HM Treasury

Amending the definition of financial advice:

consultation response

February 2017

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1 Introduction

Background to this document

1.1 Consumers face complex financial choices and the government is committed to ensuring that they can access the help they need to make these choices. The Financial Advice Market Review (FAMR) found that there is a growing trend towards consumers making and executing their own financial decisions, and that for consumers with relatively straightforward needs or relatively small amounts to invest the cost of regulated advice may outweigh the benefits.[1] FAMR suggested that in these cases, individuals would benefit from high quality and more specialised and detailed guidance services.

1.2 Firms highlighted a lack of clarity about the point at which general forms of consumer support become regulated advice. As a result of this uncertainty, FAMR found that firms are limiting the amount of guidance they are giving consumers for fear of inadvertently straying into the provision of regulated advice without meeting the relevant regulatory requirements. By stepping back from the regulated advice boundary, firms are providing less support to consumers and therefore increasing the risk that consumers make potentially poor investment decisions.

1.3 There was a strong consensus during FAMR that bringing the UK definition of advice in line with the Markets in Financial Instruments Directive (MiFID) definition of advice as a personal recommendation, would allow firms to better help consumers. Firms who responded to the FAMR consultation stated that they would be more confident in providing information to support customer decision making, such as the merits and risks associated with particular investments. They also said that the MiFID definition of advice is much easier to build into their compliance processes. FAMR also recognised the potential risks of changing the definition and recommended HM Treasury consult on the benefits and risks of the change.

1.4 Therefore, the government published a consultation in September 2016 on amending the definition of financial advice. The consultation ran for 12 weeks and received 63 responses.

The consultation on *amending the definition of financial advice*

1.5 The consultation set out the government's proposal to amend the definition of regulated advice in Article 53 of the existing Financial Services and Markets Act 2000 (Regulated Activities) Order 2001(RAO), to bring it in line with the EU definition set out in the Markets in Financial Instruments Directive (MiFID).[2] This would mean that only advice which makes a personal recommendation would be regulated.

1.6 The majority of respondents agreed that the proposed definition was simpler for firms, and supported the change.

1.7 In the consultation on 'Amending the definition of financial advice', the government set out a number of potential risks posed by moving the regulatory boundary. The government also acknowledged that there was a risk that fraudsters may attempt to use guidance services to distribute products, without being subject to regulation. A significant number of respondents

[1] In general terms, 'financial advice' is a regulated activity. Other forms of help provided to consumers, often described as 'financial guidance' are not regulated by the Financial Conduct Authority. This document uses 'advice' as shorthand for regulated financial advice. Other forms of help, which do not meet this definition, are referred to as 'guidance'.

[2] On 23 June 2016, the EU referendum took place and the people of the United Kingdom voted to leave the European Union. Until exit negotiations are concluded, the UK remains a full member of the European Union and all rights and obligations of EU membership remain in force. During this period, the government will continue to negotiate, implement and apply EU legislation. The outcome of these negotiations will determine what arrangements apply in relation to EU legislation in future once the UK has left the EU.

expressed concerns that using a narrower definition could allow more fraudsters to operate in this space. Specifically, they were concerned that fraudsters would attempt to deliver 'advice' that stopped short of a personal recommendation, but nevertheless is intended to persuade an individual to purchase risky investment products. The Financial Conduct Authority (FCA) might not be able to take action against these individuals.

1.8 The government acknowledges these concerns, and will therefore take mitigating action against the risks posed to consumers.

The new definition of financial advice

1.9 Having considered responses to the consultation, the government has decided to change the definition of financial advice **for regulated firms.**[3] Regulated firms will therefore be giving advice only where they provide a personal recommendation. The government will leave the wider RAO definition of advice as "advising on investments" in place for unregulated firms.

1.10 This means that regulated firms will be able to provide more advanced guidance services, that would previously have been caught by the RAO definition of advice as "advising on investments", without being subject to the higher regulatory requirements associated with regulated advice. However, unregulated firms will not be able to provide these more detailed and tailored guidance services. This dual approach mitigates the risk of consumers being scammed.

