HM Treasury

Retail Disclosure Consultation

9 Dec 2022-3 Mar 2023

Response from Martin White, BSc, FIA 3 March 2023

This submission contains my personal views, and approaches the subject largely from a consumer perspective. It is very critical of the entire savings regime, which in my opinion allows ordinary consumers to be taken advantage of by the industry.

This response is about more than the relatively narrow scope of the 10 questions in HM Treasury's consultation document. I want to advance the argument that the entire regime is exploitative and not fit for purpose.

The fundamental problem seems to be that whilst the government sponsors some very useful financial advice bodies, they do not give useful information in relation to long term investing. And all arms of government, especially the FCA, fail to emphasise the importance to consumers of minimising expenses. To be fair, the FCA has commissioned much research that demonstrates the importance of expenses, and even pointed out, in the foreword to its 2020 "Call for Input" into Consumer Investments that *"The consumer investment market is not working as well as it should. Too often consumers receive lower returns than they should because of unsuitable products with high fees."*

I can see no efforts at all by the FCA to change that situation and I note that the Interim Chief Executive of the FCA that wrote that foreword was not given the permanent post. I have to conclude that successive governments of all parties like the high profitability of the financial sector more than they care about the outcomes for consumers. Intermediaries are still not required to have a full fiduciary duty to their customers. I do wonder whether Parliament as a whole quite appreciates the scale of the consumer detriment and the force for increased inequality that the "information asymmetry" that pervades finance leads to.

Having taken a deep interest in these matters for over 30 years, I reluctantly conclude that the only way in which the lot of consumers will be materially changed is if knowledgeable, non-conflicted, consumers help other consumers for free. The term I have devised for this idea is "Savers Take Control".

Consultation paper 9 Dec 2022 HM Treasury regarding the future of retail disclosure in UK financial services

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My reluctant and sad conclusion

My reluctant conclusion: the interests of consumers do NOT come first in practice

1. I am not sure the extent to which Parliament appreciates the unsatisfactory position of ordinary people in relation to managing their long term personal finances. I cannot emphasise strongly enough how important it is to consumer outcomes to minimise the impact of expenses of all kinds, especially those that are levied as an annual percentage of funds. I suspect that not enough members of Parliament fully appreciate how the principles of compound interest apply to expense and charges. Nor am I sure the extent to which Parliament appreciates how the FCA continually stops short of actions that either directly help individuals identify the cheapest and simplest suitable products, or otherwise permit or encourage the free publication of such information. Were this to happen, it would totally transform the situation for ordinary people.

Who is there that can be trusted to be both knowledgeable and objective in informing the public about the essentials of personal savings and investment?

2. This is a huge problem. Some people are both able and minded to work things out for themselves by reading the appropriate books[1] and talking to like-minded people. Most UK Shareholders Association (UKSA) members (I will talk about UKSA more later) are either already in this category, or join to deepen their knowledge through discussion with friends. However, most people are not in this category. You cannot trust the financial sector as a whole to tell you the importance of minimising expenses, let alone how.

3. People who are really knowledgeable about the principles of finance and investment are likely to work in the financial sector. But it is not in the interests of their employers that they share this knowledge, as the profitability of the financial sector relies on "information asymmetry" more than any other sector of the economy. It is when they are retired and no longer have a conflict of interest that such people are free to share that knowledge in the public interest.

[1] Such as John Kay's "the long and the short of it", or Roger Bootle's "the trouble with markets"

4. It is a determination to change the situation through consumers helping themselves that primarily motivates me to write this present submission. Though it would be wonderful if Parliament could change course in its attitude to the consumer and the financial sector.

About the author

5. Martin White. Fellow of the Institute and Faculty of Actuaries (IFoA), with experience in life insurance, pensions and general insurance

6. Past member of the IFoA general insurance board

7. Past chairman of the London Market Actuaries Group

8. Member of Actuaries for Transformational Change

9. Co-Chair of IFoA's Economics Member Interest Group

10. Member of the advisory group of the Transparency Task Force

11. Member of the team that created the UK Shareholders' Association (UKSA) in 1992; a past chair and currently a director of UKSA

12. It is important to emphasise that this submission is a personal one. Whilst I refer to the UK Shareholders' Association quite extensively, there was not time for this draft to receive the level of peer scrutiny and input for it to be adopted as a submission from UKSA.

What are successive Governments' true objectives for ordinary people and their outcomes from long term savings and investment?

