



Institute
and Faculty
of Actuaries

GC14/3 Retail investment advice: Clarifying the boundaries and exploring the barriers to market development

Response to the Financial Conduct Authority

10 October 2014

About the Institute and Faculty of Actuaries

The Institute and Faculty of Actuaries is the chartered professional body for actuaries in the United Kingdom. A rigorous examination system is supported by a programme of continuous professional development and a professional code of conduct supports high standards, reflecting the significant role of the Profession in society.

Actuaries' training is founded on mathematical and statistical techniques used in insurance, pension fund management and investment and then builds the management skills associated with the application of these techniques. The training includes the derivation and application of 'mortality tables' used to assess probabilities of death or survival. It also includes the financial mathematics of interest and risk associated with different investment vehicles – from simple deposits through to complex stock market derivatives.

Actuaries provide commercial, financial and prudential advice on the management of a business' assets and liabilities, especially where long term management and planning are critical to the success of any business venture. A majority of actuaries work for insurance companies or pension funds – either as their direct employees or in firms which undertake work on a consultancy basis – but they also advise individuals and offer comment on social and public interest issues. Members of the profession have a statutory role in the supervision of pension funds and life insurance companies as well as a statutory role to provide actuarial opinions for managing agents at Lloyd's.



The Advice and Distribution team
Policy, Risk and Research Division
Financial Conduct Authority
25 The North Colonnade
Canary Wharf
London, E14 5HS

10 October 2014

Dear Sirs

GC14/3 Retail investment advice: Clarifying the boundaries and exploring the barriers to market development

General Comments

1. The Institute and Faculty of Actuaries (IFoA) welcomes the opportunity to respond to the FCA's Guidance Consultation 'Retail investment advice: Clarifying the boundaries and exploring the barriers to market development'. This response has been led by IFoA members who work in the retail investment market.
2. The IFoA welcomes this additional guidance, as an important step in ensuring that stakeholders, including the customer, the FCA, product providers, advisors, consumer groups and the Financial Ombudsman Service have a common understanding of the boundaries of a 'personal recommendation'.
3. The IFoA would concur with the FCA that it is difficult to define an absolute boundary of a 'personal recommendation'. However, we do believe there are some areas where further explanation could help to clarify the parameters; for example, in relation to paragraph 6c. Clear criteria within the advice framework are important from the customer's perspective if they are to be able to take full advantage of a broad range of products and services.
4. We would also highlight the relevance of these issues beyond the FCA's remit of retail investment. In particular, the IFoA would welcome corresponding guidance for trustees of DC pension schemes on approaches they can take to support member decision-making, without providing regulated investment advice. We would urge the FCA and the Pensions Regulator (tPR) to work collaboratively to take this forward.

Question 1: Have we provided a sufficient range of examples for customers and firms to be more confident on the boundaries between services that provide a 'personal recommendation' and those that do not?

5. We support the FCA's aim to assist those providers that want to offer services between execution-only and full advice. The examples given are helpful but we have identified some areas where additional explanation and / or further detail might improve their illustrative value:
 - a. In all of the examples, the FCA has suggested that certain courses of action are "depending on the circumstances likely to be regulated advice". While we understand the FCA may not be willing to prescribe exact circumstances in which the advice

would be regulated, it would be helpful to have greater clarity around the principles that would determine whether the customer had obtained regulated advice.

- b. In example A, we suggest further guidance on what constitutes 'biased information' could be useful.
- c. The examples provided under D and E are useful illustrations of a 'personal recommendation'. However, further explanation of a number of elements, may clarify the scope 'and the different factors to be considered' in the reaching the ultimate definition; for example:
 - i. Would it be a 'personal recommendation' if a risk profiling tool were used to determine risk tolerance, by suggesting a filtered range of funds, based on the length of time until an individual retires?
 - ii. Should the treatment of risk-graded portfolios of funds that are created via questions in a decision tree format be different to an online tool that suggested a preferred outcome?
 - iii. Where a fund is closing, a customer may select a fund with similar characteristics as a replacement investment vehicle. Should this customer be treated differently to one that makes an active decision to invest in an alternative fund, with similar characteristics, when the original fund remains open?
 - iv. Looking to the future, it could also be helpful to include an example where the use of social media by customers is integrated into the sales process. There is some broader interest in allowing customers to access information about other similar investors' strategies, alongside an illustration of which strategies have been the best, or worst, performing. Could such an approach constitute a 'personal recommendation'?

Question 2: In example D we set out an opinion of how filtering may be used to help provide more help to customers without providing a 'personal recommendation'. Do you agree with this interpretation? Please provide reasons for your views.

6. Some product providers and fund managers have risk-rated funds and provide a filtering option for customers (example D2). The FCA has clearly stated that offering a risk-level filter of funds does not constitute a 'personal recommendation'. However, it would be useful if the guidance could explain, and provide a clear example, of how a filter might become a 'personal recommendation', explaining the features that define it as such. For example:
 - a. Providers may issue psychometric risk questionnaires that would enable customers to better understand their own risk profiles. It would be helpful if the FCA could clarify whether the use of such questionnaires would constitute a 'personal recommendation'.

We suggest some ambiguity remains, particularly where the questionnaire results in an output that describes the type of investor by risk profile and a generic asset allocation. If the output from the risk profile questionnaire were mapped to specific risk-rated funds, it could be argued that the customer has been directed to a suitable investment. Alternatively, the risk filter could be just one of several filters that the customer might choose to apply e.g. rating, charges, type of fund.

