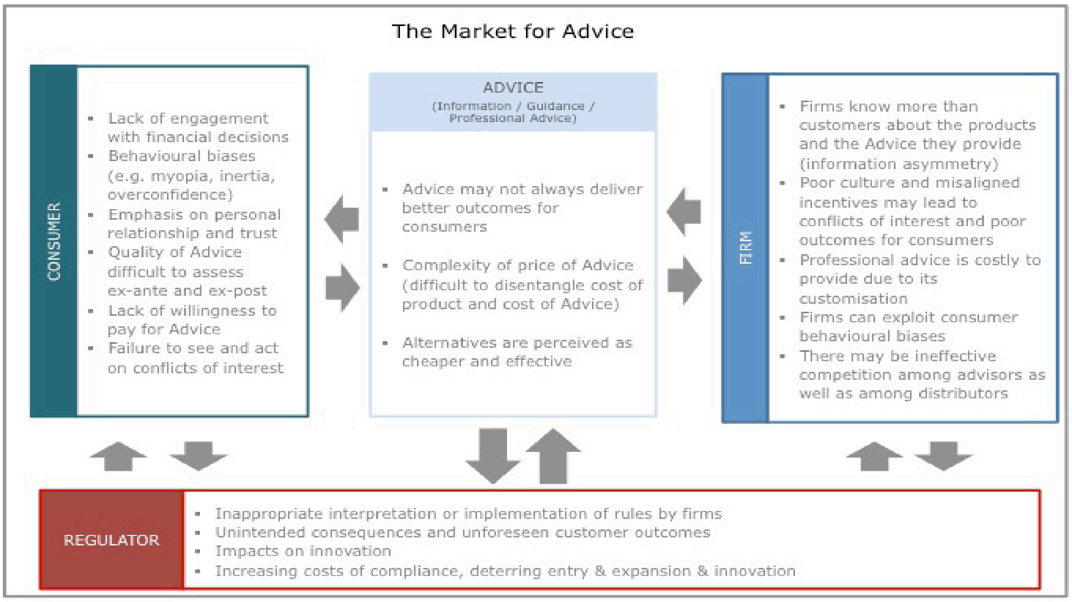
21 FSA, *Quality of advice on pension switching: A report on the findings of a thematic review,* December 2008: http://www.fsa.gov.uk/pubs/other/pensions_switch.pdf

22 FSA, *Assessing the quality of investment advice in the retail banking sector*, February 2013: http://www.fsa.gov.uk/static/pubs/other/thematic_assessing_retail_banking.pdf

23 FSA, *Quality of advice on structured investment products,* October 2009: http://www.fsa.gov.uk/pubs/other/qa_structured.pdf

2. Regulation sets minimum standards that firms must meet and aims to provide appropriate levels of protection for consumers in a market that would otherwise risk being stacked against their needs. A balance needs to be struck to ensure that regulation is proportionate, however, and allows innovation and competition to take place, where it is in the interests of consumers, without setting inappropriate barriers that limit consumer access to advice.

3. In a well-functioning market, we would expect to see consumers able to access and obtain the form of advice that best meets their needs, in order to make good financial decisions, with providers offering competitive prices, quality, choice and innovation. As is the case in many other financial services markets, however, there are economic mechanisms at play in the market for advice.[24] We present our view of this market in the figure below.



Consumers

4. Trust has been suggested to be a very important factor for consumers when taking up professional advice.[25] This seems to be the case in the UK as suggested by the FCA's Consumer Spotlight work:

- around half of people do not trust financial services firms at all (survey evidence, for instance, shows that 42% of those starting out and 51% of hard pressed consumers have this opinion)
- similar proportions of people think there is not enough trustworthy information on financial services

24 Associated with these mechanisms are market failures, which in a broad sense, consist of features that prevent a market from working well and delivering good and efficient outcomes for consumers. Typical examples of drivers of market failure are information asymmetries, externalities, market power, behavioural characteristics of participants and regulatory interventions.

25 See Hung, A. A., Clancy, N., Dominitz, J., Talley, E., & Berrebi, C. (2008), *Investor and industry perspectives on investment advisers and broker-dealers,* Vol 767. Rand Corporation.

5. Lack of trust results in consumers not wanting to spend time assessing financial issues. As a result, consumers may decide to make their own decisions, which can be problematic because they often find it hard to make good decisions, even for simpler matters.[26] In some cases, consumers may simply prefer not to take any form of formal advice at all and to make no decisions in relation to their financial planning.

