THE
INVESTMENT
ASSOCIATION
INVESTMENT MATTERS

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Dear Sir/Madam

RE: The Investment Association response to FAMR call for input

ABOUT THE INVESTMENT ASSOCIATION

The Investment Association represents UK investment managers. We have over 200 members who manage more than £5 trillion for clients around the world. Our aim is to make investment better for clients so they achieve their financial goals, better for companies so they get the capital they need to grow, and better for the economy so that everyone prospers. We cover every link in the investment chain:

- We work with investors, helping them to understand the industry and the options available to them.

- We know investing can seem daunting, so we work hard to make it clear and accessible.

- We work with investment managers, promoting high standards and the need to put clients first. Our work includes helping members to manage money efficiently and communicate effectively.

- We work with the companies we invest in, helping them to achieve better long-term results and, ultimately, greater returns for investors and the economy.

- We work with regulators and governments around the world. We've built close, trusting relationships with these bodies and play an active role in shaping the rules that govern the industry.

The Investment Association's purpose is to ensure that investment managers are in the best possible position to help people build resilience to financial adversity, achieve their financial objectives and maintain a decent standard of living as they get older. It is also to help investment managers maximise their contribution to economic growth through the efficient allocation of capital.

General Comments

The Investment Association recognises the importance of the current debate on how to encourage and support ordinary savers looking to put money aside for their future wellbeing. Although the two immediate drivers are the post-Retail Distribution Review environment and the introduction this year of the 'Pension Freedoms', it is clear that the debate has a much wider and longer history. Indeed, there have been repeated attempts to re-engineer both the demand and supply side of the UK long-term savings and pensions market over the past 15 years. On the supply side, we have seen the introduction of stakeholder products, CAT standards, Sandler products and, most recently, new BIS Kitemark products (Sergeant Review). To date, these supply-side initiatives have had far less impact on behaviour than the dramatic demand-side intervention that is automatic enrolment into workplace pensions.

As we consider the question specifically of financial advice, we believe that it is essential to draw on the lessons of these previous interventions in the long-term savings and pensions markets. First, it is very difficult to separate the question of how to support saving from the question of why people do not save more, to which the answers have no straightforward solution. Second, behavioural economics may provide answers where traditional assumptions based on classical economics have failed. Third, the role of trusted third parties, such as employers, could be built on further. Finally, while simple products may have a role, there is little evidence of this in the past. Furthermore, in investment markets, there is little consensus to answer the question of what is 'simple': a simple product might be one that delivers a simple outcome (eg. not losing money) with a sophisticated approach to ensuring this is the case; equally, it might be a simple investment process that provides diversified access across a range of markets, subject to investment risk.

There is also a broader point about the nature of the UK savings market that is perhaps not sufficiently captured in the Call for Input: the rise of the property market as a store of wealth and the potential for significant diversion of savings away from diversified long-term investment and pensions into residential property. In this regard, we find recent ONS data particularly striking: notably that just 41% of those questioned considered employer pensions as the safest way to save for retirement versus 28% identifying property; and 44% considering property as the most likely way to make the most of their money against 25% opting for an employer scheme.[1] Some of this may be cyclical in nature, with respect to both recent housing and investment market history. However, it should be taken seriously in the context of any initiative aiming to build greater confidence in traditional savings and investment channels.

Yours faithfully

Florian van Megen
RETAIL MARKETS SPECIALIST

[1] ONS, *Early indicator estimates from the Wealth and Assets Survey, Wave 5, July 2014 to June 2015*, November 2015.

Appendix

IA Response and Recommendations

Our response to the call for input takes the form of a series of recommendations for Government, regulators and industry. They focus on the need for **catalysts** in the savings and pensions market; **clarity** of definitions, language and responsibilities; and **accessibility** of information and advice to savers.

In our view, there is no silver bullet. The changes we propose are incremental and designed to sit alongside successful initiatives to date. We remain very strong supporters of automatic enrolment and the use of default arrangements. However, there is also a need for engagement, particularly given the implications of Freedom and Choice. In this regard, we believe that there is scope to build a different culture that neither requires high levels of financial education nor a dependence upon regulated advice, which while a valuable service, will continue to be beyond the means, and perhaps ambitions, of many.