1.11 The new advice definition will give greater certainty to regulated firms, allowing them to better help their customers whilst ensuring that there is proportionate protection in place to avoid consumers being sold inappropriate products.

1.12 The government will lay a statutory instrument shortly. The new definition will come into effect on 3 January 2018. This will allow the FCA to consult on and publish new guidance. It will also align the change with the implementation of the Markets in Financial Instruments Directive II.

The structure of this document

1.13 This document is the government's formal response to the consultation on 'Amending the definition of financial advice'.

1.14 Chapter 2 provides more detail on the new definition of financial advice. The chapter sets out:

- how the new definition applies to regulated firms
- the boundary that applies to unregulated firms
- how the new definition mitigates the risks posed to consumers

1.15 Chapter 3 provides a summary of the costs and benefits of changing the definition of financial advice. The costs and benefits will be set out in more detail in an Impact Assessment that will be published shortly after the statutory instrument is laid.

1.16 Chapter 4 sets out next steps for how the change will be implemented, including details of the FCA's forthcoming guidance.

1.17 Chapter 5 provides a summary of responses to the consultation and provides the government's response to stakeholders' views. Annex A lists the 63 responses to the consultation.

1.18 A copy of the revised Article 53 text will be published shortly.

[3] Except those that hold only the Article 53 permission, or only the "agreeing to advise on investments" permission, and no other permission. This restriction will affect only a negligible number of regulated firms.

2 The new definition of financial advice

2.1 This chapter sets out how the new definition will apply to both regulated and unregulated firms. The FCA have published a short explanatory note alongside this response.

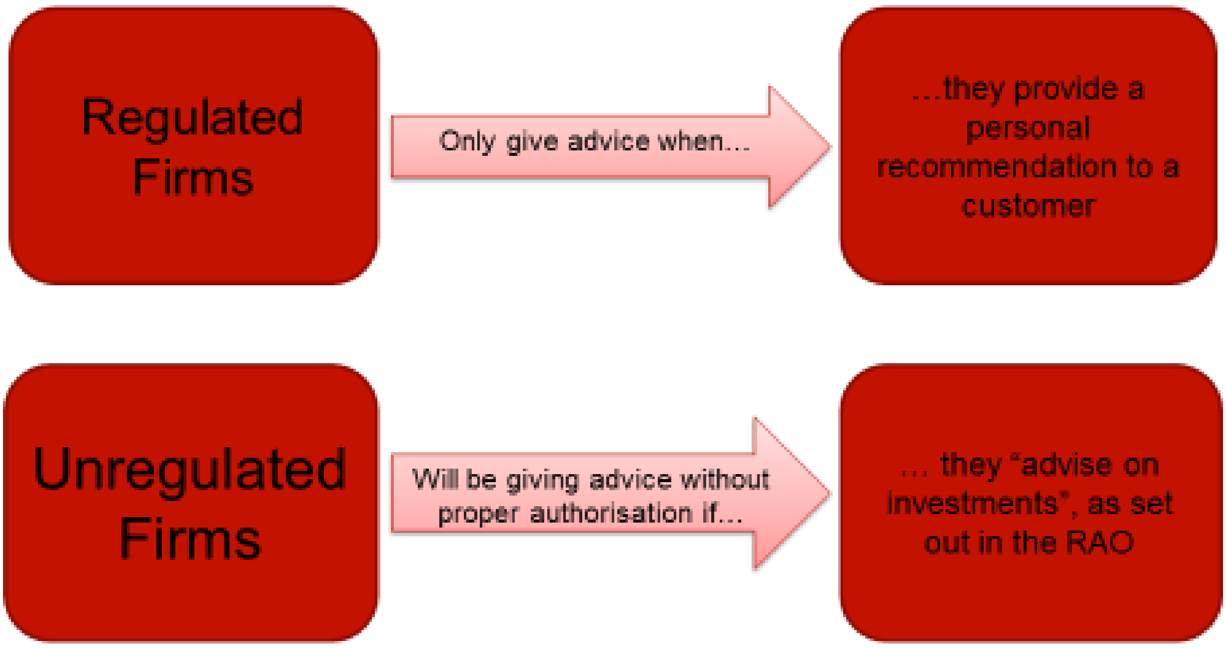
The advice boundary for regulated and unregulated firms

2.2 The objective of this regulatory change is to provide firms with the confidence to develop detailed guidance services, whilst protecting consumers from fraudsters. The government will replace the two current definitions of financial advice with a definition based on the MiFID definition of a personal recommendation **for regulated firms only**. Unregulated firms will remain subject to the advice boundary currently set out in Article 53 of the RAO, 'advising on investments' and will not be able to provide such advice.

