The Financial Inclusion Centre

Financial markets that work for society

FCA FINANCIAL ADVICE MARKET REVIEW-CALL FOR INPUT SUBMISSION BY THE FINANCIAL INCLUSION CENTRE

We are pleased to submit a response to the FCA's Call for Input on the Financial Advice Market Review (FAMR).

Our submission is in two parts. Part 1 is a supporting paper explaining in more detail our views on the real causes of the 'advice gap'. Part 2 contains our response to the specific questions.

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PART 1: SUPPORTING PAPER

Summary
We welcome the launch of the FAMR call for input into the so-called 'financial advice gap' in the UK – concerns that large numbers of consumers are unable (or unwilling) to access good quality, appropriate financial advice. It is very important that some of the misconceptions about the 'advice gap' are dealt with.

Good advice is critical for promoting financial inclusion, financial resilience and security amongst households – particularly lower-medium income households which are the focus of our work at the Financial Inclusion Centre. But, it is important that we understand the real causes of the advice gap. Claims that the advice gap is caused by or has *emerged* because of over-regulation are wrong - or disingenuous and used to try to reduce much needed consumer protection. Remedies based on false analysis would exacerbate rather than improve the situation.

A more accurate assessment is that robust, better regulation has *exposed* a long established advice gap. Of course, many lower-medium income consumers were 'advised' on and sold insurance, investment and personal pension products in the past. But, as we now know from the litany of misselling scandals, these products were all too often unsuitable and represented poor value for consumers due to high charges and commission payments to advisers/ intermediaries. In effect, consumers were cross-subsidising the sale and distribution of these poor value products.

Therefore, when thinking about the concept of an advice gap, it is important not just to think of access to advice *per se* but whether it produces the right outcomes for consumers. It would be easy to close the advice gap if we just allowed the industry to go back to advising on and selling poor value, unsuitable products. But, of course, that would be unacceptable.

The real reasons for the advice gap in our view are:

- growing numbers of consumers simply cannot afford to save and invest, or pay for for-profit advice; and
- large numbers of consumers are 'underserved' by the financial services industry because the industry is still too inefficient to meet their needs.

In other words, it's all about the economics of access and distribution.

Reducing consumer protection to encourage the industry to serve more consumers is not the way forward. Instead the industry would continue to serve medium-higher income consumers but with weaker constraints on its behaviours. The overall effect would be to just transfer the risk of misselling to consumers thereby undermining confidence and trust in financial services. Closing the advice gap, therefore, means focusing on making the financial services industry more efficient so it can extend its reach to more consumers and providing alternative provision for consumers who are not commercially viable for the for-profit advice sector.

Which consumers are affected by the advice gap?

It is important not to oversimplify but we consider there are two groups of consumers who don't have access to appropriate financial advice:

- consumers who are permanently financially excluded and who will never be commercially viable for the for-profit financial services industry - this group needs alternative solutions provided by the state and/ or non-profit agencies; and
- consumers who could benefit from access to good financial advice and guidance but are prevented from doing so by a range of barriers (economic, structural and supply side, and

demand side barriers, see below) - this group is 'underserved' rather than excluded in the conventional sense but if the market was working better could be better served.

Barriers to financial advice

There are a number of barriers that prevent excluded/ underserved consumers from accessing financial advice. We group these into the following categories:

- **External economic factors:** growing numbers of households simply do not have enough spare income to save or invest for the future, or cannot afford to pay for regulated financial advice. In other words, they are not economically viable for commercial, for-profit financial services providers.
- **Structural and supply side barriers:** due to supply side inefficiencies, the financial services industry is limited in the numbers of households (particularly those on lower-medium incomes) it can serve on terms that make sense for those households[1]. These barriers include: oversupply of providers and products, poor product design, weak competition and innovation (from consumer perspective), inefficient business models and supply chains, and conflicts of interest caused by remuneration policies. Some people assert that the current regulatory system acts as a supply side barrier. We think these claims are much overstated – see below.
- **Demand side barriers:** this can include low levels of financial capability, confidence and trust. Or consumers may just not recognise the need to take advice, plan for the future, or just do not value paid-for financial advice.

