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UK Individual Shareholders Society

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15 December 2020

To: Financial Conduct Authority

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We are pleased the FCA is doing this consultation and the positioning of it. Viz. Chris Woolard's introduction. We have copied this below and highlighted the comments which we believe are of key importance to this consultation.

> ***The consumer investment market is not working as well as it should.*** *Too often consumers receive lower returns than they should because of unsuitable products with high fees. Too often there have been scams and scandals in this market leading to consumer loss. Too often consumers leave their savings in cash because they don't have confidence in the alternatives. That's why we have made Consumer Investments a priority in our current Business Plan.*
>
> *The overwhelming majority of retail investors are best served by readily understood, well-diversified and low-cost investments which are already available from a range of providers, but many retail investors don't choose these. We are seeing some progress on reforms of governance and a focus on making investments better value for money, but* ***progress is still slower than we might like****.*
>
> *Many consumers don't seek financial advice, perhaps because of complexity and cost.* ***Many financial services firms seem reluctant to provide simple advice*** *and guidance which will serve the needs of large numbers of consumers. We need the system as a whole, including regulation, to work better for consumers.*

We welcome the clear recognition in the CFI's Foreword that there is indeed a problem - that there are suitable and inexpensive products, but people do not use them enough. In addition, that firms are not generally keen to promote them and that progress is slower than the FCA would like.

KEY ISSUES AND SOLUTIONS

1. The market runs largely in the interests of the providers of financial services, not in the interests of the consumers

The main issue is one of charges paid by the consumer and the value they receive in return. 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 industry makes more profit by promoting more expensive and complex products and by promoting the message that finance is too difficult for consumers to understand. Whilst always well-intended, we suspect that the regulatory regime **may, if anything, have unintentionally given cover to this message.**

The job of helping people to make the best choices with particular regards to the long term impact of costs is not one for which, hitherto, we have detected much appetite in the FCA, other financial regulators or in the Money and Pensions Service. This consultation, with its promising introduction and careful analysis of the problems, suggests change is on the horizon and we welcome this.

We also 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 improving financial capability. The FCA should support this.

"Consumer" is an umbrella term which covers a spectrum from the novice to the sophisticated and a One-Size-Fits-All approach is not appropriate.

It is also important that the FCA does not introduce heavy handed solutions that restrict market access for sophisticated individual investors in the mistaken belief that this is necessary to protect the majority.

Today's competition between market providers does not serve the consumer's interests, because providers have much deeper knowledge of their products and their potential drawbacks. That is the problem that needs to be tackled; currently we see no plans to tackle it.

2. The importance of tacking these problems?

The FCA states that its strategic objective is one of "ensuring that the relevant markets function well". However, as an objective this is only of practical value if it demonstrably results in ensuring the best outcome for consumers.

We would like the FCA to confirm unequivocally that this is how they intend to interpret their objective going forward.

It needs to be recognised that much better outcomes for consumers, are likely to mean **less profit for the industry**. On the other hand, it has also to be recognised that anything which improves consumer perceptions of the industry's trustworthiness is likely to benefit it in the longer term. It is clear[1] that the FCA have long understood the impact of expenses on consumer outcomes. Yet the power of the financial sector lobby gives us concern whether 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 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[2] a

[1] https://www.fca.org.uk/news/speeches/competition-and-savings-regulator-perspective

[2] UK-Strategy-for-Financial-Wellbeing-2020-2030-Money-and-Pensions-Service.pdf

search for the word “fee” does not find a single hit; the same is also true of the word “charge” and the word “expense”.

3. Our Recommended Solutions:

1. **Tell the full truth about expenses, especially the importance of minimising, or avoiding altogether, annual percentage charges;**
2. **Empower people by pointing out the simple good value services they can actually use, that do not normally need the involvement of a financial adviser;**
3. **There needs to be a step change in financial education at all ages. Financial education needs a radical reform and a much better plan;**
4. **There is a wide spectrum of sophistication of financial knowledge among consumers. This spectrum from novices to experts needs to be taken into account. The solution is not to apply a ‘one-size-fits-all’ approach which all too often produces a ‘nanny-state’ outcome. Most consumers see this a patronising and unhelpful.**
5. **Better regulation.**

1. Tell the full truth about expenses

Providers must tell the full truth about expenses, especially the importance of minimising, or avoiding altogether, annual percentage charges. This must be clear and transparent. It needs to be visible, not hidden away and not in small print. The long term impact must be shown as well as up-front costs. Transaction costs in funds must be transparently shown. Consumers also need to be able to understand the truth.

2. Empower people by pointing out the simple good value services they can use

Below 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 with the “who to trust” void. But if essential information were widely available 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 properties of debt and expenses, as well as the positive compounding properties of investment returns.

The table below provides a concrete illustration of the type of advice which organisations such as ours need to be able to give to people without being exposed to penalties under the regulatory regime. Such clear financial advice would be suitable for the overwhelming majority of UK consumers:

1. If you have any dependents, after taking into account employer provided death cover, ensure that you have about 20 times your annual income in term insurance before you buy any other financial products.
2. 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 market capitalisation weighted ETF.
3. After taking into account your confidence in finding other employment if you lose your job, ensure that you have several years, preferably five, of cash deposits before you buy any savings products. The reason is that you should not buy a savings product unless you are almost certain that you will never need to convert it into cash for spending for at least five years, and preferably 10 years.
4. 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.
5. 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.
6. Never buy any individual company shares unless you consider yourself an expert analyst or are a hobbyist.
7. Never buy any actively managed funds unless you consider yourself an expert analyst or are a hobbyist.

