The **Financial Inclusion** and **Markets Centre**

Promoting finance that works for the economy, environment, and society

Financial Conduct Authority (FCA)

Consultation Paper CP26/24** Simplifying Consumer Investment Disclosures

Submission by the Financial inclusion and Markets Centre (FIMC)

About The Financial Inclusion and Markets Centre

The Financial Inclusion and Markets Centre is a dedicated unit of the Financial Inclusion Centre which focuses on financial services policy and regulation, financial market reform, and evaluating the economic, environmental, and social utility of finance. The new unit also covers work evaluating the impact of developments at the intersection of finance and technology including AI.[1]

[1] About | The Financial Inclusion Centre

Introduction

We are pleased to submit a response to such an important consultation. For further information, please contact Mick McAteer mick.mcateer@inclusioncentre.org.uk

Summary of our submission

- We agree with the FCA's general approach that all ongoing costs should be disclosed. We also agree that the disclosure should be simplified as far as possible. We also very much agree with the FCA's general efforts to streamline the rulebook and the principle of combining and consolidating relevant rules for all investment business as long as this does not inadvertently result in losing important consumer protections.
- But we disagree with some of the FCA's detailed proposals. It is critical that the FCA ensures that the market competes on costs. We have seen real progress in reducing costs in the market for investment products over recent years. However, a number of recent initiatives threaten to reverse that progress. The FCA's and TPR's Value for Money (VFM) agenda will create opportunities for active managers to extract higher charges and fees[2] as will the drive to persuade pension funds and others to invest more in opaque, poorly regulated and governed, risky private assets which offer questionable value. The proposals in CP26/24 will provide firms with significant discretion on disclosing charges making it difficult for consumers to compare charges and fees, and recognise how much potential value is likely to be extracted as a result of high charges and fees. This is likely to weaken competitive pressures on the market to the disadvantage of consumers. If competition is to be effective, it is critical that the FCA is very prescriptive on what costs are disclosed and in what format at the pre-sale stage. We do not agree that one-off product costs should be shown separately.
- The FCA should be very prescriptive in how firms explain how performance fees work including: which benchmarks/hurdles have been chosen and why; how and when performance fees apply including whether costs will be reduced for underperformance; and the potential upsides and downsides of performance fees including clear warnings on any additional market risks to be taken in pursuit of outperformance. However, relying on disclosure is unlikely to protect investors from the potential detriment created by performance fees. The FCA should be prescriptive on the basis for calculating the gross pre cost 'outperformance' against which performance fees are calculated including time periods and appropriate benchmarks/hurdles. Moreover, if the FCA allows fund managers to receive explicit performance fees for outperformance over a specified period then, by rights, the FCA should require firms to reduce charges if the fund underperforms against a benchmark or just performs in line with the benchmark.

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[2] The VFM initiative will allow investment firms and advisers to elevate the importance of investment performance (even though future performance cannot be predicted from past performance) and distract attention from the importance of charges and fees. FCA/TPR Consultation CP26/1 The Value for Money Framework: Response to consultation, further consultation and discussion paper | The Financial Inclusion Centre