13. On the face of it, I see encouraging signs. For example, we have the Chancellor's 8 December 2022 letter "Recommendations for the Financial Conduct Authority". Quoting from this letter and the annex to it, we have

"(FCA's) duty to promote effective competition in the interests of consumers"

"the government's commitment to securing better outcomes for all consumers,

including through improved competition in the interests of consumers and having regard to the needs of different consumers who use or may use financial services"

14. And quoting from the ministerial foreword to the 8 December retail disclosure consultation, we have

    "This consultation is the first step in that process, setting out an alternative vision for a UK retail disclosure regime that encourages retail investor participation rather than stifling it"

15. But I don't really buy it. What we have seen over the years is fine words, coupled with a systematic reluctance to address the fundamental issue, which is the way that the profitability of the retail finance industry overall relies on consumers suffering from what is politely called "information asymmetry". This is not a wealth creation process, it is a wealth extraction process.

16. Simply specifying certain "disclosure" is not enough. We must look at the problem from the perspective of the typical real consumer. I believe the regulatory regime operates to stifle the free sharing of information which would help people better understand their options. This requires an emphasis on the importance of costs and charges to long term returns, it involves a discussion of the principles of compound interest and how they operate in respect of costs and charges, and it involves ready access to information on how to identify the low-cost and simple products that I believe are right for almost everyone.

17. The financial sector will do everything it can to discourage a focus on costs and charges. Public interest demands that they no longer succeed in this.

18. To what extent is Parliament aware of the huge impact of costs and charges on the lifetime financial outcomes for consumers? I am doubtful that Parliament is really aware of this, and we would hope that better awareness would bring about some serious enquiries into the situation.

19. Referring again to the 8 December Recommendations for the Financial Conduct Authority, this explains that the economic strategy includes "supply side reforms to promote investment, skilled employment, infrastructure, and enterprise to create a more pro-growth environment in all parts of the UK, increasing long-term energy security and delivering Net Zero".

20. The focus on growth is understandable. However, many investment decisions that matter are those made within companies. The corporate sector is not currently a major capital raiser. The impact of the financial sector is arguably a force for short-termism and an encourager of greed within its investee companies, and the way that the consumer investment sector operates, with a

focus on chasing short term returns, is perhaps one driver of this situation. But absent good, trusted education and information on the long term fundamentals of investment, I cannot see this situation changing in a hurry. Andrew Smithers' book "productivity and the bonus culture" (OUP, 2019) contains in my opinion some much needed insights into the true drivers of the wealth creation process.

I am not alone in my concerns about the impact of the financial sector

21. In October 2010, whilst still Chairman of the Financial Services Authority, Lord Adair Turner gave 3 lectures at the London School of Economics. The series was called the "Lionel Robbins Memorial Lectures".

22. The second lecture in the series had the title "Market Efficiency and Rationalty: Why Financial Markets are Different. This is available as a youtube video at https://www.youtube.com/watch?v=PIRHM_Dz_fQ

23. 57 minutes into this talk Lord Turner makes the precise point that excess charges could well reduce a typical pension outcome by 50%.

24. This is an illustration of the adverse impact that the way the financial sector works can have on ordinary people.

25. In his lectures Lord Turner referred to Roger Bootle's description of the financial sector as operating a "distributive" process, rather than a creative one. Roger Bootle's book "the trouble with markets" (Nicholas Brealey, 2011) does not mince words. "Accordingly the really serious problem with the investment management industry is the huge amount of resources it uses to such poor effect, and the inordinate charges it makes to its clients." And perhaps it would be wise for me not to quote what he says about financial advisers (page 278 in the 2011 edition).

26. John Kay's book "the long and the short of it" (Profile Books 2016, earlier edition 2009) was described by one of the reviews on the back cover as "the best book ever written for the British individual investor". Both Bootle and Kay advise people to avoid financial advisers if they can. Quoting from Kay, "An obvious and depressing reason for relying on your own judgement is that most people who offer financial advice to small and medium-size investors aren't much good."

27. Who is there that people can really trust in relation to investment? And how can different types of consumer best be helped? This deserves a national

discussion, but led by consumers themselves, and ideally with current members of the financial sector kept out of the room.

Adding further credibility to the argument – the Frank Redington Prize

The Institute and Faculty of Actuaries recently held an essay competition, the Frank Redington Prize, with anonymous entries, for ideas on how to improve the operation of the financial sector in the public interest. The results were announced on 20 October 2022.

28. The judges for this competition included Sir John Kay as head judge and also the Rt. Hon David Heath, a former MP and government minister.

