Financial Conduct Authority
Consultation Paper CP22/24

Broadening access to financial advice for mainstream investments

JOINT RESPONSE FROM:

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&

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CP22/24 - Broadening access to financial advice for mainstream investments

To: Consumer Investments and Advice, Policy Team, Financial Conduct Authority

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1. Introduction

1. We welcome the FCA's goals underlying this consultation. Although we have not carried out any data analysis of the type that the FCA will have undertaken, we agree that many UK consumers impair their long-term financial prospects by holding too large a proportion of their savings in cash.

2. As you will see below, we are organisations of consumers. Our members are generally self-directed investors with larger portfolios than discussed in the consultation paper, and many are very knowledgeable individuals either through formal financial education (such as actuaries and chartered accountants) or from long experience of self-directed investment.

3. Despite that, we are responding because both organisations also have a strong interest in public policy in the area of savings and investment.

4. We are concerned that the paper has not considered the needs of the consumer carefully enough for several reasons.

Quantum of potential investable funds

5. Your consultation document's paragraph 1.3, reproduced below, appears to underlie your thinking.

   "Our Financial Lives Survey (FLS) in 2022 identify that approximately 4.2 million consumers hold £10,000 or more of investable assets mostly or entirely in cash despite having some appetite to take investment risk. Whilst retaining such significant cash reserves can be appropriate in some circumstances, many consumers in this position are likely to experience harm as a result of the real value of their assets falling due to inflation (versus the upside potential from investing)."

6. There is a clear implication that you consider that most consumers should invest all, or almost all, of this £10,000 in equity related assets. We have significant concerns about such thinking.

7. To explain our concern in a concrete manner, we have in mind an individual who earns about £25,000 – £30,000 per year, which is roughly the median income in the UK. This person has no inherited wealth and no expert knowledge about savings and investments.

8. To our hypothetical consumer, £10,000 savings in cash (the amount cited in your document's paragraph 1.3) is a large amount. It is also something that this individual cannot afford to see fall significantly in value, even if only temporarily. By definition, this person has no other savings. Anyone is capable of having unexpected financial needs.

9. Accordingly, this hypothetical consumer cannot, in our opinion, take equity risk on their entire £10,000 of savings.

10. We do consider that they may be able to allocate a fraction, say, £2,500 for equity savings. While this hypothetical individual should not take the risk of financial emergencies arising while having no cash savings, we suspect that for the overwhelming majority of financial emergencies £7,500 in cash savings would provide as much effective buffer as £10,000, taking into account the assumption that they earn the median income.

11. Even when investing the £2,500 identified above, before investing they would need to clearly understand that they should not rely upon being able to touch this element of their savings for a long period of time, (at least the five years implied by your consultation document, and perhaps nearer a decade.)

12. This reduction from your research figure of £10,000 to the fraction of the £10,000 that it would be appropriate for the average individual to expose to equity risk (£2,500 in our figures) makes the hypothetical consumer an even smaller potential client for the financial advice industry than the FCA paper has in mind.

Universe of permitted investments

13. The paper rightly proposes a simplified investment advice regime. However, it appears that the only limitation on the investments would be that they be capable of being held within an ISA.

14. Given that the financial advice will be simplified and limited, serious harm to consumers may result if the permitted investment universe includes everything that can be held in an ISA.

15. The hypothetical consumer described in our paragraph 7 above does not have the knowledge and competence to select individual shares. Nor indeed does the hypothetical investment adviser within the simplified investment advice regime that the FCA appears to have in mind.

16. Accordingly, the only equity-related products permitted within this simplified investment advice regime should be collective investment schemes, namely OEICs, ETFs, and investment trusts.

17. For the avoidance of doubt, we are not proposing that the particular ISA vehicle made available to the consumer under this regime should be limited to only owning collective investment schemes. It should be as flexible for the consumer as any other ISA, so that the consumer is able to change the asset mix over time as the consumer’s circumstances and knowledge develop. As well as enabling the acquisition of collective investment schemes, a self-select ISA

should also enable the acquisition of government bonds and individual company shares.

18. Our comments in paragraph 16 above are solely about limiting the investments that the adviser under this simplified investment advice scheme should be able to recommend. In many cases the consumer will be starting on many years of savings into equity-type assets. Accordingly, the ISA contract (or other platform vehicle) they start with needs to be able to accommodate the consumer's developing experience without the need for expensive changes of wrapping vehicle later on.

Investment product costs

19. Furthermore, the paper appears not to mention investment product charges anywhere.

20. As you will be aware, even apparently low annual ad valorem charges, when compounded over a long period of time, result in a major reduction in the final value of the investment. Accordingly, the FCA should encourage and facilitate the publishing and open discussion of how the costs of advice and the costs charged within a financial product work and impact consumers' returns over time.