Firms

6. The provision of advice leads to costs for firms, which become higher as advice becomes more complex or tailored. Of the types of advice considered in this paper, information is likely to be the cheapest to provide, while professional advice is likely to be the most costly.

7. Firms may decide that it is unprofitable to provide certain types of advice below a given price level. This impacts consumers who do not have the means or are not willing to pay for it. Depending on such willingness to pay for advice, there may be cases of mismatch between the supply of and demand for advice.

8. Note that we do not regard there to be a problem where it is sufficient for consumers to have access to information or generic advice, provided it is readily available, rather than a full, professional advice service. In these cases, information or generic advice may be already providing the necessary support for consumers to make good financial decisions. In other words, the market is working well because substitutes are used by consumers without loss in their welfare.

9. We also need to consider that, in some cases, poor business culture and structure – such as sales pressure, misaligned incentives and ineffective competition – may result in firms not competing to supply the best quality service to consumers. In these cases, advisers may compete to extract revenues from consumers without necessarily providing the best quality or suitable advice.

26 See Chater, N., Huck, S., & Inderst, R. (2010), *Consumer decision-making in retail investment services: a behavioural economics perspective:* http://ec.europa.eu/consumers/archive/strategy/docs/final_report_en.pdf

Summary of regulation

10. In brief, if a firm wishes to provide regulated financial advice, the FCA generally requires them to comply with a number of rules in the following areas.

Authorisation	The FCA has a 'gatekeeper' role: firms must meet minimum threshold conditions including meeting minimum capital requirements and ensuring staff are competent for their roles.
Principles for Businesses	The FCA has 11 Principles for Businesses which are the fundamental obligations with which authorised firms must comply. They include, for example, requirements that firms pay due regard to the interests of customers and treat them fairly, pay due regard to the information needs of clients, and communicate information to them in a way which is clear, fair and not misleading.
Systems and controls	Firms must take reasonable care to establish and maintain appropriate systems and controls, including effective risk management processes. Systems must include, for example, orderly and sufficient record keeping, and procedures in relation to conflicts of interest.
Disclosure	In addition to the Principle relating to the communication of information, the rules require that firm communications to clients are fair, clear and not misleading. Additional rules expand on what is expected in particular cases, such as when providing information on the past performance of investments.
Regulated advice	Where a firm provides a personal recommendation, it must take reasonable steps to ensure that the recommendation is suitable for the client. For some products, to help consumers understand the implications of the advice, firms are obliged to write to the client to explain why the recommendation is suitable and to highlight any possible disadvantages.
Redress	Where a firm receives a complaint from an eligible complainant, the complaint must be handled promptly and assessed fairly. Complainants dissatisfied with a firm's response may be able to refer their complaint to the Financial Ombudsman Service. An ombudsman determines complaints by reference to what the ombudsman considers is fair and reasonable in all the circumstances of the case, and determinations are binding on firms.

11. Some of the most important regulatory concepts for financial advice are summarised below.

Basic advice	A regulated activity, which is, in summary, providing advice on stakeholder products (such as certain child trust funds and stakeholder pension schemes) using a process that involves putting pre-scripted questions to a retail client by advisers who do not need to be qualified and where advice is remunerated by commission.
Focused advice	Advice focused, at the request of the customer, on the provision of personal recommendations relating to a specific need, designated investment or certain assets.
Independent advice	A personal recommendation to a retail client in relation to a retail investment product (such as a life policy, stakeholder pension scheme, or personal pension scheme, etc.) where the personal recommendation provided is based on a comprehensive and fair analysis of the relevant market and is unbiased and unrestricted.
Personal recommendation	A recommendation relating to taking certain steps in respect of a particular investment, made to a person in their capacity as an investor or potential investor (or their agent), which is presented as suitable based on a consideration of the person's circumstances.
Regulated advice	Advice relating to a particular investment given to a person in their capacity as an investor or potential investor (or their agent) which relates to the merits of them buying, selling, subscribing for, or underwriting (or exercising rights to acquire, dispose of, or underwrite) the investment.

12. Many of the specific requirements that govern the provision of financial advice are set by the EU and cannot be reduced at national level. Where the Review is to recommend a reduction in standard, we will need to consider whether this is compatible with the UK's international obligations.