Catalysts

An overarching savings action plan in which Government, regulators and all parts of financial services, including asset managers, will play a role. This would have three core components:

- *Accessible ways to help people to understand their saving targets should be to reach and maintain an envisaged life style*. The general success of the 'five a day' campaign for fruit and vegetables is often cited in the long-term investment and savings debate. A heuristic - or rule of thumb - is not a substitute for proper advice or support. However, it can provide a simple, easy-to-remember and. Such heuristics can be just as useful in raising awareness as in actually ensuring the change of behaviour takes place. For example, trying to set a rule of thumb for savings rates, such as 'save half your age' (30 = 15%, 40 = 20%). Clearly, there will be affordability issues and individual circumstances differ. However, the goal of a programme such as this has to be to formulate engaging not didactic messages, in coordination with more innovative engagement and delivery processes as described elsewhere in this response.

- *An innovative agenda to encourage saving.* At a societal level, we may have to rethink conventional assumptions and drivers. Both behavioural insights and advancing technology create the scope for radical change in this area, for example, apps that link saving to spending patterns where a visit to a supermarket or retailer might prompt action based on offers or allocation of change. Furthermore, the experience both of automatic enrolment and the failure of mass take up of simple products reinforces the message that context matters. The relationship between providers and saver can be transformed by an intermediary such as an employer, not just an adviser in the traditional retail or pensions market. There may be more scope in areas such as workplace savings where initiatives such as 'Save More Tomorrow' could help to transform behaviour both for pensions and other forms of saving.

- *Awareness campaigns for the necessity of saving and explaining the purpose of investing*. A combination of approaches, including government campaigns and activities in schools and colleges, can help to raise awareness. While international evidence suggests that expectations of what financial education can achieve should be realistic, there are alternatives to formal education that can ensure the communication of a broader message. Again, using the workplace differently is one method that has been successful both in the UK and overseas.

Clarity

- *Simplicity of language in long-term savings and investment products*. Product providers have to be able to deliver jargon-free products, with clear objectives and risk warnings. Regulators and industry could work together to consider how to simplify communication to the extent permitted by existing regulation (eg. European product-level disclosure rules). Both the Investment Association and the Association of British Insurers currently have projects under way to product industry-standard glossaries to help consumers.

- *A definition of regulated advice that is accessible and inclusive.* Advice plays an important role in bringing savers and products together. However, the industry and regulators speak one language on advice, while consumers and agencies supporting them speak another: Money Advice Service or The Pensions Advice Service offer individuals a valuable service which is understood to be advice. This divide must be bridged. A clearer definition of advice will allow the development both of technology based solutions that may make the advice process more accessible, and of support processes that are not regulated advice. This will incentivise more service and product providers to develop digital solutions for the under-saved and under-invested.

Accessibility

- *An ability to purchase a product without onerous and potentially disincentivising compliance processes*. A widely shared observation about the long-term savings and investment market is that it is easier to access consumer goods via credit on the high street than to walk into a bank or building society and open a savings account or access an investment product. We strongly endorse initiatives, such as the TISA Digital Passport, designed to simplify AML checks that exist both in physical and online application procedures. We also encourage Government and regulators to consider how compliance processes without regulated advice can be streamlined. Again, we note that even a basic savings product can require an appointment on the high street.

- *Provision of simple products and standard solutions that are easily accessible for people*. We remain cautious about attempts to introduce simple products in isolation, given previous experience. However, with the right broader context, we recognise the potential of having an investment product that can be widely sold as a straightforward way to gain access to capital markets. As we note in our introductory comments, a central concern remains whether simple means a 'CAT'-type product or a product with a sophisticated objective, such as positive returns regardless of market cycles. We believe that there ought to be room for both. However, it ought to be a broad success measure of savings policy that investment risk is taken and understood in order to offer savers the best chance to achieve diversified sources of return over their savings lifetimes.

