FINANCIAL CONDUCT AUTHORITY

Call For Input:

The Consumer Investments Market September 2020

RESPONSE FROM:

United Kingdom Shareholders' Association

15 December 2020

UKSA
UK Shareholders' Association

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FCA Call For Input: The Consumer Investments Market

To: Financial Conduct Authority
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The UK Shareholders' Association have pleasure in submitting this response to the Financial Conduct Authority's Call for input (CFI) which was published on 22 September 2020. We have worked closely with ShareSoc in drafting our respective responses. However we have some differences of scope, perspective, and emphasis; hence we are making separate submissions.

We very much appreciate this CFI and the clear recognition in its Foreword that there is a problem – namely that there are suitable and inexpensive products, but people do not use them enough. Adding to the problem, firms are not generally keen to promote those products.

The main problem is costs to the consumer. Very little of significance has been done to tackle the conflict of interest between financial service providers and their customers. The power of the financial lobby acts to prevent progress and innovation in this regard.

The job of helping people to make the best choices with particular regard to the long-term impact of costs is not one for which we detect much appetite in providers, the FCA, other financial regulators, or in the Money and Pensions Service.

One of the FCA's "principles of good regulation" is the general principle that consumers should take responsibility for their own decisions. We support this. But consumers need ready access to the fundamental truths about investment, freely shared by disinterested parties with a public interest motivation. Competition will not work for consumers without this.

It is also vital to recognise the diversity amongst consumers. At one end of the spectrum, it is important that the FCA does not introduce heavy handed solutions that restrict market access for knowledgeable and well-informed, or sophisticated, individual investors in the mistaken belief that such restrictions are essential to protect the majority. But whilst we believe that there are benefits for society in more people taking an interest in investment, we must recognise that the majority of people are at the other end of the spectrum from sophisticated investors, and are vulnerable to exploitation, inadvertently as well as advertently, even if the FCA does not class them as "vulnerable".

We believe it is time for individual savers and investors to help themselves and each other to identify and support the best value solutions. They should be encouraged to become actively involved in meeting the country's challenge of improving financial capability. The FCA should ensure that its regulations support this.

We believe that this enquiry is enormously important in ensuring that much needed and meaningful change is achieved within the consumer investment market. We would be very pleased to provide further feedback either orally or as further written evidence. If this is required, please contact Martin White at mgwuksa@mm.st .

Contents

1 Introduction

This introduction highlights our main points. Then the body of our response covers most of your 39 questions. We end with some appendices.

There is a problem, which arises from the big power imbalance between providers and consumers. Consequently the market runs largely in the interests of providers of financial services, not in the interests of consumers.

The game is heavily stacked against ordinary people due to the deep conflict of interest between financial services providers and consumers, and the fact that most consumers, below those that are knowledgeable and well informed on the spectrum, lack the knowledge to assess what is, or what is not, good value. The FCA's research work over the years has forcefully demonstrated this; the FCA's excellent asset management market study is a good example. The problem is not limited to the retail investment market; the 2013 study[1] commissioned by the Department for Communities and Government into the investment of local government pension schemes identified huge potential savings achievable by moving from an active to a passive strategy.

We find Chris Woolard's Foreword to the CFI particularly encouraging, in that it acknowledges that there already exist "readily understood, well-diversified and low-cost investments", yet most people do not use them. This is not surprising; the industry makes more profit by promoting expensive and complex products, and by promoting the message that finance is too difficult for consumers to understand by themselves. Whilst always well-intended, we suspect that the regulatory regime may, if anything, have unintentionally given cover to this message.

Today's competition between market providers does not serve consumers' interests, because providers have much deeper knowledge and understanding of their products and their potential drawbacks. We believe that Chris Woollard's Foreword acknowledges this.

We would suggest that within that foreword there may be the germ of at least a partial solution. The FCA is clearly well able to identify which individual products are "readily understood, well-diversified and low-cost investments". But people need to be pointed to such products without needing to go to an IFA. Our understanding of the regulatory regime is that it makes it extremely difficult to share information of this nature, a situation which we regard as supportive of the status quo and not in the public interest.

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[1] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/307926/Hymans_Robertson_report.pdf

Our initial thought was this; why should the FCA not publish details of these products with explanations, including explanations of how the costs operate, on the FCA web site? But on reflection, we understand why the FCA and its predecessor have always been resistant to recommending individual products since there would be a reputational risk if a recommended product underperformed for some reason.

Might there be a way round this? The FCA could describe classes of products and services that in their view met the criteria of "readily understood, well-diversified and low-cost investments", explain why they met these criteria, and encourage the publication of costs for individual brands. We will use the term "FCA criteria" in Q8 later in this document to refer to the characteristics of readily understood, well-diversified and low-cost investments.

The FCA should have the power and the appetite to interpret its strategic objective to ensure relevant markets function well as trying to get those markets to operate in the best interests of consumers.

The FCA has to pursue its objectives as set out in statute. Reproduced below is the relevant part of FSMA 2000 after amendment by FSA 2012:

> *1B The FCA's general duties*
>
> *(1) In discharging its general functions the FCA must, so far as is reasonably possible, act in a way which—*
>
> *(a) is compatible with its strategic objective, and*
>
> *(b) advances one or more of its operational objectives.*
>
> *(2) The FCA's strategic objective is: ensuring that the relevant markets (see section 1F) function well.*
>
> *(3) The FCA's operational objectives are—*
>
> *(a) the consumer protection objective (see section 1C);*
>
> *(b) the integrity objective (see section 1D);*
>
> *(c) the competition objective (see section 1E).*
>
> *(4) The FCA must, so far as is compatible with acting in a way which advances the consumer protection objective or the integrity objective, discharge its general functions in a way which promotes effective competition in the interests of consumers.*

How does the FCA interpret its strategic objective of "ensuring that the relevant markets function well"? Our concern is that the FCA has not seen that as identical to getting the best outcome for consumers. Yet we consider that it is open to the FCA to interpret "ensuring that the relevant markets function well" in precisely this way. And we detect an increasing acknowledgement in FCA publications, culminating in the Foreword of the CFI, that the current system does indeed give poor outcomes for many consumers.

It is clear[2] that the FCA have long understood the impact of expenses on consumer outcomes. Yet the power of the financial services lobby makes us doubt that the FCA will ever be permitted to tackle the problem properly. We also recognise that the Government sponsors the Money and Pensions Service (MAPS), which gives good information about basic financial management, and which has a major emphasis on managing debt. But the existence of the MAPS does not currently tackle the conflicts and the consumer disempowerment in the long-term savings market. We also note that in MAPS' 2020-2030 UK Strategy for Financial Wellbeing[3] a search for the word "fee" does not find a single hit; the same is also true of the word "charge" and the word "expense". The word "cost" appeared in the context of the cost of credit, but not that of investment costs.

The FCA's own Financial Services Consumer Panel (FSCP) has long taken an interest in the question of costs, and the position of consumers vis-à-vis the industry. Quoting from an FSCP discussion paper[4] from around 2015 "*Investment costs – more than meets the eye*":-

> "The evidence reveals a market characterised by a weak demand side that is rapidly growing numerically, and a powerful industry in which misaligned incentives are systemic and which enjoys, largely unchallenged, the potential to exploit consumer behaviour, product structure complexity and the lack of cost transparency. As such, the Panel believes that this is not a market where competition works in the consumers' best interests."

The FSCP paper also explains that the effective total costs suffered by investors in managed funds, especially active funds with high turnover, can be materially greater than the explicit charges quoted by the managers.

The impact on consumer outcomes of costs involved in the investment chain is much greater than most people would appreciate – this is the process of (negative) compound interest at work. Cutting the annual costs suffered on a lump sum by 1% over a period of 30 years would improve the final capital sum by over one-third. Over a 51-year period, it would improve the outcome by just over two thirds. And the difference between the cheapest solution and the typical retail product may be well over 1% per annum, even before any IFA costs. So the benefits for consumers of shaving what may look like "a small percentage" per annum from the expenses they suffer are huge. The claim one often hears that "performance matters more than charges" is a smokescreen – the impact of expenses is predictable, performance is not.

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[2] https://www.fca.org.uk/news/speeches/competition-and-savings-regulator-perspective
[3] UK-Strategy-for-Financial-Wellbeing-2020-2030-Money-and-Pensions-Service.pdf
[4] investment_discussion_paper_investment_cost_and_charges.pdf (fs-cp.org.uk)

Of course there is another side to this story. It is the profits and high pay within the financial services sector. Therefore, it needs to be recognised that much better outcomes for consumers that will result from their being empowered and supported would mean less wealth is extracted by the financial services sector.

The truth is controversial when it threatens livelihoods

Solution:

An independent voice is needed to tell the full truth about expenses, especially the importance of minimising annual percentage charges, or avoiding them altogether; and

Empower people by pointing out the simple good value products and services they can actually use, that do not normally need the involvement of a financial adviser.

Given that the financial services sector will never provide the information consumers need in a disinterested way, there is a huge void in trust that needs to be filled. Can the FCA fill the void? Who are consumers to trust?

We believe that savers and investors should be allowed to voluntarily help each other. ***What we ask of the FCA is to remove the existing regulatory blocks in the way of this process.***

This is our main point in response to Q1 below and to the last but one paragraph of the Foreword. We would want to be confident, for example, that we could mention by name particular providers as being especially low cost, and to explain the benefits of, for example, self-select ISAs that just charge a modest fixed fee, in which you can purchase a low-cost well-diversified passive ETF, on which the ISA provider does not make an annual percentage charge.

The UK Shareholders' Association has for some time been working on an initiative that we call "Savers Take Control[5]". This is an entirely voluntary attempt, involving knowledgeable investors who are not conflicted by being financial services providers, and who want to do something useful for society as a whole, to tackle the causes of declining public respect for the entire wealth creation process. More information on Savers Take Control is given in Appendix 1. UKSA also has a freely available financial training site we call "honestmoneynow"[6].

[5] https://www.uksa.org.uk/Savers_Take_Control

[6] https://honestmoneynow.co.uk/

Resolving the expense problem is not enough. There are other important truths about investment, relating to fundamental uncertainties and how to manage and live with them.

In Appendix 2, we set out a brief discussion of the kind of basic but essential, empowering information that everyone needs to have readily available. All of the behavioural research on consumer decision making has been in the context of the current situation where there is no easy answer to the question “who do we trust”. But if such essential information were widely available, trusted and discussed, we believe this would lead to a gentle revolution towards a more financially engaged and aware society, with huge benefits for future generations. Essential information includes not only helping people face up to uncertainty but also understanding the negative compounding implications of debt and expenses, as well as the positive compounding effects of investment returns.

The problem of financial education is a long term one with no quick and easy solution. It needs a step change in approach across many agencies, not just regulators.

It is all too easy to talk about education as a simple solution to the problem of financial capability. But there is no quick solution, and it is not just about educating the young, important as that is. A step change in national approach to financial education is called for at all ages. Our understanding is that levels of financial education as well as numeracy are relatively poor in the UK. On the plus side, there are a number of bodies, including charities, outside the official sector with a brief to help with numeracy, financial capability and many other aspects of personal development. Such bodies should work together, and there may be a role for the FCA in encouraging this. It would also need representative consumers to come forward to get involved, so that we can collectively discover what works. This would be an exciting exercise to be part of. But it would be vital to ensure that the financial sector was not given the opportunity to influence the discussion or the messages.

At the same time as expressing concern about general levels of financial education it is also important to recognise that there is a wide spectrum, in terms of the depth and sophistication of people’s financial knowledge. And for people who are interested to learn for themselves, there are plenty of resources available. There is also mutual support available from our organisation for those who wish to engage with us. Our experience is that people with an interest in investment often enjoy sharing knowledge and learning from each other.