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.

3. 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.

Financial education in the UK is poor - much worse than in the USA, for example. It is not clear why this is so and it would be helpful and valuable if the FCA were to investigate and find out why this is the case and what the UK can learn from it.

Levels of financial education enable the Financial Services Industry to sell its products the way it does and is one reason the industry resists improving things. There needs to be a step change in financial education at all ages.

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's not just about educating the young, important as that is.

At the same time as expressing concern about 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.** For people who are interested to learn for themselves, there are already plenty of resources available. There is also mutual support available from organisations such as ShareSoc and UKSA for those who wish to engage with us.

Both UKSA and ShareSoc have investment education work streams. and ShareSoc has its investor academy https://www.sharesoc.org/investor-academy/ and UKSA has a freely available site it calls "honestmoneynow"[3]. UKSA has for some time been working on an initiative that it calls "Savers Take Control[4]". 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 https://www.uksa.org.uk/Savers_Take_Control .

4. It would be inappropriate to put regulatory measures in place that failed to recognise the diversity of investment knowledge and experience of the population and, as a result, restricted market access for knowledgeable individual investors.

There is a spectrum of sophistication of financial knowledge. There is a spectrum of novices and experts which needs to be addressed. Not one size fits all. We have got used to grades in exams, but there is no equivalent for investing.

The more knowledge an investor has, the less regulation is needed. See in particular our answer to Q19.

5. Better Regulation

We are seriously concerned about the regulator and the state of the markets. As we explain in this Call for Input, we now have a disorderly and dysfunctional financial services market. On 3rd August Mark Steward, FCA Executive Director of Enforcement and Market Oversight gave a speech to ShareSoc and UKSA members, which illustrated the progress and renewed vigour the FCA is applying to enforcement[5]; however, it was clear that, despite this work there is still a very strong perceived problem about market abuse and other regulatory issues. The lack of transparency and the very long lead time to deal with cases does not help deal with this problem, whether real or perceived.

In addition, The Treasury seems to be telling the FCA to switch off the monitoring and enforcement of live law and regulation, with no transparency.

The following are the regulatory regimes that come to mind that are being ignored, there may be more;

1. Shareholders' pre-emptive rights
2. MiFID Costs and Charges Disclosures (this is so important)
3. Investment Platforms (FCA exit charge ban abandoned last week)
4. Assessment of Value – we have read 3 disclosures in detail and have between 40-45 FCA rule breaches in total. The large managers are just playing lip service to this regime.
5. The ACD Model – the FCA were due to investigate this in Q4 but all has gone quiet. This is the next scandal.
6. Social Lending – the FCA have given up and have advised investors not to use it!
7. Closet Tackers – the FCA's initiative has now disappeared.

The UK regulators have failed individual investors in the above examples. How can you ignore your consumers at a time like this? We would refer you to the FCA's 3 stated operational objectives (pg.14 of 19/20 annual report):

- To secure an appropriate degree of protection for consumers

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

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

[5] https://www.fca.org.uk/news/speeches/capital-market-regulation-and-coronavirus

- To protect and enhance the integrity of the UK financial systems
- To promote effective competition in the interests of consumers

We make specific recommendations for change in Q17, as a result of our learnings from the Woodford scandal, and in Q21 about Pre-emption rights for minority shareholders.

ShareSoc and UKSA, the UK Shareholders' Association have worked closely in drafting our responses. However we have some differences of scope, perspective, and emphasis; hence we have made separate submissions to this CFI.

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 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[6]. The Retail Distribution Review was definitely a good first step. However, as regards intermediaries commission, bias is also present for non-advised sales, so the extent to which consumers use intermediaries they are unlikely to get completely disinterested advice. In this context, some platforms may be regarded as intermediaries due to some of the ways in which they earn their revenues.

We note that there is no mention in the CFI of any input received from the FCA's Consumer Panel (FSCP). We believe that there is a good case for starting the thinking afresh, asking: "What would the market look like if the consumer's interest were paramount?"

We believe that consumers need a "who to trust" body that can help them identify the best value products and services. Whilst this is not obviously directly within the brief of the FCA to provide, the FCA may have an important role in helping such a "who to trust" body to know just what kinds of information may be freely published, and included in educational 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. All the behavioural research that has been carried out has been against the background of a financial sector that was not trusted. The presence of an effective "who to trust" body might change the climate and generate more constructive engagement by people with their long term finances.

Today's competition between market providers does not serve the consumer's interests, because providers have much deeper knowledge of their products and their potential drawbacks. That is the problem that needs to be tackled; currently we see no plans to tackle it.

The question is: how much appetite does the FCA have to really tackle this problem?

