Financial Advice Market Review – final report

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HM Treasury (**HMT**) and the Financial Conduct Authority (**FCA**) recently published the final report of the Financial Advice Market Review (**FAMR**). The aim of FAMR is to support the development of a market which "provides affordable and accessible financial advice and guidance for everyone, at all stages in their lives". FAMR found that, at the moment, there is a significant proportion of the population that would benefit from advice that is not currently receiving it. This has been called the “advice gap”.

1. Why is there an "advice gap"?

Both the FCA and HMT believe that there is significant confusion regarding what level of guidance and information constitutes regulated advice. As a result, they believe many firms have restricted their activities with consumers so that any information they provide stops well short of regulated advice.

Another factor identified as contributing to the gap is the impact of the Retail Distribution Review (**RDR**). While the RDR was considered to have been successful in driving up the quality and professionalism of financial advice in the UK, it was also acknowledged that the cost of advice (and indeed the perceived cost of advice) had risen as a result. Cost is a factor in the advice gap as there is a segment of the market unwilling to pay the high costs of regulated advice to address what they consider as their relatively straightforward financial needs.

2. Closing the advice gap

HMT and the FCA believe that the market should work better and FAMR has a number of recommendations designed to close the advice gap.

2.1 Changing the definition of advice

One of the key proposals is to update the definition of advice in order to encourage firms to feel comfortable giving useful guidance to clients without being concerned that they are overstepping the "regulated advice" boundary.

As a result, HMT is proposing to consult on amending the definition of regulated advice in the existing Regulated Activities Order so that it is aligned with the "personal recommendation" definition as set out in the Markets in Financial Instruments Directive (**MiFID**). This is intended to give firms certainty and confidence in offering more useful guidance and information to consumers without straying into the field of regulated advice. Firms providing this type of guidance would not be obliged to comply with suitability rules and would not need to hold the "advising on investments" permission. However, firms would still need to act in the client's best interests and provide information which was clear, fair and not misleading.

2.2 Streamlined regulated advice

While HMT is consulting on the definition of regulated advice, and potentially moving certain guidance and information outside the scope of regulated advice, the FCA will be working on developing a clear framework for regulated streamlined advice. FAMR recognises that many people only want advice in relation to specific needs (such as investing in a stocks and shares ISA for the medium to long-term) or at certain trigger points in their life (such as investing a lump sum for a newly born grandchild) . Such consumers do not want in-depth advice across all of their financial circumstances.

It is intended that a streamlined advice framework will allow firms to easily provide limited regulated advice on specific customer needs without being obliged to meet the "full" advice standard with its comprehensive fact find and extensive suitability obligations. While the current regulatory framework does allow for "simplified" "focused" and "basic" advice, firms have not developed these services, and stakeholders have indicated to the FCA and HMT that this is because of the lack of regulatory clarity in this area.

As a result, the FCA is to develop guidance for this streamlined regulated advice which will:

- set out the "core elements of a personal recommendation" which need to be included in streamlined services;
- provide "greater clarity on firms ability to narrow their suitability considerations" outside the scope of the streamlined advice;
- set out the "implications for the fact-finding, suitability and customer disclosure parts of the streamlined advice process".

The FCA has previously attempted to encourage limited advice services and as FAMR has acknowledged such previous attempts have not been crowned with success. We believe that the guidance framework will need to be very detailed with extensive examples of good and bad practice and numerous illustrative case studies in order to give the necessary comfort to market participants. Without the detailed and well-thought through guidance and examples there is a real risk that this "streamlined advice" category could cause further confusion in the market.

2.3 Use of technology

HMT and the FCA believe there is a role for technology to reduce the costs of advice (noting that the costs of face-to-face advice are particularly high) and that it has a part to play in closing the advice gap. FAMR recommends that Project Innovate is expanded to provide an advice hub to investigate how technology can be used to facilitate the provision of high quality advice. It has already been noted in the press that Royal Bank of Scotland will be using so called “robo-advice” for investors with less than £250,000 to invest.

3. Other proposals to note in FAMR

3.1 Long stop proposal

The FCA has decided not to proceed with a 15 year long-stop provision relating to complaints about financial products and services as their research found that relatively few complaints date that far back.

3.2 Training and Competence qualifications

The FCA is to consult on modifying the time limits for employees to attain appropriate qualifications as set out in the FCA's Training and Competence sourcebook. It is proposed that employees should be able to work for up to four years under supervision to obtain the relevant qualification. FAMR believes that this will give firms sufficient flexibility to train a new generation of advisers while continuing to increase standards of professionalism.

3.3 Cross-subsidisation guidance

The FCA is also to consult on cross-subsidisation rules in relation to firms advising on their own products. The current guidance around cross-subsidisation states that "the allocation of costs and profit between the adviser's charge and product cost should be such that any cross subsidisation is insignificant in 'the long term'". However "long term" is not defined and each situation has to be considered on its own merits. The FCA's standard approach is to see whether costs will be recovered over a reasonable payback period compared to the time period available to non-vertically integrated firms investing in new business models. The time period should also be consistent with the firm's standard payback period. While FAMR is clear that vertically integrated firms should not be able to obtain an unfair advantage through their control of the product manufacturing process, FAMR notes that this should not prevent firms from having a level of flexibility on recouping their costs. Therefore, the FCA is to consult on the guidance relating to cross-subsidisation and in particular to consider the interpretation of “long term” and the flexibility allowed.

3.4 Fact find consultation

Further FAMR recommended that the FCA should consult on guidance to clarify the standard types of information required as part of a fact find, and guidance on the extent that a firm needs to verify a fact find carried out by a third party.

4. MiFID II and other European developments

HMT and the FCA have taken on board that many of the specific requirements that govern the provision of financial advice are set at a European level, in particular through MiFID. MiFID II is currently set to be implemented in January 2018 although key details are yet to be published. Where uncertainties arise the FCA will work with ESMA and the European Commission to resolve them before the transposition date. Further, HMT is to ensure that in implementing MiFID II in the UK, any changes to the law and regulation do not interfere with the ability of the FCA to create clear regulatory guidance for firms as to how to provide streamlined regulated advice to consumers.

It is worth noting that the European Commission Green Paper consultation on retail financial services, which recently closed to responses, has noted the lack of cross-

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border competition for financial services and the varying costs for financial products across the EU. It also concluded that technology has a useful role to play in assisting consumers to achieve the best, most cost effective, outcomes in this market.

5. Future developments

FAMR has left both HMT and the FCA with significant workloads if they are to carry out all of the 28 recommendations set out in the report. The FCA will be issuing a number of consultations and additional guidance and it has highlighted this work as one of its key objectives in the business plan published on 5 April 2016. The FCA has also announced that it will shortly be conducting a suitability review of over 700 advisory firms. Undoubtedly this has been informed by FAMR which noted that there was "scope to improve the quality of, and shorten the time spent on, suitability reports and make them more accessible for consumers."

HMT will also be busy consulting on the new definition of regulated advice and ensuring that the transposition of MiFID II does not interfere with the FCA's ability to give clear guidance in relation to streamlined advice. HMT will also be working with the FCA to develop appropriate indicators to monitor the development of the advice market which will be published annually.

Further, the European Commission is expecting to publish an Action Plan on Retail Financial Services (following on from the Green Paper) for consultation around summer 2016 which, depending on the outcome of the Referendum in June, could also add to the workload of the FCA and HMT in this area.