

Online investment and advice services – the consumer experience

Consumer Panel Position Paper

Introduction

The so-called ‘robo’ advice sector has grown dramatically in recent years as regulatory and technological changes have driven the market for online solutions for investors unable or unwilling to take traditional regulated advice. ‘Robo’ advice is an all-encompassing term used to cover a range of online advice and investment services. However it is far from clear with many of the current online services whether they are providing regulated financial advice and therefore accepting liability for the appropriateness of the product sale, or whether the customer is transacting ‘execution-only’ and shouldering all the responsibility.

The Financial Services Consumer Panel (the Panel) has long been concerned about the lack of transparency and consistency in online investment services, and in July 2016 we commissioned Boring Money Ltd to investigate the consumer experience. We wanted to know whether these services were making it clear to consumers what they were offering, how much they cost and the extent to which they would have regulatory protection in the event of something going wrong. Our aim was to highlight both good and bad practice and offer recommendations for the regulator and firms that would help improve consumer engagement and trust in the sector.

The Panel commissioned research to:

- Understand what firms offered to investors and how those propositions were being communicated;
- Assess the extent to which firms made clear to consumers whether they were providing regulated advice and the implications this would have on potential complaints and redress;
- Assess whether firms were adequately communicating risk to consumers;
- Assess whether the language firms’ websites used was consistent, easy-to-understand and clear, including identifying misleading or unclear statements that may undermine consumer understanding; and
- Identify shortcomings in transparency of costs and charges and how services were paid for.

The Panel will use this research to recommend minimum standards for improving transparency, communication and consumer protection in the sector.

Research scope and findings

The project covered 15 online investment services including those who offered regulated advice and those who did not.

The study comprised of two main strands – a live ‘walk through’ as consumers used the selected services, and a professional assessment of the same services.

The research found:

- The regulatory distinctions between guidance and advice and its associated implications, such as recourse to the Financial Ombudsman Service (FOS) and Financial Services Compensation Scheme (FSCS), were not clear.
- References to the FOS and FSCS were not prominent on many websites.
- Costs and charges were poorly communicated, often misleading and difficult to find. They were typically disclosed in a way that made it difficult for consumers to understand how much they would be paying and what for. Only one of the 15 consumers who used the websites was able to calculate correctly what the total cost of a £1,000 investment would be.
- Several firms promoted ‘all-in’ fees that did not include additional costs borne by the consumer, such as underlying fund charges. Additional costs were always provided separately to fees and were always in smaller fonts, at the bottom of pages or hidden in charts.
- Firms did not use language that consumers understood. Whilst some websites were better than others, jargon was prevalent and explanations were frequently misleading. The language used generally assumed an unrealistic level of familiarity even with concepts that might be expected to be widely understood, such as ‘funds’ and ISAs.
- While the language used in risk profile questionnaires was usually clear and well understood, the language used to describe portfolios was generally unclear and confusing to consumers.

Conclusion and Recommendations

These findings indicate that, despite rules already being in place to protect consumers (see Annex 2), there are serious shortcomings in the online investment sector that need to be addressed if consumers are to get good outcomes. Poor practice relating to transparency, clarity and consistency mean some firms are not treating their customers fairly and are failing to meet their needs.

The Panel concludes that there is a need for the FCA to clarify the rules across the online investment market, whether or not regulated advice is being provided. This is all the more important if the current definition of advice is changed in the way the Treasury has proposed¹. It is also something for the FCA to consider when it is developing a framework for ‘streamlined’ advice under the FAMR recommendations.

The Panel’s recommendations are:

¹ HM Treasury Consultation: Amending the Definition of Financial Advice, September 2016: <https://www.gov.uk/government/consultations/amending-the-definition-of-financial-advice-consultation/amending-the-definition-of-financial-advice-consultation>

- 1 The FCA should clarify existing rules, including issuing guidance, to ensure providers of online investment sales and advice are reminded of the need to:
 - Be clear about the service being provided, i.e. whether it is regulated advice with a personal recommendation; regulated advice without a recommendation or self-service execution-only sales, and what protection (if any) is afforded by the service;
 - Disclose in clear terms all costs and charges relating to the service provided and the management of the investments;
 - Make clear in what circumstances, if any, consumers would have access to the FOS;
 - Make clear the role of the FSCS and under what circumstances consumers would have FSCS protection by making this information more prominent;
 - Present terms and conditions in such a way that key terms and risks are brought to the attention of consumers; and
 - Present risk profile descriptions and investment choices in a way that is consistent, easy to understand and promotes good consumer outcomes.