Whilst the protection of the majority is vital, it would be inappropriate to put regulatory measures in place that failed to recognise the diversity of investment knowledge and experience and, as a result, restricted market access for knowledgeable and well informed (sophisticated) individual investors.

On a wider canvas the whole principle of protecting the public by regulating the supply of advice has had the unintended consequence of denying savers access to the support of their employers, pension administrators, local authorities, low-cost professional helpers and even qualified friends.

Another unintended consequence is imposing costs on all consumers to provide something which some consumers do not need. One example is where providers are required to send specified information at regular intervals to consumers, with an associated charge for sending the information. A specific case is projections of the future value of a SIPP. While many consumers are unable to compute this for themselves, those consumers with appropriate knowledge can, yet they are forced by regulation to pay for the supply of these projections by their provider.

We have worked closely with ShareSoc in drafting our respective responses. However, we have some differences of scope, perspective, and emphasis; hence the separate submissions.

We believe that this enquiry is enormously important in ensuring that much needed and meaningful change is achieved within the consumer investment market. We would be very pleased to provide further feedback either orally or as further written evidence. If this is required, please contact Martin White at mgwuksa@mm.st .

2 Answers to your numbered questions

Q1: Have we prioritised the right issues and questions? Are there other things you think we should be looking at?

We particularly appreciate the way in which the FCA have pointed to the fundamental problems, especially when these problems are not within the FCA's formal brief to solve. We understand that regulation can be a difficult and sometimes thankless task. To quote the FSCP, we have "a powerful industry in which misaligned incentives are systemic and which enjoys, largely unchallenged, the potential to exploit consumer behaviour, product structure complexity and the lack of cost transparency". Many levers are going to be needed to change this situation, and an important regulatory lever, or catalyst, may be to require far more transparency including in relation to costs.

All 39 questions are worth asking. But yes, we would prioritise quite differently. We would recognise the scale of the consumer detriment from avoidable expenses and would be determined to tackle the inherent conflicts of interest, where the fundamental picture is not really improving[7]. The Retail Distribution Review was definitely a good first step. However, as regards intermediaries, commission bias is also present for non-advised sales, so to the extent to which consumers use intermediaries, they are unlikely to get completely disinterested advice. In this context some platforms may realistically be regarded as intermediaries due to some of the ways in which they earn their revenues.

We note that there is no explicit mention in the CFI of any input received from the FCA's FSCP. We believe that there is a good case for involving the panel in an exercise to start the thinking afresh, asking: "What would the market look like if the consumer's interest were paramount?"

We have made it clear in our Introduction above that we believe that consumers need a "who to trust" body that can help them identify suitable value products and services. Whilst this is not obviously directly within the current brief of the FCA to provide, the FCA may have an important role in helping such a "who to trust" body to operate by creating regulations that make it clear just what kinds of information may be freely published, and included in educational or guidance or training material, without falling foul of the regulatory regime.

We would not underestimate the scale of the challenge of empowering people to make better financial choices. However, all the behavioural research that has been carried out has been against the background of a financial services sector that was not trusted. The

[7] The Royal Society of Arts' 2008 Tomorrows Investor report is another powerful document that is still completely relevant today. We would recommend the whole of this report as entirely relevant to the FCA's current Call for Input. For maximum benefit, we would suggest starting with the key findings and recommendations, starting at page 5.
https://www.thersa.org/globalassets/pdfs/reports/rsa_tomorrows_investor_dec08.pdf

presence of an effective “who to trust” body might change the climate and generate more constructive engagement by people with their long-term finances.

Q2: Are there other underlying issues which have an impact on the consumer experience in this market that you think we should consider? What are they and how do you think they affect consumers?

We would say there is limited engagement by consumers, which arises from a combination of lack of knowledge, lack of access to unbiased and useful information, and a subliminal message promoted by the financial services industry that “it’s all too difficult for you to understand”. On the other hand, for those individuals who are both able and keen enough to study the issues for themselves, there are indeed good, competitively-priced products and services available. Such people are in the minority but find it useful to discuss the issues with like-minded colleagues. Our organisation attracts such people, but we would not suggest that it is fair that only those who have the inclination to do the research work for themselves should have access to the best solutions.

Nobody can predict the future and risks are unavoidable. For example, you could choose to keep your money in cash or in fixed interest investments in order to minimise the risk of loss. But if we enter an inflationary period[8], your savings can rapidly lose purchasing power. The solution is to diversify appropriately so that you are more resilient to the uncertain future. Most people need help to face these problems. The education system (including adult education) does not provide what is needed, but over time we believe better material can be developed.

For many situations, the stock answer given at present is “consult a financial adviser”. But we regard the financial advice community as part of “this market” that is presently failing consumers.

Q3: What role could or should ‘just in time’ consumer education play in helping consumers make more effective investment decisions?

We are sceptical about the value of this. Education at the point of decision is hardly education. However making essential comparative information available at the right time might be helpful, providing there is already in place a framework for people to use.

[8] An inflation revival is far from impossible if the analysis in a recently published book by Charles Goodhart and Manoj Pradhan is correct: *The great demographic reversal: ageing societies, waning inequality and an inflation revival.* An OECD video discussion is available at http://video.oecd.org/7198/or/NAEC-virtual-seminar-on-The-Great-Demographic-Reversal.html

Q4: What more can we do to help the market offer a range of products and services that meet straightforward investment needs?

Unpicking this question, we would say that “helping the market” is quite the wrong way to look at it, because the products needed already exist. Instead, ask “what more can we do to help people identify the appropriate and best value (e.g. cheapest) solutions for straightforward investment needs?” Unfortunately, if you let the financial services industry play much of a part in this, the competitive process will not be one that leads consumers to the best value products.

If there existed a fiduciary duty towards customers, that would entirely change the situation. Without such a fiduciary duty on the seller or the provider or both, selling consumer investment products in the sense of the supplier pushing them onto the consumer becomes the main problem. Somehow the process needs to be turned around so the products sell themselves through consumer demand for them with some regulatory overlay driven by a fiduciary duty by the suppliers to the consumers.

But there are some steps that we would strongly advise to help consumers to use products and services that meet straightforward investment needs. One is to ban direct selling of financial services products, as opposed to consumer-initiated purchasing. Another is to ban exit fees. These will help people avoid having unsuitable products pushed on them or being trapped in bad value products and services.

It would be wonderful if we could simply recommend that the FCA take responsibility for creating an education framework that will allow consumers of all capacities to understand the essential messages, and thus enable fairness in the consumer market. But we are not sure that this would fit appropriately with the FCA’s brief. Instead, we believe that the FCA should look to see which parts of Government, as well as which external organisations could work together on this. In terms of the quality and depth of research done, and the knowledge that exists within the FCA, we believe that the FCA could play an important role, providing the interests of consumers are moved sufficiently high up its priorities.

Q5: Could clearer, consistent labelling of investment products help consumers make effective decisions? Please provide examples where this approach has/has not been successful.

See responses to Q2, Q3 and Q4 above and Q6 below.

Q6: What are the potential risks and benefits of standardised labelling requirements for consumer investments?

Consumer investments are not always simple, so there is always a risk that an attempt to standardise is not actually helpful. However, one suggestion from the RSA (Royal Society of Arts)[9] is as follows:-

> *"Fees should be expressed in a different way: as the total over the lifetime of the investment, rather than an annual charge. This would give ordinary investors a much better idea of what they are paying."*

We would hasten to add that explicit fees are frequently not the whole story. In addition to explicit fees, active managed funds will typically suffer much greater trading costs than passive funds. Although trading costs are not easily measurable, anyone purchasing any managed fund should be given a realistic projection of the impact of likely trading costs over the lifetime of the investment. There is also a range of additional costs suffered by funds. The FCA commissioned Professor Chris Sier to devise a template for disclosure of costs; we are not sure whether this has had any impact on retail funds.

Q7: What are the barriers to firms providing simple investment products for consumers?

It is important that "simple" also means cheap. There are not any real barriers. Except that firms which also market more expensive products would make less profit if they also provided cheaper products - unless consumers generally were to become more savvy and then shunned the expensive products of competitor firms.

Realistically, in the face of a properly informed, cost aware, customer base, the number of businesses and jobs that could viably exist in the investment services and advice sector would be reduced, and their total profitability would also likely be reduced. But the outcomes for consumers would be greatly improved.

We understand that the cheapest fund management services globally are provided by a large mutual company. In other words, the savings from scale are shared with the customers by reducing expenses, rather than taken as profits.

[9] https://www.thersa.org/reports/tomorrows-investor-report

Q8: Do you think financial guidance can help consumers make effective investment decisions? Why?

Not if the guidance is limited to any one firm's products, since the best value products may be provided by another firm, or firms. A lot depends upon the level of knowledge that the customer already has.

We believe that there may be a role for a type of adviser that charges only by the hour and whose remuneration is independent of how wealthy the client is or the decisions the client makes. We will call such an adviser a "financial trainer". Referring back to the idea of the "FCA criteria" from our Introduction, if there were a class of "readily understood, well-diversified and low-cost investments" that such an adviser were able to point the client to without major regulatory impediments, while the adviser was not permitted to go wider than this class, it might be possible to have much lighter regulation for such advisers. This might put a form of truly independent financial advice within the grasp of many more ordinary consumers that are not wealthy enough to interest a regulated independent financial adviser.

Q9: What are the barriers to firms providing financial guidance services?

This question could be interpreted as relating to product providers providing guidance services, or advisory firms providing a cut down, or less expensive, type of advice. We touch on both in our comments below.

We are not sure there are many barriers other than the unintended regulatory ones that prevent providers giving appropriate transparency information to their consumers or engaging directly with them. However, if the dynamic of the market continues to be that firms "sell" their products to consumers, rather than consumers either having the information to choose between products and providers or assessing whether they should continue to invest, the market will continue to operate more in the interests of the industry than the consumers. We have introduced above the idea of financial training as a potentially helpful way forward, but the essence of such a relationship is that it is independent of the decisions made, and the costs are only incurred on a time spent basis as needed.

There is also the other dilemma that most people with money to invest will want to employ someone to do their thinking for them for multiple reasons. There follows the problem of the implications of the ways of charging for this service, which again will not be obvious to the consumer, especially over long periods of time. Our various suggestions in our response, such as a trusted body, or financial coaching / training or the mandatory provision of certain information and certification requirements on buying investment products may help to reduce barriers and improve competition in the distribution and advice structures that currently exist.

See also Q8 above.

Q10: Do you think straightforward financial advice can help consumers make effective investment decisions?

If "financial advice" means advice given by an IFA, then unfortunately the current complex regulatory system can make the provision of much advice prohibitively expensive except for the wealthiest investors. And even the wealthiest investors may find the fees high. Also, there will continue to be the bias on the IFA to appear to have provided something for the money they receive.

We would, however, be supportive of some sort of regulatory regime that enabled certain very simple and inexpensive products to be sold with less regulatory overhead. See also our responses to Q8 and Q9 above.

Q11: What are the barriers to firms providing simple advice models?

One barrier may be profitability – simple advice models may not generate as much in ongoing fees. Another barrier may be the cost of regulation.

We discuss Robo advice later under Q35.

Q 12: Should the redress model for simple advice be any different to standard financial advice? If yes, please explain.

We do not feel qualified to say much on this. But if certain products had some form of regulatory seal of approval, perhaps contingent on the circumstances of the customer, then they may represent less risk to an adviser or a provider, and redress might rightly be harder for a customer to obtain.

Q13: What do you think are the main causes of unsuitable financial advice e.g. weak competition, complex products, etc?

