Altus Consulting

CLEAR THINKING FOR FINANCIAL SERVICES

Consultation Response
FCA Mission Statement

A response from Altus Consulting

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1 EXECUTIVE SUMMARY

As a business and technology consultancy specialising solely in financial services, Altus has extensive experience working with clients in the UK market, including investment platforms, insurers, life companies and retail banks. With practical involvement in both system and business developments across the pension and investment sector we welcome this opportunity to respond to the Financial Conduct Authority consultation on its mission.

Overall the consultation is very nicely structured and clearly written and it is encouraging to see the FCA opening up to external input on its future direction. We have responded below to those questions where we have strong views or particular insights but, in summary, we believe that the FCA ought to become more proactive in its mission in the future.

The social and political landscape has changed enormously since the UK Financial Services regulator was originally founded and the challenges facing the country are very different. The continued decline of DB pensions, gradual reduction of the state safety net and a growing culture of debt point to a looming crisis for a large proportion of the UK population as they approach retirement.

In our opinion that suggests the FCA should move beyond simply preventing harm from financial services products and towards promoting better financial outcomes for consumers. That translates, in our view, into the regulator creating an environment which promotes saving and investing whilst balancing this against inappropriate risks. We believe that ultimately this will require the FCA to agree some low risk investment products that can be offered to the mass market via simpler and cheaper routes than is currently possible.

Whilst the detail of this would need to be worked through, we note that the FCA has used an automotive industry analogy on a number of occasions and we would suggest that something akin to the NCAP safety regime adopted by motor manufacturers provides a useful model of what can be achieved without compulsion. Without some such initiative, we fear that the regulator will increasingly be seen as an obstacle to reform rather than an enabler.

2 ANSWERS TO QUESTIONS

Q1: Do you think our definition of a well-functioning market is complete? What other characteristics do you think we should consider?

The proposed definition is complete but quite generic and we suggest a couple of additional characteristics would be appropriate in a financial services context.

The first is around "consensus pricing". The paper talks about "genuine rivalry between firms" but it may be helpful to spell out that clustering of prices will be seen as potential evidence of a market which is not functioning well and to be clear that the FCA will monitor this.

Second, given the prominent role that tax treatment plays in shaping the financial services market, we would propose that the definition be extended to consider the extent to which the market achieves the policy objectives intended by the tax regime.

For example, if the government incentivises retirement saving for basic rate taxpayers, we might expect a well-functioning market to produce an increased income in retirement for that segment of the population.

Q2: Do you think our approach to consumer loss in well-functioning markets is appropriate?

We agree that consumer loss cannot realistically be eliminated in financial services and that consumers should be encouraged to take responsibility for their investment decisions.

Q3: Do you think we have got the balance right between individual due diligence and the regulator's role in enforcing market discipline?

The consultation paper acknowledges that consumers must be protected from harm in some cases and uses the car industry as an example. We agree that vehicle safety is an excellent analogy and would encourage the FCA to adopt a similar approach to the NCAP safety regime adopted by motor manufacturers.

The FCA acknowledges in the paper that FS relationships are typically long-term making it impractical for consumers to learn from their mistakes and this is surely a strong argument for regulating products.

We also note some inconsistency in how risk is regarded between the sections on loss as part of well-functioning markets and that on regulating real world markets. The former lists a number of risk categories which can lead to loss whilst the latter summarily defines General Insurance as low risk and Investment as high risk based on just one of these; certainty of outcome.

The truth is more subtle than this and ought to take account of the risk customers may deliberately take on via investment versus the accidental risk of failing to adequately insure against particular risks with, say, car insurance. The latter is, after all, why certain minimum cover is laid down by law.

Q4: Do you think the distinction we make between wholesale and retail markets is right? If not, can you tell us why and what other factors you believe we should consider?

The distinction is reasonable but we would dispute the contention that "advice" is widespread in retail markets. Even for investment business, HMRC data indicates that less than 50% of new ISAs are advised whilst, for other sectors such as general insurance or retail banking, there is very little actual advice – unless the FCA is using the term more loosely than usual?

Q5: Do you think the way we measure performance is meaningful? What other criteria do you think are central to measuring our effectiveness?