The FCA should also enforce against existing rules.

- 2 The FCA should establish a working group, including consumer bodies and industry, to develop simpler, more consumer friendly language that can be used consistently across the retail investment industry. The recent 'Making Retirement Choices Clear' guide, led by the Association of British Insurers (ABI)², is a recent example of an effective co-ordinated approach to developing more consistent language for communicating with consumers.
- 3 The FCA should enforce its rules on all-in fees.

ANNEX 1

Regulatory background

Retail Distribution Review (RDR)

The RDR came into force in October 2012 and made fundamental changes to the way financial advice could be delivered. These included a ban on the receipt of commission by advisers and the need for advisers to be more transparent about costs, fees and charges. RDR also introduced a minimum level of qualifications (Level 4) for financial advisers and introduced a distinction between 'independent' and 'restricted' advice.

² ABI consultation on Making Retirement Choices Clear, April 2016:
<https://www.abi.org.uk/~media/Files/Documents/Publications/Public/2016/Pensions/Making%20retirement%20choices%20clear.pdf>

The Panel supported these changes and said that in principle it welcomed the development of automated advice processes where the process itself would be regulated. The process would need to operate at the equivalent of Level 4 or above and consumer users of these automated advice services should have access to the Financial Ombudsman Service.³

Financial Advice Market Review (FAMR)

The FCA and HM Treasury launched FAMR⁴ in 2015 to consider how financial advice could work better for consumers. One of the points FAMR considered was how advances in technology, particularly the increasing availability of online services, could be used to fill ‘advice gaps’ for investments, pensions (accumulation and decumulation) and protection.

In March 2016 the FAMR Final Report⁵ made a series of recommendations under three headings: affordability, accessibility and liabilities and consumers redress. The recommendations most relevant to this paper are:

- For the FCA to build on the success of Project Innovate and establish an Advice Unit to help firms develop their automated advice models;
- For the FCA to develop a clear framework that gives firms the confidence to provide streamlined advice on simple consumer needs in a proportionate way. As part of this, new guidance should be produced to support firms offering ‘streamlined’ advice on a limited range of consumer needs. This should include a series of illustrative case studies highlighting the main considerations when developing such models;
- For HMT to consult on amending the definition of regulated advice under the existing Regulated Activities Order so that regulated advice is based upon a personal recommendation, in line with the definition set out in the Markets in Financial Instruments Directive; and
- For the Financial Advice Working Group (formed as a recommendation of FAMR) to publish a shortlist of potential terms to describe “guidance” and “advice”, with the final choice of words and approach to implementing them to be confirmed after market research and consumer testing.

Creation of the FCA’s Advice Unit

The FCA launched its Advice Unit in Spring 2016 to focus on fully or partly automated models that looked to serve the gaps in the current market for advice identified by FAMR⁶.

The FCA defined automated advice as models providing “a *personal recommendation*’ or *discretionary investment management services* (*‘managing*

³ Financial Service Consumer Panel Position Paper on Advice, 2012: <https://www.fs-cp.org.uk/sites/default/files/position-paper-may12.pdf>

⁴ Joint FCA and HMT Financial Advice Market Review Call for Input, October 2015: <https://www.fca.org.uk/publication/call-for-input/famr-cfi.pdf>

⁵ Joint FCA and HMT Financial Advice Market Review Final Report, March 2016: <https://www.fca.org.uk/publication/corporate/famr-final-report.pdf>

⁶FCA Advice Unit web page: <https://www.fca.org.uk/firms/project-innovate-and-innovation-hub/advice-unit>

investments') for their clients." This includes *"fully or partly automated online services and other models that use technology to deliver lower cost advice."*

HMT consultation on amending the definition of financial advice

HMT published a consultation on amending the definition of financial advice in September 2016⁷. The current UK definition is in Article 53 of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (RAO). HMT is consulting on bringing this definition in line with the EU definition set out in the Markets in Financial Instruments Directive (MiFID). This would mean that only advice which makes a personal recommendation would be regulated. This consultation is now closed and HMT is considering its next steps.

The Panel responded to this consultation and said⁸ amending the RAO would not provide any obvious benefits to consumers but would increase risk. This is because it would make it easier for unregulated firms to provide 'advice' on regulated products, exposing consumers to high-risk and unsuitable products. This could undermine the pensions freedoms, where scams and poor products were already an issue. The Panel also did not agree that changing the definition in this way would provide the clarity that firms sought as it would simply move the debate from what was advice or guidance to what was a personal recommendation.