Overcoming the barriers to advice

The FAMR is very important and timely. Identifying genuine barriers to advice and ways of overcoming those barriers is critical.

The external economic barriers are to a large degree outside of the control of the FAMR. Many households simply do not have enough income to save or pay for advice. But, it is worth noting that if the financial services industry becomes more efficient and innovative this will reduce the unit costs of selling and advising on financial products. This should then allow the industry to extend its reach further to larger numbers of previously commercially unviable consumers.

It may be possible to overcome the demand side barriers to some degree. Sustained public awareness campaigns and efforts to improve levels of professionalism in the industry could increase consumer confidence in the sector. This in turn might encourage more consumers to proactively seek advice – which again would reduce unit costs of distribution as firms would need to spend less on 'prospecting' for and acquiring new business (see below). But it is worth noting that financial capability interventions have not been effective at actually changing the long term behaviours of consumers.

But, we think that the most productive approach is to look at the structural and supply side barriers to see where efficiency gains might be made. We must also deconstruct the supply chain and understand the basic economics of distribution to identify whether regulation per se represents a real barriers to advice.

[1] This is an important distinction. The financial services industry could profitably serve lower-medium income households if it sold them poor value, high cost products and services. But this would not make sense for consumers. This was a feature of old style personal pensions and insurance based investment products that used to be sold in the UK and the 'man from the Pru'.

There is no guarantee that reducing consumer protection would encourage for-profit firms to reach out to underserved households. These consumers would still be less profitable than medium-higher income consumers. What is more likely is that those consumers who are targeted by the financial services industry would end up having reduced regulatory protection. In other words, there would be a transfer of risk from the industry to consumers which could undermine long term confidence in financial services.

The economics of financial advice and distribution

Much of the debate around the advice gap is based on the assertion that regulation pushes up the costs of distributing and advising on products and/or inhibits the ability of the financial services industry to develop innovative, efficient ways of providing advice to consumers.

To examine whether this is the case, we need to break down the end-to-end process of manufacturing, distributing, and advising on financial products into its component stages.

The main stages are as follows.

Pre-sale

- Product design and manufacturing
- General marketing and promotion
- 'Prospecting' for and acquiring new customers
- The 'know-your-customer process - information gathering, fact finding, assessing attitude to risks and so on
- Advice and recommendation – the stage at which the adviser/ intermediary makes a recommendation to the consumer
- Executing the recommendation – the administration process to set up new product etc

Post-sale

Once the advice has been given and sale been made, there are a number of post-sale stages and costs.

- Ongoing relationship management, administration, regular communications
- Redress – firms and advisers/ intermediaries may be liable to paying redress if consumers have been badly advised/ missold.

There are, of course, direct regulatory costs such as the levy firms are required to pay to fund the regulators and compensation scheme. But, we are concerned here with the manufacturing, distribution and advice costs.

Each of these stages have associated costs of doing business. Firms spend large sums of money on: product design and development; marketing, advertising and promotion; prospecting for new business; gathering information and getting to know their potential customers; training staff so they can provide good quality advice; and research and analysis on products available on the market (for advisers/ intermediaries/ distributors).

Post sale firms also spend large sums on administering accounts and regular communications with consumers.

There are also regulatory requirements associated with each of these stages – for example, specific rules relating to product governance, marketing or the 'know your customer' process. And, of course, if firms, advisers, or intermediaries have breached regulatory standards, they may be liable for redress costs - which as we know from experience can be huge.

Does regulation push up the cost of distribution, and cause the advice gap?

The claims we want to examine are: the fear of potential future redress costs makes firms reluctant to advise and sell products to certain groups of consumers; and regulation has pushed up the costs of advising and selling at each of the stages outlined above.

But do these claims stand up when looked at objectively? There are two points we have to remember.

Firstly, it is important to remember that even if regulation didn't exist, firms and advisers would still be subject to duties of care in law. The fundamental reason for financial regulation is that society does not trust the financial services industry to abide by these general legal principles and that expecting consumers to challenge firms (and therefore constrain their behaviours) through the courts is not effective, nor acceptable. Therefore, regulation can be thought of as codifying legal principles which can then be supervised and enforced against and provide the basis for redress through the Financial Ombudsman Scheme rather than the more costly, less accessible court system.