Like the FSCP, we would cite the conflict of interest between providers and consumers, combined with the fact that most consumers do not have the knowledge or access to information that they need to manage this conflict. In our answer to Q2, we refer to a study and 2008 report by the RSA. Quoting from the foreword of that report:-

> "The level of costs and charges also demonstrate the fundamental misalignment of interests between ordinary savers and investment professionals. Long-term savers will commonly find themselves paying out 40 per cent of an investment over its lifetime in fees (a figure equivalent to roughly ten years of contributions). Fees have risen dramatically in recent years, doubling in unit trusts for example. Yet performance has not followed suit. People are paying more for less. Yet the RSA's research shows that not only are investors unaware of the scale of charges they are paying, but that they are shocked when they do find out. This is a shocking sign of investor disenfranchisement."

The "financial advice" market was historically a "sales" market, rewarded with commission. And the way for product providers to sell a given product was to up the charges and up the commissions. We still see commission-driven scandals today. PPI is a case in point. Equity release may be another in the wings since advisors are allowed to give "advice" on the basis that the "advisor" only gets paid if the potential customer enters into the equity release mortgage. Those financial arrangements, with a fee being dependent upon the "client" taking only one course of action, are simply incompatible with giving objective advice.

Q14: How can we target and prevent unsuitable advice without imposing additional requirements on firms which provide suitable advice?

This may be one of those situations where a direct and simple solution is not available. We would instead suggest thinking about how to transform the market into one where the consumer's interest comes first. We would expect that imposing a duty of care, something that we understand Parliament would need to do, would go some way to discouraging the most egregious situations as well as reducing the need for and therefore the cost of the compensation system. See also our answer to Q4.

Q15: What role do you think there is for direct sales in a well-functioning consumer investment market?

Consumers should remain able to buy, at their own initiative, financial services directly from providers. It is good to avoid intermediaries where possible. However, when providers employ "sales" personnel on commission, the results will never be good for the consumer. The existence of such salesforces is an inherent part of the problem. While direct provision should continue to be permitted, highly incentivised direct selling should be banned.

However, devising the regulatory framework to permit "appropriate" and to prohibit "inappropriate" direct sales might be challenging and as we suggest in our answer to Q4 a ban on direct selling may be the simplest solution as in our view it has no place in a well-functioning consumer investment market.

Q16: What protections are necessary for consumers buying direct?

To identify the protections that consumers buying direct require, it helps to first consider the problems that the average direct consumer faces.

- Not understanding how the service/product works
- Not knowing about how to use the product/service
- Needing, typically, to understand two distinct elements
    - How the "mechanism for holding" the asset (could be SIPP, ISA, simple broker nominee account) works
    - How the underlying asset / assets work
        - – you can typically "own" (sort of, through nominee) individual shares, investment trusts, ETFs – all of which do not involve commissions or special deals to the "mechanism for holding" - cheap
        - Or you can own assets that typically provide extra revenue for the platform provider. An example would be where the platform provider negotiates a special discount with the fund manager, and uses the existence of that discount as marketing justification for making an ad valorem charges to platform customers, and also steers platform customers towards investing in the fund concerned, even though it may be an expensive fund and therefore at serious risk of under-performance due to its high costs.
- Not identifying that the overall provider contract locks in the consumer in a very inflexible way. For example the provider's charges may appear initially low, but lock in a future "payday for the provider", such as big charges once a SIPP goes into drawdown.
- Varying investment freedom. For example, some SIPPs are cheap to use, but limit the range of assets that can be invested in. Others are almost as cheap but enable investment in a wide range of assets. The less knowledgeable consumer may not identify the difference, or appreciate its significance, at the time they first become a customer.
- The quality of the provider's market execution of transactions. Some enable consumers to pay extra to use their dealers for negotiating prices with the market makers for illiquid stocks. Again, an appreciation of this issue requires a knowledgeable consumer.
- The consumer may not know how to implement a simple, diversified, cost efficient strategy within the platform that the provider is offering.

So this is about platforms and wrappers and the associated services on the one hand, and the products or investments held within them on the other – two things to understand as well as how they relate to each other.

There are of course solutions to all of the above problems, but they require a knowledgeable consumer. The key question is what the FCA can do to help non-knowledgeable consumers.

We have touched on what the FCA can do in many parts of this response, such as:

- Making it easier for independent organisations to make information available to consumers without being at risk of infringing regulatory prohibitions.
- Enabling a new category of "Financial Trainer" (the terminology we use in this response) to recommend a limited range of investment platform types and underlying investment holdings to consumers, without being subject to the full range of regulatory provisions presently applied to IFAs.
- Banning exit charges.
- Banning platform providers from charging ad valorem fees, unless they are capped at a sensible annual level.

Q17: What safeguarding requirements should apply to those who distribute products to consumers through online platforms?

Paragraph 3.18 of your consultation highlights the main needs of people buying directly through online platforms – clear information to help them decide to invest or not and understand what to do if something goes wrong. We have expanded elsewhere in our response, including our answers to Qs 15 and 16, what we think consumers need when buying directly and these suggestions would apply to platforms as well as anywhere else. The key needs are:

- a clear explanation on the product being considered, how it works and what its objectives are;
- a notice that there may be competing products that are more suitable and where to find information on these;
- information that illustrates the impact of the costs, expenses or charges of the product split between those of the platform, of any advice if provided and of the product over various appropriate time periods;
- a referral to a financial trainer where there is a certain level of complexity;
- information on where to obtain ongoing monitoring information;
- information on what to do if something goes wrong; and
- a pre purchase certification from the buyer to confirm the buyer's consideration of all the information provided and/or an acknowledgement of potential losses and the ability to cover these.

The problems for investors in or consumers of the Woodford Equity Income Fund (WEIF) towards the end of its existence and/or in its closure and liquidation illustrate some other safeguarding requirements in respect of open-ended authorised investment funds including when they are bought through platforms.

Platforms should be neutral (or independent of the providers) in respect of the products they distribute to consumers. Therefore, they should not receive preferential terms or payments from the provider of a fund. There is also an argument that they should not receive ad valorem fees based on their customers' portfolios and their values; instead, there should be an annual subscription payable flexibly such as monthly for use of the platform and fixed charges for such services as buying and selling shares. These should all be clearly provided when a customer subscribes to the platform along with the illustrations of the impacts of these costs and those of the relevant products and/or the provision of advice or financial training over appropriate time periods.

The regulations for open ended authorised investment funds, which we understand to be mainly in the Collective Investment Schemes Sourcebook or COLL, and possibly those for alternative investment funds (mainly in the Investment Funds Sourcebook or FUND), should consider limiting the interest in a fund of any single investor or platform. This is because any large interest will have a potentially detrimental impact due to their size on the other investors when that interest decides to redeem. While the redeeming interest will get the price of the fund at the time of redemption, the negative impact on the market prices of the underlying securities consequent on the large sale will fall on the remaining investors. There is also a possibility that a fund becomes no longer sustainable or viable because of its remaining small size after the redemption also with the consequent negative impacts on remaining investors. There will also be a natural bias from the provider towards the large interest in their fund that may result in the other interests in the fund not being treated equitably. With these points in mind, we would suggest an interest in a fund is limit to no more than 20% for any one investor or platform, and development of the practical requirements for dealing with this including actions if there is a breach of this limit.

Following on from this, large redemptions from open ended authorised investment funds should require a special treatment that is more likely to treat all its investors, especially those not redeeming and instead remaining invested in the fund, equitably. Rather than the redeemer receiving the fund price at the time of redemption, or the fund's dealing being suspended, the assets or property of the fund pro rata to the size of the redemption should be separated out into a redemption fund to be sold to meet the redemption(s). We would suggest that a "large" redemption is set as individually or collectively at the same time at least 10% of the fund. The rules would also need to specify the treatment where a pro rata proportion of any asset of the fund is too small to be used in the redemption fund; and there may be other details to work through.

Other areas of the rules for open ended authorised investment funds that should be reviewed in the interests of their consumers are:

- Making it clearer that fund managers owe a duty of care or fiduciary duty to investors in their funds
- Removing the option of not holding annual general meetings to make sure that these are always held and therefore improve the engagement and dialogue between a fund's investors and their fund manager, authorised corporate director and depositary

or trustee. Any review of this area should also consider ensuring nominee accounts representing beneficial owners of funds provide those beneficial owners direct access to general meetings at no additional cost to the investors

- Allowing direct engagement of investors with their fund managers
- Providing regular appropriate reporting such as an annual report that allows investors to better understand what is happening in their funds and be able to monitor appropriately their investments on an ongoing basis.

Q18: Are there any products or investment decisions which bring greater or specific risks of harm when consumers buy them directly?

Whether a product is bought directly or indirectly, if it is an exploitative product, designed as such, it should never be bought or sold by anyone, whatever the sales route. "Structured products" generally come into this category. An article discussing one such product can be found on page 5 of the document linked below[10]. Another example is the interest rate swaps sold to, or pushed onto, small businesses and buy-to-let landlords that became prohibitively expensive when interest rates fell to almost zero, far below their swap fixed rates. Hence our consistent suggestions in previous questions that consumer investments should not be sold, only bought and then with enough transparency and information to enable the buyer to know what they are getting into and to be able to monitor their investment over the long term.

Q19: How can we better ensure that those who have the financial resources to accept higher investment risk can do so if they choose, but in a way that ensures they understand the risk they are taking?

The present definition of a *"certified high net worth investor"* is set out in the FCA document COBS 4.12.6. While the FCA will of course be familiar with this, the definition is reproduced below to assist other readers of this submission.

> *"A certified high net worth investor is an individual who has signed, within the period of twelve months ending with the day on which the communication is made, a statement in the following terms:*
>
> *"HIGH NET WORTH INVESTOR STATEMENT*
>
> *I make this statement so that I can receive promotional communications which are exempt from the restriction on promotion of non-mainstream pooled*

[10] https://www.uksa.org.uk/sites/default/files/upload/2020-01/TPI-203.pdf

investments. The exemption relates to certified high net worth investors and I declare that I qualify as such because at least one of the following applies to me:

I had, throughout the financial year immediately preceding the date below, an annual income to the value of £100,000 or more. Annual income for these purposes does not include money withdrawn from my pension savings (except where the withdrawals are used directly for income in retirement).

I held, throughout the financial year immediately preceding the date below, net assets to the value of £250,000 or more. Net assets for these purposes do not include:

(a) the property which is my primary residence or any money raised through a loan secured on that property; or

(b) any rights of mine under a qualifying contract of insurance; or

(c) any benefits (in the form of pensions or otherwise) which are payable on the termination of my service or on my death or retirement and to which I am (or my dependants are), or may be, entitled; or

(d) any withdrawals from my pension savings (except where the withdrawals are used directly for income in retirement).

I accept that the investments to which the promotions will relate may expose me to a significant risk of losing all of the money or other property invested. I am aware that it is open to me to seek advice from an authorised person who specialises in advising on non-mainstream pooled investments.

Signature: & Date:"

We consider the thinking behind this definition to be unsatisfactory for several reasons.

Firstly, the income requirement could be satisfied by someone who has no net assets (as defined). We do not regard it as adequate regulatory protection for an individual earning £100,000 per year, who has no net assets as defined, to be able to invest £200,000 in a risky investment (financed by borrowing on the security of their house).

We recommend that the income test be deleted.

Secondly, once the net asset test is satisfied, there is no attempt to relate the size of the risky investment to the size of the individual's net assets.

While that is not unreasonable for the receipt of financial promotions of non-mainstream pooled investments, we consider that a further test is required at the point when the investment is made.

If after having received a financial promotion, the individual wishes to make an investment, he or she should be required to sign a certificate along the following lines:

"I am making an investment of £xxxx. I understand that 100% of this investment may be lost. I certify that I have net assets [reusing the full definition above] greater than £yyyy [where £yyyy is 20 x £xxxx]."