Panel's position on non-advised sales

In 2012 the Panel considered market developments in annuities. As part of this it carried out a literature review of past research and commissioned three qualitative studies to examine consumer's annuity purchasing experience. Although this research focused on the sale of annuities, it highlighted weaknesses in the non-advised sales process that led to detriment for consumers. As a result, the Panel recommended a non-advice code of conduct for non-advice services to be incorporated into FCA rules⁹. Such a code of conduct has not been incorporated into FCA rules.

Annex 2

Background – Extracts of relevant existing FCA Handbook Rules

COBS 2.2.1R Information disclosure before providing services

1) A *firm* must provide appropriate information in a comprehensible form to a *client* about:

(a) the *firm* and its services;

(b) *designated investments* and proposed investment strategies; including appropriate guidance on and warnings of the risks associated with

⁷ <https://www.gov.uk/government/consultations/amending-the-definition-of-financial-advice-consultation/amending-the-definition-of-financial-advice-consultation>

⁸ FSCP response to HMT Consultation on Amending the Definition of Financial Advice, 2016: [https://www.fs-](https://www.fs-cp.org.uk/sites/default/files/fscp_response_hmt_amending_the_definition_of_financial_advice.pdf)

[cp.org.uk/sites/default/files/fscp_response_hmt_amending_the_definition_of_financial_advice.pdf](https://www.fs-cp.org.uk/sites/default/files/fscp_response_hmt_amending_the_definition_of_financial_advice.pdf)

⁹ Financial Services Consumer Panel Discussion Paper, Annuities: Time for Regulatory Reform, 2013: https://www.fs-cp.org.uk/sites/default/files/annuities_position_paper_20131203.pdf

investments in those *designated investments* or in respect of particular investment strategies;

(c) execution venues; and

(d) costs and associated charges;

so that the *client* is reasonably able to understand the nature and risks of the service and of the specific type of *designated investment* that is being offered and, consequently, to take investment decisions on an informed basis.

COBS 6.1.9R Information about costs and associated charges

A *firm* must provide a *retail client* with information on costs and associated charges including, if applicable:

(1) the total price to be paid by the *client* in connection with the *designated investment* or the *designated investment business* or *ancillary services*, including all related fees, commissions, charges and expenses, and all taxes payable via the *firm* or, if an exact price cannot be indicated, the basis for the calculation of the total price so that the *client* can verify it. The commissions charged by the *firm* must be itemised separately in every case;

(2) if any part of the total price referred to (1) is to be paid in or represents an amount of foreign currency, an indication of the currency involved and the applicable currency conversion rates and costs;

(3) notice of the possibility that other costs, including taxes, related to transactions in connection with the *designated investment* or the *designated investment business* may arise for the *client* that are not paid via the *firm* or imposed by it; and

(4) the arrangements for payment or other performance.

DISP 1.2.1R Publishing and providing summary details, and information about the Financial Ombudsman Service

To aid consumer awareness of the protections offered by the provisions in this chapter, respondents must:

...

(4) provide information to *eligible complainants*, in a clear, comprehensible and easily accessible way, about the *Financial Ombudsman Service* including the *Financial Ombudsman Service's* website address:

(a) on the *respondent's* website, where one exists; and

(b) if applicable, in the general conditions of the *respondent's* contract with the *eligible complainant*.

COBS 14.3.2R Providing a description of the nature and risks of designated investments

A *firm* must provide a *client* with a general description of the nature and risks of *designated investments*, taking into account, in particular, the *client's* categorisation as a *retail client* or a *professional client*. That description must:

(1) explain the nature of the specific type of *designated investment* concerned, as well as the risks particular to that specific type of *designated investment*, in sufficient detail to enable the *client* to take investment decisions on an informed basis; and

(2) include, where relevant to the specific type of *designated investment* concerned and the status and level of knowledge of the *client*, the following elements:

(a) the risks associated with that type of *designated investment* including an explanation of leverage and its effects and the risk of losing the entire investment;

(b) the volatility of the price of *designated investments* and any limitations on the available market for such investments;

(c) the fact that an investor might assume, as a result of transactions in such *designated investments*, financial commitments and other additional obligations, including contingent liabilities, additional to the cost of acquiring the *designated investments*; and

(d) any margin requirements or similar obligations, applicable to *designated investments* of that type.