The Markets in Financial Instruments Directive (MiFID)

As an example of the impact of EU legislation on regulation, MiFID sets standards across the EU in relation to the distribution of investments. Some of the most significant requirements in MiFID include:

- a requirement that firms act honestly, fairly and professionally in the best interests of their clients
- conditions about what third party inducements firms can pay and accept and the circumstances in which they can do so
- standards to ensure personal recommendations (amongst other things) are suitable for clients
- for sales of certain products not involving for example personal recommendations, obligations to assess whether the investor has the knowledge or experience to understand the risks, and
- obligations for firms to ensure communications with clients are 'fair, clear and not misleading' and to disclose key information about their investments and services

The directive has been updated and amended. MiFID II is due to be implemented in 2017 and will strengthen some of the requirements, providing additional levels of consumer protection. Not all firms selling investments are subject to the directive but the FCA has to date applied the directive requirements to all firms selling investments. This simplifies the rules for firms and avoids situations where investor protection differs depending on whether or not a particular transaction falls within MiFID.

There are constraints on what the FCA is able to do in relation to matters that fall within the scope of the directive.

13. It is also important to consider recent regulatory changes in the UK, such as those introduced by the Retail Distribution Review (RDR).

The Retail Distribution Review

The RDR was launched by the Financial Services Authority (FSA), the predecessor body to the FCA, in 2006. It aimed to fundamentally change the way investment products were distributed to retail consumers in the UK, with the aim of establishing an effective retail investment market that consumers had confidence in and trusted.

In particular the RDR introduced new rules for investment advisers and platforms, which introduced higher minimum levels of adviser qualifications, amended disclosure rules in relation to adviser charging and services, and realigned adviser and platform incentives with those of consumers by removing the commission they received from providers.

The majority of changes arising from the RDR came into force at the end of 2012.

14. While developing the proposals, the FSA (and later the FCA) committed to carrying out a Post-Implementation Review to help determine the extent to which the RDR delivered the outcomes it was designed to achieve.

15. That review found that the RDR has achieved much of what it was designed to do:[27]

- adviser recommendations are no longer influenced by commission paid by product providers, potentially prejudicing the advice
- advisers are now better qualified and there are indications the industry is becoming increasingly professional
- product prices have reduced in some areas as a result of more effective competition in the market
- firms appear slightly better placed to deliver on their long-term commitments, with both average revenues and profitability of advisory firms having increased, and
- the costs to firms of complying with the RDR have been in line with or lower than expectations

16. The Post-Implementation Review was tasked with considering the extent to which the RDR may have had an impact on any gap in advice provision. It found that there is little evidence that the availability of advice has reduced significantly, with the majority of advisers still willing and able to take on more clients. However, by revealing the true cost of advice, the RDR has led some consumers to consider the extent to which the advice they receive represents value for money, and in some cases conclude it does not. To the extent that there is demand from some consumers for lower cost simplified advice, not currently offered by the market, this demand also existed pre-RDR.

17. The Post-Implementation Review also recognised that in some areas the transparency rules were not resulting in improved consumer understanding, in particular in relation to the descriptions of the nature of the service on offer. In their *Smarter consumer communications* Discussion Paper, the FCA have asked for suggestions of how consumers' understanding of the type of advice they are being offered could be improved, as well as requested ideas for how information on advice charges might be better presented by firms.[28]

18. Changes were also introduced to mortgage regulation by the Mortgage Market Review in April 2014.

FCA regime for mortgage and equity release advice

The FCA's mortgage regime is designed to ensure that the great majority of consumers receive advice, with the aim of ensuring they are only recommended mortgages which are appropriate and suitable for their needs.

However the regime recognises that not every consumer needs advice. Firms are permitted to conduct a mortgage sale without advice (known as an 'execution only' sale) in certain specified circumstances, for example, where the consumer is considered 'high net worth' or the loan is solely for business purposes.

The approach is very similar for the equity release market. FCA rules, reinforcing long-established industry practice, require advice as part of every sale. There are very limited exceptions – either where (i) the consumer has received advice but is rejecting it and making their own choice or (ii) is varying their existing equity release product but not borrowing or releasing more, for example they could be switching to a product with a different interest rate.

27 Europe Economics, *Retail Distribution Review Post Implementation Review*, 16 December 2014: http://www.fca.org.uk/static/documents/research/rdr-post-implementation-review-europe-economics.pdf

28 FCA, DP15/5, *Smarter consumer communications,* June 2015: http://www.fca.org.uk/static/channel-page/dp-smarter-comms/dp-smarter-comms.html?utm_source=smarter-comms&utm_medium=smarter-comms&utm_campaign=smarter-comms#scc2

19. During 2014 and 2015, the FCA carried out a thematic review[29] to consider the suitability and quality of mortgage advice being provided under the new rules. It concluded that, while some firms were engaging customers in focused, relevant discussions leading to suitable recommendations the quality of advice in the mortgage market was mixed. Further work engaging with industry to address the issues identified is underway. This is outside the scope of this Review.