The act of giving a certificate in this form would concentrate the mind of the investor and negate any ability to go after the provider if something goes wrong except where there has been deliberate negligence or fraud.

The rules should also cater for situations where more than 100% of the investment can be lost, for example where the investor is entering into a futures transaction. The rules should require the investor and the firm sponsoring the investment to agree a maximum closeout loss, and the certificate of the kind stated above should make that close-out arrangement explicit and require the investor to certify having net assets greater than 20 times that agreed maximum close out loss.

Q20: How can we and the industry help consumers understand the benefits of diversifying their investments?

The best way is to focus the mind of the consumer on the implications of losing 100% of their investment.

All of the guidance from the FCA and from the financial services industry should emphasise to consumers the importance of investing in collective investment schemes or authorised investment funds first, and, for most people, only investing in specific individual company shares and specific individual company debt instruments once they have achieved an investment portfolio of a particular size, perhaps expressed as a percentage of their net assets.

The simpler and the clearer the advice, the better. As an example only:

"Do not invest in any individual company shares or securities until you have become competent at reading company accounts and assessing the values of companies to compare against the market price of their shares. Even after that, always hold at least 40% of your total portfolio in collective investment schemes to protect yourself against individual company investments resulting in a total loss."

Investors who have strong reason to regard themselves as well informed and who are prepared to study individual companies should, however, remain free to make their own decisions.

Q21: Would more investments benefit from 'prospectus-like' disclosure, and/or the disciplines involved in this? If so, in what circumstances?

'Prospectus-like' disclosure is desirable in principle but needs to be implemented in a way that avoids the regulatory provisions leading to unwanted outcomes. This can be illustrated by current practices regarding raising of additional equity capital by companies which are already listed on the stock exchange.

It has become very common for such companies to raise additional capital by means of placings rather than rights issues, thereby overriding the pre-emption entitlement of existing shareholders. In placings, shares are often issued to third parties who may be "friends" of the management, at issue prices which dilute the existing shareholders. The company's excuse is that issuing the prospectus required for a rights issue would be too slow and too expensive.

We regard pre-emption rights as an essential ownership right of shareholders, to be overridden only where the share issue is genuinely de-minimis. We regard even standard 5% limit permitted by the Pre-Emption Group[11] to be too high, let alone the 20% that was allowed during the COVID-19 crisis, and consider that 1% would be a more appropriate limit.

However, to make reducing the limit feasible, the requirements for prospectuses when shares are being issued in the form of a rights issue by companies which are already listed need to be simplified to focus on only the essentials, while protecting investors by imposing sanctions on directors who fail to disclose all information which a prudent shareholder would consider relevant.

Even in cases of financial distress we would prefer to see the company make a large deeply discounted rights issue, without paying for underwriting, rather than spending the shareholders' money on underwriting fees. Either the deeply discounted shares will be taken up by the existing shareholders, or they can then be placed elsewhere, having given the existing shareholders the chance to subscribe.

Q22: Should more investments be subject to continuing disclosure requirements after they are issued, and what liabilities should be attached to these disclosures?

[11] https://www.ft.com/content/630dcb71-d5cc-4c02-9381-4760eb21cf9c

Our answer to this question follows on from our preceding answer. The short answer is yes and liabilities should only attach if the continuing disclosure requirements are deliberately misleading or fraudulent. For example, the recently introduced authorised investment funds value for money annual reports are a good thing; the question is do they provide adequate information in the interests of consumers?

Once a company has issued shares or securities to consumers, it should be required to publish accounts each year drawn up to the same standards as other public interest entities, which are published on its website and filed with a central government registry, such as Companies House, on a relatively tight timescale similar to the listing requirements of the stock exchange.

Q23: What do you think about how the current high net worth and self-certified sophisticated investor exemptions are working in practice and the level they are set at?

We consider it essential for regulators to think separately about high-net-worth investors and sophisticated investors.

Overall, we consider the high-net-worth exemption to be fundamentally misconceived. See Q19 above.

An individual does not become more competent at assessing non-standard investment promotions simply because they have more money. Even if they have £100 million, it may have been acquired in a walk of life that did not require financial competence in order to be successful.

We recommend that the entire policy of enabling financial promotions that would otherwise be prohibited for the general public to be sent to individuals who have a particular level of wealth should be abolished.

The sophisticated investor exemption is conceptually different. The approach here is that if an investor has a sufficient level of knowledge/skills, they are able to evaluate financial promotions that would otherwise be prohibited for the general public.

At present the FCA has two distinct definitions, *"certified sophisticated investor"* defined in COBS 4.12.7 and *"self-certified sophisticated investor"* defined in COBS 4.12.8.

As previously, we have reproduced below those definitions for the benefits of other readers of this submission.

"A certified sophisticated investor is an individual:

(1) who has a written certificate signed within the last 36 months by a firm confirming he has been assessed by that firm as sufficiently knowledgeable to understand the risks associated with engaging in investment activity in non-mainstream pooled investments; and

(2) who has signed, within the period of twelve months ending with the day on which the communication is made, a statement in the following terms:

"SOPHISTICATED INVESTOR STATEMENT

I make this statement so that I can receive promotional communications which are exempt from the restriction on promotion of non-mainstream pooled investments. The exemption relates to certified sophisticated investors and I declare that I qualify as such.

I accept that the investments to which the promotions will relate may expose me to a significant risk of losing all of the money or other property invested. I am aware that it is open to me to seek advice from an authorised person who specialises in advising on non-mainstream pooled investments.

Signature: & Date:"

The consultation document does not ask for comments about the *"certified sophisticated investor"* scheme. However we generally support it, as it has the advantage that it is the firm that is required to assess the investor and reach a conclusion regarding whether the investor is sophisticated. The FCA has laid down various requirements, and can sanction the firm if it carries out the assessment negligently or wilfully incorrectly.

The FCA seeks views about the *"self-certified sophisticated investor"* exemption. The definition is reproduced below.

"A self-certified sophisticated investor is an individual who has signed, within the period of twelve months ending with the day on which the communication is made, a statement in the following terms:

"SELF-CERTIFIED SOPHISTICATED INVESTOR STATEMENT

I declare that I am a self-certified sophisticated investor for the purposes of the restriction on promotion of non-mainstream pooled investments. I understand that this means:

(i) I can receive promotional communications made by a person who is authorised by the Financial Conduct Authority which relate to investment activity in non-mainstream pooled investments;

(ii) the investments to which the promotions will relate may expose me to a significant risk of losing all of the property invested.

I am a self-certified sophisticated investor because at least one of the following applies:

(a) I am a member of a network or syndicate of business angels and have been so for at least the last six months prior to the date below;

(b) I have made more than one investment in an unlisted company in the two years prior to the date below;

(c) I am working, or have worked in the two years prior to the date below, in a professional capacity in the private equity sector, or in the provision of finance for small and medium enterprises;

(d) I am currently, or have been in the two years prior to the date below, a director of a company with an annual turnover of at least £1 million.

I accept that the investments to which the promotions will relate may expose me to a significant risk of losing all of the money or other property invested. I am aware that it is open to me seek advice from someone who specialises in advising on non-mainstream pooled investments.

Signature: & Date:"

As a preliminary point, there is nothing wrong with self-certification as a concept.

For example, an investor may be able to self-certify that he has a degree in mathematics, is a chartered accountant, is a chartered tax adviser, and is also a member of the Association of Corporate Treasurers, and has been investing in quoted shares, warrants and options for over 30 years, and that for these reasons he considers himself as meeting the requirements of a sophisticated investor.

We would regard the giving of such a certificate, and the associated exemption, as appropriate.

The challenge is to come up with acceptable criteria suitable for general use.

We consider the existing criteria in the FCA Handbook as reproduced above to be seriously flawed.

(c) is the only criterion that involves some assessment of competence by a third party, since either the private equity employer or the bank which employ the individual to provide finance to small and medium enterprises must have assessed the competence of the individual.

The other criteria, (a), (b) and (d) involved no requirement for any kind of competence or knowledge. (d) is particularly inadequate since being the HR director of a small company running a grocery warehouse, with a turnover exceeding £1m p.a. could not conceivably be regarded as making the individual into a sophisticated investor.

Since relatively few individuals are likely to have existing formal qualifications that would clearly qualify them as sophisticated investors, we recommend that the FCA along with the industry develops a series of online tests that could be taken by individuals wishing to achieve sophisticated investor status.

A certain level of formality should surround these tests.

For example, the individual could be required to apply for testing, then be sent an access code by paper post, and be timed while sitting the test online. The risk would still remain of impersonation, with the individual seeking someone else to sit the test on their behalf. The FCA could either choose to accept that risk, or could make the test even more rigorous by requiring the test-taker to be video recorded by their laptop webcam while taking the test. This would almost certainly deter impersonation.

What matters is having the will to introduce rigorous standards. The principle of trust but verify should be followed. We also refer to our answer to Q 19 and our suggested requirement to make an additional certification on investment.

Q24: Firms: Have you relied on the exemptions recently to communicate promotions? Why did you do so? Consumers: Have you categorised yourself recently as high net worth or sophisticated? Why did you do so and what was your experience?

No response as we are not a firm. However we would be pleased to arrange conversations between the FCA and some of our members who do have experience of this.

Q25: What more can we do to help consumers understand the high net worth and sophisticated investor exemptions and what they mean for them in practice?

We refer to our earlier answers.

If these were implemented, consumers would understand the significance of these categorisations much more clearly.

Q26: How can we make it easier for people to understand the risks of investment and the level of regulatory protection afforded to them when they invest?

This is really two quite separate questions, and posing them in this way is likely to cause people to focus on short term risks and to give too little attention to the long term.

Starting with the level of regulatory protection, it is necessary to set out the principles in a way that can be easily understood. Consumers are expected to take responsibility for their decisions, but if they have relied on inappropriate advice they may have cause for redress. The regulatory protection regime is not there to protect people from fluctuations in asset values, but good advice should ensure that people understand the risks they are taking.

Does this leave an open, unprotected, window if people are sold products that are intrinsically “bad value”, such as certain exploitative structured products, without anyone actually giving “advice”? The RDR regime did leave a window for providers to effectively take commission for “unadvised sales”.

“Risks of investment” is not a simple topic. The typical focus is often on short term fluctuations in market values. Instead, this is a fundamental question of education and financial capability. There is plenty of good information out there for those with the will and curiosity to explore it, but it would be worth also trying to identify the main ideas into some short lists, and to test how useful people find them. These main ideas might include:-

- Not saving anything, or not saving enough, is a big risk with a predictable adverse outcome.
- Expensive borrowing destroys wealth quickly – managing and keeping out of debt can be the place to start
- The future is unknowable, but that is no reason not to plan for it
- You cannot avoid risk altogether. For example if you keep all your savings in cash or fixed interest investments, you may be avoiding exposure to market value falls of stock market investments, but in the event of inflation or the collapse of the entity with your cash deposit and exposure above the deposit protection scheme limit the real value of your savings could be wiped out.
- Diversification, or not putting all your eggs in one basket, is vital to managing risks.
- You can diversify investments by spreading your money between different investments. But you need to diversify between types of investment. If you concentrate on a particular area, then if that area goes bad you will be in trouble. For example many private investors held too much of their investment portfolio in bank shares prior to the global financial crisis.
- Time and uncertainty are vital themes, as is coping with human emotions. If market values of assets fluctuate it is important not to worry too much. In arguably the most famous book on investment, "*The intelligent investor"*, by Benjamin Graham, the author has a chapter called "The investor and market fluctuations". And in Warren Buffett's foreword to the 4th edition we have the following:

  > "To invest successfully over a lifetime does not require a stratospheric IQ, unusual business insights, or inside information. What's needed is a sound intellectual framework for making decisions and the ability to keep emotions from corroding that framework. This book precisely and clearly describes the proper framework. You must supply the emotional discipline."