- We are unclear as to why the FCA is proposing that the ongoing costs of CEIFs, which are deducted from the Net Asset Value (NAV) of the fund, should not be added together with other ongoing costs. These costs may well be borne indirectly but these still form part of the overall investment management costs levied by the relevant manager and should be communicated in a consistent way to consumers.
- We are also concerned about the amount of discretion and flexibility the FCA wants to allow firms on disclosing post-sale costs. Allowing so much discretion will result in inconsistencies of presentation not 'dynamism' and 'innovation' on disclosure and will make it more difficult for consumers to compare on a like-for-like basis.
- We strongly disagree with removing the requirement for a cumulative illustration pre-sale. Consumers should be given a realistic assessment of the potential value firms/distributors could extract from their funds and how much charges/fees are likely to reduce investment returns *pre*-sale as well as being told the impact *post*-sale.
- The FCA should stipulate projected investment returns to be used and require firms to show the net reduction in yield caused by the impact of all end-to-end charges over the appropriate period in a prescribed template (in effect, reintroducing the approach dropped in 2021). The cumulative amount of charges and fees extracted should also be shown in monetary terms. Firms/distributors should include benchmarks such as a model portfolio comprised of low cost passive funds and 'risk free' deposit accounts.
- We agree that up-front disclosure on cash interest should be improved. But, limiting this to requiring firms to notify or explain to consumers what their policies are is unlikely to be enough. Firms should be required to explain to consumers in simple pounds and pence terms the financial cost of practices such charging fees on customers' cash and passing on interest earned in full and retaining some or all of the interest on their customers' cash holdings instead of charging a fee on it.
- We strongly disagree with the FCA's proposals on pensions business. The FCA rightly sees the case for pre-and post- sale consistency around disclosure of charges and fees on investment products. The case for meaningful post sale disclosure is arguably even stronger with pensions given the central role they play consumers' long term financial security. If consumers are to make effective, informed decisions about retirement planning they need access to clear information post sale to keep track of the impact of the value extraction caused by high charges and fees on those retirement plans.
- We urge the FCA to treat pension schemes, local authorities, and charities as equivalent to retail clients and provide them with the same protections. The decisions made by trustees and local authority representatives can affect the financial wellbeing of large numbers of individuals. They may well have access to professional advice from consultants and advisers. But, that is all the more reason to ensure they have robust protections given the conflicts of interest in the supply chain when advisers and consultants are involved. The VFM agenda and the push to get institutions such as pension schemes to invest more in private assets increases the risks of poor outcomes.

Response to specific questions

Question 1: Do you agree with our proposals on how firms should disclose pre-sale costs of investing? If not, why not, and what presentation would you propose?

We agree with the general approach that all ongoing costs should be disclosed. We also agree that the disclosure should be simplified as far as possible. That is, firms should not have to disclose detailed itemised costs as a matter of course but investors should be able to request one.

But we do not agree with some of the FCA's detailed proposals. We do not agree that one-off product costs should be shown separately. We would argue that the FCA should stipulate typical holding periods (based on consumer research) over which the impact of total end-to-end costs of investing should be shown.

For example, the FCA could specify that firms should assume a holding period of three or five years and show the total annualised cost (including one-off costs) of using that fund over that period in a template prescribed by the FCA.

An alternative would be for the FCA to require firms (including intermediaries and platforms) to establish the investor's expected preferences with regards to holding periods and tailor the disclosure accordingly. With technological advances including the use of AI, this should not be difficult for the industry to deliver.

We are also very concerned about the FCA's risky proposals on cumulative impact of charges and fees – see Q5, below.

We agree it would be difficult to incorporate performance fees into a total cost disclosure template. But, real care must be taken with active management performance fees. Ordinary investors (and pension scheme members) have seen significant gains as a result of the growth in passive management. Passive management introduced much needed competition into the retail investment market. Costs matter. We are concerned that a number of initiatives, including the Value for Money (VFM)[3] agenda pursued by the FCA and The Pensions Regulator (TPR) and the push by government and regulators to promote greater use of high cost private assets, will enable active managers to extract higher charges from pensions and investment pots so reversing the gains made. We would urge the FCA to take care to not design a disclosure regime that encourages the growth in the use of active fund performance fees which would just exacerbate the negative impacts of the VFM and private assets agendas.

[3] The VFM initiative will allow investment firms and advisers to elevate the importance of investment performance (even though future performance cannot be predicted from past performance) and distract attention from the importance of charges and fees. FCA/TPR Consultation CP26/1 The Value for Money Framework: Response to consultation, further consultation and discussion paper | The Financial Inclusion Centre

The FCA should be very prescriptive in how it requires firms to explain how performance fees work including: which benchmarks/hurdles have been chosen and why; how and when performance fees apply including whether costs will be reduced for underperformance; and the potential upsides and downsides of performance fees including clear warnings on any additional market risks to be taken in pursuit of outperformance.

However, relying on disclosure is unlikely to protect investors from the potential detriment created by performance fees. Perhaps more important is the structure of performance fees.