2.3 The government will exempt regulated firms from requiring authorisation to carry out activities under Article 53 of the regulated activities order, except where they are making a personal recommendation (defined using the text set out in MiFID).[1] A revised text of article 53 with amendments, shown in bold, can be found in Annex B. This approach will amend the definition of advice for securities and relevant investments as defined by the RAO, including contracts of insurance. The change will be made by way of an order made under the Financial Service and Markets Act 2000. It will require secondary legislation that is subject to negative resolution procedure in Parliament.

2.4 This policy change is illustrated in the diagram below:

2.5 The box below sets out more detail on the definitions that will apply to regulated and unregulated firms.



[1] Except those that hold only the Article 53 permission, or the "agreeing to advise on investments" permission, and no other permission.

Box 1.A:

The definition of advice applicable to regulated firms: "Investment advice" under MiFID

MiFID investment advice involves the provision of personal recommendations to a customers, either upon the customer's request or on the firm's initiative. It comprises three main elements:

- there must be a recommendation that is made to a person in their capacity as an investor or potential investor (or in their capacity as an agent for an investor or potential investor)
- the recommendation must be presented as suitable for the person to whom it is made or based on the investor's circumstances
- the recommendation must relate to taking certain steps in respect of a particular investment which is a MiFID financial instrument, namely to buy, sell, subscribe for, exchange, redeem, hold or underwrite a particular financial instrument (or exercise a right to buy, sell, subscribe for, exchange or redeem a financial instrument)

The definition of advice applicable to unregulated firms: 'Advising on investments' under the Regulated Activities Order

The regulated activity of 'advising on investments' under Article 53 of the Regulated Activities Order is wider in scope than 'investment advice' under MiFID.

For advice to qualify as 'advising on investments', it must:

- relate to a relevant investment, which includes contracts of insurance
- be given to a person in their capacity as an investor or potential investor (or in their capacity as agent for an investor or potential investor)
- relate to the merits of them buying, selling, subscribing for or underwriting the investment (or exercising rights to buy, sell, subscribe for or underwrite such an investment)

2.6 This change will remove the regulatory barriers constraining the content of current guidance services, including the different regulatory requirements that currently apply depending on whether a firm is providing factual information on particular investments, or moving beyond that into more tailored guidance on the merits and risks associated with buying or selling particular investments.

2.7 Firms who responded to the consultation said that they would be more confident in providing information and guidance to their customers. For example, under the new definition firms will have the confidence to contact customers to let them know that they have not used their ISA allowance in a given tax year; provide information on the risk profile of the funds available within their stocks and shares ISA; or highlight that a customer had never increased their pension payments.

The case for retaining the existing advice boundary for unregulated firms

2.8 In the consultation on 'Amending the definition of financial advice', the government asked for respondents' views on the risks posed by changing the definition of advice to the MiFID definition. Under the regime proposed in the consultation businesses would not require authorisation to give tailored and detailed guidance services, and would therefore not be subject to the regulatory obligations set out in FCA rules. The government acknowledged that a risk existed that fraudsters may provide guidance encouraging consumers to invest in risky products. Whilst fraudsters can be prosecuted through the courts for running an illegal investment scheme, or for conspiracy to defraud, the FCA would be unable to take action against fraudsters for providing misleading but unregulated advice. It would also be more difficult to take early preventive steps to protect consumers from scams.