The problem could be seen as starting with the FCA's objectives as set out in statute. Reproduced below is the relevant part of FSMA 2000 after amendment by FSA 2012:

[6] The Royal Society of Arts' 2008 Tomorrows Investor report is a 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

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.

We consider that it is open to the FCA to interpret "ensuring that the relevant markets function well" as meaning giving the best outcome for consumers.

However, it needs to be recognised that much better outcomes for consumers that will result from better empowered and supported consumers will mean less profit for the industry. It is clear[7] that the FCA have long understood the impact of expenses on consumer outcomes. Yet the power of the financial sector lobby gives us little hope 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 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[8] 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".

[7] https://www.fca.org.uk/news/speeches/competition-and-savings-regulator-perspective

[8] UK-Strategy-for-Financial-Wellbeing-2020-2030-Money-and-Pensions-Service.pdf

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, 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 organisations attract 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[9], 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 will 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.

However, we believe that what most people need, certainly to start with, is to consult a *financial coach*. A coach will not advise on regulated products, but will help people understand their financial situation and their options, and to develop a plan. A coach will charge by the hour only, and their remuneration is not in any way dependent on either what investment decisions you make or on how wealthy you are. If, in line with our response to Q1, there exist a number of good value and simple investment implementation solutions that a coach is permitted to point clients to without it being classed as "giving regulated advice", this would provide a satisfactory outcome for most consumers without the need to approach an IFA. The coach could be a person, robo or AI.

[9] 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

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, in the absence of widespread and publicly available information about the fundamental truths about investment, along the lines set out in the Introduction above.

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

We would suggest that this is the entirely 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 (i.e. cheapest) solutions for straightforward investment needs?" Unfortunately, if you let the 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. Many products that are marketed today would arguably not be saleable if providers had a fiduciary duty.

We would like to be able to 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 interests 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 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 answer to Q2

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 at https://www.thersa.org/reports/tomorrows-investor-report is as follows:-

“Fees should be expressed in a different way: as the total over a 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, actively managed funds will typically suffer much greater trading costs than passive funds. Although trading costs are not easily measurable, anyone purchasing an actively managed fund should be given a realistic projection of the impact of likely trading costs over the lifetime of the investment.

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

None really. Except that firms would make less profit if they provided such products and gave them priority in their promotional activities.

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 be likely to 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.

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.

However if we are talking about financial guidance being given by independent people, such as financial coaches, that is a much more positive story. The coaching process is all about reflecting the situation and the needs of the individual. A process which is really a form of “sales” will not meet this requirement.

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

See Q8

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

Yes. The table below provides a concrete illustration of the type of advice which organisations such as ours need to be able to give to people without being exposed to penalties under the regulatory regime. Such clear financial advice would be suitable for the overwhelming majority of UK consumers:

1. If you have any dependents, after taking into account employer provided death cover, ensure that you have about 20 times your annual income in term insurance before you buy any other financial products.
2. 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 market capitalisation weighted ETF.
3. After taking into account your confidence in finding other employment if you lose your job, ensure that you have several years, preferably five, of cash deposits before you buy any savings products. The reason is that you should not buy a savings product unless you are almost certain that you will never need to convert it into cash for spending for at least five years, and preferably 10 years.
4. 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.
5. 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.
6. Never buy any individual company shares unless you consider yourself an expert analyst or are a hobbyist.
7. Never buy any actively managed funds unless you consider yourself an expert analyst or are a hobbyist.

Straightforward financial advice can help consumers make effective investment decisions, but only if provided under very specific arrangements. The adviser must have no financial interest that would be affected by the customer's decision, or should disclose their interest clearly and transparently in a readily understand manner.

We would, however, be supportive of a regulatory "kite mark" approach that enabled certain very simple and inexpensive products to be sold with less regulatory overhead.

Unfortunately, the current complex regulatory system can make the provision of much advice prohibitively expensive except for the wealthiest investors.

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

None - providing they are independent and impartial. But if they are selling financial services providers' own products, there is no reason to expect that the outcome will be the best available for the consumer.

Once again, there could be a considerable benefit from a “kite mark” approach as mentioned in Q10 above. That would make it possible for many people to use financial coaches and then implement their advice without needing to approach an IFA.

A similar point may be made about robo-advice. Where a product or service meets certain essential standards, it would be appropriate to have a more relaxed regulation around the marketing of such product or service.

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

No comment.

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

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 Royal Society of Arts. 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?

No comment.

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

Consumers should remain able to buy 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.

Where a provider employs staff to respond to customer enquiries, their remuneration should not be affected by whether the enquirer buys the product or not. It might be appropriate to relax this principle if the product met "kite mark" conditions of simplicity and cheapness.

Q16: What protections are necessary for consumers buying direct?

We note this is a complex issue and suggest you refer to the response from Leigh Day to this question.

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

1. Your consultation highlights the important issues in the text, we have reproduced below, with **bolding** added by us:

> 3.18 If people are buying directly through online platforms, **they need clear information** to help them make a decision and understand what to do **if something goes wrong**. Many firms have developed tools to support direct investors. For example, helping them with prompts to consider tax beneficial wrappers or **diversifying their portfolio of investments**. Clearly there is a **balance** to be struck between responsibilities placed on those facilitating direct investments and the cost of the services provided. However, there are some decisions that regulators consider too complex or important to be made without advice.
>
> 3.19 We want a consumer investment market where **people can benefit from buying directly** but, given the complexities involved, **we also want safeguards** in place to **ensure that consumers can invest with confidence**. This may mean placing more obligations on those who distribute products to consumers through online platforms.