If superior investment performance is achieved this will have been though good fortune (as future superior performance cannot be guaranteed) and/or by the fund manager taking on significant additional risks.

As fees and costs (generally speaking) are linked to asset values (although specific structures will vary), fund managers who do happen to outperform against a benchmark (eg. an index, basket of indices, or peer groups) will automatically receive a performance fee anyway – the additional revenue is built into the rising asset values. Unless the FCA determines how performance fees are calculated, firms could end up getting a double benefit by generating additional ad valorem revenue as a result of naturally rising markets and also an additional performance fee.

The FCA should be prescriptive on the basis for calculating the gross pre cost 'outperformance' against which performance fees are calculated including time periods and appropriate benchmarks/hurdles. Moreover, if the FCA allows fund managers to receive explicit performance fees for outperformance over a specified period then, by rights, the FCA should require firms to reduce charges if the fund underperforms against a benchmark or just performs in line with the benchmark. The FCA should make it clear to senior management and relevant fund governance bodies that as part of the Consumer Duty they are expected to exercise enhanced oversight over the use of performance fees to ensure the structures do not produce asymmetric benefits for the firm and investors (outcome) and that investors are not being misled (understanding).

We are unclear as to why the FCA is proposing that the ongoing costs of CEIFs, which are deducted from the Net Asset Value (NAV) of the fund, should also not be added together with other ongoing costs. These costs may well be borne indirectly but these costs still impact on the return received by the investor. If they form part of the total costs relating to investment management levied by the relevant manager, then investors have a right to know. Investors should be able to compare the total costs levied by a CEIF manager with those levied by managers of funds with a similar purpose on a consistent basis.

There may well be a case for excluding costs incurred in the maintenance and commercial operation of real assets such as property holdings If these are genuine physical asset running costs rather than costs relating to investment management. However, if the costs deducted from the NAV are levied for the investment management assets rather than direct maintenance of underlying assets, CEIFs should not be granted favourable treatment.

Question 2: What can be done to enable and encourage firms to deliver dynamic and engaging pre-sale cost disclosures?

We are unsure as to what the FCA means by this question. The FCA already allows firms significant discretion these days on how they engage with consumers as part of the Consumer Duty. We would suggest that, rather than adopt an 'encouraging and enabling' approach to the market, the FCA should be specific in terms of directing firms how and when to present core information on charges and costs. The FCA should make it clear that it expects firms to use methods that have been shown to encourage positive consumer behaviours and engagement with the importance of charges – for example, the 'review screen' mentioned in para 2.24.

Question 3: Do you agree with our proposals for the presentation of post-sale cost disclosures? If not, why?

We very much support the FCA's intention that consumers should continue to be told the total costs incurred across all categories including transaction costs. As the FCA quite rightly says, different fund strategies will have different levels of transaction cost. It is the firm's decision to promote particular fund strategies, and the effects of that decision should be properly disclosed.

We have no particular view on whether firms should be automatically required to provide a detailed breakdown of total costs. But, we are concerned about the amount of discretion and flexibility the FCA wants to allow firms on how to disclose post sale costs. Allowing too much discretion on presentation will result in inconsistencies of presentation not 'dynamism' and 'innovation' on disclosure and will make it more difficult for consumers to compare on a like-for-like basis. For example, the FCA says firms could: 'group together service and ongoing product costs in the period, presenting a sub-total matching the presentation of pre-sale disclosures, and then include the actually incurred one-off and transaction costs in an overall total.' We argue that firms should *not* be allowed the choice of deciding whether or not to include one-off and transaction costs in the total. This should be a requirement.

As above, we do not agree with the FCA's approach to CEIF costs. Any costs levied by the firm in relation to investment management including those which are deducted from the NAV should be disclosed.

Question 4: Do you agree with our proposal to permit a 'reasonable estimate' of costs to be disclosed post-sale? If not, why?

The FCA proposes to permit a 'reasonable' estimate of actually incurred costs where it would require 'disproportionate' effort to obtain exact figures. We agree it would be sensible not to require firms/distributors to spend undue time and resources on obtaining exact values for costs where the difference between estimates and the actual costs would make a very small difference to the overall total cost disclosure presentation and would be unlikely to mislead consumers.