2.9 Respondents to the consultation said that the risks posed by moving the advice boundary for all firms were significant enough to require mitigating action to protect consumers. Risks outlined by respondents included:

- that fraudsters may disguise sales of risky investment products as 'guidance', escaping regulation and raising the risk of scams and misselling
- that the guidance given by unregulated firms could be inaccurate and misleading
- that changing the definition for all firms might legitimise fraudsters in the eyes of consumers
- that the FCA's perimeter work to monitor unregulated firms might not be enough to prevent consumer detriment

2.10 The government takes the issue of consumer protection very seriously, and therefore judges that the risks to consumers justify retaining the current advice boundary for unregulated firms. This means that regulated firms who must abide by the FCA's rules and principles benefit from the new advice definition, whereas unregulated firms will not be able to move beyond providing factual information about products into providing detailed guidance on the merits and disadvantages of investment products without being regulated. If they are found to have done so, the FCA will be able to take action against them. This will ensure that consumers are protected from the risks outlined in paragraph 2.9.

Clarifications

2.11 Respondents requested a number of clarifications on how the new definition would work in practice. The FCA will publish a short explanatory note alongside this response explaining how the legislative changes will affect its rules and guidance. The government also provides clarification on some key issues below.

Interaction with EU guidance

2.12 The MiFID definition of a personal recommendation will be transposed without change into the Regulated Activities Order.[2] This reflects the government's intention that the advice boundary for regulated firms exactly matches the definition of a personal recommendation set out in MiFID. EU guidance on what constitutes a personal recommendation will therefore continue to apply to the new UK definition of advice for regulated firms.

[2] The relevant definition will be that set out in MiFID II.

Implicit recommendations

2.13 Respondents requested clarification on whether a firm that did not go as far as explicitly saying 'this product would be the best option for you' or 'I recommended that you buy this product', would be caught by the new definition.

2.14 Under MiFID a product can be recommended to a customer either explicitly or implicitly. In both cases the firm will be providing MiFID investment advice.[3] A firm might be providing an implicit personal recommendation if it is presented to the customer in a way that would influence the customer to choose a specific financial product over others, for example by making a statement such as 'people like you buy this product'. This will continue to be the case for regulated firms subject to the new definition of financial advice.

Product sales

2.15 A number of respondents expressed concerns that the new definition of advice means that if a product is not purchased, no advice has been given. This is not the case. MiFID is clear that recommendations to hold a product (to do nothing) will count as investment advice. Additionally, whether a recommendation to purchase a specific product is advice does not depend on the purchase actually being made.

[3] If the other tests for MiFID investment advice are met.

3 Costs and benefits

3.1 The government will publish a full impact assessment shortly after laying the order to bring about the policy change. This assessment will be based on input from the regulators and market participants, alongside responses to the consultation on 'Amending the definition of financial advice'. This chapter will outline the key costs and benefits of the change, including input from respondents to the consultation.

Key benefits of changing the definition

3.2 The consultation outlined the main benefits likely to arise from the change. The first benefit relates to savings from a reduction in the resources needed to avoid crossing the boundary from guidance to advice when offering help to consumers. The current uncertainty about the boundary means that firms often include a 'second line of defence team' to prevent a breach of current regulation. With a clearer distinction between the two activities, firms will be able to allocate less time and resource to their compliance mechanisms associated with the advice boundary.

3.3 There were varying views amongst respondents on the extent of these benefits. Attempts to quantify the monetary benefits to firms ranged from approximately £70,000 per annum to £4,400 per annum. Some firms stated that they did not expect to receive any monetary benefit. A significant number of respondents commented that they would have difficulty quantifying the benefits until further FCA guidance on the boundary is published.

3.4 The second main benefit related to opportunity cost. Due to the current uncertainty, firms are deliberately limiting their guidance services to remain well short of the regulated advice boundary. This creates an opportunity cost in terms of customers not served. After the change, firms will be able to give more tailored information and guidance to better serve customers. The vast majority of respondents to the consultation felt that this was the main, and a significant, benefit of the change. This opportunity cost is non-monetary and therefore non-quantifiable.

3.5 There is also a benefit to consumers. FAMR found that a significant number of consumers were not getting the help they wanted or needed to make financial decisions. As this change will allow firms to better support consumers in their financial decision making, it will have a significant benefit to consumers.