2. We believe that the Woodford scandal has seriously damaged consumers' ability to be able to **"invest with confidence".** Our reply to this Q17 uses this story as a useful and topical illustration. It is shocking to us and the general public that the FCA has so far been unable to hold to account those who were the key players in this scandal.

3. Section 138D(2) of the Financial Services and Markets Act 2000 ("FSMA") provides *that "a contravention by an authorised person of a rule made by the FCA is actionable at the suit of a private person who suffers loss as a result of the contravention, subject to the defences and other incidents applying to actions for breach of statutory duty."* However, if the FCA so provides in its rules, breach of a rule will not be actionable (s.138D (3) FSMA).

Recommendation

We recommend you review the above in recognition of the Woodford case and the apparent inability to safeguard customers in that case.

4. When a fund says that it will not invest more than 10% in unlisted securities, consumers should be able to expect this to be **true in spirit** as well as in law/regulation.

Obligations in respect of the liquidity of the WEIF are covered in Chapter 5 of the FCA's Collective Investment Schemes Sourcebook **("COLL 5**"):

> COLL 5.2.8R(3) provides that transferrable securities and approved money-market instruments held within a UCITS scheme must be: (a) admitted to or dealt in an eligible market (save for an approved money market instrument as provided for by 5.2.8R(3)(d)); or (b) recently issued transferable securities, provided that the terms of issue include an undertaking that application will be made to be admitted to an eligible market and such admission is secured within a year of issue.

A transferrable security or approved money market instrument which does not meet the requirements of COLL 5.2.8R(3) is referred to in this response as an **"unlisted security".**

"Transferrable security" is defined in COLL 5.2.7R as any of: a share, a debenture, an alternative debenture, a government and public security, a warrant or a certificate representing certain securities.

COLL 5.2.8R(4) provides that a UCITS scheme may invest no more than 10% of the scheme property in transferable securities and approved money-market instruments other than those referred to in (3). Accordingly, unlisted securities held by the WEIF must not exceed 10% of the scheme property.

In its letter to Nicky Morgan MP following the suspension of the WEIF, the FCA stated that *"in February and March 2018, the FCA engaged with Link in connection with two breaches of the 10% limit on the maximum proportion of unlisted securities held within WEIF. Following our engagement, these breaches were each notified to us as resolved within a timeframe we agreed with Link."* The FCA further noted that *"no further breaches of the 10% limit were notified".*

The evidence to the Treasury Select Committee discusses whether WEIF agreed with the FCA that listing some of its unquoted investments on the Guernsey Stock Exchange allowed it to keep within the 10% limit. The volumes of shares traded on the Guernsey Stock Exchange were very low. In our view, the volumes traded of some investments were not sufficiently large to justify a view that there was liquidity in (some of) those investments (and that the FCA seem to have accepted were "liquid").

Recommendation

The FCA should review how it regulates this 10% limit.. The ability to list a company on an "eligible market" should not be accepted, in future, as evidence of liquidity. The test should take account of the volumes of transactions and the potential for future liquidity.

5. COBS 2.1.1R provides that a firm must act honestly, fairly and professionally in accordance with the best interests of its client (the client's best interests rule). The client's best interest rule applies in relation to designated investment business carried on for a retail client and MiFID business carried on for any client.

The failure in the Woodford case (and this is how it is perceived in the eyes of the public), may be because the regulations are inadequate, or because the FCA has failed to implement the regulations.

Recommendation

If the regulations are inadequate then they need to be changed.

If the FCA has failed to implement the regulations, then the FCA leadership needs to be changed, so that a more robust and more effective regulator works to stop any such future re-occurrences.

6. The role of Woodford as valuer was evidently a matter of concern to the FCA. There was a potential for a conflict of interest, because Woodford heard fees based on the value of the fund, so a higher value of the unquoted shares meant higher fees. In addition a higher value enables Woodford to present a picture of the fund success to the wider market. In the initial goal Woodford was valuer, although subsequently Link removed this task and responsibility from Woodford.

The role also had a potential conflict as Woodford also had a hand in setting the valuation of the companies who were participating in fundraising.

Recommendation

The FCA should review their regulations in relation to valuations and conflicts of interest. The FCA should also review what information should be required to be communicated to customers to ensure that they are aware of the risks involved in the investment.

The FCA should also review if COLL 5.2.7A(1)(c) is fit for purpose.