Secondly, we need to ask: are the behavioural standards required by regulators during the advice and selling process are any more onerous than would be expected of a firm that already had the interests of its customers at heart? To put it another way: does regulation imposes ***unnecessary*** constraints or costs on firms at each of those stages outlined above?

If it is truly the case that regulators demand higher standards than would be expected from a well-run business, then the FAMR could safely reduce or clarify regulatory requirements for the industry which could then:

- lower the total end-to-end costs of advising on and selling products to consumers; and/or
- reduce the inhibitions firms have about selling products to underserved consumers due to the fear of unknown future redress costs.

Objective examination would suggest this is not the case.

We have been through each of the pre-sale stages of the process and considered the relevant regulatory requirements associated with each of those stages. But, we cannot identify any significant regulatory requirements which demand standards of behaviour over and above those that would be expected of a well-run firm that sought to understand the needs of its prospective customers, communicate fairly and openly, and provide a professional, quality service.

Regulators provide a degree of flexibility for firms and advisers as to how they interpret and apply the regulations. It seems to us that any 'belt and braces' approach to regulation may be more down to firms not trusting their own compliance and risk management safeguards rather than zealous regulators.

There are claims that regulation inhibits the ability of firms to use innovative technology to improve the efficiency of the advice process – particularly at the 'know-your-customer' stage. But, we cannot identify any particular regulatory requirement which prevents firms and advisers from using technology to improve the efficiency of the process as long as the firm still complies with the general principles relating to know-your-customer. Again, regulations allow a significant amount of discretion as to the steps the firm/ adviser should take to satisfy itself before providing regulated advice.

One solution proposed is to allow a suite of simple financial products to be distributed using a reduced or more restricted advice process. The theory here is that these simple products would be 'safer' to sell so consumers do not require the same level of protection provided by 'full' advice. Again, looking at the existing regulations, it is difficult to see what prevents firms and advisers from using a streamlined advice process to distribute simpler products *on their own initiative.*

Therefore, we would conclude that the existing regulations do not:

- require standards of behaviour higher than would be expected from a well-run business;
- overly restrict flexibility in the advice process;
- prevent firms and advisers from using innovative technology to improve the efficiency of the advice process nor advising on simpler financial products using a streamlined process if they choose to do so.

Indeed there would seem to be much scope for the industry to improve the efficiency of the advice process and cut distribution costs – but this could be done within the existing regulations. The critical point from the consumer perspective is that the firm/ adviser should retain responsibility for the recommendation/ advice.

But, the problem seems to be more to do with the lack of confidence certain firms and advisers have in their own business processes and the reluctance to advise on products without first following a 'belts and braces' approach to complying with regulatory standards.

Another concern raised by the industry is that it faces the risk of unknown and unquantifiable future redress costs. In particular, claims have been made that the regulatory system imposes fault and redress retrospectively – that is, that firms and advisers may behave honourably at the time of a product being bought but the regulators then reinterpret the standards at some future stage. But, we are not aware of any cases where regulators have reinterpreted and applied regulations retrospectively. Regulators have made it clear on a number of occasions that firms and advisers are judged by the standards of the time.

There is a trade-off between the quality of the sales and advice process and the likelihood of firms and advisers being exposed to future redress costs and damaging the reputation of the industry. Well-governed firms, with well-trained staff and robust 'quality control' procedures are less likely to develop poor quality, toxic products or mistreat their customers. Therefore, they are less likely to fall foul of the regulators and end up having to pay redress to consumers.

Arguments put forward by certain financial services industry representatives seem to be somewhat disingenuous. Calls for 'safe harbours' for firms and advisers seem to be intended more to protect firms and advisers from misselling claims rather than genuine attempts to close the advice gap.

Cutting corners and protecting firms and advisers from potential redress claims simply transfers the risks of and liability for misselling to consumers – an illusory efficiency gain and, ultimately, a false economy.

So what could be done?

There are a number of interventions which could improve access to advice without compromising much needed consumer protection.