Costs of the change

3.6 The change to the definition of financial advice is a permissive measure; it allows firms to adapt their business models to offer more guidance, but does not compel them to do so. Therefore, the main costs for firms are likely to arise from familiarising themselves with the change, for example by consulting with compliance experts, and potentially making small wording changes to documentation such as disclosure forms. Respondents said that this would be a small to negligible one off cost. Estimates ranged between approximately £600 and £4,000 (for larger firms).

4 Next steps

FCA guidance and explanatory note

4.1 The FCA have published an explanatory note alongside this response, which also sets out their intention to consult on and publish new guidance on the advice boundary before the change takes effect on 3 January 2018.

Legislation

4.2 A statutory instrument will be laid shortly. The new definition of financial advice will come into effect on 3 January 2018. The statutory instrument amending Article 53 will be published shortly.

Impact assessment

4.3 An impact assessment will be published shortly after the statutory instrument is laid.

5 Summary of responses

5.1 The consultation on 'Amending the definition of financial advice' was published on 16 September 2016 and ran for 12 weeks. 63 responses were received, including from financial advisers, product providers and consumer bodies.

5.2 This section summarises the responses by question. The government has taken these views into account in developing the final definition of financial advice set out in Chapter 2.

5.3 A list of respondents to the consultation is included at Annex A.

Question 1: The policy proposal

5.4 Overall, the majority of respondents said that the new definition would be an improvement on the current regulatory regime. Most respondents stated that they were either supportive of the change, believed that the new definition was simpler, or agreed that it was better to have a single definition.

5.5 Many respondents stressed that the proposed change would be positive; however they were clear that they would welcome guidance from the FCA, and as part of this process the regulator should revisit their current guidance FG15/1. The FCA will publish a short explanatory note alongside this response, and set out their plans to produce new guidance on the regulatory boundary.

5.6 Some respondents raised concerns that advice that does not result in the sale of a product will no longer be regulated as a result of the change. Chapter 2 has clarified that this is not the case; the proposed definition is intended to align exactly with the MIFID definition of advice, which is clear that recommendations to buy, sell or hold a particular investment, or to do nothing are all within scope. Additionally, implicit recommendations remain in scope, as set out in EU guidance.

Questions 2 and 3: Costs and benefits

5.7 Respondents generally agreed with the benefits to consumers that the government has outlined. They agreed that this change will help firms to deliver guidance to consumers, and that firms currently face an 'opportunity cost'; a number of firms that responded noted that they do not offer the guidance they would like to because of uncertainty around the definition. Respondents also noted that many consumers shy away from investing due to a lack of help.

5.8 However, some firms felt that they would be unable to give an opinion on the costs and benefits of the change until the FCA publishes their guidance.

5.9 Respondents were split on whether there would be any substantive monetary benefit to firms. Some noted that burdens on firms would be reduced, for example reducing costs associated with ensuring that consumer facing staff do not inadvertently cross the regulatory boundary. Others did not think that compliance costs would be significantly reduced, as firms still need to comply with other regulatory requirements such as the financial promotions regime. This means that their communications and staff will still need to be monitored.

5.10 Firms agreed with the government that there would be either no or negligible costs imposed on them as a result of this change. They may incur costs if they choose to adapt their business models to offer more guidance.

5.11 Generally, firms were unable to quantify the costs and benefits associated with the change. This was for a variety of reasons, for example that they were unable to quantify benefits until the

FCA publishes their guidance, or felt that the change would result primarily in non-monetary benefits, such as encouraging innovation, increased competition and consumers receiving more detailed guidance.

Questions 4 and 5: The risks posed by to consumers by moving the advice boundary for all firms

5.12 Respondents to these questions were split. Some felt that the regulatory requirements set out in the consultation limit the commercial benefit of unregulated firms providing guidance on regulated products. These respondents tended to argue that there is always going to be some degree of risk posed by unregulated firms, and that the risks posed need to be balanced against the benefits of wider availability of guidance.

5.13 Respondents raised a number of concerns about moving the advice boundary for all firms that are outlined in Chapter 2. The government recognises these concerns and has limited the definition change to regulated firms in response.