But, firms should not be allowed to abuse this proposed permission. The FCA intends to align and consolidate the disclosure of costs across product types, along the supply chain, and pre- and post-sale. This should reduce the current degree of fragmentation in terms of cost disclosure and reduce the amount of administrative effort involved in obtaining cost data. There should be fewer reasons for firms to have to use estimates or work unduly hard to obtain data. Indeed, we would question whether firms/distributors should be willing to enter arrangements with other firms in the supply chain unable to supply accurate cost data.

However, the FCA does not elaborate on what it means by 'reasonable' or 'disproportionate'. Nor does the FCA elaborate on how it will monitor how firms/distributors are interpreting reasonable and disproportionate and what action it will take if it finds out that firms/distributors are abusing this new permission to not obtain accurate cost data. We would welcome clarification from the FCA on how it expects firms to use this permission and what action it would take against firms abusing this permission.

Question 5: Do you agree with our proposal to remove the requirement for a cumulative effect illustration pre-sale? If not, why?

No, we strongly disagree with this proposal. We are genuinely at a loss as to why the FCA is proposing this. The FCA seems to elevate its new principle of allowing the market discretion and freedom to 'innovate' over the importance of ensuring the market adopts the most effective methods of disclosure to help consumers make informed decisions.

The FCA uses phrases such as: 'Firms *may* [our emphasis] produce generic or dynamic cost impact illustrations where they believe them to be helpful for consumers and relevant to the nature of the product' – see para 2.48.

Yet, in the very next paragraph, the FCA highlights an example of presentation which research has shown to be effective in helping consumers select better value funds. This particular presentation shows clearly the potential cumulative impact of charges and fees over time. Allowing firms/distributors to adopt their own 'dynamic' cost impact illustrations would surely make it more difficult for consumers to compare different offers.

We would urge the FCA to reconsider this very risky proposal and mandate how firms should show the cumulative effect of charges and fees. There are a number of very good reasons for doing so.

Consumers should be able to obtain a realistic assessment of how much value firms/distributors are likely to be able to extract from their funds and how much charges/fees are likely to reduce investment returns *pre*-sale as well as the impact *post* sale. As the FCA says in para 2.36, 'they [consumers] need to know that even small differences in charges can have significant impacts on long-term returns so that they can choose better value products and services.' Using a one year period, as per the template in para 2.22, would downplay the likely cumulative impact of different fund charges and fees on returns and the value extracted by firms/intermediaries.

Consumers should be able to see how much value a firm is likely to extract from their funds as a result of rising markets. *Ad valorem* fees produce increased value for firms/intermediaries as a consequence of rising markets not due to any particular skill of the relevant fund manager. A template of the type proposed in para 2.22 would not allow consumers to see how much firms might extract from their funds over longer periods if markets rise.

Consumers should also be able to consider whether it might be worthwhile taking a risk on investment products as opposed to obtaining a 'safe' return from a deposit account.

So, some form of assumption about potential returns is needed. Clearly, allowing firms to use past performance data would be misleading. The FCA should stipulate projected investment returns to be used and require firms to show the net reduction in yield caused by the impact of all end-to-end charges over the appropriate period in a prescribed template (in effect, reintroducing the approach dropped in 2021). The cumulative amount of charges and fees extracted should also be shown in monetary terms. It would also make sense to require firms/distributors to include benchmarks such as a model portfolio comprised of low cost passive funds and 'risk free' deposit accounts.

The FCA recognises its proposals will mean consumers do not have comparable pre-sale illustrations of the impact charges could have on returns. Yet, it justifies this on the grounds that: 'given the variation in approaches currently taken, this is already the case and we do not think it is practical to design a methodology that covers the breadth of products and services caught by these rules.' Just because something is 'already the case' is no grounds for continuing such an approach.

Moreover, we think the FCA is overstating the difficulties of designing a consistent approach. There may well be different types of products on the market. But, regardless of the specific legal or corporate structure, these products are ultimately wrappers for portfolios of assets.