<u>Questions from the call for input covered in 3 themes:</u>

Consumer needs and the advice gap (Covering questions 5, 7, 17, 18, 19, 21, 22 & 27)

As rightly stated in the call for input, different consumers have different needs for advice. This leads to the question whether help is accessible for various needs. Some just want help with saving for retirement. Others might have to deal with credit card debt and ambitions to improve their living situation by for example buying property.

The Investment Association is of the view that the focus of this consultation should be on consumer segments as identified by the FCA 6 - 8. As research has shown, those with less than £100,000 investible assets or incomes under £50,000 are least well equipped for dealing with the consequences of less public support during later life and more responsibility during the accumulation period (despite the auto enrolment system). These are the people who have the fewest resources for a secure financial future but because of that are most vulnerable and therefore need to be empowered to deal with this challenge. Because of a potentially low capability to save, they will have difficulty accessing fully fletched while economical professional advice. Generally, The Investment Association is of the view that any proposals put forward following this consultation should focus on serving the majority of the population and not the few.

Ultimately, the challenge is that professional high quality advice is a service that comes at a price. The resolution of the perceived problem of commission bias and the removal of manufacturer control over platform and adviser payments following the introduction of RDR has crystallised the need for advisers to segment their services according to economically-viable clients. Since it is clear what the costs of establishing the suitability of individual clients are, evidence suggests that the advice market has (possibly more than before) focused on clients with higher levels of savings. This doesn't mean however, that all client needs require the same level of attention by a professional adviser. Rather, it underlines the need to reach a position of greater clarity on the boundaries of regulated advice in order to encourage the emergence of alternative models that can help people reach their saving objectives more easily.

People who need assistance to take the right financial decisions and can't access it for any reason suffer from the 'advice gap'. This covers a diverse group of savers, and is therefore challenging:

- Those who cannot access professional advice economically.
- Those unconvinced by the relevance or quality of existing services and therefore not making use of them.
- Those who are not aware that they would be better off financially if they had support.

With respect to the third group, strictly speaking, a lack of demand for advice does not reflect an advice gap. However, this goes to the core of the problem; many people with limited income and savings are not sufficiently aware of the need to take action and make sure that they are prepared for retirement age. This is an awareness/educational gap but needs addressing with the same if not higher urgency than the advice gap.

Additionally, the advice gap raises the question of the distinction between products and services such as advice. In this regard, there may be scope for greater development and use of product sets that embed advice in the form of strategy or asset allocation, which goes to the heart of the debate about 'simple' investment products.

The diversity of needs and behaviours reinforces our view that there is no silver bullet to tackle the challenge of the advice gap. It underscores the need to look at a combination of approaches, focused on enablers (catalysts) as well as greater clarity and accessibility in the product and services markets.

As a first step, there needs to be an overarching savings plan put in place that brings Government, industry and regulators together to collaborate. The asset management industry, while heavily intermediated in terms of delivery to savers, is a key part of this process. From a capital markets perspective, we are currently developing a Productivity Plan to engage with corporate Britain as part of the process of generating better growth, and better ultimate returns for investors. From a savings perspective, we are exploring better tools and metrics, such as savings rate targets, that can assist savers to understand the decisions they face over their lifetimes in looking to access those returns.

These tools and metrics should ideally not be based on classical economic approaches to incentives and behaviour. Instead, they could include approaches such as heuristics, which could provide rule of thumb savings reference points. Heuristics do not solve the problem in and of themselves, but can be part of a signposting toolkit that is as important for raising awareness in an engaging fashion as it is for changing behaviour over the long term. The Financial services industry and academic research has also shown how a variety of other techniques can be used successfully online, such as encouraging people to imagine their older self, either as a physical likeness or through ideas about basic lifestyle choices (eat out once a month; go on holiday twice a year etc.).

Alongside these enablers, there are significant issues over accessibility. Below, we further explore the question of the role of regulated advice versus guidance and/or other support services. But one other key issue is accessibility in terms of the language and terminology that the industry itself uses. Some of the material is, of course, determined by regulatory requirements and there is a separate assessment that needs to take place with respect to the overall length and content of some communications. However, the Investment Association, along with other industry bodies such as the Association of British Insurers (ABI), recognises the value of 'plain English' campaigns. We are currently developing a glossary of investment terms that we hope may provide industry standards for consistency as well as accessibility. We are in close contact with the ABI as it develops its own thinking around the question of simplifying and clarifying pensions terminology.