7. WEIF sold part of its portfolio to WPCT (Woodford Patient Capital Trust). It is unclear to us at present how the unquoted shares were valued, and if and how any discount was applied for quoted companies that had low liquidity. Subsequently, the value of many of

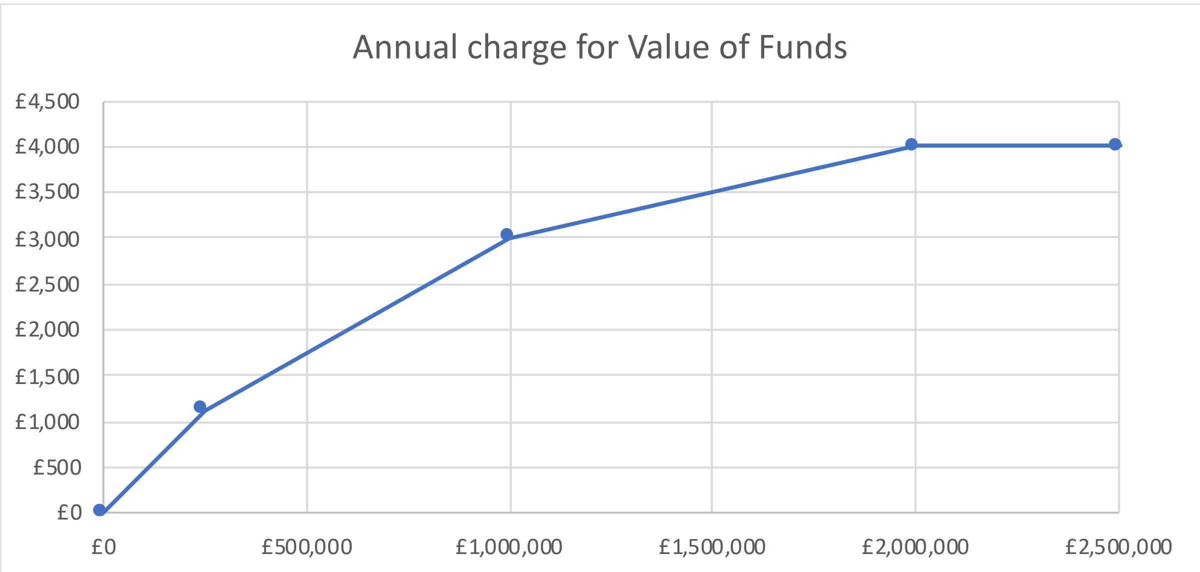
these shares declined, in some cases significantly. There is much comment in the media as to this transaction.

Recommendation

The FCA should investigate this transaction and publish a report so that investors can either be reassured that the markets, in such circumstances, work fairly; or if the FCA were to find that this is not the case, those involved should be censured at the very least.

8. Hargreaves Lansdown charges its customers:

Value of funds	Charge
On the first £250,000	0.45%
On the value between £250,000 - £1m	0.25%
On the value between £1m - £2m	0.1%
On the value over £2m	No charge



HL entered into an arrangement with Link/Woodford whereby it was the only platform offering investors access to **WEIF Z class** shares with **"the lowest annual management charge".**

We question whether this was the case for those investors who were also paying the 0.45% account fee.

Recommendation

We suggest that the FCA review its rules and if necessary changes its rules to ensure that claims of "lowest" charge reflect all the costs/charges/expenses the individual investor pays. The issue here comes back again to the financial education of investors. In this case "point of sale" information could be useful, e.g. if it was a

requirement that any claim of lowest required a footnote/hyperlink to explain what lowest meant in this context and also provided a link which explained the total costs and the link to a KIDs document which gives full information.

9. The Z sterling income shares and Z sterling accumulation shares each had a minimum holding requirement of £500 million. Accordingly, HL supported the WEIF with seed funding of £1 billion. No other UK open ended investment company appears to have had a minimum holding amount on the same terms. Furthermore, HL was the single largest investor in the WEIF, holding about 46% of the units locked in the fund at its suspension.

Accordingly, the terms of HL's arrangements with Woodford/Link might have created an incentive for it to continue to promote the WEIF even after it ceased to believe in the fund's potential.

Recommendation

We believe the FCA needs to look at how it regulates this industry to ensure that a Duty of Care to consumers is achieved. We consider that COBS 2.1.1R does not apply only to the mechanics of providing the service concerned. The fact that the definition of a "client" includes a "potential client" supports this analysis. The FCA needs to review COBS 2.1.1R and announce its view on this important issue.

10. Furthermore, HL's position in respect of consumers was complicated because of its customers' sizeable investment in the WEIF through the MMFs (Multi Manager Funds).

The HL Wealth Lists are likely to be regarded as financial promotions. We suggest you look at a number of articles from HL's websites. E.g., articles dated 8 December 2014, 6 April 2016 and 13 December 2016.

However, there is a practical difficulty with seeking to prove breach of COBS 4.2.1R by reference to the articles on HL's website. This is because of the need to prove that the customers read/relied upon any statements contained in these articles or were misled as a result of material omissions. Furthermore, the fair, clear and not misleading rule does not impose an obligation on a regulated firm to disclose all relevant facts.

Recommendation

The above example highlights why the FCA needs to re-examine how a Duty of Care to Consumers should work. The test should include whether total costs (clearly and transparently explained in a consumer friendly way), style drift and deterioration in liquidity should be required to be communicated to consumers of WEIF and similar products.

11. HL Vantage Service customers have access to over 2,500 funds. The purpose of the HL Wealth List is to provide customers with a manageable number of funds to choose from. HL launched the Wealth 150 in November 2003. In March 2014, it launched the Wealth 150+

as a sub-group of funds within the Wealth 150. In January 2019, the Wealth 50 replaced the Wealth 150 and the Wealth 150+.

