Opinion: Final stage IA
Origin: Domestic
RPC reference number: RPC17-3656(1)-HMT
Date of implementation: 3rd January 2018

# Amending the UK definition of investment advice

## HM Treasury

## RPC rating: fit for purpose, EANDCB not validated

## Description of proposal

The Financial Advice Market Review (FAMR) was conducted to consider how to improve financial advice for consumers, ensuring they have the advice and guidance needed to make well informed financial choices. 'Financial advice' is regulated by the Financial Conduct Authority (FCA), whilst 'financial guidance' is not a regulated activity. Financial guidance comprises general customer support and information on different investments. Financial advice extends to recommendations on the advantages and risks of buying or selling specific investments. The review revealed that a large number of customers are not willing to, or cannot, pay for financial advice, or would prefer make their own decisions on investments.

The UK definition of investment advice, as defined by the Regulated Activities Order (RAO), is broader than the EU definition that is set out in the Market in Financial Instruments Directive (MiFID). Therefore, the boundary between regulated advice and guidance is not clear. Due to this uncertainty, at present, firms are only providing basic guidance services to customers. The FAMR was conducted to consider how to improve financial advice for consumers. One of the FAMR recommendations was to consult industry on changing the RAO definition of regulated advice to the MiFID definition, to aid consumer decision-making on investments.

The proposal will change the RAO definition of investment advice to the MiFID definition for regulated firms. The department believes that this will enable firms to clearly distinguish between regulated advice and guidance, and thus be able to provide more useful information on investments to consumers.

A number of consultation respondents raised concerns that unregulated firms would provide detailed, tailored guidance with the aim of persuading customers to purchase '*risky investment products',* without technically providing a personal recommendation. Unregulated firms are not in scope of FCA enforcement, so the FCA would be unable to take action in these circumstances. Under the proposal, the RAO definition will still apply to unregulated firms in order to safeguard consumers from *'fraudsters who might try to use guidance to sell consumers risky investments'.*

## Impacts of proposal

The IA states that the impacts of the proposal will only fall on firms that communicate with retail investors, such as, banks, building societies and life insurers. Retail investors are defined as retail customers who purchase, or are planning on purchasing, financial products. The department explains that financial advice is only regulated if delivered to financial investors. Based on FCA data, the number of affected firms is estimated to be 12,335.

The IA calculates the direct impacts on business by considering two groups of firms – firms currently providing personal recommendations and firms not currently providing personal recommendations.

The department estimates that 4,312 firms already provide personal recommendations. This estimate is based on the assumption that all firms whose main activity is retail investment mediation currently give personal recommendations, as all these firms have at least one financial advisor. The IA notes that these firms will not be significantly impacted by the proposal, as they already offer full regulated advice. This assessment was confirmed by business at consultation.

The department estimates that 8,023 firms do not currently provide personal recommendations. This is calculated by subtracting 4,312 from the figure for the total population. Consultation respondents reported that this group of firms will incur familiarisation costs, but also reap significant benefits from the change.

Business has indicated that familiarisation with the change will involve *'a review by the firm's compliance team or an external compliance expert'* that is estimated to cost an individual business between £124 and £600. Changes to wording in documentation will also be required. This is estimated to cost between £500 and £4000 per firm. These figures have been provided by businesses and are used as the lower and upper bounds in calculating total costs of familiarisation. The department has taken the central points as the best estimates. The total one-off cost to business is estimated at £28.6 million.

The IA states that a significant benefit of the change will be *'a reduction in the costs of ensuring that the firm does not inadvertently cross the boundary into regulated financial advice'.* This reduction in costs arises from decreased time spent monitoring customer communications and decreased spending on external legal and compliance experts.

The department has made the assumption that 90 per cent of firms currently providing personal recommendations will receive no monetary benefit, as financial advisors in these firms are more aware of where the boundary between financial guidance and advice lies. The department also assumes that 30 per cent of firms not currently providing personal recommendations will gain no monetary benefit, to reflect the higher level of risk aversion in some businesses and the fact that some consultation respondents reported that they would make no changes to their internal compliance controls following the introduction of this proposal. The IA also contains sensitivity analysis that varies these percentages.