- To these themes we would of course add the importance of minimising expenses. And actually being shown how to achieve this is a vital part of individual empowerment and financial capability.
- The time dimension is important. There are often immediate high priority risks and responsibilities to be managed. Do you have enough cash to cope for a number of months in the event that you lost your job? Is there life insurance in place to protect the family in the event that a breadwinner dies? Are you saving ahead for major expenditures rather than needing to go into debt?
- For the shorter term savings needs, equity-type risk is inappropriate. But for longer term savings needs, retirement etc., the more dangerous approach may be <u>not</u> taking equity-type risk.

A good approach to managing uncertainty is to face up to it, to ask yourself what might happen, and how you might cope in that circumstance. This is not a process that people necessarily find natural comfortable, especially around money. But if we revert to the idea of a Financial Trainer, he or she would probably need to develop counselling or coaching skills in order to help clients tackle financial planning.

So to return to the question “How can we make it easier for people to understand the risks of investment”, we would suggest that there is nothing particularly complicated in the material we have set out above. The challenge is how to help people to engage with it, and the FCA could consider how it might encourage that.

With all the above as essential background, financial services providers could be required to explicitly set out the worst case losses that investors have ever suffered over a 1, 3, 5, 10 and 20-year period in financial products of a similar type. For example, if the product is an equity fund, the data provided would be for the worst case losses over those time scales that have occurred within the universe of equity funds; if it is a property fund, then it would be with property funds.

Where the product is a platform which enables the purchase of individual equities, the potential customer should be reminded that every purchase of a specific company share can result in a 100% loss. It is of course vital that the period that is used in the “have ever suffered test” includes all the big crashes of the 20th and the 21st century from 1929 onwards.

But before we move on from the above suggestion to illustrate the potential for loss, it is essential that the “you could lose lots” message is not where the communication stops. The history will show that following crashes there are very frequently recoveries. The disaster is where you are forced to sell at a low price, or emotion takes control and you choose to do so. In “*The intelligent investor”*, Graham has a useful section headed “*Note on the concept of risk”*, in which he argues that assets that fluctuate in price should not necessarily be thought of as “risky”. Understanding this is an important part of “understanding the risks of investment” in this Q26 of the CFI.

This illustrates the question of suitability of an investment for an individual. If you may <u>need</u> to sell a stock market asset in say the next five years or less, it is arguably not suitable for you.

It is also important to appreciate other risks that are more important than market price fluctuation. First, there is a risk of simply paying too much for an investment. The “dot com bubble” of 2000 comes to mind here. Second, there is the risk of total loss. Investing in individual companies, a company that has significant debt on the balance sheet is more likely to experience total wipe-out of the ordinary shareholders than a company that has net cash on the balance sheet. And complex “structured products” may also involve the risk of total wipe-out.

We hope the paragraphs above illustrate how the term “risk” can be misleading if viewed too simplistically. Regarding price volatility as synonymous with “risk” can lead to misunderstanding and consequently to bad decisions.

Is education “the” solution?

We totally support the principle that the more knowledge and engagement there is amongst consumers, the better. But it is not realistic to require that everybody can fend for themselves. In the area of support for financial decisions, an essential principle is “one size does not fit all”.

First, on a cautionary note, it is vital to recognise that getting everyone to a good level of financial capability is just not going to happen. So it is essential that there is trustworthy and unbiased help readily available to all. This is a world away from where we are today.

On a more positive note, we suspect that people are generally a lot more capable of understanding the basic principles than the financial sector tells them they are.

Fundamental to empowerment is knowledge and understanding. Without that, consumers are not capable of making sensible decisions. The answer is education, but research has shown that ‘education’ has made little contribution to financial understanding for the great majority of people. Further, the supply of knowledge (‘advice’) has become a protected market, discouraging innovation and imperilling independence.

What is missing is a modern approach to learning. Writing essays and sticking them on a website just does not cut it. What is needed is a network of trusted learning paths, mostly online, that copes with the enormous variety of human understanding and the enormous variety of human circumstance to which the understanding might need to be applied. This is a technique that is revolutionising learning, enabled by the Web.

Development of this learning network cannot be left to the market: it would be corrupted by special interests – consumer ignorance is a friend to high margins for the financial services industry. It has to be provided by a body answerable to Parliament; the FCA is ideally placed to be that body within its existing statutory brief. And it will be cheap. All it needs is skilled direction – by teachers, practical investors, economists, systems specialists, psychologists; and not necessarily by industry representatives. And there is a role for community involvement, such as evening classes run by local authorities.

In a small way UKSA’s education offering offers a glimpse into this future. It was developed at no cost by committed volunteers. UKSA’s Savers Take Control project is designed to draw on the efforts of financially highly literate volunteers, ultimately to help the population at large to deal better with a financial services sector that will not put its customers’ interests above its own.

Q27: What can be done to help consumers to better understand the circumstances in which they will be able to claim on the FSCS?

We would note that people need to understand when they are NOT able to claim - and importantly the principles which determine when they are able to claim.

Q28: What more can we do to ensure that when people lose money because of an act or omission of a regulated firm, they are appropriately compensated?

There are some situations where the consumer has absolutely no way to avoid exposure – the regulatory regime in many circumstances now requires the use of nominees. This is true for ISAs and for SIPPs.

It is completely unacceptable that there is no formal regime to avoid the situation that in the event of a failure, with or without an associated fraud, of an entity (the ISA / SIPP provider or its nominee company) which is supposed to exercise a stewardship role, investors could simply lose title to their investments, no matter how diversified or carefully selected those investments may be. This was the risk that Beaufort Securities posed. We believe it is an urgent and serious problem. It is a particularly serious problem, since there is no way that an individual can protect themselves against this risk. The FSCS limit is small compared to the sums potentially involved, say, in the total loss of a pension pot.

We have long campaigned for the beneficial holder of shares held by a nominee to be personally identified in the share registers of the investee companies concerned, and the same would apply to holdings in pooled investment vehicles held via a nominee.

We agree with the outcomes looked for in Chapter 6. These mainly are:

- It is important that consumers receive redress when they have been harmed by a regulated firm's act or omission.
- That the costs of this redress should be met in a fair and sustainable way.
- Regulation cannot prevent all harms from happening.

Where a consumer is harmed through receiving bad advice, then they have the right to seek redress.

However, for practical reasons, you may have been focusing too much on the providers of compensation rather than on the consumers, the receivers of compensation. By turning the focus around, the outcome looked for may reduce the need for compensation.

A starting point would be identifying all circumstances where compensation should and can practically be made from the consumers' perspective. As you say, regulation cannot prevent all harms from happening. At the same time regulation should recognise that some harms are not compensatable. For example, the harms from a potential failure of an investment or its reduction in market value as "known to the consumer investment risks" should not be compensated when they crystallise. However, if a consumer is provided with an unsuitable savings and/or investment product and as a result they experience financial loss, then this would be a harm needing to be compensated, unless it was clear that the unsuitable choice was down to the consumer themselves.

We believe this process of identifying those circumstances where compensation should and can practically be made will be a good starting point to ensure that when people lose money because of an act or omission of a regulated firm, they are appropriately compensated. We would be happy to help with such an identification process. The resulting list would also need to be reviewed regularly for changes required by market developments.

At the same time, you will need to decide what is the appropriate compensation for each identified circumstance and its source, some of which is covered in our answers to Qs 29 to 31 below. We recognise that fairness in compensation requires balance between:-

- What a consumer cannot afford to lose;
- Which circumstances should be compensatable.
- What a provider can reasonably afford, taking into account appropriate insurance.

We agree that if more advice becomes suitable or consumers are in future provided with suitable products, the need for redress should diminish. This points to regulation trying to ensure the provision of advice or products (as advice may not lead to the provision of a product) to consumers is suitable. Again, putting yourselves in the position of consumers rather than the providers or producers of consumer investment products should lead you to what is needed to ensure suitability. Some of this may be requiring sufficient initial and ongoing information and transparency in respect of a product; or an appropriate suitability assessment by a provider or the consumer or both.

While nothing can ever be perfect, we support the redress process of the Financial Ombudsman Service ("FOS"). However, we are not sure how clear it is to consumers that FOS is available only to seek redress for a compensatable circumstance, despite regulatory requirements to point the consumer in its direction. This process may need to be reviewed from a consumer perspective. The identification of compensatable circumstances may also help the FOS process by providing clear guidance of what it should consider.

Q29: What more can we do to ensure that compensation is paid for fairly by those that cause the loss?

In the context of ensuring compensation is paid fairly in appropriate circumstances where loss is due to an act or omission of a regulated firm, we support your capital adequacy regime and the Financial Services Compensation Scheme ("FSCS") as a compensation scheme of last resort.

However, the main issue appears to be where a guilty party runs out of money to provide appropriate compensation; and this means compensation must then come from FOS or FSCS and be funded by the rest of the industry who were not the guilty party. The consumer expectation therefore is that if they have suffered a compensatable circumstance (see our answer to Q28), they will not suffer even if the guilty party runs out of resources to compensate them.

You may have touched on the solution in your reference to Professional Indemnity Insurance ("PII"). You mention that PII is required by firms providing advice. We suggest PII should be required by all regulated firms and should include any instance of providing unsuitable products or advice. We accept that while a firm remains in existence and is paying for PII, the more likely it will be able to provide compensation through PII if they are a guilty party. However, you point out rightly that by the time consumers realise there is a problem, the firm that gave the advice or provided the product may no longer be in the market, so neither their capital nor insurance is there to provide redress.

We recommend that the PII compensation insurance cover applicable at the time the consumer contract is entered into is required to remain with the consumer contract after the firm providing the advice or product disappears. Requiring an extended discovery clause of this nature in professional indemnity insurance would increase the cost, but it would much more fairly meet the need. Some implications of this are further discussed under Q30 below.

We also believe you could do more to go after the assets of the individuals involved in causing compensatable losses, especially where it is clear that the provided advice or product was unsuitable, and the individuals' firms do not have the capital or insurance to cover the compensation.

Q30: What do you think should be done to help ensure that the 'polluter pays' for unsuitable advice?

It is not just unsuitable advice that we should be concerned about. There also exist fundamentally unsuitable products. The CFI's Foreword refers explicitly to "unsuitable products with high fees".

For our main thoughts, see our comments for Qs 28 and 29, and note in particular the comments about insurance. Requiring extended discovery in insurance cover would very much concentrate the minds of insurance underwriters, who will become much more interested in how their insured clients treat their customers. This could be a powerful way of harnessing the power of the market, the market for insurance, in the public interest.

We would suggest that regulation needs to require a minimum level and standard of professional indemnity cover for advisers and producers. This would lead to more attention being paid to the conflicts of interest between customer and intermediary or provider.

We cannot be privy to the details of course, but we do wonder why wrongdoers in the financial sector seem to get away with it.

Q31: What do you consider to be the right balance of approaches to ensure we provide an appropriate level of protection to consumers?

As referred to in our comments for Qs 28 and 29, we believe an appropriate level of consumer protection will come from the following:

- Putting consumers first, alongside the necessary cultural changes for providers.
- Identifying compensatable circumstances and if possible specifying the level of compensation for each.
- Making this clear to the consumer.
- Identifying the “polluters” (firms or individuals or both) and obtaining the required compensation from them including through FOS.
- If this is insufficient, reverting to insurance cover allocated to the consumer investment contract.
- If this is insufficient reverting to the FSCS as a last resort.