Questions 6 and 7: Additional risks

5.14 A number of respondents raised concerns that through this change, the government is encouraging firms to charge for financial guidance where they previously offered it for free. This is not the government's intention. It is worth noting that firms are permitted to charge for guidance services under the current rules. However, most services are currently offered for free, reflecting the fact that consumers are for the most part unwilling to pay for guidance, and that many firms view guidance as essential help for their customers to be better informed consumers of paid for services. In light of the current landscape, the government does not expect that the change will encourage firms to charge for guidance that is currently free of charge.

5.15 Some respondents asked the government to take action to ban charges for guidance services. The government does not think it would be proportionate to do so. This is because the government believes that the vast majority of guidance services will continue to be available free of charge, and because of the potential costs involved with imposing such a ban.

5.16 Some respondents were concerned that low quality guidance services may enter the market. A number suggested that the FCA should enforce standards for guidance services, such as a register of approved guidance services, and compulsory qualifications. As the new definition will apply only to FCA regulated firms, which are already subject to high regulatory standards, the government thinks that these concerns have been met.

5.17 A common theme was concern that consumers will still not understand the difference between advice and guidance, even after the boundary is changed. The government acknowledges that the terms can be confusing for consumers. That is why the Financial Advice Working Group is developing new consumer friendly terms to describe advice and guidance services.

5.18 A small number of respondents expressed concerns that the change would undermine unbiased government guidance, and that product providers should not provide guidance as they cannot be impartial. Whilst there is an important role for impartial government-backed guidance, it is right that providers should be able to give guidance to their customers. The government wants consumers to make good financial decisions, and that can often mean choosing a product that is appropriate for them. Providers play an essential role offering help in these cases.

5.19 The government is consulting on setting up a new single money guidance body that will bring together publicly-funded pensions and money guidance and debt advice in one place. Although the new body will directly provide guidance on pensions, debt and general money matters, it is not the government' intention that the new body should be the market's sole provider of guidance. Rather, the new body should work alongside providers in industry and the third sector and take on a strategic role focussed on ensuring consumers with low incomes or who are just about managing, can get the help they need.

Question 8: Are people with protected characteristics, or any consumers in vulnerable circumstances, impacted by the policy proposed?

5.20 The majority of respondents suggested that more guidance would benefit consumers in vulnerable circumstances, that there wouldn't be an effect, or did not note any impacts.

5.21 Others suggested that the risks previously raised would affect consumers in vulnerable circumstances; they may be at risk of making poor decisions based on guidance from unregulated firms, may be targeted by fraudsters, or may not understand the service they are getting. The government is confident that limiting the new definition to regulated firms will prevent risks to vulnerable consumers. The Financial Advice Working Group is also developing new terms to describe advice and guidance more clearly.

A List of respondents

A.1 The government received 63 responses to the consultation on 'Amending the definition of financial advice'. Respondents are listed below.

Association of British Insurers

Aegon

Association of Investment Companies

Association of Professional Financial Advisers

Aviva

Barclays

British Banking Association

Ben Tyler

Blackrock

Blevin Franks

Brewin Dolphin

Capita Employee Benefits

Chartered Institute for Securities and Investments

Chevening Financial

CLLS Regulatory Law Committee

Close Brothers Asset Management

Citizens' Advice

City of London Law Society

Dynamic Planner

Equity Release Council

Eversheds LLP

Fidelity International

Fieldfisher

Financial Services Consumer Panel

Graham M Phillips

Hargreaves Lansdown

I for Change

ICAEW

IG Markets

Institute and Faculty of Actuaries

Investment and Life Assurance Group

Jane Hodges

JLT Group

Killik & Co

Kingfisher

Legal & General

London Stock Exchange Group

LV=

Money Advice Trust

Nationwide

Netwealth

The Personal Finance Society

Prudential

SimplyBiz

Skipton Building Society

Small Business Practitioner Panel

Society of Pension Professionals

Stepchange

Tenet Group Limited

Tessa Pollock

The Law Society

The Money Charity

The Investment and Savings Association

Threesixty Services

Tim May

The Pensions Advisory Services

Vanguard

Virgin Money

The Wealth Management Association

Which?

Yorkshire Building Society

Zurich

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