Different forms of advice (covering questions 2, 28, 38 & 40)

With the ongoing shift in responsibility from government to the individual to take care of their own savings for retirement, it is clear that the number of people needing help will continue to rise in the future. This is unlikely to be help that is given only once. Individuals need support in planning over their life time, in the run up to retirement, and probably, during retirement.

This help / advice can or has to be delivered in a number of ways, and certainly for those in workplace pensions, strong governance and oversight mechanisms are being put in place which also provide the framework for investment decisions (default arrangements) and contribution levels. In this respect, automatic enrolment, accompanied for many by automatic investment, and possibly some form of automatic escalation of contributions, is a valuable tool. It should not be overlooked that many in workplace pension schemes see the default arrangement as a form of advice.

It has to be taken into account, however, that not everyone is aware that support for dealing with financial matters and financial planning would be beneficial for them. And even if it is recognised that advice should be sought, not all individuals take action and take it.

As we outlined in the previous section, this has various explanations. The perceived – or actual - complexity of the matter can be discouraging. Sharing personal financial circumstances can be intimidating. Formal advice can be burdensome to access and is not always / immediately rewarding. Furthermore, different individual situations such as family status, level of income, level of savings, education and knowledge and experience trigger different demands for advice. Irrespective of the level of wealth, the degree of complexity of advice doesn't necessarily have to be different. Low income households with considerable levels of debt may, from their perspective, have a greater need for sophisticated advice then individuals in the highly affluent segments. The actual advice must of course be different.

What is advice?

Financial advice can be categorised in many ways. From a consumer perspective, advice is arguably a simple concept: it should help the individual solve their questions and reach financial ambitions and security across their lifetime, particularly for later life. Different needs can be satisfied via different interactions. Investors can consume advice from literature (including digital offerings), friends, acquaintances and family, online engagement, phone calls and face to face interactions with professionals or any combination of some or all of these.

The key question therefore is how a regulatory and policy regime can provide a framework that can cater to these diverse needs. In particular, there is the question of whether full fact find and suitability requirements should apply to all forms of professional advice, or whether there is scope to separate a detailed financial planning service from potentially ad hoc savings needs, such as speaking to an adviser about an ISA.

This links to a fundamental issue, which is that savers do not perceive advice as the regulated activity that a regulator, financial adviser or industry participant understands it to be. Savers are offered a variety of services called advice – such as the Money Advice Service or The Pensions Advisory Service – that are in the strictest legal sense guidance and never provide personal recommendations. Many others have made this point: it is not a clear basis for moving forward.

There needs to be a new way to conceptualise different kinds of advice. In the eyes of professional advisers, their services are provided in order to help their customers with a very broad range of savings and investment questions as raised above. However, for regulatory reasons, they have to focus major resource on establishing the needs and personal situations of clients in order to make personal recommendations that are suitable. At the same time, for product manufacturers, including fund managers, advice is one of the key links between their products and end investors and therefore a critical conduit. However, it should not be the only way in which those that seek support for their savings decisions, can access it.

Impact of technology

The access debate is also being revolutionised by technological change. The way people access and consume information has changed a lot over the past decade and accelerated further in the last 3- 5 years. The combination of the ability to access vast resources via the internet and a widespread distrust of services offered by the professionals from the financial industry offers both a challenge and a major opportunity as people look to take their own decisions, often in discussion with peers.

The internet has also improved accessibility to execution only services. And although these do not deliver holistic solutions like proper financial advice can, some people clearly feel they have taken care of their financial planning in this way. The big advantage of non-advised transactions over the advice process is the smaller amount of time and resources invested by the individual. Feedback about the quality of decisions taken will only emerge in the medium to long-term future.

However, the execution only route also draws attention to a key set of ambiguities in a middle ground between true execution only and fully regulated advice services. While the FCA has sought to clarify the distinctions, there is still concern in the investment industry about the status – and associated liabilities – of offering guidance and support services that are clearly more than an execution instruction in the strictest sense, but much less than a personal recommendation based on fact find and suitability check. Ensuring appropriateness tests are proportionate and enable rather than inhibit access to the market and product innovation will be essential.