The FCA should mandate specific annual returns for asset classes for all firms to use so ensuring a level playing field and require firms/distributors to apply these following steps to communicate the cumulative impact of total charges and fees in tabular and chart format. Firms/distributors should be required to:

1. calculate a portfolio gross annual return based on applying the mandated annual returns to the specific underlying portfolio asset allocation;
2. calculate and disclose/display the cumulative gross portfolio annualised return and gross fund value over prescribed periods or over tailored, personalised periods;
3. calculate and disclose the total annual and cumulative charges and fees over the relevant period;
4. disclose and display the total annual and cumulative value extracted from the gross portfolio as a result of the charges and fees levied; and
5. display the equivalent value extracted from a benchmark fund assumed to have an equivalent asset allocation but with typical passive management charges where available (with some asset classes, passive funds may not be widely available on the market so average charges could be used).

The FCA is very positive about the market's potential for using technology to communicate to consumers. It should not be difficult for firms/distributors to apply these steps pre-sale, to either lump sums or regular savings amounts, to show consumers the potential impact of high charges and fees on their investments.

Question 6: Do you agree with our proposal to require firms to show the effect of costs on performance in regular post-sale reporting in the way described? If not, why?

We agree that firms should be required to show the effect of all costs and fees on performance in regular post sale reporting and that information should be made available over the lifetime of the service.

But, we do not agree that firms should be given the freedom to choose how to present the information. We do not understand why the FCA believes this will better achieve the original policy intent of showing the long-term effect of costs, and illustrate what drives the gap between gross and net performance. The FCA's approach will surely create an incentive for firms with high charges and fees to select methods that downplay the impact of their charging structures.

The FCA should mandate the core elements of reporting including the use of relevant benchmarks. If consumers are to be able to hold firms to account for poor performance and high costs, then they should be able to see clearly what the firm is costing them compared to other available options. The FCA should also require firms to explain to consumers why underperformance has occurred.

With respect to performance fees, as explained above, the FCA should be prescriptive on the basis for calculating the gross pre cost 'outperformance' against which performance fees are calculated including time periods and appropriate benchmarks/hurdles. Moreover, if the FCA allows fund managers to receive explicit performance fees for outperformance over a specified period then, by rights, the FCA should require firms to reduce charges if the fund underperforms against a benchmark or just performs in line with the benchmark.

Question 7: Do you agree with our proposal to improve up-front disclosures about cash interest? If not, why?

We agree that up-front disclosure should be improved. But, limiting this to requiring firms to notify or explain to consumers what their policies are is unlikely to be enough. We would argue that firms should be required to explain to consumers in simple pounds and pence terms the financial cost of practices such charging fees on customers' cash and passing on interest earned in full and retaining some or all of the interest on their customers' cash holdings instead of charging a fee on it.

Question 8: Do you agree with our proposals on how information should be disclosed when firms receive money from consumers? If not, why? Would our proposals present any operational difficulties?

Yes, we agree. But, as above, consumers should be told in clear monetary terms the financial impact of charging practices relating to fees and withholding interest.

Question 9: Do you agree with our proposal to require disclosure of interest paid and fees charged on cash balances in periodic reporting to retail clients? If not, why?

Yes, we agree. Where there is combination charging ie. charging fees and passing on interest, the net impact should be shown.[4]

Question 10: Do you agree with our proposals to combine COBS 6.1 and COBS 6.1ZA and other relevant rules into one new chapter, COBS 6A, for all investments business? If not, why?

Question 11: Do you agree with our proposals to remove the rules in COBS 6.1ZA.15B-15J? If not, why?