21. It is well known that although some active investment managers do succeed in outperforming the stock market over an extended period, identifying such managers in advance is extremely difficult. There is absolutely no reason to believe that either the hypothetical consumer or the investment adviser within the regime envisaged will have this incredibly rare skill of identifying successful active managers in advance.

22. Furthermore, the problem that it is extremely difficult to identify in advance active managers who will be successful in outperforming the stock market over an extended period is not ameliorated by diversifying by purchasing holdings in a number of actively managed investment funds. While diversification in general is an important principle in investing, paradoxically the very low likelihood of an active portfolio outperforming a passive one is reduced as one adds to the number of actively managed investment funds held.

23. For the above reasons, we consider that if the FCA is serious about helping the hypothetical consumers under discussion, it needs to unequivocally recommend that within the envisaged regime the only investments that advisers are expected to recommend are investments which are:

23.1. Collective investment schemes

23.2. Low cost

23.3. Not actively managed

23.4. Do not involve taking sectoral risk by limiting investment to one particular category of company (such as collective investment companies focusing on a theme such as artificial intelligence or sustainability)

23.5. Do not involve taking specific country risk by limiting investments to one country or region

23.6. Suitable for being owned indefinitely without requiring repeated reviews for suitability.

24. The criteria we lay out above point towards a low-cost global collective investment scheme, most probably an ETF, which could be either market capitalisation weighted or equal weighted (since the choice between the two is finely balanced). These are the only equity-related investments which a non-knowledgeable consumer can realistically and safely "buy and forget."

25. We also emphasise that the ISA wrapper must be both flexible and cost-efficient, including the ability to transfer to another provider without penalty. ISAs can be found where the ISA platform provider does not make any annual percentage charge and this becomes increasingly important as funds grow through investment returns and further contributions.

Regulatory barriers to giving consumers unbiased advice

26. Paradoxically, Government's desire to protect consumers from unqualified financial advisers has led to a regime which makes it legally extremely problematical for organisations like ours to unambiguously help consumers about financial products including the naming of specific products, even when we are free from all conflicts of interest and would be seeking to do so as an act of public service.

27. For example, Issue 209 December 2020 of UKSA's magazine "The Private Investor"[1] on page 10 carries an article by Mohammed Amin "Personal finance 101 – advice for children and friends." This article had to avoid mentioning any specific investment product by name in order to stay within the law, just as this present response document does not name any specific products.

28. We consider that the FCA should make it a priority to resolve the problems outlined in the paragraphs above.

[1] Download from https://www.uksa.org.uk/sites/default/files/2021-01/TPI-209.pdf

29. The same point applies even more strongly to employers and to the trustees of employer-sponsored pension schemes. They should be free to provide such guidance to their employees / pensioners.

30. We can see no public policy reason for not making these changes. Instead, in this consultation document the FCA appears to expect the financial advice industry to provide a service to average income consumers which the financial advice industry cannot be expected to provide cost effectively. Instead of looking at the entire problem from a first principles consumer perspective, the current consultation could be read more as an idea to help the financial sector grow its advice business by adding to the universe of potential consumers of financial advice.

2. About us

31. UKSA and ShareSoc represent the views of individual investors. Between us we have over 23,000 members. In addition to our own members, 6 million people own shares or have investment accounts with platforms in the UK.

32. The Office for National Statistics estimates that at the end of 2018 UK-resident individuals held 13.5% of the UK stock market, up by 1.2% from 2016 and moving away from the historical lows of 10.2% in 2008. In 2020, the Financial Times estimated that 15% of the UK stock market is held by individual shareholders. In addition to this there are many more who have money invested in shares via funds, pensions and savings products such as employee share ownership schemes. See https://www.sharesoc.org/investor-academy/advanced-topics/uk-stock-market-statistics/

UKSA (United Kingdom Shareholders' Association)

33. UKSA was originally formed to provide individual shareholders with a voice, influence and an opportunity to meet like-minded fellow investors. It is structured as a non-profit making company with annual subscriptions. An elected Chairman and Board of Directors (all volunteers and individuals with a wide range of backgrounds and experience) monitor a regional organisation. Each region benefits from oversight by an elected regional Chairman and Committee.

