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By email: ConsumerInvestmentsCFI@fca.org.uk

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Dear Sir or Madam

FCA Call for Input: The Consumer Investments Market

The City of London Law Society ("**CLLS**") represents approximately 17,000 City lawyers through individual and corporate membership including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multi-jurisdictional legal issues. The CLLS responds to a variety of consultations on issues of importance to its members through its 19 specialist committees.

This letter has been prepared by the CLLS Regulatory Law Committee (the "**Committee**"). The Committee not only responds to consultations but also proactively raises concerns where it becomes aware of issues which it considers to be of importance in a regulatory context.

The CLLS Regulatory Law sub-Committee welcomes the opportunity to respond to the FCA's Call for Input ("**CFI**") on the Consumer Investments Market, and strongly supports the FCA's desire to strike the right balance between consumer protection and consumer choice. We have not sought to respond to all the questions raised in the CFI.

Wider considerations

Although the CFI alludes to a number of policy and legislative changes currently in contemplation, some of the proposals under discussion in the CFI are not considered in the context the potential changes and their impacts.

Clearly the broader consumer protection legislation is relevant to the discussions set out in the CFI. In formulating proposals for developments in the regulatory approach to the consumer investment market, and to prevent the harms which are being considered, we believe it is important that in this discussion the FCA should consider:

I. the role of existing consumer protection legislation, and how well it is working;

II. the FCA's own role in particular contexts, including for example as a regulator under the Consumer Rights Act 2015 and a qualifying body under the Unfair Terms in Consumer Contracts Regulations 1999 (as amended) ("**UTCCRs**"); and

III. whether or not reform is needed in those areas.

This will be key to the debate. The FCA might also take look at the role of the Government's Money Advice Service and how effective it is in reaching consumers

The FCA's proposals regarding a duty of care, on which we understand the FCA intends to consult in Q1/2021, must also be considered in the context of this discussion, as should the common law duty of care.

In similar vein, a number of the CFI's questions relate to the regulatory requirements relating to investment disclosure rules (eg PRIIPS KIIDS, KFDs etc) and financial promotions. As the CFI acknowledges, Government is consulting on the legislative framework underpinning the regulation of financial promotions, and it would be good for this debate to engage with and be considered in the light of those wider policy considerations, so that the impact of proposals that the FCA may develop can be calibrated to wider legislative changes under consideration.

It is also critical to consider all possible impacts of changes to the perimeter or the range of products available to UK customers (e.g. such as CFD product restrictions), as it is not inconceivable that these might lead UK customers to seek less regulated and/or overseas providers of financial services and products.

Finally, as noted in our response to the consultation on the FCA's vulnerability guidance, whilst we are strongly supportive of the need to treat vulnerable customers appropriately, the approach of requiring firms to consider the majority of the customer population as vulnerable (since this includes the potentially vulnerable) also has implications for firms who wish to innovate and offer investment products (particularly any product or service which requires even a rudimentary suitability assessment); the risk of financial exclusion also needs to be considered in the balance.

Unregulated activities

The CFI discusses the challenges in seeking to provide a panoply of protection for consumers engaging in regulated and unregulated sectors (crypto-asset tokens are referenced) where 'investments' might pose similar risks.[1] The CFI acknowledges the FCA's limited role in supervising activity outside the perimeter, and, at paragraph 4.17, the inherent difficulties it faces in policing such activities. A full and clearer discussion of those limitations would be helpful, to inform the policy discussion around the unregulated sector and future developments, and also to provide more certainty to firms.

We note that the FCA's Principles for Businesses and the Conduct Rules respectively extend to (i) conduct by regulated firms with respect to the carrying on of unregulated activities, and the activity of other members of the group of which the regulated firm is a member, and (ii) the conduct of persons subject to the Conduct Rules in relation to their performance of functions relating to the carrying on of activities (whether or not regulated activities) by their employer. It is crucial to the issues under discussion here for firms and their Conduct Rules staff to have clarity about regulatory expectations and potential liabilities in this context. This is all the more critical since the FCA wishes to foster innovation in services in the Consumer Investments Market.

[1] In this regard we note the comments in our response to FCA CP19/22 – Consultation Paper on prohibiting the sale to retail clients of investment products that reference cryptoassets, regarding the definition of the breadth of the proposed definition of unregulated transferable cryptoassets.