Measuring outcomes in markets is, in our opinion, the most meaningful of the proposed approaches. Given our response to question 1, we would suggest that the scope of these outcomes be extended to measure UK savings and investment ratios as this is a key outcome of a well-functioning financial services market.

Q6: Do you think our intervention framework is the correct one?

The FCA intervention framework is useful in a reactive context but, in our view, the FCA could take more proactive steps to avoid unsuitable financial services products reaching the market in the first place.

Returning to the NCAP analogy, we would encourage the FCA to provide some oversight of product design to ensure appropriate products are made available particularly to less sophisticated consumers. We are aware that this topic has been looked at before with a number of consultations and even the introduction of a kitemarked product in the form of Stakeholder pensions. However, all these pre-dated the RDR which has transformed the distribution landscape by removing commission bias and we would suggest that the potential for positive intervention by the FCA is now far greater than ever before.

Q7: Do you think the way we interpret our objective to protect and enhance the integrity of the UK financial system is appropriate? Are there other aspects you think we should include?

The FCA's focus on preventing harm is appropriate in our view although we would suggest interpreting this more broadly to consider the harm to consumers of not investing. Given the well documented pressures on individuals to take greater responsibility for their finances in retirement, it would seem important to encourage greater levels of retail saving and investment.

Q8: Where do you believe the boundary between broader policy and the FCA's regulatory responsibility lies?

This is a very broad question but, in summary, we believe the FCA should take more responsibility for policy outcomes than is currently the case.

The UK regulator was originally established in the mid-80s following several financial scandals and with a focus on preventing further crises. The social and political context at the time was still relatively paternalistic with a strong safety net culture. Focusing on the regulation of high risk financial products to the mass market was therefore a natural response.

However, thirty years on we face a very different landscape where arguably the greatest financial challenge faced by society is the lack of saving for retirement. Against this backdrop, we suggest the FCA should have some responsibility for encouraging responsible saving and investment which is clearly far more policy focused.

Q9: Is our understanding of the benefits and risk of price discrimination and cross subsidy correct? Is our approach to intervention the right one?

The logic of the paper in this section is difficult to dispute but the market fallout from RDR has surely demonstrated the risks of simply removing cross-subsidy as mass market consumers have eschewed financial advice in large numbers resulting in the so called "advice gap".

Whilst we certainly do not suggest a return to providers paying advisers, we do believe that the market needs to adapt to provide cheaper replacement services and the FCA has a responsibility to modify its rules to encourage such adaptation.

Beyond ensuring that regulation does not stifle innovation, we agree with the FCA that some level of price discrimination and cross-subsidy is an inevitable feature of a competitive market.

Q10: Does increased individual responsibility increase the need and scope for a greater and more innovative regulatory response?

Definitely. Project Innovate and the Regulatory Sandbox are both useful developments but we believe the regulator should go further to help providers design a set of simple products which could be made available to consumers without the need for regulated advice.

Q11: Would a Duty of Care help ensure that financial markets function well?

No. We agree with the FCA that TCF principles already cover this. In addition the Equality Act 2010 legislates against sex, race, disability, beliefs, age discrimination etc. whilst various consumer protection acts cover subjects such as advertising, fitness for purpose etc.

Q12: Is our approach to offering consumers greater protection for more complex products the right one?

Yes we agree with the FCA approach although we would encourage the regulator to go further with relaxing rules at the simple product end of the spectrum. We would also point out that just because a product carries investment risk does not mean it is necessarily complex; a structured product is far more complex than an index tracker.

Q13: Is our regulatory distinction between consumers with greater and lesser capability appropriate?

Yes it is an appropriate distinction and should align with MiFID client categorisations.

Q14: Is our approach to redress schemes for issues outside our regulatory perimeter the right one? Would more specific criteria help firms and consumers?

Broadly speaking the FCA approach seems to work although we do have concerns about the emergence of a claims culture in the UK which the FCA should be careful not to stoke.

Q15: What more can we do to ensure consumers using redress schemes feel they are receiving the appropriate level of personal attention?

No strong views

Q16: Is our approach to giving vulnerable consumers greater levels of protection the right one?