34. There are many agents and intermediaries in financial markets. Unlike them, UKSA represents solely those people who are investing their own money. UKSA and ShareSoc work together to build relations with regulators, politicians and the media to ensure that the voices of individual shareholders and their interests in the long-term public good are reflected in the development of law, regulation, and other forms of public policy. See www.uksa.org.uk

35. We build relations with regulators, politicians and the media to ensure that the voice of individual shareholders is reflected in the development of law, regulation, and other forms of public policy. See www.uksa.org.uk

ShareSoc (UK Individual Shareholders Society)

36. ShareSoc is a not-for-profit company. It is dedicated to the support of individual investors (private shareholders as opposed to institutional investors). It aims to make and keep investors better informed to improve their investment skills and protect the value of their investments. It engages with companies, the Government or other institutions if we think individual shareholders are not being treated fairly.

37. ShareSoc actively campaigns to seek redress for private shareholders in cases where they have been the victims of unfair or unscrupulous treatment by companies and / or the financial services industry. See www.sharesoc.org

3. <u>Answers to your numbered questions</u>

38. We are organisations of consumers, whereas most of your questions relate to the detailed running of financial advisory firms. That is the reason why for most questions, we give no response.

Q1: Do you agree with our proposed defining features of core investment advice? Please explain your answer and suggest alternative approaches if you believe these could achieve the same objective.

39. We broadly agree with paragraph 3.23.

40. However, the last bullet states: *"the client should have indicated that they have a time horizon for investing of at least 5 years or more."*

    40.1. We broadly agree that as far as actual holding periods are concerned, five years is a reasonable minimum time horizon.

    40.2. However, we consider that individuals frequently fail to accurately predict their likely future behaviours. In particular, we are concerned that "five years" in such customer fact finding is likely to be perceived by most clients as a theoretical maximum.

    40.3. Accordingly, we consider that 10 years would be a more appropriate time period for the adviser to discuss with the client. This should help the consumer to properly understand the need to invest without the expectation of being able to withdraw cash from the investment if unexpected financial needs arise.

41. Overall, we considered that consumers often overstate their risk tolerance, fail to think in advance how they are likely to behave in a stock market crash, and also often underestimate the probability of financial emergencies requiring them to spend out of their savings.

Q2: Do you think that consumers who have received transactional core investment advice should be able to receive further instances of transactional core investment advice in the years immediately following their initial advice (for example for up to 3 years)?

42. We are dubious about repeated advice.

43. While there would be a clear incentive for firms to provide this, in the scenario we discuss in our Introduction section, once the hypothetical consumer knows what to do, they should not require any further advice.

Q3: Please explain your answer and state any alternative suggestions for supporting consumers who receive transactional core investment advice to make initial investments and who would like transactional advice in future years on their existing S&S ISA.

44. See answer to earlier question.

Q4: Do you agree with our proposed criteria for the provision of core investment advice set out above? Please explain your answer and suggest alternative approaches if you believe these could achieve the same objective.

45. We cover this in the Introduction section.

Q5: Do you agree with the proposed approach to service design and filtering? Please explain your answer and suggest alternative approaches if you believe these could achieve the same objective.

46. No additional comments beyond those made earlier.

Q6: Do you agree with our suggested approach for how a firm may choose to undertake the knowledge and experience element of the Know Your Customer process for core investment advice? Please elaborate on the reasons for your answer, as well as outlining any alternative approaches that you would suggest.

47. Nil response.

Q7: Do you agree with our proposed approach for the factors that we consider are relevant for obtaining the necessary information on a client's financial situation? Please elaborate on the reasons for your answer, as well as outlining where applicable any alternative approaches that you would suggest.

48. Given the characteristics of the hypothetical consumer discussed in our Introduction section, we think that your paragraph 4.8 is realistic when you write *"Given the target market for this regime, in many cases, clients will have very limited knowledge and experience of investing."* Conversely, your paragraphs 4.6 and 4.7 appear to make unrealistic assumptions about the level of knowledge of the consumers whose needs underlie this consultation.

49. For example, giving a meaningful answer to a question about whether they have a "preference of 'investing for growth'" requires the consumer to have quite a significant degree of knowledge about what the phrase means, what the risks are, and what the alternatives are. Otherwise, the danger is a simplistic answer based on the consumer's reaction that growth sounds good.

50. As we do not represent financial services firms, we are unable to set out how they should go about obtaining the necessary information on clients' financial situations. However, taking into account the cost of professional time, even in the case of the relatively junior financial advisory staff envisaged, we are dubious that an investment advisory firm could obtain a proper understanding of the client's financial understanding and attitude to the risk of financial loss required within the time-budget necessary to deliver the service cost effectively if a human is involved.

Q8: Do you agree with the production of non-Handbook guidance to support firms in arriving at a suitability decision for core investment advice? Please elaborate on the reasons for your answer, as well as outlining any alternative approaches that you would suggest.