Fundamentally, however, regulation of 'unregulated activities' through principles-based measures can only impact the regulated community, and will not deal with the conduct of unauthorised firms, whether in the UK or overseas. Accordingly, for some issues, legislation may prove the more effective solution. This is of course a matter for Government, but given its commitment for the UK to make its own decisions about the rules governing its world-leading financial sector, this is the opportune time to consider whether the regulatory perimeter is still fit for purpose in light of fast-moving developments in technological capability.

The role of 'just in time' consumer education

Many of the questions in the CFI relate to improving consumer understanding of investments' market, the importance of diversifying investments etc. it seems to us that there is a role for the Government's Money Advice Service here, potentially working together with the FCA, to make available general advice and uncontroversial but useful information for consumers in short video format on issues such as:

- how generally debt should be paid down and a rainy-day cash fund collected before investments are made;
- the role of tax wrappers and pensions as investment vehicles; and
- a basic asset allocation strategy for a portfolio.

This might also assist firms in wrestling with the concept of 'just in time' education.

The CFI suggests that firms should incorporate *"the basics of what effective learning looks like from psychology*"; and appears in many ways to be seeking to place the onus for consumer education on regulated firms. Nonetheless, the FCA acknowledges that its own research suggests that methods that firms might adopt to help consumers navigate complexity would need to be nuanced to reflect the fact that consumer behaviour is not identical.

It is therefore important to have a very clear understanding of what the FCA has in mind here, and how the provision of such 'just in time education' would be characterised in regulatory terms.

It is unclear whether what the FCA envisages in terms of 'just in time' education is limited to the kind of clear information referred to in paragraph 3.18 of the CFI which is designed to help investors make a decision and understand what to do if something goes wrong, or extends to more generic information about tax consequences or diversification, or indeed a form of simplified advice.

The nature of what is envisaged will affect the regulatory characterisation of such 'just in time education' and the risks this may pose for firms wishing to help consumers navigate complexity. The potential legal responsibility of firms for such education, and the extent to which a firm would be required to take accountability for undisclosed customer vulnerability (for example mental capacity) will be a critical consideration for firms in seeking to develop solutions.

We also note in passing that by making public – in a consumer centric form - learnings about root causes from remediation and redress schemes, could be an effective educational tool for consumers, as well as for firms who would consider these in light of their own processes.

Simplified Advice

The application of the suitability rules, professional standards requirements, and the role of the FOS have proved to be regulatory obstacles impacting the potential for Simplified Advice processes to be commercially viable.

The FCA has confirmed that firms providing Simplified Advice would only reduce their potential liability by ensuring that they deliver suitable advice. The FCA's guidance states that:

"*Although streamlined advice services may be designed to deal with more limited client needs and may not, therefore, involve an analysis of all the client's circumstances, any personal recommendation which is given to a client through a streamlined advice service must nevertheless be suitable (as is also the case where a firm provides 'full-scope' advice to a client). Offering a streamlined advice service, with a narrower scope, does not allow a firm to lower the level of protection due to clients.*"

The nature of a Simplified Advice process is such there will inevitably be some customers who receive recommendations that are suitable on the basis of the limited form of advice that it offers but which would not be suitable in the context of a full financial planning advisory service. Acceptance that this outcome should not - of itself - amount to a breach of the suitability rules is required. Although the FCA's guidance implicitly recognises this, its clear expectation is that there would need to be exit points to ensure an unsuitable recommendation is not given.

The guidance is helpful in stating that a firm is entitled to rely on the information provided by its clients. However it goes on to note the firm may not do so if the firm ought to be aware that the data is incomplete, and that firms should use relevant existing information on the client to cross-check the reliability of the information obtained from the client, and will often need to take into account information about existing investments. This requirement lends a significant degree of complexity to any Simplified Advice process, and plainly impacts its potential commercial viability.

Understanding how the FOS will examine questions of suitability in the context of customer complaints is clearly also crucial to any firm that seeks to develop a Simplified Advice process, and has proved a barrier – particularly for firms wishing to use automated systems (which could then face potential systemic mis-selling risks). In addition, of course, the FOS's concept of "fairness" is not grounded in precedent, and the unpredictability and uncertainty surrounding potential FOS responses makes it difficult for firms to assess the commercial viability of processes designed to develop retail investment offerings. Whilst the FOS guidance on Simplified Advice formerly on the FOS website was helpful,[2] there may be more room for the FCA and the FOS to work together with industry, using the digital sandbox, to develop a more common view of how the suitability regime applies to Simplified Advice processes in practice.