We very much agree with the general principle of combining and consolidating relevant rules for all investment business. But, while consolidation *per se* may well deliver benefits for the industry (by reducing administrative requirements), the extent of the benefits for consumers will very much depend on what the new consolidated rules demand of firms. As explained above, we have significant concerns about some of the details in the FCA

[4] As an aside, we note with interest the FCA's comment that: 'Where a firm is aware that a consumer has significant cash holdings on a platform, we would expect them to consider their obligations under the Duty to enable and support retail customers to pursue their financial objectives and avoid causing foreseeable harm. As part of this, a firm may contact the customer to make them aware of the drawbacks of holding significant levels of uninvested cash.' In our response to the FCA's Targeted Support and Simplified Advice reforms, we argued that these deregulatory measures were not necessary to ensure firms provided support to consumers who may be at risk of making suboptimal financial decisions. We said that the FCA could have chosen to use the Consumer Duty to ensure firms acted responsibly to identify and provide support to clients at risk of making suboptimal decisions. XXXXXXXXX The FCA confirms that this is indeed possible. This would have been a safer, more effective option than deregulating via Targeted Support and Simplified Advice.

proposals and the degree of discretion and flexibility given to firms on how to disclose the impact of charges to consumers. If the rules are consolidated on the basis of the proposals set out in CP26/24, this is unlikely to deliver benefits for consumers.

With regards to IDD-derived rules on remuneration practices, we do have concerns about the FCA's reliance on the Consumer Duty to deliver the right outcomes. We take the view that the FCA is allowing the market too much discretion on how to interpret what good outcomes mean. Rather than relax the IDD remuneration rules, we would argue that the FCA should issue more explicit guidance across all the relevant product sectors.

Question 12: Do you agree with our proposals in relation to pensions business? If not, why?

No, we do not agree with the FCA's proposals on pensions business. We do not understand why the FCA wants to take a different approach to post-sale disclosure with pensions. If the FCA rightly sees the case for pre-and post- sale consistency around disclosure of charges and fees on investment products, surely the same approach should be adopted with pensions.

Indeed, the case for meaningful disclosure post sale is arguably even stronger with pensions given the central role they play consumers' long term financial security. If consumers are to make effective, informed decisions about retirement planning they need access to clear information post sale to keep track of the impact of the value extraction caused by high charges and fees on those plans. Moreover, as mentioned, the VFM agenda promoted by FCA and TPR is likely to enable firms to use claims about superior investment performance to distract consumers' attention from the importance of charges.

Question 13: Do you agree with our proposals to delete CASS 9.4 and move these requirements solely into COBS 6A? If not, why?

Yes, we agree with the general principle of consolidating the CASS 9.4 requirements and move to COBS 6A.

Question 14: Do you agree with our proposed requirements on disclosures for professional clients and eligible counterparties? If not, why?

We agree with removing the requirement to disclose non-consequential information such as that mentioned in para 4.19.

We agree with the proposal that firms should not generally be required to provide eligible counterparties with the information required by the rules in COBS 6A other than high level information about costs and charges and information about the safeguarding of client assets (as currently required by CASS 9.4).

We do not understand why the FCA is proposing firms should not be required to disclose fees and interest related to cash holdings to eligible counterparties. These may well be sophisticated clients but they are still engaged in a commercial transaction and disclosing core information is surely a matter of good practice.

With regards to other professional clients, we would urge the FCA to treat pension schemes, local authorities, and charities as equivalent to retail clients and provide them with the same protections, see above, in this consultation and more generally as part of its work on client categorisation. Trustees and local authority representatives are stewards of often significant amounts of assets and the decisions they make can affect the financial wellbeing of large numbers of individuals. Few will be investment and financial experts. The impact of a poor decision can have significant consequences.

They may well have access to professional advice from consultants and advisers. But, that is all the more reason to ensure they have robust protections given the conflicts of interest in the supply chain when advisers and consultants are involved. Indeed, these clients are likely to be prime targets for advisers and consultants promoting costly, poorly regulated and governed private assets with questionable investment performance track records and prospects. As mentioned above, the FCA's and TPR's Value for Money (VFM) agenda will create opportunities for active managers to extract higher charges and fees from pension funds and other institutions such as local authorities and charities so reversing the gains made in driving down investment charges and fees.

Question 15: Do you agree with our proposals for the transition period? If not, what would you suggest?

Yes, we agree.

Question 16: Do you agree with our proposed changes to the CCI transition period?

Yes, we agree.

This marks the end of our submission.

Financial Inclusion and Markets Centre (FIMC)
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