There is scope for regulators to clarify that:

- firms have discretion to interpret and apply standards to suit their own business models;
- regulation does not prevent firms and advisers from using technology to improve the efficiency of the information gathering and know your customer process – as long as the technology solutions are suitable; and
- regulation does not prevent firms and advisers from using a streamlined process to advise on and sell simple, safer products – as long as the firms and advisers are confident that the products have been subject to robust product governance procedures and a streamlined process does not result in consumers being sold unsuitable products.

These clarifications should at least remove any excuse that regulation is inhibiting genuine innovation and efficiency gains.

There is also significant scope for technology to improve the efficiency of the supply chain at several of the stages outlined above.

For example, one innovation which we think could have potential is 'portable fact finds'. There is a cost involved in collecting basic financial information on a prospective consumer's financial circumstances. If a consumer moves to a new adviser (or from a non-profit adviser to a regulated adviser) there is no point duplicating the collection of that information if his/ her financial circumstances haven't changed much. So we can see merit in allowing consumers to take the 'fact-find' with them to a new adviser. This new adviser should be allowed to rely on that fact-find to provide advice – providing, of course, that the information is relatively current and the consumer has confirmed that there have been no changes in basic financial circumstances.

Moreover, technology has potential for helping advisers (and consumers) better understand attitudes to risk, expose biases and preferences and so on.

But the important thing to note is that we do not need to reduce regulations to encourage greater use of these innovations.

Ultimately, as we have explained, the main barriers to good quality, objective advice are economic not regulatory – consumers can't afford to save, can't afford to pay for advice, and the industry is just not efficient enough to extend access to under-served consumers.

Financial policymakers and regulators cannot do much about the fact that many households are on low incomes and cannot afford to save. But, they can tackle supply side inefficiencies and reduce the unit costs of distribution. This would reduce the price consumers pay for products and make products more affordable for hitherto under-served consumers.

One of the major barriers to market efficiency - and therefore access to advice - is the unnecessary proliferation of providers and products on the market.

Therefore, we urge the FCA to concentrate on improving the efficiency of the financial services supply chain – building on the success of the Retail Distribution Review – and become more proactive in using its product governance powers to drive out poor value providers and products.

There are other supply side interventions which could improve market efficiency. The FCA could make the investment market more efficient, for example, by requiring fund managers to bear all the transaction costs involved in managing portfolios and charge a clean, single fee. This would align the interests of fund manager and clients and reduce product manufacturing and distribution unit costs. Furthermore, we argue for a new form of RU64 which would require advisers and intermediaries to justify clearly to consumers why the adviser/ intermediary is recommending a more expensive investment fund rather than a cheaper passive fund.

Moreover, it is important to remove any confusion around the definition of advice and advisers. There is no need for spurious distinctions such as simplified advice, basic advice, focused advice or generic advice.

Either advice is given or it isn't. Anything involving a recommendation on a course of action (whether it involves an investment strategy or recommendation on specific product) provided by an adviser or algorithm ('robo advice') is advice. Anything else is execution only and should carry prominent warnings regarding the risks of losing valuable consumer protection measures.

Similarly, it should be made clearer that only advisers who comply with strict definitions of independence – fee based, duty of care to client, no ties to any product manufacturer – are allowed to use the term independent financial adviser. All other types of adviser should be called sales agents.

But, even with major efficiency gains, large numbers of consumers will always be commercially unviable for for-profit financial services firms. Alternative solutions are needed for this group. We support the creation of a National Financial Advice Network to provide advice, guidance, and information to consumers who are not commercially viable for the for-profit financial services industry[2]. This must involve some form of cross-subsidy either from the public purse or from the industry.

Conclusion

If the advice gap is to be tackled, alternative solutions such as the creation of a National Financial Advice Network will be necessary. But, it is important not to exacerbate an already serious problem by trying to 'flex' the regulatory system to incentivise commercial providers to meet the needs of excluded/ underserved consumers. This will not work – and indeed will be counterproductive.

[2] This idea was originally proposed by Which? in 2002 http://www.staticwhich.co.uk/documents/pdf/a-national-financial-advice-network-which-response-181710.pdf

It is important to challenge the false arguments about the so called 'advice gap' and understand the real reasons why lower-medium income consumers cannot get access to good quality, objective financial advice.