We would also like to mention here a possible need for you to look again at conflicts of interest in the system with a consumer perspective, especially where you can see the rules are not working in the interests of those consumers. We believe that a lot of good financial services firms put their customers first and treat them fairly. However, this may depend on who they define as their customer. For example, a fund management firm and therefore their employees may see their customers as the financial advisers or platforms who distribute their products rather than the beneficial owners of or end investors in their products, who are the real consumers.

If a financial services firm’s purpose is clear and focused on their ultimate customers or consumers, their business model should develop in a way that provides suitable products at a cost or price that is sufficient and sustainable for the organisation and its main stakeholders and therefore provides an appropriate level of protection to their consumers.

Q32: Do you have any views on how the AR regime is working in practice?

We have insufficient collective experience of how the appointed representative ("AR") regime is working in practice and therefore do not have a fully developed position on this question. However, we would like to point out that the AR regime appears to have been created from the perspective of the industry rather than the consumer. If looked at from a consumer perspective, we cannot see any need for it and therefore suggest, in the interests of consumers, it is abandoned. This will require all providers of advice and products to be authorised and fully accountable under the regulatory system; and therefore mindful of any of our suggestions mentioned in Qs 28 to 31 that are put into practice.

In our response to Q33 below, sub-para 33.4, we discuss financial promotions by unauthorised firms. We refer here to our earlier response to a consultation paper issued by HM Treasury in July 2020 on this subject.

Q33: How can people be better protected from scams?

A key point to make is that few scammers are 'chancers' who think they will try their hand at fraud to earn a bit of extra cash. Most are sophisticated and professional. They are also adept at what might loosely be called 'new product development'. For them it is a form of business and they do it because it is profitable and it pays in terms of the risks and rewards that it involves. In a significant number of cases it is almost certainly linked to organised crime. Consumers need to understand what they are up against and how to deal with it.

At a recent Transparency Taskforce TTF seminar [12] several participants at the event made the point (directly or indirectly) that there is much that the financial services industry and regulators could learn from the scammers. This includes things like:

- providing a simple, easy-to-understand message;
- providing clear alternatives which are easy to understand;
- making sure the best option is clearly presented and clearly shown as being in the customer's best interests;
- making a clear statement of benefits from following their advice;
- presenting themselves as being likeable, on your side and keen to help;
- not being constrained by a load of regulation which gets in the way and is of little interest to the customer (e.g. complex T&Cs with lots of small print, copies of documents like the KID, long questionnaires with how-long-is-a-piece-of-string questions);
- avoiding investment jargon - except to the extent that it enhances their plausibility and provides a veneer of financial expertise;
- being happy to do and say things which (in reality) don't sound like being in their interests - like warning people to beware of scammers and offering to help them avoid getting scammed.

[12] 'How would you fix the Pension Scams Problem?'; Transparency Taskforce – 24th November 2020.

These are all behaviours that will be found in any basic primer on persuasion techniques. Yet regulators, government and the financial services industry still seem to wonder why so many people continue to fall for the lure of the scammers while failing to realise where they themselves are going wrong.

We note what you say in paragraph 7.4 of the Call for Input about where the FCA's focus lies in trying to tackle scams and fraud. However, the current approach to managing scamming and fraud relies too heavily on 'reaction' i.e. the consumer contacting Action Fraud, the FCA or the Money Advice Service when they realise they have been scammed and it is too late.

There are a number of actions that could be taken to help combat fraud and scamming which we discuss below.

33.1. Equipping consumers to look after themselves

As in other areas of consumer finance there is a need to make sure that consumers are self-reliant and well placed to look after their own interests rather than hoping that the regulator will do it for them and that compensation will be forthcoming when it all goes wrong.

First the good news: it is clear that there is a significant amount of good content on the websites of the FCA, the Money and Pensions Service and Action Fraud on frauds and scams. The FCA ScamSmart system is a useful interactive tool for checking quickly whether an approach by any firm or individual might be a scam.

But there is also bad news: there are serious weaknesses in the way that the various agencies and their websites set out their stalls and appeal to consumers:

- There is confusion – particularly in the area surrounding the Money and Pensions Service, the Money Advice Service and the Pensions Advisory Service. They are all part of the same organisation but why do they need three different titles? The FCA also has a section on its website about pension scams.
- They all seem to be aiming at slightly different potential audiences, with significant overlap in some areas (e.g. MAS and FCA on pensions) although it is not clear how those audiences and their needs really differ;
- It is unlikely to be clear to users at the start of their search for information on fraud and scamming which website / agency is most appropriate for their needs;
- There is significant duplication of information;
- A search for 'Money Advice Service' on Google produces a list of three other commercial organisations (four counting an advert by Harcus Parker for the Woodford action) ahead of the MAS website; all appear on the initial search with a similar sounding title; it is only by clicking on one of them that you realise that they are commercial sites offering services that have to be paid for;

- It is not clear which of the publicly funded organisations is the most appropriate one to go to for a particular type of fraud-related issue.

This means that the main organisations that are supposed to be combatting fraud and scams and helping consumers to avoid them are presenting consumers with a fragmented and incoherent array of options. This is not helped by the fact that Action Fraud has had poor publicity over the last eighteen months which has seriously damaged its credibility. Given that it is the only one with ‘fraud’ its name, and therefore an obvious first port of call for anyone worried that they are being defrauded, this is most regrettable.

These issues need to be resolved and, at the same time, we also believe that there is an important educational opportunity that could be developed. We suggest that:

- The various agencies with an interest in trying to combat fraud and scamming should work more closely together to develop a single point of contact and information on fraud and scamming. This should be easy to navigate so that consumers can quickly find their way to the relevant part of the site to deal with the issue they are facing.
- The site must aim to educate and train people as well as providing information;
- The site should be interesting and entertaining as well as being informative; there is scope to make use of interactive tools (such as Scam Smart), videos, recorded discussions and case studies and on-line chat and advisory services (from an ‘expert’ who is part of the ‘service’, not via a public chatroom); many people are happy to spend hours online watching light entertainment and sport; the site should aim to compete for their attention.
- There must be a strong element of public interest which ensures that people identify and empathise with the issues being raised.
- Content should be regularly updated with older information archived but still accessible.

To support this and to build and maintain engagement we believe that the sort of ‘nudge’ approach mentioned by the FCA in its Call for Input (paras. 2.5 and 2.6) could be used to ensure that basic awareness and understanding of fraud / scam prevention is kept at the forefront of people’s minds.

This could be done by the FCA periodically requiring regulated providers to disseminate to consumers messages created by the FCA about the importance of frauds, scams, and red flags to watch out for. These messages could include references to on-demand webinars and other resources.

The success of the BBC’s Crimewatch programme (now superseded by Crimewatch Roadshow) which ran for 33 years and at its peak achieved 14 million viewers a week demonstrates that there is strong public interest in matters of crime. The combined might of the FCA, the MSA, Action Fraud, the FSCS and the SFO (the last two of which have just agreed to co-operate more closely in the growing fight against fraud) should be able to develop an effective programme of public engagement to help combat fraud and scamming.

33.2. Banning cold-calling

In January 2019 unsolicited calls about pensions became illegal – except by companies authorised by the FCA and where the recipient has consented to receiving calls. This ban should be extended to cover unsolicited calls about all savings and investment products.

Clearly, a ban is not going to stop scammers and fraudsters cold-calling. However, it does send a powerful message to consumers that any individual or company cold calling them about a financial product or service is operating illegally and that they should either put the phone down or delete the email unless they have expressly given their consent to be contacted.

33.3. Simplifying the message

In our response to Question 35 below we discuss the increasing interest in robo-advisors. There are clearly a number of pros and cons to robo-advisors which we discus in more detail below in Section 35.2.5. However, what is undeniable is that robo-advisors rely on the ability to strip away superfluous and superficial complexity from mainstream investment products. Based on a few straightforward questions to the would-be investor the system uses an algorithm to determine the best product (or basket of products) for the individual to invest in. For many savers and investors this sort of simplicity is entirely appropriate.

33.4. Financial promotions

In July of this year (2020) HM Treasury circulated a consultation paper on revised procedures for approving financial promotions by unauthorised firms[13] . While the subject of the consultation was not in itself about fraud and scamming, it was nonetheless been prompted by serious weaknesses in the current system of approvals which up until now has left the door wide-open for unauthorised firms to promote products using claims which could potentially be seriously misleading.

We responded to the consultation expressing some surprise that steps were only now being taken to tighten a system which was clearly deficient in terms of its effectiveness in preventing consumer harm. We welcomed the consultation and we recommended that Option 2 for revising the current procedure (the more stringent of the two options presented) should be adopted.

However, we also said that the proposals did not go far enough and that there should be effective monitoring of the approvals process as follows:

[13] Regulatory Framework for Approval of Financial Promotions: Consultation. HM Treasury July 2020.

- Authorised firms which have approval to sign off promotions for unauthorised firms should be required to report to the FCA on the approvals that they had given during the year with details of:
    - the client (unauthorised) firm, the nature of the product and its promotion;
    - the outcome of approval process (approved, refused, approved with amendments);
    - an 'identifier' or reference number allocated to each application for approval; against each reference number the approver should be required to keep a file showing all correspondence relating to the request for approval and a brief report stating the work carried out under the approval procedure and why approval was given or refused.
- A spot check should be carried out each year by the FCA on a meaningful number of approval applications by selecting reference numbers from the reports sent in by the approvers. This would form a quality check to ensure that the approvals process was working properly. It should also pick up any emerging issues with innovative products and their promotion. This process would be similar to the quality review process that the FRC currently carries out on company reports and audits – although in this case it should be far less onerous and time consuming for the regulator.
- The FCA should publish annually a report summarising its findings and conclusions from the annual submissions from the approvers and its own quality checks on approvals. This report should be submitted to the Treasury and placed in the public domain.

When systems of control are put in place it is important that they are supported by effective on-going monitoring to ensure that they are having the desired outcome. It is not appropriate to hope for the best and wait to see what happens to the level of consumer complaints and claims to the FSCS for compensation.

Q34: What do you think are the most suitable and proportionate remedies to further tackle scams and other online investment harms?

See answer to Question 33 above.

Q35: What opportunities do you think can emerge for the consumer investment market from innovation?

Innovation for its own sake is of little value; it has to address an identified need and in doing so should bring benefit – in this case to consumers. Furthermore, it should be appreciated that there is a range of types of innovation, including:

- Innovative thinking in problem solving
- Introduction of innovative products and services
- Innovate methods of service delivery
- Use of innovative new technology – as well as the innovative use of existing technology.

Innovation may not benefit everyone. For example, the introduction of new technology might result in a cost to service providers (because they would have to fund it). However, if there is a significant benefit to consumers there may be an argument for the government or regulators stepping in to ensure that the technology is applied. A good example would be the use of innovative technology to help counter scamming and fraud.

Below we consider a number of issues currently facing consumer savings and investment markets. We go on to consider how innovation might help to address them.

35.1. Some pressing problems:

35.1.1 Lack of numeracy among the UK population

The UK was ranked joint bottom for adult financial literacy in a league table in 2016 of 17 OECD nations, on a level with Albania, and is the only OECD country where the numeracy skills of 16-24-year-olds are lower than the over-55s. The Financial Times (FT) noted in a recent article[14] that only one in four Britons of working age was said to be functionally numerate. Half the population has low confidence in making decisions to do with money according to the FCA's own research. Fifty per cent have problems understanding credit card repayments.

This is a disastrous state of affairs. In the Call for Input the FCA discusses the merits of ensuring that consumers have at least a basic level of financial education. However, while standards of numeracy remain so poor, providing financial education is likely to have little impact. Poor standards of numeracy are an issue that the FCA cannot ignore if it wants to ensure that consumers are better protected when making savings and investment decisions.