As to the aim of the Wealth Lists, in March 2014, HL published the 10 core principles of the Wealth 150. The first principle was that the Wealth 150 "aims to help investors choose funds which could outperform over the long term." Another principle was that HL "judges prospective performance on investment skill first, and price second."

From August 2015, HL has stated that its "goal" for the Wealth List is "to help [customers] choose [their] own investments from those funds where HL has complete confidence in the fund manager" and that the list is "constantly reviewed against strict criteria and updated to ensure that it includes those funds that have delivered consistent outperformance.

However, Woodford Equity Income Fund (WEIF) suffered from style drift. It was allowed to invest up to 10% of its assets in unlisted companies. It went into breach of this limit on at least 2 occasions. Further, WEIF agreed with the FCA that listing some of its unquoted investments on the Guernsey Stock Exchange allowed it to keep within the 10% limit. The volumes of shares traded on the Guernsey Stock Exchange was low.

The difficulties of proving loss may allow managers to play fast and loose, rather than putting customers first.

Recommendation

We think FCA needs to reconsider how best to protect consumers. It could take steps to make the test of a breach (under COBS 4) easier to meet. We recognise this is a complex area and think careful analysis is required before making changes. We would not like to get to a situation like PPI , where we believe it was so easy to claim that many did when they were probably not entitled to do so.

12. COBS 12.4.4R does not apply to funds. Nor does Article 20 of Regulation 594/2014 of the European Parliament and of the Council on Market Abuse (the "Market Abuse Regulations") which replaced COBS 12.4.4R from 3 July 2016.

Recommendation

We recommend that FCA review whether Funds, such as those like WEIF, should be covered by Article 20.

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

Yes, of course there must be. However there is a spectrum of sophistication of financial knowledge. There is a spectrum between novices and experts which needs to be addressed. Not one size fits all. We have got used to grades in exams, but no equivalent for investing. Financial education needs a radical reform and a much better plan.

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 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]."

A certificate given in this form would concentrate the mind of the investor.

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 closeout arrangement explicit and require the investor to certify having net assets greater than 20 times that 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 first, and only investing in specific individual company shares and specific individual company debt instruments, only 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 valuing company 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 that have strong reason to regard themselves well informed and are prepared to study individual companies should, however, be 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?

Chapter 4 section 4.7 discusses Making Risks Clearer. It is not entirely clear to us whether this answer should be here, in response to Q21, or to Q26, or to Q1.

If a company wishes to IPO on London Stock Exchange or AIM then it is required to create a prospectus, and it **should publish that prospectus on its website, and file that prospectus with a central governmental registry where it remains permanently available.** Knowingly making untrue statements in such a prospectus should be a criminal offence.

The UK needs to learn from the reforms introduced in the USA, e.g. in 1934 when the Securities and Exchange Commission was set up; and Sarbanes Oxley, which makes officers accountable for disclosures.

The FRC appears to be planning to introduce a Sarbanes Oxley type requirement in respect of annual reports and we presume this should extend to prospectus like disclosures too. **The FCA should support this.**

CA2006 contains provisions to protect the rights of minority shareholders. These are very important and great care should be taken to preserve these rights.

Currently, Pre-emption rights are being ignored. Pre-emption rights exist for a reason – to prevent existing minority shareholders from being exploited by a majority of shareholders. **The FCA needs to review this.**

There is another problem that is immediately apparent to us:

> **Mates rates.** Shares are placed with a small group of loosely connected (n.b. not “connected” in the legal sense) or associates or business. Acquaintances. On announcement of a placing (and sometimes in the run up to the placing) shares prices decline and a select group of investors are able to buy shares in the placing at a lower price than other investors have had to pay in the proceeding weeks. We can provide examples if you want them.

We are pleased that the temporary relaxation of the Pre-emption rights rules which allowed up to 20% placings, has now been removed and the 10% rule is now again operational.

The EU €8m limit on placings that can be reserved for retail shareholders should be removed. Placings do not require a full prospectus. This arbitrary limit has the effect of treating retail investors unfairly. This is in conflict with the CA2006 s172 requirement for Companies to act fairly between shareholders.

We understand that some of the less sophisticated members of the EU proposed the €8m limit. It is not for the UK to change EU limits. However, having left the EU in January 2020, the FCA should seek to implement the best regime for the UK markets.

Whilst believing that **appropriate disclosure is essential**, we would also be concerned if the cost of providing this disclosure were so great that it had unintended consequences. For example, to protect investors we strongly support the principle of pre-emption rights. But if a company needing to raise capital regards the regulatory costs of a rights issue to be too high, this means that the ability to subscribe can be denied to “ordinary” shareholders, because they do not have access to the alternative placing mechanisms.

The IPO prospectus is a very detailed document and every word has to be signed off by the Directors.

The combination of the IPO documents, annual and interim reports, and trading and RNS updates provides adequate information for investors to decide whether to invest in a placing.