The barriers to advice are primarily economic, not regulatory. We must take great care not to reduce regulatory protection in a misguided attempt to encourage the provision of advice to consumers who are currently not commercially viable for or under-served by the financial services industry.

In our view, the industry would still not be interested in serving lower-medium income consumers. Instead, the industry would continue to serve medium-higher income consumers but with weaker constraints on its behaviours. The overall effect would be to just transfer the risk of misselling to consumers which will undermine confidence and trust in financial services. This would produce illusory efficiency gains, be counterproductive as it would affect confidence and trust in financial services and the advice process and, ultimately, be a false economy.

PART 2: RESPONSE TO SPECIFIC QUESTIONS

Q1: Do people with protected characteristics under the Equalities Act 2010, or any consumers in vulnerable circumstances, have particular needs for financial advice or difficulty finding and obtaining that advice?

As a general point, many vulnerable consumers face the same problems and other consumers in that the main barriers to effective advice are the inefficiencies of the commercial financial sector and the lack of a comprehensive, national non-profit, free advice agency.

But, certain groups such as those with protected characteristics do have specific needs which cannot be met by the commercial sector. This requires specialist, non-profit advice.

Q2: Do you have any thoughts on how different forms of financial advice could be categorised and described?

There is no need for complex categorisations. Either advice is given or it isn't. Anything involving a recommendation on a course of action (whether it involves a financial strategy or recommendation on specific product) provided by an adviser or algorithm ('robo advice') is advice. Anything else is execution only and should carry prominent warnings regarding the risks of losing valuable consumer protection measures.

Similarly, it should be made clearer that only advisers who comply with strict definitions of independence – fee based, duty of care to client, no ties to any product manufacturer – are allowed to use the term independent financial adviser. All other types of adviser should be called sales agents.

Q3: What comments do you have on consumer demand for professional financial advice?
It may be possible to overcome the demand side barriers to some degree. Sustained public awareness campaigns and efforts to improve levels of professionalism in the industry could increase consumer confidence in the sector. This in turn might encourage more consumers to proactively seek advice – which again would reduce unit costs of distribution as firms would need to spend less on 'prospecting' for and acquiring new business. But it is worth noting that financial capability interventions have not been effective at actually changing the long term behaviours of consumers.

The most productive approach is to look at the structural and supply side barriers to see where efficiency gains might be made.

Q4: Do you have any comments or evidence on the demand for advice from sources other than professional financial advisers?

No comment except to say that generally demand has to be created.

Q5: Do you have any comments or evidence on the financial needs for which consumers may seek advice?

No comment. The description set out by the FCA on page 10 of the call for input describes those needs very well.

Q6: Is the FCA Consumer Spotlight segmentation model useful for exploring consumers' advice needs?

It could be helpful for understanding consumer behaviours and biases. Therefore, it could be helpful to the FCA in understanding how and where to target interventions to prevent firms exploiting those biases.

Q7: Do you have any observations on the segments and whether any should be the subject of particular focus in the Review?

It is important not to overcomplicate the subject. The important thing is to identify which part of the consumer population the market can serve, intervene to make the market more efficient for those consumers and develop alternative solutions for those consumers the market cannot serve.

Q8: Do you have any comments or evidence on the impact that consumer wealth and income has on demand for advice?
N/A

Q9: Do you have any comments or evidence on why consumers do not seek advice?

The main barriers to advice would appear to be: low levels of confidence and trust in the industry, low levels of financial capability, lack of understanding of the potential benefits of advice, not seeing the relevance of advice (for example because of not having sufficient assets/ income to warrant advice), the unnecessary complexity of the financial services market and unnecessary proliferation of providers and products. But demand side barriers are not the important issue here. The critical thing is improving the efficiency of the supply side.

Q10: Do you have any information about the supply of financial advice that we should take into account in our review?

This is the critical issue. The main cause of the 'advice gap' is inefficiencies in the supply chain. This is explained in our supporting paper.

Q11: Do you have any comments or evidence about the recent shift away from sales based on professional advice, and the reasons for this shift?

This is very positive. It has exposed the advice gap which has always existed and made the market work better. But more needs to be done to further improve the efficiency of the industry.