29. I was the winner of the first prize in this competition[2]. The title of my essay was *"A world of information asymmetry: knowledge is power, and lack of knowledge may mean impotence without access to deservedly trusted voices"***.** The essay contains a number of ideas, among them a suggestion that the actuarial profession has potentially "so much to contribute to the public interest, especially helping people to minimise the amount which is extracted from their lifetime wealth by the financial sector, and also to understand the unavoidable nature of the uncertainties involved". The essay appealed especially to retired actuaries that share these concerns and wish to volunteer to contribute in this way to come forward to help. The volunteer aspect is essential to maintaining independence and being able to speak up freely.

30. The essay competition was for me a great opportunity to share the conclusion I had reluctantly reached over many years that absent legal changes requiring fiduciary duty, the only people who are ever going to help ordinary people access the information they need in order not to be exploited by the financial sector are knowledgeable savers and investors working together to develop and publicise the necessary information. This of course, is exactly what a core team of volunteers at the UK Shareholders' Association is already working to do.

31. The next few paragraphs discuss some of the issues covered in the essay

[2] https://actuaries.org.uk/frank-redington-prizes/

Information asymmetry and the problem of who to trust: decades of regulatory reluctance.

32. Individuals have to make financial decisions for themselves or their families, the outcomes of which may not be apparent for many years. Unless they are able and minded to work things out for themselves, they need completely trustworthy sources of information and, where necessary, advice. But they also need to trust all the intermediaries in the investment chain to act in the client's best interest. The need for stewardship, the lack of a fiduciary duty, a bias to action in the case of fee-based advisers – all these were thoroughly discussed in the Kay Review (2012)[3] and a number of recommendations made, including that a fiduciary duty be imposed in law on all the participants in the investment chain. The fiduciary duty requirement was one of the most important recommendations of the Kay review. Yet it did not happen and has not happened. Parliament listened to lobbying by the financial sector and the consumer interest lost out.

33. Some 10 years before the Kay review, the Sandler review into retail savings was published. The ultimate consequence of this was that commissions to advisers by product providers were banned. This changed the landscape for the good, but other recommendations for charge-capped products were less successful. One of the recommendations that did not get taken up was in para 143 of the Summary report, that intermediaries should not describe themselves as "advisers" unless they met an independence condition. We can see a pattern here – Parliament and the regulatory arm of Government find it hard to make changes that increase the power of the consumer relative to the financial sector.

34. To its credit the FCA has over the years commissioned a number of studies that have provided great insight into matters of consumer interest. I would highlight the "asset management market study" which commenced in 2015. This demonstrated conclusively that passive funds can be expected to outperform active funds. And that there was a "negative relationship between net returns and charges".

35. This was really good and balanced work, but does not appear to have had any impact on regulatory policy.

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3 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/253454/bis-12-917-kay-review-of-equity-markets-final-report.pdf. Some 10 years prior to the Kay review, Ron Sandler was commissioned to conduct a study into retail savings: https://webarchive.nationalarchives.gov.uk/ukgwa/20100401165710/http://www.hm-treasury.gov.uk/medium_and_long_term_retail_savings_in_uk.htm.

36. The essay also mentioned the FCA’s more recent (2020) “Call for Input” into Consumer Investments. The Foreword to that document was frank about the problems from the consumer perspective.

- “The consumer investment market is not working as well as it should. Too often consumers receive lower returns than they should because of unsuitable products with high fees.”
- “The overwhelming majority of retail investors are best served by *readily understood, well-diversified and low-cost investments which are already available from a range of providers* [my emphasis], but many retail investors don’t choose these.”
- “We need the system as a whole, including regulation, to work better for consumers.”

37. Yet none of the questions in the body of that document would lead to policy changes that really tackle the problem.

38. In the essay, using information from the FCA’s Asset Management Market Study, I demonstrate just how credible is Adair Turner’s comment mentioned above about how (avoidable) excess charges can reduce the outcome from people’s lifetime pension savings by 50%.

39. The essay covers wider topics than those set out above, including the problems policymakers have in obtaining truly objective information and advice from people working in the sectors of the economy under discussion. The essay is in the public domain, and the link to all the essays published by the IFoA is given in an earlier footnote. There is also a youtube published by the IFoA of the discussion of the “Frank Redington Prize evening”, which also covered some pension essays as well as mine.

40. Rather than set out all the material in the essay here, I would respectfully ask the Treasury to read it. It is about 8000 words in total.

The importance of volunteering in our National life

41. At the Redington prize-giving event, a number of entrants were told that they were on the shortlist and that they should prepare 5 minutes of introduction to their papers in case they turned out to win. My talk was about the importance of volunteering in our national life.

42. Our society relies on volunteers far more than one might first realise. Volunteering is even the backbone of politics. So much of what makes life interesting and enjoyable – clubs, societies, children’s weekend football – relies

on volunteers. This also applies to many religious institutions, the Citizens Advice service relies hugely on volunteers, and school governors are all volunteers.