Other relevant current regulatory initiatives

20. The FCA is currently working on a number of other initiatives that will have a bearing on the Review. We will liaise with the FCA and take account of developments in these projects as the Review progresses.

EU legislation

21. A number of new EU initiatives are in progress that may have a bearing on FAMR. These include reviews of the Insurance Mediation Directive (which will become the Insurance Distribution Directive) and the Markets in Financial Instruments Directive, and the introduction of the Packaged Retail and Insurance-based Investment Products (PRIIPs) Regulation. This work will continue as FAMR develops. As noted earlier, we may consider recommending representations be made by the appropriate authorities to the European institutions in respect of these EU initiatives, if appropriate.

Financial Services Compensation Scheme funding review

22. The FCA is committed to review the FSCS funding model which sets out in detail how the FSCS is funded. FAMR will be relevant to this review as fees and levies to fund the regulatory bodies in the UK are costs for the industry, which may shape the way in which advice is provided and the groups of consumers with which firms are willing to engage. We are therefore proposing to consult on the FSCS funding model once FAMR has made its recommendations in 2016.

Review of FCA rules for pensions and retirement

23. In late September the FCA published a consultation paper following a review of its pension and retirement rules.[30] Among other issues, this raises concerns about commission payments on non-advised sales of annuities. This work will continue alongside FAMR and will be coordinated with it.

Capital requirements for Personal Investment Firms

24. Capital requirements are the obligations placed on financial services firms to hold certain amounts of specified financial resources for regulatory purposes. Capital requirements are important because they aim to minimise the risk of harm to consumers by ensuring that firms behave prudently in monitoring and managing business and financial risks. Experience tells us that if a firm is in financial difficulty or fails, it can cause harm and disruption for consumers. A firm under financial strain is more vulnerable to behaving in a way that increases the probability of consumers suffering loss.

25. The requirements are tailored to the needs of firms and consumers in different sectors. In May 2015 the FCA published a consultation paper which proposed new capital resources requirements

29 FCA, TR15/9, *Embedding the Mortgage Market Review: Advice and Distribution,* June 2015: http://www.fca.org.uk/news/tr15-09-embedding-the-mortgage-market-review-advice-and-distribution

30 FCA, CP15/30, Pension reforms – proposed changes to our rules and guidance, September 2015: http://www.fca.org.uk/static/documents/consultation-papers/cp15-30.pdf

for the 5,000 Personal Investment Firms subject to IPRU (INV) chapter 13.[31] For the most part, personal investment firms are independent financial advisers (IFAs). The consultation also proposed to revoke rules made by an earlier policy statement,[32] which are otherwise due to come into effect on 31 December 2015.

26. The consultation closed on 7 September 2015 and the policy statement making final rules is due to be published before 31 December 2015. This work will continue alongside FAMR and will be coordinated with it.

Project Innovate

27. Project Innovate is an FCA initiative designed to help innovative businesses (both start-ups and established players) get to grips with the regulatory dimension of their innovations as easily as possible. Our Innovation Hub gives regulatory advice to businesses developing innovations that hold out the prospect of consumer benefit via heightened competition. It also seeks to streamline policies and processes so that they do not needlessly hinder innovation.

28. Initiatives in train include the following:

- from October 2015 innovators that receive Hub support will benefit from continuity in the context of the authorisation process. They will also receive dedicated supervisory support, normally for one year
- increased international engagement will help innovative UK businesses that want to expand abroad, and/or non-UK businesses that want to enter the UK market
- engagement with larger institutions will be stepped up
- new initiatives that focus on improving competition in the market, including:
  - regulatory sandboxes: safe spaces in which businesses, both authorised and unauthorised, small and large, can experiment with innovative products, services, business models and delivery mechanisms without immediately incurring all the normal regulatory consequences of engaging in the activity
  - themed weeks: dedicated periods designed to stimulate intense engagement between the FCA and stakeholders with an interest in a particular area of innovation
  - discussion on barriers to entry for digital and mobile solutions
  - discussion on how to support the adoption of new technologies to facilitate the delivery of regulatory requirements

31 FCA, CP15/17, *Capital Resources Requirements for Personal Investment Firms (PIFs)*, May 2015: https://www.fca.org.uk/static/documents/consultation-papers/cp15-17.pdf

32 FCA, PS09/19, *Review of the prudential rules for personal investment firms (PIFs)*, November 2009: http://www.fsa.gov.uk/pubs/policy/ps09_19.pdf

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