If the directors are aware of market sensitive information they should announce this to the whole market **at the same time.** It should be illegal to only inform those who are consulted about a fund raise. We would argue that it is already illegal for directors not to make market sensitive information available to all shareholders promptly when they become are of it. S80 and S80A of FSMA should be rigorously applied by the FCA.

If the above proposed regime were followed it would greatly simplify the administration of fund raises, in many cases, whilst still allowing companies to do the more formal rights issue if they wished.

Many people have said to us they find it entirely unnecessary to have a prospectus of hundreds of pages and would prefer a much shorter version with the key facts. The current regime is a product of the nanny state approach which we feel is inappropriate to sophisticated investors and needs to be streamlined.

We note that the eventual costs of all of this over-zealous over-regulation is eventually paid for by investors and leads to increased cost of capital for UK companies, which makes the UK a less attractive place to invest and reduces the size of the UK economy with negative social consequences.

What about companies near to bankruptcy and the argument that if word gets out of their problems the shorts might make matters worse? E.g. AA is a recent example, also Carillion and Sirius. Directors want to be able to sew up deals behind closed doors. I think this is a false (specious and self-serving) argument as the going concern rules/laws already requires directors to put relevant information out in the market place. Sharp investors (e.g. Muddy Waters) can easily see the debt and covenant issues. Many investors shorted Carillion. JP Morgan shorted Sirius Minerals. The current rules act to the detriment of individual investors, because of information asymmetry.

The focus of our organisations is on investments in quoted and AIM companies and funds. We do not wish to comment on unquoted shares in our answer to this question.

Recommendations

Removal of the €8m limit for placings in UK listed companies.

Note: the consequence of this recommendation is the removal of the need for a full prospectus when raising money.

If company wishes to IPO on London Stock Exchange or AIM, it should publish that prospectus on its website, and file that prospectus with a central governmental registry where it remains permanently available. Knowingly making untrue statements in such a prospectus should be a criminal offence.

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

Our answer to this question follows on from our preceding answer.

Once a company has issued such shares or securities, 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.

When Directors become aware of market sensitive information, they are under an obligation to inform the market promptly. Directors who fail to do so should be subject to personal penalties. Too often penalties are paid by the company's shareholders and not by those who perpetrated the misdemeanours.

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?

Overall, we consider the high net worth exemption to be fundamentally flawed.

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, if that has been earned by writing fiction or playing sport, it brings with it no additional financial competence.

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.

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 being required to apply for testing, being sent an access code by paper post, and being timed while sitting the test. The risk would remain of 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 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.

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.

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, which contain several practical suggestions. 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 questions. It is more constructive to focus on understanding the risks of investment. Harm can arise from inappropriate, in the form of erroneous advice, but it is more likely to arise from conflicts of interest. The entire regime needs to be viewed with the question of how best to manage conflicts of interest.

Financial services providers should be required to explicitly set out the maximum losses that investors have ever suffered over a 1, 3, and 5-year period in financial products of a similar type. For example, if the product is an equity fund, the comparison would be with equity funds; if it is a property fund, the 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.

Three principles underly this consultation response:

1) That the FCA's strategic objective that 'markets' function includes the market for consumer products and means primarily that the consumers achieve good outcomes through the use of inexpensive and effective products.
2) That the object of regulation by parliament is to achieve the most good for the most people
3) That market efficiency is maximised and the need for regulation is minimised if purchasers understand what sellers are offering them, i.e. that consumers are suitably empowered to make their own decisions. This requires that consumers who do not have any particular level of expertise, have available a "who to trust" source of simple generic advice and information that is freely available.

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"**.

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 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. It has to be provided by a body answerable to parliament and **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.

In a small way, the education offerings of UKSA and ShareSoc offer a glimpse into this future. ShareSoc's is targeted at savers with an interest in becoming active managers of their equity portfolio; UKSA's is targeted at intelligent savers who have no interest in the subject but ought to. Both were 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 better to deal with a financial sector that cannot put its customers interests above its own.

Once regulated learning paths are in place all sorts of processes can be simplified. For example regulated suppliers (advisers or fund managers or product providers) could be required to direct customers down particular learning paths and the customer could sign that they have done so and understood the content. This would simplify all issues of protection and compensation within government's desire of making consumers responsible for their own affairs.

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

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 required the use of nominees. This is true for ISAs and for SIPPs. It is completely unacceptable that there is no formal regime to ensure that in the event of a failure, with or without an associated fraud, of an entity which is supposed to exercise a stewardship role, the 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 posed. We believe it is an urgent and serious problem. It is particularly serious problem, since there is no way that an individual can protect themselves against this risk. The FSCS limit is too small compared to the sums potentially involved.

We have long campaigned for the beneficial holder in nominee to be personally identified in share registers, and the same should apply to holdings in pooled investments 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, and that the costs of this redress should be met in a fair and sustainable way; and 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 required changes.

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 should balance between what a consumer cannot afford to lose (especially with reference to suitability), what a compensatable circumstance should allow for loss and what a provider can reasonably afford including appropriate insurance.

We agree that if more advice is suitable or consumers are 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 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. Although we are not sure how easy this will be in practice, we suggest that somehow the PII compensation insurance cover applicable at the time the consumer contract is entered into remains with the consumer contract after the firm providing the advice or product disappears.