- b. The customer could build a portfolio of sector funds to match a generic asset allocation, or select a fund from a list, depending on the number of filters that have been applied. In this example, the risk questionnaire does not necessarily point the customer to a suitable investment, but it could influence which other filters apply to the final decision.
- c. Whilst risk profiling tools can be valuable to customers in guiding them towards a fund, or a selection of funds; there is a delicate balance to be struck between providing helpful tools and information to members and the perception that advice has been given. In this example, if the funds do not perform as expected, a customer may believe they have received advice. However, mitigating this by taking a restricted view of these tools could result in their removal from the market, thus limiting access to only those who pay for advice. This would appear to run contrary to the FCA's aim to provide "*low-cost methods of meeting customers' straightforward needs ...[and] how they can help customers to make informed decisions without stepping over the boundary into providing a 'personal recommendation'*" (paragraph 1.5).

In this scenario, the preferred outcome would be for customers to have access to risk profiling tools, but in the context of clearly communicated FCA guidance that plainly outlines their purpose - as useful information, not regulated advice.

- 7. In paragraph 3.9, the FCA states "*use of a decision tree does not, in itself, determine whether a firm is providing regulated advice or not*". The determination of advice will depend on the questions asked and the solution presented. Some detailed guidance on the use of a risk profile questionnaire and a fund filter would be helpful if the distinction depends on how the information is deployed.
- 8. Whilst the FCA does not recognise the ranking of results as a 'personal recommendation' (example D6), it is possible that customers could interpret it as such. Mitigating against this possible misinterpretation by customers will be important and the examples should be as clear as possible to support this objective.

Question 3: Based on the examples do you agree that our rules provide sufficient customer protection? If not, please provide feedback on areas where you believe our rules may need to be enhanced.

- 9. The IFoA welcomes both the requirement outlined in Table 1 (page 19) - for designers of an automated system of advice to be qualified to at least QCF Level 4; and the statement in paragraph 3.53 - that disclaimers cannot be used to say the service provided is not a 'personal recommendation', when it would otherwise appear to be.
- 10. Financial services firms have a part to play in increasing awareness and understanding by producing clear and helpful information on the products and services they offer (we note the conclusions set out in paragraph 4.9 support the need for improvements in this area). The IFoA would welcome the opportunity to work with the FCA to develop further guidance for advisors and providers; the greater the clarity that providers have on the distinction between information and advice, the more willing they are likely to be to provide information, without the concern it would be misinterpreted by the customer.
- 11. We agree with the FCA that it is important to deliver greater clarity on the concepts of regulated advice, generic advice and personal recommendations. There may be value in the FCA producing a well signposted glossary of these terms, so these definitions are easily

accessible. It would also be beneficial to include a number of other definitions, such as information, investment advice, simplified advice, restricted advice, limited advice, guided sales and basic advice.

Question 4: Are there other areas where you would need greater clarification or other factors that you believe act as a barrier to providing the services discussed in this paper?

12. The IFoA encourages the FCA to conduct further research into the potential cost and resource implications that the Guidance Service might have for providers and the impact of these costs on customers. This could be usefully supplemented by further analysis of the boundaries of advice and barriers to market development in the post-2014 Budget environment.
13. The IFoA notes (from B.23) that pension decumulation has been excluded from the consumer research and that the FCA has acknowledged (2.14) the importance of advice and guidance in the post-2014 Budget environment. We look forward to further analysis on the regulatory environment facing providers, advisors and members in Defined Contribution (DC) pensions. Where possible, we would like to see a level regulatory playing field established between contract and trust-based DC pensions. Again, this is a specific area where we would encourage the FCA and tPR to take a similar approach.
14. We agree with the FCA that behavioural biases play a significant role in individual investment decision-making and suggest that customer engagement is a key challenge to the development of a guidance model.
15. Research by the IFoA's Consumer Information Working Party indicates that individuals are more likely to engage in financial decision making if they believe their efforts are worthwhile and will ultimately lead to positive outcomes. The report suggests that this can be achieved through clear illustration, at an individual level, of how a person's current financial circumstances might impact their future situation. For example, providing an individual with a projection of retirement income, based on their current assets and savings, relative to their retirement income goals would be one way of demonstrating potential risks and rewards of their financial decisions.¹ This has clear implications for the design of guidance, as asking customers to provide a large amount of information before gaining a "reward" (i.e. some valuable / tangible output) can result in disengagement with the process.
16. It would be useful to have further guidance from the FCA on what information providers can give to help customers counter these bias risks. We would also welcome any future research by the FCA examining the behavioural biases in decision-making by customers.

Question 5: Would you find it helpful if the guidance set out in this paper was codified in our Handbook?

17. The IFoA agrees that adding the guidance in the consultation paper to the FCA's Handbook (so that all the available guidance is brought together in one place) would be helpful and would help reduce any unnecessary uncertainty that might be created by having the guidance contained in separate documents.

¹ IFoA (2012) [Transforming consumer information: a discussion paper](#)

Question 6: Would you find it helpful if the examples were included in the Perimeter Guidance section of our Handbook?

18. The IFoA agrees that adding the guidance in the consultation paper to the FCA's Handbook, so that all the available guidance is brought together in one place, would be helpful, as would including the examples in the Perimeter Guidance Manual.
19. If you wish to discuss any of the points raised please contact Philip Doggart, Policy Manager (philip.doggart@actuaries.org.uk/ 01312401319) in the first instance.

Yours faithfully,

A handwritten signature in black ink, appearing to read 'Nick Salter', written in a cursive style.

Nick Salter
President, Institute and Faculty of Actuaries