Q12: Do you have any comments or evidence about the role of new and emerging technology in delivering advice?

As we explain in the supporting paper, technology has the potential for helping advisers (and consumers) better understand attitudes to risk, expose biases and preferences and so on. But it is important to note that reductions in consumer protection are not needed to encourage wider use of these innovations.

But the important thing to note is that we do not need to reduce regulations to encourage greater use of these innovations.

Q13: Do you have any comments on how we look at the economics of supplying advice?

The economics of distribution should be the focus of the FAMR. As we explain in the supporting paper, the main barriers to advice are the inefficiencies in the supply chain. We have set out in the supporting paper how the FCA can approach analysis of the economics of distribution.

Q14: Do you have any comments on the different ways that firms do or could cover the cost of giving advice (through revenue generation or other means)? Do you have any evidence on the nature and levels of costs and revenues associated with different advice models?

N/A

Q15: Which consumer segments are economic to serve given the cost of supplying advice?

It is difficult to specify precisely which segments are economic. And indeed it may not be very productive to approach the subject in this way. The crucial point is to identify the real causes of the advice gap (the economics of distribution) and avoid blaming the wrong causes (so called 'red tape' and regulation).

The solution in our view is for: i. the FCA to be proactive in making markets more efficient so that the market can find its level and serve more consumers; and ii. government, with the aid of the FCA, to create a viable, non-profit alternative advice agency to meet the needs of those who are not commercially viable for commercial providers and to provide some competition for the commercial sector.

Q16: Do you have any comments on the barriers faced by firms providing advice?

See supporting paper. The main barriers are economic inefficiencies not regulation.

Q17: What do you understand to be an advice gap?

We define the advice gap as large numbers of consumers unable (or unwilling) to access good quality, appropriate financial advice. Good advice is critical for promoting financial inclusion, financial resilience and security amongst households – particularly lower-medium income households which are the focus of our work at the Financial Inclusion Centre.

But, it is very important that some of the misconceptions about the 'advice gap' are dealt with. Claims that the advice gap is caused by or has *emerged* because of over-regulation are wrong - or disingenuous and used to try to reduce much needed consumer protection. Remedies based on false analysis would exacerbate rather than improve the situation.

A more accurate assessment is that robust, better regulation has *exposed* a long established advice gap. Of course, many lower-medium income consumers were 'advised' on and sold insurance, investment and personal pension products in the past. But, as we now know from the litany of misselling scandals, these products were all too often unsuitable and represented poor value for consumers due to high charges and commission payments to advisers/ intermediaries. In effect, consumers were cross-subsidising the sale and distribution of these poor value products.

Therefore, when thinking about the concept of an advice gap, it is important not just to think of access to advice *per se* but whether it produces the right outcomes for consumers. It would be easy to close the advice gap if we just allowed the industry to go back to advising on and selling poor value, unsuitable products. But, of course, that would be unacceptable.

Q18: To what extent does a lack of demand for advice reflect an advice gap?

Demand side barriers are a factor – see above. But the main barriers are supply side. Moreover, given the limited effectiveness of demand side interventions (such as financial education), it is also more effective use of regulatory resources to act on the supply side barriers.

Q19: Where do you consider there to be advice gaps?

Q20: Do you have any evidence to support the existence of these gaps?

Q21: Which advice gaps are most important for the Review to address?

As with Q15 above, it may not be the most productive use of resources to try to focus on specific segments or gaps. There is a large segment of the consumer population who are not being served by the commercial advice sector. These are primarily low-medium incomes/ asset households. Rather than try to engineer specific solutions for specific segments/ gaps, the FCA should concentrate on forcing through improvements in the economics of distribution.

Q22: Do you agree we should focus our initial work on advice in relation to investing, saving into a pension and taking an income in retirement?

No. This risks recreating a silo approach to regulation.

Q23: Do you agree we should focus our initial work on consumers with some money but without significant wealth (those with less than £100,000 investible assets or incomes under £50,000)?

No. The FCA should focus on making the market more efficient so it can extend its reach to underserved consumers and help the government create a non-profit alternative to meet the needs of lower income households who are not commercially viable for commercial providers and provide competition for commercial providers.