35.1.2 Ultra-low interest rates on savings

[14] Counting the cost of the UK's deficit in numeracy skills: FT Money; Saturday, 31st October 2020

Following the banking crash in 2007/8 and copious amounts of quantitative easing, interest rates on many bank accounts fell to 0.5% per annum. It seemed at the time that they could not possibly go any lower. However, the economic impact of the Covid-19 pandemic has cause interest rates on many savings accounts to fall to almost zero. At the end of September NS&I announced that it would be cutting interest rates on its popular (index linked) income bonds from 1.15% to 0.01%. This will prompt other providers to cut rates on their products.

Faced with this situation savers have, basically, three options:

- Do nothing and accept very low interest rates; many will not do this because they need some level of income from savings and / or they realise that, unless they put their money into an index linked account, inflation will erode their savings.
- Spend the money; some will do this but others won't because they are by nature savers.
- Look for other savings products. Most of those which offer the prospect of better income will involve more risk. The real risk, however, is that in many cases people will simply not understand the products and will be in no position to make a meaningful assessment of the financial risks. There is also a risk that certain providers will take advantage of this with products that offer returns that are too good to be true. The FCA is clearly aware of this but being aware is not enough. Urgent action is needed to address it. Innovative thinking is likely to be required.

35.1.3 Pressures on personal savings caused by the Covid pandemic

With many people at risk of losing their jobs there is a strong incentive for them or, equally importantly, other members of their family, to raid savings built up over a lifetime. Some may decide to draw down early from pension pots (some of which will already be under-funded) while others will turn to products such as equity release mortgages (ERMs). ERMs are likely to be particularly attractive to older people who have paid off their own mortgage but who want to help children who may be in financial distress. Even before the pandemic the ERM market had grown from around £1bn in 2009 to £3.9bn in 2019.

In the case of ERMs it is still possible under FCA rules for so-called 'advisors' to charge contingent fees. This provides an incentive for the advisor to encourage homeowners to withdraw more than they need to from the equity in their home. Some providers, such as Age Partnership, persist in claiming that they offer 'free, no-obligation quotations'. However, if the home owner does decide to go ahead (and there is every incentive for the provider to encourage them to do so) the quotation and 'advice' are anything but free. We have written to the FCA recently about this but it shows little interest in addressing the issue.

35.1.4 Access to advice

In the light of the above issues, it is more important than ever that people have access to sound and impartial advice. In 2012 the FCA, rightly, banned commission payments to advisors on retail investments. Advisors are now largely paid by clients on a ‘percentage of assets’ basis. As a result clients are now more likely to get impartial advice rather than a ‘sell’ based on suggestions that provide the most lucrative outcome for the advisor.

However, it has also meant that:

- Consumers are more aware of the cost of using an advisor; many are reluctant to take on this cost;
- Many advisors have found that it is not worth dealing with anyone with a relatively small amount to invest. Between 2013 and 2015 the proportion of advisors insisting on a portfolio of at least £100,000 doubled to 32%.

It is tempting to conclude that financial advice has become the preserve of the wealthy. In reality, the issue maybe more nuanced. The so-called ‘wealthy’ are likely to be older people who have accumulated significant assets over a lifetime of work and who are now retired - some on generous occupational pensions.

Until recently this has meant that many younger people who will not have any meaningful savings have no, or very limited, access to financial advice. However, the advent of robo-advisors could provide an on-line service which meets the needs of many millennial saver and investors. We discuss this in more detail below under ‘Options and opportunities for innovation’.

Under Q8 above, we discuss the possibility of using what we have called Financial Trainers, who charge by the hour and their remuneration is not linked to how wealthy you are or what decisions you make.

35.1.5 Availability and comparability of relevant information

Pilita Clarke writing in the Financial Times Business Life column recently[15] noted the ease with which she could go onto the internet and find the cheapest flights to the south of Spain. From holidays to haircuts and computers to cars we can compare all sorts of options and prices at a click. She noted, however, that when it comes to the much grander sums that we put towards retirement or serious investments the picture is depressingly different. Her latest pension fund statement told her that her money had gone into a blended multi-asset fund here, a blended global equity fund there and that all were doing well against some not-entirely-obvious market benchmarks. She added that what she would really like to know was how climate-friendly those investments were and how their returns measured up against

[15] Financial Times; 16th November 2020; ‘It is time we had a better way to judge where to put our money’.

rivals. If only one could compare such things as easily as, say, airline flights on Kayak or hotels on TripAdvisor.

Despite the fact that more information is now available to consumers when making investment decisions, it is still often very difficult to make easy comparisons – even for very similar products. In many cases, information about issues such as climate change, which consumers increasingly want to consider in making their investment decisions, is not presented in a way that is easy to understand and compare.

35.2. Options and opportunities for innovation

So how can the FCA apply innovation to address some of the issues outlined above? Possible options include:

35.2.1 Numeracy and financial awareness

Regardless of how the FCA's statutory objectives are framed, there is only so much that can be achieved by applying more and more regulation to the supply side. The FCA needs to accept that if it is to achieve better protection for consumers much of this can only be achieved by making consumers more self-reliant. This in turn requires them to be more 'financially aware'. This can only be effective if standards of numeracy are significantly improved.

The FCA needs to become much more involved in joining forces with other parties – schools, employers and voluntary organisations such as debt counselling services, Citizens' Advice and National Numeracy - to lobby government to get a range of initiatives into place to improve numeracy among the whole population.

35.2.2 Basic impartial advice

The FCA and government need to accept that many consumers require basic impartial help and advice. Some sort of government sponsored service should be set up to provide, at the very least, basic advice on savings and simple investment options. It should be made easy for consumers to access the service. It should also be heavily promoted and people should be encouraged to use it. It is not realistic to expect the financial services industry to provide it. This suggestion also has links to suggestions in Section 35.2.4 below which calls for greater clarity of information. This service should be free of charge to the users.

35.2.3 Product labelling and classification

A system of clearly classifying and or labelling financial products might be worth considering in more detail but we note the FCA's comments (para 3.4) that this sort of initiative has not been particularly successful in the past. We also note the very appropriate reference to labelling of food. However, the evidence with regard to food labelling suggests that people take little notice of things like the traffic-light information on food packaging. Similarly, despite continued warnings about the health problems associated with obesity and media fascination with healthy diets and lifestyles, the message fails to get through. With regard to consumer finance it would be appropriate be to look closely at what has worked and what hasn't in other sectors in terms of changing consumer behaviour.

35.2.4 Availability and comparability of information

In the case of Pilita Clark's pension statement described in 35.1.5 above, it seems that help may already be at hand. Swiss banker Retto Ringer runs Globalance, a private bank, which has just rolled out what he calls a 'Google Earth for investors' - and anyone else who wants to see how green a company really is. Its online site, called Globalance World[16] , lets users compare the financial performance of thousands of companies as well as their impact on society, the environment and other areas.

The site is clearly aimed at the more sophisticated investor. It also seems likely that there will be quibbles with the methodology used for some of the data – partly due to the lack of uniform official standards for measuring things like climate risk. However, as the FT notes, the transparency Ringer is trying to achieve is laudable and overdue. The basic principles of what he is trying to do merits close attention and provides a template for other innovative approaches to comparison websites for retail investors and savers.

35.2.5 New technology

A recent article, again in FT Money[17], described how constraints imposed by lockdowns during the Covid pandemic had forced financial advisors to engage with their clients by phone and online rather than meeting them face to face. This has resulted in a significant reduction in the time and expense associated with travelling. One company interviewed estimated the cost of taking on a new client at £1,500. It commented that, if these costs could be brought down by using online contact, advisers might be willing to work with people who have not been a target audience in the past. Another firm, Sanlam, has launched an online 'on demand' service to prospective clients. The service is advertised through Facebook and provides a free 45-minute same-day consultation.

The recent arrival of robo-advisors means that for those with small sums to invest a form of advice is now available. However, it appears that the amount of meaningful advice provided is usually very limited. A robo-advisor is simply an online investment service which typically asks 10-15 simple questions and then allocates the investor to a suitable basket of investments and manages them for the investor on an on-going basis. Costs, and the

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[16] Globalance World: https://fe.globalanceworld.com/en

[17] Financial Times; FT Money, 7th November 2020: 'Pandemic drives financial advisers to speed tech change'.

charging mechanisms used vary and, as always can have a significant impact on investor returns.

Boring Money[18] carried out research on the returns achieved by a number of robo-advisors on a £500 investment over a two-year period from January 2018 to January 2020. The best three achieved an increase in the value of the initial investment after charges of between £44 and £54. The poorest three lost between £41 and £66 over the two year period. However, much of this is down to the way in which they charge. The worst performers all had an element of fixed monthly fees or minimum monthly fees. On the £500 investment the impact of even a small fixed or minimum monthly fee was very significant. Boring Money noted that, for example, Barclays Smart Investor, which charges a £4 fixed monthly fee, was one of the worst performers assuming an investment of £500 but a much better performer with an investment of £50,000.

While interest in robo-advisors is certainly growing, the Financial Times recently noted that only a small proportion of investors actually use such digital services[19]. There is evidence that they are popular with Generation X (those born between the mid-60s and early 80s) and millennials. It appears also that many who invest using robo-advisors are 'nudged' into using them by companies whose funds they already use.

There is, however, one particularly intriguing aspect of the robo-advisor 'model' which the FCA should consider carefully. The model is based on the 'commoditisation' of investment products and services. It strips away all the superficial, unnecessary and often meaningless differentiating factors that the financial services industry typically applies to try and confuse customers. Instead, on the basis of a few answers to simple and straightforward questions the system immediately suggests an investment approach which in many cases is likely to be appropriate for the consumer. The conclusion has to be that much of the complexity and 'dark-art' that has built up around the investment industry is based on nothing more than artifice that it has engineered to suit its own purposes. We also comment on this in our response to Question 33 (Sub-section 3) above.

Finally, and with reference to a service aimed at more sophisticated investors, Primary Bid[20] seems to have cracked the age-old problem of private investors being excluded from public offerings and new placings. By simply registering with the Primary Bid platform, which was launched earlier this year, investors can join corporate fundraisings on the same terms as institutional investors. This is a clear demonstration of the fundamental changes that can be achieved in retail investment by harnessing technology and the determination of those who want to bring about change.

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[18] Boring Money https://www.boringmoney.co.uk/learn/investing-guides/product-guides/robo-adviser/

[19] Financial Times: 'Roboadvisers make slow progress gaining ground with investors' – 9th September 2020.

[20] Primary Bid https://primarybid.com/about

There are already, as outlined above, a number of good examples of innovation that can be built upon – from National Numeracy through to Globalance World and free or low-cost online advisory services. However, a concerted centrally coordinated effort is required to build on these and further develop new ideas.

Q36: What do you think are the main risks of innovation for consumers?

There are a number of risks. These include:

36.1. Increased scamming

We note the increasing ease with which scammers and fraudsters can pose as legitimate businesses to deceive consumers into parting with money. It is important to understand, as already mentioned in the responses to questions Chapter 7, that the criminals perpetrating this type of deception are sophisticated and professional. They will exploit to the full every opportunity presented by innovative new technology to maximise their own gains. For them it is a business opportunity whose legitimacy is of no relevance to them.

36.2. Lock-in

There is a possibility that some new developments in, for example, platform technology could be used to lock clients into certain providers. There has been significant debate recently about the ease with which investors should be able to switch between investment platforms. Much of this has focused on platform switching charges levied by platform providers. We have commented elsewhere (Q37) that competition between platform providers is limited by the fact that ‘functionality’ across platforms is very similar. However, if significantly different functionality emerges, whilst welcome, it could also be used lock consumers into a provider. Experience in the mobile phone market may be instructive in this respect.