51. Nil response.

Q9: Do you have any comments on the content in the non-Handbook suitability guidance? Please provide supporting information in explaining your answer and if there is anything additional that you consider should be included.

52. Nil response.

Q10: Do you consider it would be helpful for a regulatory pro forma document to be produced to assist in setting out the key areas that firms should consider when providing core investment advice? Please outline any reasons supporting your answer when responding.

53. Nil response.

Q11: Do you agree with our proposals to create a new TC activity for core investment advice? Please explain your answer and state any alternative approaches you believe would achieve the same objective.

54. Nil response.

Q12: Do you agree with our proposals that core investment advisers should only pass the modules in Financial Services, Regulation and Ethics as well as Investment Principles and Risk? Please explain your answer and state any alternative approaches you believe would achieve the same objective.

55. Nil response.

Q13: Are you proposing to offer these examinations to candidates who wish to be qualified to provide core investment advice? If so, do you propose to offer these modules as a complete course or as individual separate modules? Additionally, please let us know if you offer courses that you consider may cover the necessary competencies required for an adviser to provide core investment advice.

56. Nil response.

Q14: If you are proposing to offer a course to cover the modules required, do you consider there to be any challenges in order for these to be operational by the effective date of the regime? If so, please outline any options that you would suggest.

57. Nil response.

Q15: Do you agree with our proposals that core investment advisers should pass the qualifications to provide core investment advice within 24 months, rather than the current 48-month timeframe for retail investment advice? Please elaborate on the reasons for your answer, as well as outlining any alternative approaches that you would suggest.

58. Nil response.

Q16: Do you agree with the proposals that core investment advisers will only need to undertake a minimum of 15 hours CPD each year? Please elaborate on the reasons for your answer, as well as outlining any alternative approaches that you would suggest.

59. Nil response.

Q17: Do you agree that the CPD hours may be either structured or unstructured? Please elaborate on the reasons for your answer, as well as outlining any alternative approaches that you would suggest.

60. Nil response.

Q18: Do you agree with the proposal to remove the requirement for core investment advisers to hold a Statement of Professional standing? Please explain the reasons for your answer.

61. Nil response.

Q19: Do you agree with the proposal to remove the requirement that CPD will need to be independently verified by an accredited body? Please explain the reasons for your answer.

62. Nil response.

Q20: Do you agree with our proposed product governance requirements for the core investment advice regime? Please explain your answer and suggest alternative approaches if you believe these would achieve the same objective without compromising consumer protection.

63. We do not agree with your proposed product governance requirements. As explained in our Introduction section, we consider that the paper has insufficiently narrowed the range of investments which an investment adviser, who is qualified only under the proposed simplified investment advice regime, is able to recommend.

64. Your paragraph 6.36 appears to be failing consumers by skirting around the issues when you write *"we would anticipate that firms place particular importance on recommending products which avoid high fees."* As set out in our Introduction section, it is quite clear that the consumers who are the intended beneficiaries of this consultation should never be advised to invest in products of the type that require high fees. Accordingly, we are disappointed that the FCA has not been more prescriptive on this matter.

Q21: Do you agree with our proposed changes around fees and charges? Please explain your answer and suggest alternative approaches if you believe these could achieve the same objective.

65. We have no fundamental objection to fixed quantified fees being paid by instalments rather than in a lump-sum.

66. However, your overall discussion of the fee questions in paragraphs 7.1 –7.9 serves to highlight the fundamental questions that your consultation document skirts around.

67. As set out in our Introduction section, the key task is to ascertain that the consumer has properly understood the risk of loss and has understood the timescale for which the investment needs to be held. Once those two filters have been passed, we consider that for the hypothetical consumer under discussion, only one kind of equity-related investment is appropriate – namely a low-cost global index tracker, whether market capitalisation weighted or equal weighted.

68. Accordingly, the key task for the financial adviser is to ensure that the consumer has understood both of the issues in the first sentence of the previous paragraph, namely risk of loss and timescale.

68.1. In paragraph 7.5 you write *"Our supervisory experience suggests that firms tend to charge around 3% as a one-off upfront payment and around 1% per annum (£600 and £200 respectively for an initial investment of £20,000)."*

68.2. The monetary amounts mentioned above, £600 upfront and £200 annually, do not look unreasonable from the perspective of the provider's cost structure taking into account the cost of professional time, if any kind of service is being provided.

68.3. However, from the perspective of the consumer of the service, who is investing only £20,000, these are grossly excessive costs. And these are just the charges made by the adviser, before even considering the charges that will be levied by the platform provider.