Firms have informed the department that they will reduce expenditure on internal controls, resulting in less staff time spent monitoring communications and reductions in legal and compliance advice. Based on evidence from firms, the department estimates that annual savings from a reduction in monitoring costs will be £64,100 per firm. The total annual saving across industry is estimated at £388 million. Annual savings from a reduction in external compliance/legal spend are estimated at £5000 per firm, resulting in a total annual saving across industry of £30 million. Combining the one-off and annual savings, the department has estimated the total monetised benefit to business over ten years at £418 million.

The IA also explores the wider benefits to consumers of the proposal. The department believes that consumers will choose more appropriate financial products for themselves and in general are more likely to purchase products due to the expected improvements in financial guidance and advice. The department has been unable to monetise these benefits.

## Quality of submission

The IA sets out clearly and comprehensively the rationale for the proposal and background to the measure. The differences between financial advice and guidance are also well explained, and the department provides a discussion of the benefits to wider society, which it does not attempt to monetise at this stage.

The department states, incorrectly, that a light touch IA is appropriate on the grounds that the proposal is deregulatory. The RPC notes that the proposal has a very significant impact on both business and wider society. A light touch assessment is not necessarily appropriate simply because a measure is deregulatory. However, in this case the department has provided a clear and concise IA which sets out the straightforward analysis required appropriately, and has undertaken a proportionate level of evidence-gathering and consultation which supports the assessment.

The RPC notes that the assumptions underlying both the proportion of firms that will receive benefits from the proposal and the scale of those benefits are less robustly evidenced than is necessary, given the significant size of the proposal.

This is because the department had difficulty collecting evidence from firms of the level of the costs and benefits they would incur as a result of the proposal, and of their propensity to make changes accordingly. The IA explains that this is because *'many firms felt unable to quantify the costs and benefits without seeing the FCA's guidance on the change'.* The department also argues that seeking further evidence from business at this stage would probably not increase the accuracy of the estimates, as uncertainties exist relating to firms' risk appetites and how firms' business models will change once FCA guidance is available.

The RPC acknowledges these issues and the supporting detail provided by the Department in response to our enquiries. However, although the department has made the best use it can of the available evidence to estimate take-up rates, costs and benefits, the estimates remain insufficiently robust to support an estimated EANDCB of this scale.

Thus, the RPC is able to confirm at this stage that the evidence presented is proportionate and appropriate for the purpose of supporting a Ministerial decision to proceed with the measure and the Impact Assessment is fit for this purpose. It is not sufficiently robust to permit the RPC to validate the specific EANDCB presented for the purposes of the Business Impact Target.

In order for the EANDCB to be validated, the Department will need to re-work the relevant assumptions and resubmit the IA, once the FCA has issued guidance and more robust evidence can be gathered.

The proposal is of domestic origin. A small and micro business assessment (SaMBA) is therefore required. The SaMBA provided offers a limited assessment of the impacts of the proposal on small and micro businesses. The IA would have benefitted from further detail on the differential impacts of the proposals upon small and micro businesses. However, the proposal is net beneficial to small and micro businesses and therefore the SaMBA provided is sufficient in this case.

### Departmental assessment

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| Classification | Qualifying regulatory provision (OUT) |
| Equivalent annual net direct cost to business (EANDCB) | -£415.1 million (indicative estimate, not validated) |
| Business net present value | £4,151.6 million (indicative estimate, not validated) |
| Societal net present value | £4,151.6 million (indicative estimate, not validated) |

### RPC assessment

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| Classification | Qualifying regulatory provision (OUT) |
| EANDCB – RPC validated[1] | Not validated at this stage. |
| Business Impact Target (BIT) Score[1] | As above |
| Small and micro business assessment | Sufficient |

**Michael Gibbons CBE,** Chairman

[1] For reporting purposes, the RPC validates EANDCB and BIT score figures to the nearest £100,000.