Q24: Are there aspects of the current regulatory framework that could be simplified so that it is better understood and achieves its objectives in a more proportionate manner?

As we explain in the supporting paper, existing regulations do not:

- require standards of behaviour higher than would be expected from a well-run business;
- overly restrict flexibility in the advice process;
- prevent firms and advisers from using innovative technology to improve the efficiency of the advice process nor advising on simpler financial products using a streamlined process if they choose to do so.

Indeed there would seem to be much scope for the industry to improve the efficiency of the advice process and cut distribution costs – but this could be done within the existing regulations.

Of course, the FCA should issue further clarifications about what is possible under the existing regulatory system if only to deal with head on the myths of overregulation.

Q25: Are there aspects of EU legislation and its implementation in the UK that could potentially be revised to enable the UK advice market to work better?

No. But the FCA could make the investment market more efficient, for example, by requiring fund managers to bear all the transaction costs involved in managing portfolios and charge a clean, single fee. This would align the interests of fund manager and clients and reduce product manufacturing and distribution unit costs.

Q26: What can be learned from previous initiatives to improve consumer engagement with financial services?

Demand side interventions such as financial education have very limited impact on consumer behaviour and, therefore, supply side behaviour. Moreover, artificial distinctions such as basic advice have not been successful as they failed to address the fundamental issue regarding the economics of distribution.

Supply side interventions have worked – for example, price caps, the RDR, and introduction of NEST.

Q27: Are there any approaches to the regulation of advice in other jurisdictions from which we could learn?

We would support the FCA adopting the more proactive, interventionist approach followed by the Netherlands regulator with regards to product governance. But, introducing a 'safe harbour' would be too great a risk for the UK financial services market.

Q28: What steps can be taken to address behavioural biases that limit consumer engagement without face-to-face advice?

As we explain above, technology may be beneficial in helping providers address consumer behavioural biases. But it is very important to note that demand side interventions – including those derived from behavioural economics – have limited effect in complex markets such as financial services. The sequence should be to clean up the market first and then try to improve consumer behaviour.

Moreover, using behavioural economics to improve firm behaviours is more productive. In simple terms, if a large firm has, say, 1 million customers intervening to improve the behaviour of that firm helps a large number of customers simultaneously with a single intervention. This is more efficient than trying to improve the behaviour of large numbers of individual consumers – and then hope that this indirectly improves the behaviour of a firm.

Q29: To what extent might the different types of safe harbour described above help address the advice gap through the increased incentive to supply advice

Arguments put forward by certain financial services industry representatives seem to be somewhat disingenuous. Calls for 'safe harbours' for firms and advisers seem to be intended more to protect firms and advisers from misselling claims rather than genuine attempts to close the advice gap. Cutting corners and protecting firms and advisers from potential redress claims simply transfers the risks of and liability for misselling to consumers – an illusory efficiency gain and, ultimately, a false economy. It is too risky to attempt to use 'safe harbours' in the UK financial services market.

Q30: Which areas of the regulatory regime would benefit most from a safe harbour, and what liabilities should a safe harbour address?

None. Firms do not require a safe harbour to do a good job for consumers. As we explain in the supporting paper, we cannot find areas of regulation which have a significant impact in preventing firms improving distribution or extending access to advice to consumers who are commercially viable.

Q31: What steps could be taken to ensure that a safe harbour includes an appropriate level of consumer protection?

See above. It is not an appropriate measure for tackling the advice gap and indeed we fear it would actually be counterproductive.

Q32: Do you have evidence that absence of a longstop is leading to an advice gap?
The effect of the longstop, as with regulation generally, has been seriously overstated. Only a very small number of claims would be affected by a longstop.

Q33: Do you have evidence that the absence of a longstop has led to a competition problem in the advice market e.g. is this leading to barriers to entry and exit for advisory firms?

No. The number of providers in this market is not a problem.

Q34: Do you have any comments about the benefits to consumers of the availability of redress for long-term advice?

Access to redress is critical to promote confidence and trust in the financial system.

Q35: Do you have any comments or suggestions for an alternative approach in order to achieve an appropriate level of protection for consumers?

