Amending the UK definition of investment advice

HM Treasury

RPC rating: fit for purpose; EANDCB validated

Description of proposal

The Financial Advice Market Review (FAMR) was conducted by the government to consider how to improve financial advice for consumers, ensuring they have the advice and guidance needed to make well informed financial choices. The review revealed that a large number of customers are not willing to, or cannot, pay for financial advice, or would prefer to make their own decisions on investments. Another 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.

This was because the UK definition of investment advice, as defined by the Regulated Activities Order (RAO), is broader than the EU definition set out in the Market in Financial Instruments Directive (MiFID). Therefore, the boundary between 'financial advice' (which is regulated by the Financial Conduct Authority (FCA)) and 'financial guidance' (which is unregulated) was not clear. 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 proposal will change the RAO definition of investment advice to match the MiFID definition for regulated firms. The department believes that 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'* (Page 5, Paragraph 19), 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 therefore apply to unregulated firms in order to safeguard consumers from *'fraudsters who might try to use guidance to sell consumers risky investments'.* (Page 1, Summary)

Impacts of proposal

The IA states that the impacts of the proposal will only fall on firms that communicate with retail investors. For example, banks, building societies and life insurers. Retail investors are defined as retail customers who purchase, or are planning on purchasing, financial products as set out in the RAO. 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 department estimates that 4,312 firms already provide personal recommendations and 8,023 do not. 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 department assumes that firms that already provide personal recommendations will not be significantly impacted by the proposal, as they already offer full regulated advice. Firms that do not provide such recommendations will incur familiarisation costs but will also benefit from being able to provide more guidance to consumers, which ought to lead to higher customer satisfaction and retention. This assessment was confirmed by businesses at consultation.

One set of costs the department had outlined, were a range of possible voluntary costs. These concerned firms not currently providing personal recommendations, who would wish to do this given the new regulations. The department believes the costs to these firms should not be scored against the EANDCB. The department believes a firm's decision to start providing personal recommendations following publication of the new guidance comes from a firm's decision that this will be a profitable action. As this is an enabling measure, it can be assumed that firms will only adapt their business models to provide more/any guidance if the benefits outweigh the costs, therefore ensuring this is not a cost imposed.

Based on consultation with businesses, the Department assumes that familiarisation with the change will involve *'a review by the firm's compliance team or an external compliance expert',* which is estimated to cost an individual business between £124 and £600. Changes to wording in documentation will also be required, which are estimated to cost between £500 and £4,000 per firm. On this basis, the total one-off cost to business is estimated at £28.6 million.

The department expects that the main 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 assumes 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. It also assumes that 30 per cent of firms not currently providing personal recommendations will gain no monetary benefit, as some consultation respondents reported that they would make no changes to their internal compliance controls following the introduction of this proposal. The IA includes sensitivity analysis to test the impact of varying these key assumptions.

Based on these assumptions and on unit cost estimates from firms, the department estimates 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 will be more likely to purchase products due to the expected improvements in financial guidance and advice. The department has been unable to monetise these benefits. This is because the extent to which these benefits will be realised depends heavily on both firm business models and consumer behaviour.

The RPC verifies the estimated equivalent annual net direct cost to business (EANDCB) of -£415.6 million. This will be a qualifying regulatory provision that will score under the business impact target.

Quality of submission

The IA sets out clearly and comprehensively the rationale for the proposal and the 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 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 to support its assessment of this significant measure.

Previously, the RPC had noted that the assumptions underlying the proportion of firms that will receive benefits from the proposal and the scale of those benefits were less robustly evidenced than was necessary, given the significant size of the proposal. The department argued that it was not possible for firms or the department to produce more robust estimates until the FCA's guidance was available.

This guidance has now been published, and the department has sought to improve its estimates by asking firms to revise their estimates in the light of the guidance, and by extending its survey more widely. In general, respondents confirmed that the figures presented in the earlier IA were broadly correct, though one firm suggested that the benefits might be lower than had previously been thought.

Respondents also suggested that there may be non-monetised benefits from the RAO amendment (providing regulatory clarity through aligning the definition of advice on investments with MiFID II, retiring old guidance and creating an "engaging and detailed approach to investment guidance").

The assumption that this is an enabling measure was reinforced by the response from the Association of Professional Financial Advisers, which said that altering the definition will make little difference to existing financial advisers. The RPC understands that it would not be possible to monetise these costs.

Given the additional evidence provided, the RPC is both able to confirm the IA is fit for purpose and validate the EANDCB.

The department notes that it plans to conduct a post-implementation review but does not describe its planned approach to this review. The IA could have been improved by describing the Department's planned approach to monitoring and evaluation for this major measure.

The proposal is of domestic origin. A small and micro business assessment (SaMBA) is therefore required. The SaMBA provided could have been improved by presenting clear evidence as to the differential impacts of the proposals upon small and micro businesses. However, the department presents sufficient evidence that the proposal is net beneficial to small and micro businesses and therefore the SaMBA provided is sufficient in this case.

Departmental assessment

Classification	Qualifying regulatory provision (OUT)
Equivalent annual net direct cost to business (EANDCB)	-£415.1 million

Business net present value	£4,151.6 million
Societal net present value	£4,151.6 million

RPC assessment

Classification	Qualifying regulatory provision (OUT)
EANDCB – RPC validated[1]	-£415.1 million
Business Impact Target (BIT) Score[1]	-£2,075.5 million
Small and micro business assessment	Sufficient

Regulatory Policy Committee

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