In our view, innovation involving the use of technology will help to develop a new generation of 'advice' services. It is unlikely that sophisticated financial planning and personal recommendations will be widely deliverable without human interaction. Nonetheless, parts of the advice process can be improved by the use of technology and data, particularly if a lighter touch / simplified advice model can develop for product-specific needs. As in all parts of the financial services industry, there are a number of initiatives already underway in this area.

Seamless and swift (online) access to savings and investment products for the consumer will improve the non face-to-face experience of customers. Why can credit be purchased within a few minutes but saving products cannot? As we outline in the final section below, there needs to be a shift in the way that regulators conceptualise regulated advice versus other forms of support. This framework could be built around a number of key messages, including:

- The availability online of a one-stop-shop environment with a high (comfort) level of cyber security should be able to improve investor demand for simple and quick solutions.
- High levels of professionalism from intermediaries and manufacturers when human contact is necessary for savers.
- Including mandatory messages that debt, mortgage and other priority objectives ought to be considered before investing into risk assets.
- Encouraging potential investors to diversify.

Regulatory environment (questions 24, 26, 35 and 41):

Many in the industry appear puzzled over the exact purpose of having advice defined differently in the RAO and in MiFID. In any case anecdotal statements from distributors, outside therefore of our core membership, suggest that suitability assessments require around a single person day of time in all. This prices the full advice service out of the reach of many. Our comments on this subject focus on three key points:

- <u>Advice vs Execution only and the 'middle ground'</u>. If full advice involves tailoring solutions and product choice specifically to each individual client, it is clear that there is considerable potential for models that classify individual clients to pre-defined categories of products or models – commonly each of those categories has a characteristic risk rating but other relevant factors could be used. While this is not without challenges, it offers a significant way in to broader market access, given the points above about the potential role of technology. We understand that the RAO does not provide firms with the regulatory clarity they need to classify clients. Some firms are actively ensuring they remain execution only whilst providing as many signposts and suggestions or role models as possible – "why are [certain type] funds popular etc." This bifurcates the industry into full advice and execution only and leaves no proper regulated area of assistance or guidance.

- Ongoing advice and support. The discussion of the full advice boundary needs also to consider ongoing care and assistance. In long-term commitments such as those that are designed to address the need for late-life provision, advice and assistance is not merely needed at the point of first investment. Ensuring advisers and distributors have an incentive to continue to assist clients is important, but one solution for the asset management industry is to consider outcome-focussed or lifestyling funds where asset allocation is altered as individuals approach key life events (and a changed risk appetite) and is then later directed at income provision. This reflection leads on to the third point.

- Need for a new paradigm? It is possible the FAMR is identifying that the current paradigm of regulating prescribed activities when carried out in relation to prescribed investments (i.e. advising on suitable funds) is no longer fit for purpose. The reality is that people are looking (or ought to be looking) at making the right decisions about their later life provision. That this involves investment decisions is arguably incidental to the manner in which the outcome is achieved. It may perhaps be time to address this in regulation and to create a regime that is explicitly designed to assist with later life provision as the outcome. If some aspects of these services were to be caught as regulated MiFID advice, then some would have to be subjected to suitability. In any event, however, services outside MiFID would be subject to proportionate regulation at lower cost with an informed acceptance that full advice could not be offered. At present, the gap between execution only and full advice seems to be too wide.

Importance of good disclosure and product design.

Consumers have to be protected when entering capital markets. Therefore education and plain language in documentation has to be combined with a high level of comprehensive and meaningful but accessible disclosure (coming in with MiFID and PRIIPs). Savers have to be aware of risk taking requirements as well as long term benefits of investing.

The Investment Association and its members take their role in helping customers to achieve their financial objectives very seriously and are constantly reviewing and improving their products and services to achieve the best outcome for their clients. The current level of product regulation is already high and suitably designed to safeguard retail customers' interest. This will still be the case with advice processes adapted to this new landscape of personal financial responsibility and of participation in the volatile financial markets.