Ultimately, as we have explained, the main barriers to good quality, objective advice are economic not regulatory – consumers can't afford to save, can't afford to pay for advice, and the industry is just not efficient enough to extend access to under-served consumers.

Financial policymakers and regulators cannot do much about the fact that many households are on low incomes and cannot afford to save. But, they can tackle supply side inefficiencies and reduce the unit costs of distribution. This would reduce the price consumers pay for products and make products more affordable for hitherto under-served consumers.

One of the major barriers to market efficiency - and therefore access to advice - is the unnecessary proliferation of providers and products on the market.

Therefore, we urge the FCA to concentrate on improving the efficiency of the financial services supply chain – building on the success of the Retail Distribution Review – and become more proactive in using its product governance powers to drive out poor value providers and products.

There are other supply side interventions which could improve market efficiency. The FCA could make the investment market more efficient, for example, by requiring fund managers to bear all the transaction costs involved in managing portfolios and charge a clean, single fee. This would align the interests of fund manager and clients and reduce product manufacturing and distribution unit costs. Furthermore, we argue for a new form of RU64 which would require advisers and intermediaries to justify clearly to consumers why the adviser/ intermediary is recommending a more expensive investment fund rather than a cheaper passive fund.

Moreover, it is important to remove any confusion around the definition of advice and advisers. There is no need for spurious distinctions such as simplified advice, basic advice, focused advice or generic advice.

Either advice is given or it isn't. Anything involving a recommendation on a course of action (whether it involves an investment strategy or recommendation on specific product) provided by an adviser or algorithm ('robo advice') is advice. Anything else is execution only and should carry prominent warnings regarding the risks of losing valuable consumer protection measures.

Similarly, it should be made clearer that only advisers who comply with strict definitions of independence – fee based, duty of care to client, no ties to any product manufacturer – are allowed to use the term independent financial adviser. All other types of adviser should be called sales agents.

But, even with major efficiency gains, large numbers of consumers will always be commercially unviable for for-profit financial services firms. Alternative solutions are needed for this group. We support the creation of a National Financial Advice Network to provide advice, guidance, and information to consumers who are not commercially viable for the for-profit financial services industry[3]. This must involve some form of cross-subsidy either from the public purse or from the industry.

Q36: Do you have any comments on the extent to which firms are able to provide consistent automated advice at low cost? Are you aware of any examples of this, either in the UK or other jurisdictions?

We do not have evidence yet. But, we do believe that there is scope for technology to improve the efficiency of distribution. However, the critical point is that the liability for wrong advice should not be transferred to the consumer.

Q37: What steps could we take to address any barriers to digital innovation and aid the development of automated advice models?

We do not see any barriers in the current regulatory system that prevents the development of innovative solutions. However, the FCA's Project Innovate has been a very welcome development. The FCA should encourage greater use of Project Innovate for new advice models.

Q38: What do you consider to be the main consumer considerations relating to automated advice?

The key issue is establishing clear lines of responsibility for advice.

[3] This idea was originally proposed by Which? in 2002 http://www.staticwhich.co.uk/documents/pdf/a-national-financial-advice-network-which-response-181710.pdf

Q39: What are the main options to address the advice gaps you have identified?

See our response to Q35, above. Moreover, as we explain in the supporting paper, the main barriers to good advice are on the supply side. Interventions are needed to improve the efficiency of distribution and develop an alternative non-profit advice network.

Q40: What steps should we take to ensure that competition in the advice markets and related financial services markets is not distorted and works to deliver good consumer outcomes as a result of any proposed changes?

It is not clear how the changes would affect competition. However, the proposals we set out in Q35 would improve competition in the interests of consumers. The critical point is that interventions must be targeted on the supply side and driving down distribution costs.

Q41: What steps should we take to ensure that the quality and standard of advice is appropriate as a result of any proposed changes?

Unfortunately, we do not see how the quality and standard of advice could be maintained if consumer protection is reduced – for example, through the introduction of 'safe harbours'.
The most effective way to improve the quality and standard of advice would be to use the product governance powers and other interventions outlined above to make competition work in the interests of consumers.

This marks the end of The Financial Inclusion Centre's submission