43. People do all these things because it feels worthwhile, and gives a sense of achievement and hopefully harmony and fun.

44. But it turns out that precisely the same motivation is to be found in a number of people who take a particular interest in investment. Ever since UKSA was founded in 1992 we have had a small band of highly knowledgeable volunteers committing time and effort to representing the interests of not just shareholders, but savers and investors generally. I will give some more information about the UK Shareholders' Association later in this submission.

45. At the end of my short talk at the Redington Prize evening, I announced that I would be appealing for retired actuaries, who are clearly no longer conflicted, to come forward and help in the effort to improve the financial capability of the population at large. We don't just need actuaries of course; the UKSA policy team over the years has included a range of skills, including accountants, engineers and civil servants.

A concern about FCA consultation processes

I believe that submissions to the FCA should be in the public domain

46. I am aware that when consumer representations make responses to some of the FCA's many consultations, there are relatively few respondents coming from a consumer perspective.   And, since responses to the FCA are normally not published, it is hard for consumer representatives to get as much wider public attention as we would like for what we have to say. But this also means we are unable to see what arguments others are making. I regard this process of dialogue "behind closed doors" with the FCA as missing an opportunity for a wider discussion and improved democracy.

47. So I am pleased to be able to respond to a consultation from the Treasury where I understand that all the submissions will be in the public domain, as what I have to say needs public attention and challenge if it is to have any impact.

Some information about the UK Shareholders' Association including its financial education web site "honestmoneynow"

A public interest perspective

48. The UK Shareholders' Association, UKSA, is a not-for-profit organisation run entirely by volunteers, apart from a very modest secretariat. It is completely independent from the financial sector, which is essential if it is to speak out without fear or favour. This is something we were advised by the late Lord Myners, who addressed UKSA meetings a number of times over the years, to ensure that we stuck to. UKSA was established in 1992 by a group of individuals concerned about aspects of corporate governance and also the lack of voice for individual shareholders.

49. There are many agents and intermediaries active in financial markets. Unlike them, we are an organisation solely representing people who are investing their own money.

50. UKSA was 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.

51. The ethos of UKSA is savers and investors helping each other. And playing their part in society. UKSA was founded in 1992 at a time when the Cadbury Commission was conducting an enquiry into corporate governance, and when there were scandals about executive pay. In the archives of the Cadbury Commission can be found correspondence with UKSA's original leaders including discussion papers on the "rights <u>and</u> responsibilities" of shareholders. Over the years we have had a succession of high calibre people, frequently but not always retired, keen to put effort into what they believed was the UK national interest. These volunteers came from a wide range of backgrounds including consulting engineers, retired civil servants, actuaries and accountants.

52. UKSA has a free financial education web site, "honestmoneynow". This was written by John Hunter, in frustration some years ago when the FSA ignored his concerns about what later became known as "precipice bonds". John was approached by someone wanting to sell him one of these, and as a mathematician and accountant had no trouble seeing through it.

53. This web site can be found at https://honestmoneynow.co.uk. The following material is taken from the introduction at the top of the site.

What we are about

This site provides basic, unbiased financial guidance, cradle-to-grave. We exist because innocent individuals cannot be expected to distinguish good from bad in the flood of purported financial advice available to them.

Where you will find this site very different from most others is in its emphasis on basic principles. Other sites teach you the characteristics of financial products but leave you ill-equipped to choose between them.

Our message

Good financial habits are not difficult. They are only made to seem so by those with a vested interest in confusion. Whatever your level of knowledge, if you work through the lessons of this site you will:

- be able to manage your own affairs,
- understand the need for good advice and be able to look for it, and
- be able to recognise biased advice and reject it.

54. The site contains, unusually, an explanation of compound interest.

55. We believe that if the information in this site were to be used by the government's various advice services, it would greatly serve the public interest. We have written it for the public interest, not to make money out of it.

2. Answers to your numbered questions

56. The points I really wish to make are already made in the sections above. As explained in the earlier sections of this document, I am coming to these questions with the start point that the particular proposals that these questions refer to will not make any material difference to the deeply unsatisfactory way in which the investment services market as a whole works, when judged from the perspective of the real needs of consumers.

Q1: Do you agree with the description of the various problems with the PRIIPs Regulation as stated above? Are there any other aspects of the regulation that you would like to raise as the government moves beyond PRIIPs into a new retail disclosure regime?

57. PRIIPS regulation is concerned with relatively complex products. In general, I would suggest that the real reason for complexity is to hide from consumers how bad a deal they are. "Innovation" in financial services products is frequently about devising new ways to extract wealth from clients.