Higher capital requirements as a mitigant

In paragraph 3.15, the CFI canvasses the possibility of applying higher capital requirements to cover potential liabilities from higher risk activities. The parameters for the application of such higher requirements would plainly need to be clear.

Operational risk capital requirements catering for such risks are well established for incumbent banks and payment services firms. We agree that all authorised firms should be required to have adequate resources (whether operational risk capital, professional liability insurance or other equivalent guarantee), to deal with customer damages that result in financial losses. Such resources should (at least) be related to the number of customers, the volume of operations and the type of services providers.

However, this will not necessarily resolve with the issue later raised at paragraph 6.6 of the CFI, namely that the time lapse between the giving of advice and customers realising this was not suitable

[2] "But in any complaints we might receive, we would judge the advice in the specific context in which it was given. So we would not expect a "full fact-finding" exercise. But we would look at the questions asked and the options open to the particular consumer concerned. … Where the "simplified advice" involves an automated process, we would look – as part of our consideration of any complaint – at whether there was a good record of the information the consumer gave and the choices they made.'"

can be significant, and that the firm and its capital may no longer still be in the market by the time consumers realise they have a problem.

We note that the FCA has extensive powers under Part XXIV of FSMA to participate in proceedings for company and individual voluntary arrangements and to heard at the hearing of applications for administration orders and in receivership and winding-up proceedings (as well as the power to present its own petition). These would appear to give the FCA a mechanism for inquiring into the potential liabilities of an authorised firm for consumers before it and its capital leave the market.

The current high net worth and self-certified sophisticated investor exemptions

The CFI notes in paragraph 4.17 that the FCA has seen evidence of firms' abuse of the exemptions with people being 'coached' through them inappropriately. If this is the case, then it is important to recognise that the mischief is not in the exemptions themselves, but rather in their misuse.

We accept that the financial thresholds in the high-net worth exemption are lower than was initially intended given the effect of inflation over the last 20 years, and that they should be reviewed in that light, whilst also recognising that

(a) net assets of £250k (after removing house, pension and insurance) remains a substantial sum; and

(b) it appears that between 2% and 4% of the population have an income of £100k pa, even if that sum has been deflated over the past 20 years.

It is important to note that the exemptions for investors who are correctly and appropriately categorised as self-certified sophisticated and high-net worth investors have assumed greater importance over recent years, particularly given the increasing restrictions on the promotion of investments such as unregulated CIS; non-Mainstream Pooled Investments; and Speculative Illiquid Securities. We acknowledge that many investments popular with wealthier or more sophisticated investors (e.g. REITS, VCT, EIS and SEIS) will generally fall outside the scope of those restrictions.

Nonetheless, it is important to ensure that changes to these exemptions do not unduly limit investment choice for investors. Otherwise, there is a risk that such investors could be tempted by offerings from firms who do not seek to comply with UK law and regulation, or from firms which operate outside the UK. There may therefore be a case for considering whether the range of investments covered by article 48 and 50A might usefully be broadened as well as the appropriateness of the thresholds.

Tackling scams

The CFI refers to the development of Online Harms legislation in paragraph 7.5. As we understand it, that proposed legislation would provide a regulatory framework that would cover companies that allow users to share or search for information written by users, or allow users to talk or communicate with each other online.

The FCA suggests that there would be a strong case to include fraud within its ambit. It would be helpful whether the FCA envisages that this would assist it in taking action persuading the online provider hosting advertisements which are inappropriate but fall short of being fraudulent.

Plainly it would be helpful if the legislation could provide a mechanism which enabled the FCA, whether directly or through the authority designated as regulator for online harms (potentially Ofcom), to engage more promptly and effectively with online companies, or their regulator, in order to ensure that the companies meet their duty of care by stopping illegal information and activity, or sending information asked for by the regulator.

If you would find it helpful to discuss any of these comments then we would be happy to do so. Please contact Karen Anderson by telephone on +44 (0) 20 7466 2404 or by email at Karen.Anderson@hsf.com in the first instance.

Yours faithfully

Karen Anderson
Chair, CLLS Regulatory Law Committee

THE CITY OF LONDON LAW SOCIETY
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