The definition of vulnerable consumers is too broad and the FCA "approach" too vague to give a useful response.

Q17: Is our approach to the effectiveness of disclosure based on the right assumption?

It is good to see the FCA reflecting on how consumers react in the real world and we would encourage the regulator to do more to ensure that disclosure is achieving its objectives. In general we would suggest that less is more when providing information and would like to see one simple figure for the cost of investing in a similar manner to APR.

Q18: Given the evidence, is it appropriate for us to take a more 'interventionist' approach where conventional disclosure steps prove ineffective?

Yes we believe it is appropriate and would go so far as to propose that the FCA should classify products according to their risk level in a similar manner to NCAP safety ratings for vehicles rather than waiting for consumers to "road test" them.

One other aspect that the FCA should consider is the relationship between pre-sale and post-sale disclosure. As the FCA notes, many financial products are bought on a long-term basis and the customer has limited opportunity to learn from their mistakes. In many cases the rules place great emphasis on pre-sale disclosure but few requirements for post-sale disclosure, and those post-sale disclosures rarely provide any direct comparison with the disclosure provided pre-sale.

For example in a similar way to general insurance renewal quotes now requiring the previous premium to be displayed, it would be useful if annual statements on investment products compared growth and charges actually delivered against the assumptions in the pre-sale literature. Post-sale disclosure could easily provide a charges figure in £, which may highlight high cost products to customers in time for them to take action, even if the percentage charges disclosed pre-sale were lost on them. Whilst there are clearly risks (especially around judging investment performance on short term basis) a clear comparison indicating that returns were less than expected, or costs greater, may provide customers with an effective prompt to review their decisions (either on choice of investments, or levels of contributions) to ensure they meet their long-term objectives.

Similarly whilst great emphasis is placed on fund managers clearly stating their objectives in KIIDs provided pre-sale, any discussion on how well these objectives were met is often confined to detailed annual reports that few customers read and which realistically customers must chose to find themselves (e.g. via their platform provider's website). Greater consideration could be given to this, and to ensuring that comparators are to objective market benchmarks rather than industry-defined "sectors".

Q22: Is there anything else in addition to the points set out above that it would be helpful for us to communicate when consulting on new proposals?

When setting out proposals we believe the FCA should place greater emphasis on the practical ability of customers to exert competitive pressure on companies. Whilst many financial products are long-term many of them, especially in the investment space, are inherently portable. The FCA should place greater emphasis on the ability of customers to move investments between providers effectively – and for investment funds, between share classes within the same fund. Whilst we agree that the FCA should not be a price regulator, the fact fees for doing this in many cases amount to the equivalent of several years of normal fees, and therefore represent a clear barrier to competition that the FCA should act on.

Q23: Do you think it is our role to encourage innovation?

Not really but neither should the FCA be an obstacle to innovation. Project Innovate and the Regulatory Sandbox are encouraging steps from the FCA but the regulator needs to be open minded about whether current regulations need to change in light of social and technology developments, and in particular whether new technology might allow more personalised disclosure that is more effective than generic disclosure currently envisaged in many regulations. Too much current FCA activity on this topic appears to proceed from the assumption that the regulatory handbook is immutable and that innovators simply need to be educated in it.

Q24: Do you think our approach to firm failure is appropriate?

No strong views.

Q25: Do you think more formal discussions with firms about lessons learned will help improve regulatory outcomes?

Yes and we would encourage more of these.

Q26: Do you think that private warnings are consistent with our desire to be more transparent?

Private warnings can inevitably be seen as undermining transparency from the FCA but, ironically, they are more likely to encourage transparency from regulated firms. It is a difficult balancing act and we sympathise!

3 ABOUT ALTUS

Altus offers two unique and independent services to the financial services industry: **Altus Consulting** and **Altus Business Systems** solutions.

Altus Consulting is a specialist provider of consultancy services to the Financial Services sector. We help clients achieve operational excellence and improved returns via a combination of proven industry models, technology expertise and market insight.

Altus Business Systems offers a range of industry leading investment automation solutions, dedicated to improving operational efficiency of companies within the Financial Services sector to keep their business critical processes running smoothly.

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