68.4. This conundrum illustrates the underlying problem very clearly. The very limited service that the consumer needs (namely helping him or her to understand the risk of loss and the timescale involved for investing) cannot be delivered at a cost that is genuinely fair to the consumer, even if the consumer is naïve enough to pay it.

69. Given the challenges of delivering this service cost effectively, we consider that the FCA could better serve consumers by engaging in clear financial education which includes unequivocal recommendations regarding what consumers should do. The government's efforts on financial education so far have been lamentable.

70. Worse still, standards of numeracy generally in the UK are depressingly low. The UK sits in the bottom half of OECD numeracy skills rankings. About half of all adults have the numeracy level expected by the end of primary school. Only a fifth are functionally numerate – measured as the equivalent of a GCSE Grade 4 (C) or above.[2]

71. In passing, if the FCA considers that the financial advice charging structure really is the essence of the problem, which is not an opinion we share, then another charging structure that could be considered as an alternative to the one in your document's paragraph 7.9 is as follows:

[2] Financial Times; 'Low adult numeracy is holding the UK back'. 3.11.2021

71.1. A fixed one-off payment of the lower of £250 or 1% of what is being invested.

71.2. The above payment to cover both initial and ongoing advice for as long as the value of the investment (including the value augmentation from future additional investment) remains below £25,000.

72. As a final point on costs and fees, we are of course aware that many financial services firms are investing in artificial intelligence.

73. We accept that at some date in the future it is likely to be possible in many circumstances for computers to give financial advice that is at least as good, if not better, than advice given by a human, just as the same is likely to be true in many circumstances in other fields such as medicine and law. However, we are dubious that this will be possible in the near future, and very sceptical about what current “Robo Advisers” can provide.

74. Accordingly, we consider that it would be a serious mistake for the FCA to take into account in any decisions about revised regulations the use of artificial intelligence to deliver the quality of advice that will be needed by the hypothetical consumer who we discuss above.

Q22: Do you agree with our proposed new guidance around core investment advice as a limited form of advice? Please explain your answer and suggest alternative approaches if you believe these could achieve the same objective.

75. We have nothing to add to our earlier comments.

Q23: Do you agree with our proposed new guidance for marketing of core investment advice to make clear the limited range or products? Please explain your answer and suggest alternative approaches if you believe these could achieve the same objective.

76. We have nothing to add to our earlier comments.

Q24: Do you agree with our proposed new guidance intended to clarify the relationship between marketing of core investment advice and personal recommendations? Please explain your answer and suggest alternative approaches if you believe these could achieve the same objective.

77. We have nothing to add to our earlier comments.

Q25: Do you agree with our proposed new requirements for initial disclosures? Please explain your answer and suggest alternative approaches if you believe these could achieve the same objective.

78. We have nothing to add to our earlier comments.

Q26: Do you agree with our proposed new requirements for suitability report disclosures? Please explain your answer and suggest alternative approaches if you believe these could achieve the same objective.

79. We have nothing to add to our earlier comments.

Q27: Do you agree that the SM&CR – including fit and proper assessment and conduct rules – should apply to directly authorised advisers offering core investment advice who are not already certified as holistic financial advisers? Please explain why.

80. Nil response.

Q28: Do you agree with our proposal to delay reporting of individuals offering core investment advice only to the FCA for a period of 1 year from the implementation date of the regime? Please explain why.

81. Nil response.

Q29: Do you agree that the APR should apply to new ARs offering core investment advice, who are not already approved, with advisers classified as CF30? Please elaborate on the reasons for your answer, as well as outlining any alternative approaches that you would suggest.

82. Nil response.

Q30: Do you agree with our proposal for principal firms to submit notifications applications to the FCA on behalf of their ARs? Please elaborate on the reasons for your answer, as well as outlining any alternative approaches that you would suggest.

83. Nil response.

Q31: Do you agree with our proposal that the core investment advice regime should be open only to those with an 'advising on investments permission', where other relevant criteria are met regarding qualifications and scope of advice? Please explain why.

84. Nil response.

Q32: Do you agree with our proposal that firms should notify us where they intend to offer core investment advice? Please explain why.

85. Nil response.

Q33: Do you agree with our proposal that firms should notify us where they intend to stop offering core investment advice? Please explain why.

86. Nil response.

Q34: Do you agree with our proposal to require firms providing core investment advice to hold the information specified in order to provide it to us on request? Please explain why.

87. Nil response.

Q35: Do you agree with the proposals that this data should be over an annual reporting period that will come into effect from the start of the regime? When responding please outline any reasons that support your answer.

88. Nil response.