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?

For our main thoughts, see our comments for Qs 28 and 29. We believe the regime should also ensure the polluter pays for unsuitable products. Weeding out the unsuitable products advice has to be the main preventative step; this involves more attention being paid to the conflicts of interest between customer and intermediary or provider.

We note with approval para 6.11 of the FCA's document: " a more preventative approach to the regulation of consumer investments is one of the long term aims of our consumer investments business priority"

Para 6.12 mentions insurance. To be more effective, insurance would need to have extended discovery clauses. Insurance isn't a lot of use if it disappears soon after a firm fails. If insurance was required to have extended discovery clause, the rating and underwriting of that insurance would pay very close attention to the moral hazards in companies' business models and cultures, which would surely be helpful.

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

https://www.fca.org.uk/firms/fair-treatment-customers has the right words.

There are six consumer outcomes that firms should strive to achieve to ensure fair treatment of customers. These remain core to what we expect of firms.

- ***Outcome 1:*** *Consumers can be confident they are dealing with firms where the fair treatment of customers is central to the corporate culture.*
- ***Outcome 2:*** *Products and services marketed and sold in the retail market are designed to meet the needs of identified consumer groups and are targeted accordingly.*
- ***Outcome 3:*** *Consumers are provided with clear information and are kept appropriately informed before, during and after the point of sale.*
- ***Outcome 4:*** *Where consumers receive advice, the advice is suitable and takes account of their circumstances.*
- ***Outcome 5:*** *Consumers are provided with products that perform as firms have led them to expect, and the associated service is of an acceptable standard and as they have been led to expect.*
- ***Outcome 6:*** *Consumers do not face unreasonable post-sale barriers imposed by firms to change product, switch provider, submit a claim or make a complaint.*

Your 2006 https://www.fca.org.uk/publication/archive/fsa-tcf-towards.pdf on the subject had it about right, see para 1.5:

The TCF initiative is also central to the delivery of our overall work in the retail market. Our retail regulatory agenda aims to ensure an efficient and effective market and thereby to help consumers achieve a fair deal. We work to achieve this through a focus on:

- *capable and confident consumers;*
- *simple and understandable information for, and used by, consumers;*
- *well managed and adequately capitalised firms who treat their customers fairly; and*
- *risk–based and proportionate regulation.*

However, as has been explained at length in this response, the experience for consumers of investments has not matched these worthy words.

As referred to in our comments for Qs 28 and 29, we believe an appropriate level of consumer protection will come from putting consumers first with any resulting requirements of providers, identifying compensatable circumstances and if possible the level of compensation for each and making these clear for 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 and 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 relook 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 any resulting views. 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.

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. It would help if the FCA and SFO were seen to be more vigorous in catching scammers. When scammers realise that the risk reward proposition is against them, they will turn their skills and enthusiasm to other tasks. Many of the scammers are highly mobile or work from outside the UK. If the rewards in the UK are reduced, they will migrate elsewhere. The FCA should work with our EU friends and US friends to learn from them.

Consumers need to understand what they are up against and how to deal with it.

At a recent Transparency Taskforce TTF seminar [10] 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.

There are all behaviours that will be found in any basic primer on persuasion techniques. Yet still regulators, government and the financial services industry seems 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.

As well as learning from the success of the scammer, there are three further actions that could be taken to help combat fraud and scamming.

33.1. Equipping consumers to look after themselves

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 three specific actions that could be taken to help combat fraud and scamming.

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

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

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:

- Requiring that anyone buying a financial product or service in the UK agrees to allow the service provider to pass their email address to the FCA (or whoever is to run the single point of contact on fraud and scams).
- Every quarter an email would be sent to all those on a database of consumers buying financial services advising them of a short webinar giving an update on fraud related issues. This offers to scope to send other important messages about the importance of saving (as well as not losing it all to scammers).
- Webinars should last 20-30 minutes and should be recorded so that people can watch them whenever convenient.

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 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. 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 HM Treasury circulated a consultation paper on revised procedures for approving financial promotions by unauthorised firms[11] . 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:

- 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

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

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 technology in general.

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[12] 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

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 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 pandemic1.3

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

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

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 the need to from the equity in their home. Some providers, such as Age Partnership, persist on 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’.

35.1.5 Availability and comparability of relevant information

Pilita Clarke writing in the Financial Times Business Life column recently[13] 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

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

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 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 take into account 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 need 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 item 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 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[14] , 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[15], 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 using on-line, 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

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

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

investments and manages them for the investor on an on-going basis. Costs, and the charging mechanisms used vary and, as always can have a significant impact on investor returns.

Boring Money[16] 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[17]. 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 suggest 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[18] 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.

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

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

[18] 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

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 on line 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 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 us 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 2.5 of the response to Question 35 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, consumers would have been hard put to it to find an exactly comparable product anywhere else.

37.2. Market equilibrium

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.

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'[19]. This problem has grown worse since then[20]. 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[21] 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 are not able to comment meaningfully on this.

Note: ShareSoc worked closely with UKSA in preparing our response to this consultation and many UKSA members have contributed to this response. We are most grateful for those who contributed to making this response as comprehensive as it is.

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

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

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