58. That said, I agree with the thinking behind FCA PS 22/2 which addressed some of the failings of the past performance illustrations required under the original EU legislation. There is a big problem with past performance information; it tends to be given much more weight by consumers than is justified. For consumers to really understand the extent to which past performance is a helpful guide to the future is quite a challenge. I would suggest that it requires a level of financial capability that is not imparted by the education system, something that should be borne in mind when designing improvements in school and adult education.

59. One often sees the argument made by promotors of financial products "performance matters more than charges". This is actually a lie, hidden within a half-truth. The FCA carried out some excellent work that exposes this in its Asset Management Market Study, for which the final report MS15/2.3 was published June 2017.

Q2: Do you agree with the principles set out in paragraph 3.2? If not, please explain.

60. The question appears to relate to para 3.1 rather than 3.2. The principles, at first sight, sound fine – making relevant information available in respect of investment products currently being put to consumers. But there is a problem. If consumers do not have the framework of understanding to judge a particular product, no amount of detailed information on that product is going to help them

make a good decision. If there is a financial adviser in the picture, one might hope that would help, but in the absence of a fiduciary duty placed on financial advisers to put the client's interest before their own, I am not so sure. And if the product is being "sold" directly to the consumer, or otherwise placed without advice by an intermediary such as a platform, I am not aware of anybody in the chain of intermediation that has a duty to point out that there are better value solutions available.

61. What people need is help to identify the most suitable products for them. Using some wording of the foreword of the FCA's September 2020 Call for Input on the Consumer Investments Market, *"The overwhelming majority of retail investors are best served by readily understood, well-diversified and low-cost investments which are already available from a range of providers, but many retail investors don't choose these."* The principles set out in Para 3.1 of this current consultation will make no progress towards tackling this most critical problem, leaving most consumers still in a very difficult position, with no solution to the challenge of effectively managing their personal finances.

Q3: Do you agree that retail disclosure should aim to ensure that an investor is empowered to make well-informed decisions related to the product that they are purchasing, rather than focusing on comparability? If not, please explain.

62. I have partly answered this above in response to Q2.

63. But I would not downplay comparability. Once the decision has been made to commit a certain amount to long term equity-type investments, it is completely vital to achieve this in a way that involves the minimum amount of expenses of all kinds. Knowing how to do this, and being pointed to the types of products that meet this criterion is arguably what people need above everything else. This requires that information be readily available on the kinds of simpler products that the FCA's September 2020 document referred to above was talking about – and there also being freely available in the public domain appropriate comparative analyses. It is completely vital in my opinion that the regulatory regime <u>encourages</u> the sharing and discussion of how individual financial products work, including the impact over time on total returns of all the expenses involved.

64. In my opinion, information such as I have set out in the paragraph above should be provided as a matter of course by financial advisers. In the absence of this, there should be no legal restriction on the compilation and sharing of information such as this by organisations such as UKSA, with a purely public interest motivation, or through educational charities.

Q4: Do you agree that disclosure requirements should be flexible, with prescriptive requirements for format and structure only when deemed necessary by the FCA? If not, please explain.

65. No additional comments beyond those made earlier.

Q5: Are you content with the decision to resolve the UCITS interaction through empowering the FCA to determine a future retail disclosure regime, as discussed above?

66. No additional comments beyond those made earlier.

Q6: Do you agree that there is no need to maintain any PRIIPs-related retail disclosure elements in legislation? If not, please explain.

67. I would wish to see legislation that required the publication in easy to access form of the way each product operated, including all the costs involved. But this should apply to all financial products of any kind.

Q7: Upon revocation of the PRIIPs Regulation, do you agree with the government's view that the FCA will not require any new additional powers to deliver a retail disclosure regime in line with the objectives stated in Chapter Three? If not, please explain.

68. As I have implied above, I do not believe the objectives in Chapter 3 are sufficient to address the deep problems of information asymmetry that exist between the financial sector and its retail customers. That demands something much more radical, and I have put forward my thinking on this earlier in this document.

Q8: Are there any wider obstacles that prevent or discourage firms from offering investment products from different jurisdictions to UK retail investors, and what actions would you suggest that the government take on this issue?

69. Nil response.

Q9: Do you have any views on digital disclosure, and in particular to what degree do you think a less prescriptive disclosure regime will facilitate innovative disclosure formats going forward?

70. Nil response.

Q10: Do you have views on other priorities for retail disclosure reform that the government and FCA should consider in future? Similarly, are there other challenges or trends in retail disclosure that regulators and policymakers should consider?

71. I have made most of the points I wish to make in response to the questions above. Nil response.