36.3. Standards of security in new systems

Increasingly, investors and savers are moving online to monitor and, to varying degrees, manage their finances. There is scope for significant innovation in the delivery of many financial services. However, along with this there will also need for an appropriate level of security so that information and money cannot be corrupted or stolen and misused. Increasingly, investors and savers are moving online to monitor and, to varying degrees, manage their finances. At the same time, security systems must not be so cumbersome that they cause major inconvenience to investors.

36.4. Added complexity and cost

There is always a risk with so-called ‘innovation’ that it will simply be a way of enabling providers to add unnecessary complexity and cost to the service they are providing. The problem is exacerbated by the fact that consumers often need little persuasion that the claimed benefits are worth the cost. Nowhere is this more evident than in the automotive market where consumers willingly spend lavishly on large, heavy SUVs which are costly to run and are bristling with features, such as four-wheel-drive, which they will rarely, if ever, use. Similarly, most people use only a very small proportion of the functionality contained within Microsoft Windows. This does not stop Microsoft regularly bringing out new versions of Windows Office with even more functionality and forcing users to spend money upgrading to the new version because earlier versions of Windows are no longer supported by Microsoft.

There is just the same scope for providers of financial services and products to use technology in a similar way.

36.5. Failure to understand complexities and risks in new systems

Innovative developments such as robo-advisors look likely to provide a useful service which may be taken up by many more people in future. However, there also create risks that need to be considered by regulators, including:

- The field of advice they offer is very ‘narrow’. For example, they will ask standard questions to assess what type of investment is best for the individual. They typically do not seek to find out whether the customer would be better off paying down credit card debt or topping up a pension instead;
- There is scope for investors to lose money just on the basis of the fee-charging structure of some services (as described in Section 35.2.5 above). Those charging a fixed monthly or minimum fee may prove to be an expensive option for those with very small amounts to invest. Given the UK’s worryingly low standards of numeracy (and hence financial literacy), consumer inability to understand the implications of fee structures could be problematical.
- The scope for investors with limited knowledge to be drawn into investing in products or services that they do not understand and which could land them in trouble. Amongst other things, critics have questioned the wisdom of offering sophisticated tools, such as options trading, to young and inexperienced investors. The case of 20-year-old Alex Kairns who apparently took his own life after mistakenly believing that he had lost $700,000 in an option bet on Robinhood’s platform was widely reported in the media.

Q37: What are the barriers to innovation and effective competition in this market?

There are a number of barriers, including:

37.1. Failure to understanding how competition works

In the FCA's platforms study in 2019 the FCA concluded that the market was working well. We disagreed stating that:

> *'If the market was working properly it is likely that we would by now have seen platforms competing to offer better functionality to investors. This might include allowing investors to receive information from the companies in which they have invested and to vote their shares easily at the AGM. Individual investors have been disenfranchised by the nominee system. Lack of competition between platforms has reinforced disenfranchisement. Some platforms make it very difficult to vote one's shares. Many make it very difficult to transfer one's shares to a platform offering better services to customers/investors.'*

In other areas of the financial services market in which products are relatively simple and offer little scope for differentiation, there is a risk that providers will seek to compete by obfuscation and confusing consumers. It is not enough, for example, to insist that costs and charges must be clearly set out and explained if providers all present the information in different ways so that comparison becomes almost impossible. The John Lewis Partnership for many years traded on the slogan 'Never knowingly undersold'. However, in many instances consumers would have been hard put to it to find an exactly comparable product anywhere else.

37.2. Market equilibrium

For any market regulator a key issue is that of finding the right balance between too much competition and insufficient competition. In any market there is a balance to be struck between suppliers overcharging (particularly in the services sector where comparisons before buying can be very difficult to assess) and, conversely, precipitating a race to the bottom in which levels of competition become unsustainable and providers either try to cut corners to survive or go out of business. In financial service the demise of a provider can leave investors with the problem of reclaiming their assets and moving them to a new provider. In terms of the number of market participants, with 5,236 advisor firms in the UK and some 27,000 advisors (approximately 5.4 advisors per firm) it looks as though competition is probably at about the right level at present. At the same time, of course, the financial advice market does not serve all consumers because their costs are so high.

37.3. Vested interests

In some cases there are risks that innovative solutions will be strangled at birth by entrenched interests. A problem that Primary Bid has faced has been that of enabling retail investors to buy shares on the Primary Bid platform and then get them transferred into their main portfolio which is held by a nominee.

37.4. Costs of innovation

In some cases innovation may be costly for providers and it may therefore be attractive not to innovate – particularly where innovation could upend established ways of doing business and the infrastructure (and associated investment) that supports them.

Q38: What more can we do to facilitate effective competition and encourage firms to develop innovative products and services which help consumers to invest?

There are two specific areas in which you could encourage firms to help consumers to invest:

38.1. Advisory investment services from brokers.

One of the services that was until quite recently offered by many retail brokers was an advisory service which allowed buyers to obtain comment and advice from the broker before buying or selling shares. Thanks to the constraints imposed by MIFID, it is now all but impossible to find a broker who will offer retail investors an advisory service. The regulatory burden of administration and report writing associated with providing any informal advice has led to a situation in which brokers now only offer:

- execution-only services (in which the investor is entirely on their own) or,
- a discretionary service in which private investors hand all decision-making for their investments over to the broker.

This is most unhelpful and, far from helping to protect private investors it has in many cases left them more exposed.

38.2. Services which allow investors to hold shares in their own name.

A service which many private investors valued and which has all but been withdrawn is that of CREST sponsored membership.

This seems to be due the fact that it easier for brokers and ‘wealth managers’ to steer their private clients into nominee accounts – often as a result of encouraging them to take up take up relatively expensive discretionary investment services. The use of nominee accounts is undoubtedly administratively convenient for many investors. However, the fact that the private investor is no longer the owner of their own shares and is therefore unable to receive communications from companies, attend AGMs and vote their shares is enormously damaging to systems of stewardship and corporate governance.

At the same time, the government and others question why it is that boards of directors (and auditors) are not being properly held to account by shareholders and are openly questioning the principle of shareholder primacy. The simple answer is that, despite the best endeavours of the Financial Reporting Council (FRC) to strengthen the Corporate Governance Code and the Stewardship Code, the financial services industry has been allowed to comprehensively undermine the key pillars that support governance and stewardship. Nominees have no interest whatsoever in voting the shares that they hold on behalf of clients. For them this is just hassle and expense. The stewardship and governance implications are also of little interest to them.

As long ago as 2009 Lord Myners commented on the problems caused by 'the ownerless corporation'[21]. This problem has grown worse since then[22]. Despite the fact that modern technology could overcome many of the shortcomings associated with nominee accounts, there seems little appetite on the part of many providers to address the issue. The industry needs to consider the recommendations put forward by the Law Commission in its recent scoping paper on Intermediated Securities[23] which has been submitted to BEIS

Q39: Have there been initiatives to promote innovation and competition in other countries that may be relevant for the UK?

We have very little to say on this. However, we note the 2019 report "*Robo-advice: a look under the hood 2.0*" produced by The European Federation of Investors and Financial Services Users (also known as Better Finance) is available at https://betterfinance.eu/publication/robo-advice-a-look-under-the-hood-2-0/ This may be interesting, since it looks at Robo advice given by 11 platforms from EU countries and 5 from North America.

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[21] Financial Times; 'Tackling ownerless corporations' – 8th November 2009

[22] Myners 2018 lecture https://www.youtube.com/watch?v=9nYJExU9Tn4

[23] Law Commission: Scoping paper on Intermediated Securities https://www.lawcom.gov.uk/project/intermediated-securities/#intermediated-securities-scoping-paper

3 Appendix 1: Savers Take Control

Savers Take Control (STC) is an ambitious, early stage, but very simple idea for altering the balance of power in relation to individual investment. It is a not-for-profit project, which relies on knowledgeable investors putting time and effort for free into helping less knowledgeable investors. The intention is for STC to develop into a well-known and trusted voice that can be relied on to be completely independent of both the financial and the corporate world.

The STC team is currently largely composed of people who are retired, having previously worked in various party of the financial sector. But we would be delighted to hear from anyone, whatever their skills and experience might be, who has an interest in investment, who meets the independence criteria above, and who has a passion for tackling the imbalances we discuss in this submission in the interests of our society as a whole. The balance of power has tipped further away from individuals and towards the financial services market. At the same time individuals are expected to be more self-reliant, with the demise of generous company pension schemes.

It's not just the savings chain that we wish to influence, however. There is also the "ownerless corporation". In our response to Q38 of the CFI, we give a link to a lecture by Lord Paul Myners on short-termism, that explains how he came to realise that many, if not most, companies operated without effective governance by their owners. A consequence of this is the explosion in executive pay. But if you raise the topic of executive pay in the corridors of power, and certainly in any discussions in the City of London, the discussion is immediately moved on to something else. So as well as independence from the investment sector, we are also determined to be able to speak out to argue for a completely different approach to executive pay. As savers and investors, we ought to be able to ask those who manage investments for us to require the companies we own to improve their behaviour. Unfortunately, it is hard for well-paid fund managers to crack down on executive pay in companies that they own on all our behalves.

A number of articles and presentations, as well as contact information, can be accessed through https://www.uksa.org.uk/Savers_Take_Control Here are the titles of some of the articles you will find in the February 2020 and June 2020 issues of UKSA's Private Investor magazine:-

- Time to engage the voice of the individual in a national debate
- Changing the world of savings and investment and driving a change in company behaviour
- John Kay on remuneration
- What does a corporate culture feel like when nobody worries about the share price or what profits are reported this quarter?
- Improving capitalism for the public good – what do we have in mind? And can it be done?
- The magic ingredient: Savers and Investors helping each other for free – would you like to help?

4 Appendix 2: Telling the truth: some essential empowering messages for consumers

This Appendix provides a concrete illustration of the type of advice which organisations such as UKSA need to be able to give to people without being exposed to penalties under the regulatory regime. Such clear generic financial advice would be suitable for the overwhelming majority of UK consumers. It could emphasise the following order of priority:

1. Repay expensive debt, which would normally mean all debt apart from mortgages.
2. If you have any dependents, after considering employer provided death cover, ensure that you have about 20 times your annual income in term insurance before you buy any other financial products.
3. If an employer pension scheme is available, join it.
4. Maximise your employee pension contributions up to the largest amount for which your employer will make matching contributions. Invest 100% of this in a global developed countries' market capitalisation weighted ETF, or the nearest equivalent out of the employer's scheme's investment choices. However in the UK be aware of taxation's annual and lifetime limits.
5. After taking into account your confidence in finding other employment if you lose your job, and any other relevant family circumstances, ensure that you have the equivalent of several years' worth of essential expenditure, perhaps as many as five, in cash or near-cash before you buy any long-term investments such as equity or property linked investment products.
6. If you are young enough to qualify, the next step after the ones above should be to put your savings into a Lifetime ISA, invested in the same ETF as mentioned above.
7. Any further savings should be put into an ISA or SIPP subject to the limits allowed, with the choice of priority depending on your forecast of current and future tax rates. If in doubt about future tax rates, ISA first and then SIPP.
8. Be very aware of the importance of costs in investment, including the costs charged by providers such as investment platforms, the explicit costs of the managers of any collective investment funds, and the implicit cost that have to be met by collective investment funds including the costs of trading.
9. Unless and until you attain sufficient confidence to make judgements about company financial reports, business models and competitive environments, do not venture into individual company shares.

The above prescriptions if followed would make most British consumers much better off in the long run. They would also drastically reduce the size of the financial services sector in the UK as most providers of investment products either shrank to serving only the expert / "hobbyist" market or went out of business.